WEBMD CORP /NEW/
Form 10-K
March 15, 2004

Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2003

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: 0-24975

WebMD Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-3236644**
(State of incorporation)	*(I.R.S. employer identification no.)*
669 River Drive, Center 2 **Elmwood Park, New Jersey** *(Address of principal executive office)*	**07407-1361** *(Zip code)*

(Registrant s telephone number including area code): (201) 703-3400

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.0001 per share

(Title of each class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference into Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

As of June 30, 2003, the aggregate market value of the registrant s common stock held by non-affiliates was approximately $3,109,441,188 (based on the closing price of the common stock of $10.87 per share on that date, as reported on the Nasdaq Stock Market s National Market and, for purposes of this computation only, the assumption that all of the registrant s directors and executive officers are affiliates). As of March 1, 2004, there were 309,464,573 shares of WebMD common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information in the registrant s definitive proxy statement to be filed with the Commission relating to the registrant s 2004 Annual Meeting of Stockholders is incorporated by reference into Part III.

TABLE OF CONTENTS

EX-99.2 COMPENSATION COMMITTEE CHARTER
EX-99.3 AMENDED & RESTATED NOMINATING COMMITTEE

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. These forward-looking statements are not based on historical facts, but rather reflect management s current expectations concerning future results and events. These forward-looking statements generally can be identified by use of expressions such as believe, expect, anticipate, intend, plan, foresee, likely, will or other similar words or phras statements that describe our objectives, plans or goals are or may be forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be different from any future results, performance and achievements expressed or implied by these statements. In addition to the risk factors described in Management s Discussion and Analysis of Financial Condition and Results of Operations Factors That May Affect Our Future Financial Condition or Results of Operations beginning on page 66, the following important risks and uncertainties could affect future results, causing these results to differ materially from those expressed in our forward-looking statements:

- the failure to achieve sufficient levels of customer utilization and market acceptance of new services or newly integrated services,
- the inability to successfully deploy new applications or newly integrated applications,
- difficulties in forming and maintaining mutually beneficial relationships with customers and strategic partners,
- the inability to attract and retain qualified personnel, and
- general economic, business or regulatory conditions affecting the healthcare, information technology, Internet and plastic industries being less favorable than expected.

These factors and the risk factors described in Management s Discussion and Analysis of Financial Condition and Results of Operations Factors That May Affect Our Future Financial Condition or Results of Operations beginning on page 66 are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could have material adverse effects on our future results. The forward-looking statements included in this Annual Report on Form 10-K are made only as of the date of this Annual Report. We expressly disclaim any intent or obligation to update any forward-looking statements to reflect subsequent events or circumstances.

Table of Contents

PART I

Item 1. ***Business***

INTRODUCTION

General Information

WebMD Corporation is a Delaware corporation that was incorporated in December 1995 and commenced operations in January 1996 as Healtheon Corporation. Our common stock has traded on the Nasdaq National Market under the symbol HLTH since February 11, 1999.

Our principal executive offices are located at 669 River Drive, Center 2, Elmwood Park, New Jersey 07407-1361 and our telephone number is (201) 703-3400.

We make available free of charge at *www.webmd.com* (in the About WebMD section) copies of materials we file with, or furnish to, the Securities and Exchange Commission, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after we electronically file such materials with, or furnish them to, the SEC.

Overview of Our Businesses

Our business is comprised of four segments. Three of our business segments, Portal Services, Transaction Services and Physician Services, provide various types of healthcare information services and technology solutions. Our fourth business segment is Plastic Technologies. The following overview describes our key products, services and markets:

Healthcare Information Services and Technology Solutions. We provide a range of information services and technology solutions for participants across the entire continuum of healthcare, including physicians and other healthcare providers, payers, suppliers and consumers. Our products and services promote administrative efficiency and assist in reducing the cost of healthcare and creating better patient outcomes.

WebMD Health. Our Portal Services segment, which is known as WebMD Health, provides online healthcare information, educational services and other resources for consumers and healthcare professionals. Our online offerings for consumers help them become better informed about healthcare choices and assist them in playing an active role in managing their own health. Our offerings for healthcare professionals help them improve their clinical knowledge, as well as their communication with patients regarding treatment options for specific health conditions. We also provide online content for use by media and healthcare partners in their Web sites, in some cases as part of a providing a co-branded site and in some cases on a private label basis under the partner s branding.

We reach a large audience of health-involved consumers and clinically active healthcare professionals. We work closely with pharmaceutical, medical device and other healthcare companies to develop innovative online channels of communication to our audience, or targeted portions of our audience, that complement their offline education, marketing and customer service programs. In addition, through our WebMD Health Services business, we provide employers and health plans with access to a suite of online tools and related services, for use by their employees and plan members. These tools and services provide a framework for better decision-making by healthcare consumers and can assist employers and plans in managing demand while improving quality of care.

We generate the majority of our Portal Services revenue by selling sponsorships of specific pages, sections or events on our portals and related e-mailed newsletters, by selling advertising on our portals and the online and offline properties of our strategic partners and by licensing our content and our online tools and related software and services. The majority of our WebMD

Table of Contents

Health revenues come from a small number of customers. Our WebMD Health customers include pharmaceutical, biotech and medical device companies, employers and health plans and media distribution companies. WebMD Health also receives a small portion of its revenues from the sale of paid subscription services. In 2003, WebMD Health revenues were $110.7 million.

WebMD Envoy. Our Transaction Services segment, which is known as WebMD Envoy, provides healthcare reimbursement cycle management services, including transmission of electronic transactions between healthcare payers and physicians, pharmacies, dentists, hospitals, laboratory companies and other healthcare providers. The use of electronic transactions significantly reduces processing time and costs, as compared to mail, fax or telephone, and increases productivity for both payers and providers. The transactions that we facilitate include:

administrative transactions, such as claims submission and status inquiry, eligibility and patient coverage verification, referrals and authorizations, and electronic remittance advice, and

clinical transactions, such as lab test ordering and reporting of results.

We processed more than 2 billion transactions in 2003, for over 200,000 providers and 5,000 hospitals transacting with more than 1,200 commercial and government healthcare payers. We also provide automated patient billing services to providers, including statement printing and mailing services. In addition, through Advanced Business Fulfillment, Inc., which we acquired in July 2003, we provide healthcare paid-claims communications services for third-party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanations of benefits. We are focused on continuing to increase the percentage of healthcare transactions that are handled electronically and on providing electronic reimbursement cycle management solutions that can be used by payers and providers to automate the entire reimbursement process.

We generate Transaction Services revenue by selling our transaction services to healthcare payers and providers, generally on either a per transaction basis or, in the case of some providers, on a monthly fixed fee basis. We also generate revenue by selling our patient statement and paid-claims communication services, typically on a per statement or per communication basis. A significant portion of WebMD Envoy revenues come from the country s leading national and regional healthcare payers. In 2003, WebMD Envoy revenues were $505.7 million.

WebMD Practice Services. Our Physician Services segment, which is known as WebMD Practice Services, develops and markets information technology systems for healthcare providers, primarily under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. Our systems include:

administrative and financial applications that enable healthcare providers and their administrative personnel to manage their practices more efficiently, and

electronic medical record and other clinical applications that assist them in delivering quality patient care.

In addition, through Medical Manager Network Services, we provide integrated access to our WebMD Envoy transaction services for our WebMD Practice Services customers. These systems and services allow physician offices to automate their scheduling, billing and other administrative tasks, to transmit transactions electronically, to maintain electronic medical records and to automate documentation of patient encounters.

WebMD Practice Services systems are scalable to meet the needs of a wide variety of healthcare provider settings, from small physician groups to large clinics, and across various medical specialties. Customers can purchase a base system and then add additional modules and services over time to expand their use of information technology as needed.

Table of Contents

We generate Physician Services revenue from one-time fees for licenses to our software modules, for system hardware and for implementation services and from recurring fees for the maintenance and support of our software and system hardware. Pricing depends on the number and type of software modules to be licensed, the number of users, the complexity of the installation and other factors. Our Medical Manager Network Services and some of our other WebMD Practice Services products and services are priced on a monthly fee per provider basis or a per transaction basis. In 2003, WebMD Practice Services revenues were $302.6 million.

We believe that the combination, in one company, of WebMD Health, WebMD Envoy and WebMD Practice Services makes us well positioned to create significant improvements in the way that information is used by the healthcare industry, enabling increased efficiency, better decision-making and, ultimately, higher quality patient care at a lower cost.

Plastic Technologies. Our Plastic Technologies segment, which is known as Porex, develops, manufactures and distributes proprietary porous plastic products and components used in healthcare, industrial and consumer applications. Our Porex customers include both end-users of our finished products, as well as manufacturers that include our components in their products for the medical device, life science, research and clinical laboratory, surgical and other markets. Porex is an international business with manufacturing operations in North America, Europe and Asia and customers in more than 65 countries. In 2003, Porex revenues from continuing operations were $71.9 million.

During 2003, our revenues were divided among our segments as follows: 52.5% from WebMD Envoy, 31.4% from WebMD Practice Services, 11.5% from WebMD Health and 7.5% from Porex. The sum of these percentages equals 102.9% of our total revenues of $964.0 million because $27.0 million of our revenues are from inter-segment transactions and are eliminated when we consolidate our results.

A more complete description of the products and services of each of our segments begins on page 10 below. For additional information regarding the results of operations of each of our segments, see Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations by Operating Segment and Note 8 to the Consolidated Financial Statements included in this Annual Report.

Key Trends Affecting Our Healthcare Information Services and Technology Solutions Business

Several key trends in the healthcare marketplace are influencing the use of healthcare information services and technology solutions of the types we provide or are developing. Those trends, and the strategies we have developed in response, are described briefly below; the implications for each of our businesses are discussed further in the descriptions of our products and services that follow.

High Rates of Increase in Healthcare Costs. According to the Centers for Medicare & Medicaid Services, or CMS, healthcare spending in the United States rose to $1.6 trillion in 2002, up from $1.4 trillion in 2001 and $1.3 trillion in 2000. The CMS report indicated a growth rate in healthcare spending of 9.3% for 2002, compared to 8.5% in 2001, and that the 9.3% rate of increase in 2002 was 5.7 percentage points higher than the 2002 increase in gross domestic product for the United States and marked the sixth consecutive year in which health spending grew at an accelerated rate. CMS projects the healthcare share of gross domestic product will be 15.3% for 2003 and increase to 18.4% by 2013. CMS expects that out-of-pocket healthcare spending by consumers including deductibles, copayments, and payments for medical care not covered by insurance will grow slightly faster in the next few years than during the previous few years, as employers continue to shift healthcare costs to employees. CMS projects that out-of-pocket spending growth will increase to a rate of 7.3% in 2005 from 6.0% in 2002 and will continue to increase as a percentage of consumer disposable personal income, from 2.7% in 2002 to 3.1%

Table of Contents

in 2013. The difficulties involved in controlling healthcare costs have resulted in the following key trends:

Cost-Shifting by Employers to their Employees and Changes in Plan Design. Employers are seeking to shift a greater portion of healthcare costs onto their employees and to redefine traditional health benefits. People in employer-sponsored health plans have been paying more out of their own pockets each year and are likely to see their share continue to increase significantly in the near future. With the shift in financial burdens, consumers are assuming a more active role in managing their health and need information to make educated benefit, provider and treatment decisions. We are in the process of transforming WebMD Health, our consumer portal, from an online place that consumers go for information to a place they go to actively manage their health. In addition, through our WebMD Health Services business, we help employers and plans provide employees and plan members with answers to healthcare and plan benefit questions and other personalized information and feedback. We intend to make significant investments in WebMD Health s infrastructure, as well as in new products and services, to position ourselves to provide additional interactive online services.

Increasing Outsourcing by Healthcare Payers. In order to be more efficient, many healthcare payers are focusing upon core activities building cost-effective provider networks, marketing their services to employers, and adjudicating claims payment and outsourcing pre- and post-adjudication administrative activities, such as printing and mailing checks and explanation of benefits. By outsourcing these services to us, payers can reduce operating costs and capital expenditures. In addition, our outsourcing services allow our customers to participate in the use of systems and technologies that would be too expensive for them to acquire for their own use. Our acquisitions of Advanced Business Fulfillment and Medifax-EDI in 2003 support our ability to provide more comprehensive outsourcing services. For more information on the services we provide to payers and on these acquisitions, see Healthcare Information Services and Technology Solutions WebMD Envoy below and Note 2 to the Consolidated Financial Statements included in this Annual Report.

Increased Use of Information Technology for Clinical Purposes. Governmental and commercial payers continue to exert considerable pricing pressure on providers. As a result, in order to maintain their incomes, providers need to see more patients and increase productivity and/or reduce their operating costs. Use of information technology can assist providers in these efforts. Healthcare providers are also under pressure to increase quality and reduce medical errors. There are currently numerous federal, state and private initiatives seeking ways to increase the use of information technology in healthcare, including in the physician s office. In his State of the Union Address this year, President Bush stated: By computerizing health records, we can avoid dangerous medical mistakes, reduce costs and improve care. In a radio address the next week, he said we can control health care costs and improve care by moving American medicine into the information age. My budget for the coming year proposes doubling to $100 million the money we spend on projects that use promising health information technology. This would encourage the replacement of handwritten charts and scattered medical files with a unified system of computerized records. By taking this action, we would improve care, and help prevent dangerous medical errors, saving both lives and money. There are an increasing number of other governmental and private initiatives in this area.

While information technology systems and electronic transaction services are used by many physician offices for administrative and financial applications, their use in clinical workflow is much more limited, especially in smaller practices. We believe that is changing and we are targeting the market for clinical applications as one of our priorities for the next several years. While it will be a long time before most physicians go to a paperless office, more and more physicians are beginning to incorporate information technology into their clinical workflow and our products allow them to make this shift in a gradual way. See Healthcare Information Services and Technology Solutions WebMD Practice Services EMR and Imaging Sys-

Table of Contents

tems below. During 2004, we plan to improve the capacity and productivity of the WebMD Practice Services support, service and training infrastructure in order to be able to provide the additional assistance needed by customers as they increase their usage of our clinical solutions.

Increased Automation of the Healthcare Reimbursement Cycle. Government regulations concerning electronic transactions in healthcare are accelerating the shift from telephone and paper claims transactions to electronic ones and have the potential to have a similar effect on other phases of the reimbursement cycle. See Government Regulation Health Insurance Portability and Accountability Act of 1996 HIPAA Transaction Standards.

Submission of claims electronically assists payers in reducing the cost of processing and servicing claims and can expedite the reimbursement process for providers. However, this is just a starting point for how electronic transactions can increase administrative efficiency. Our strategy is to be more than just a clearinghouse connection between payers and providers: we have been positioning our company to provide electronic reimbursement cycle management solutions that can be used by payers and providers to automate the entire reimbursement process. For example, our all payer transaction services include the capture, validation and routing of claims transactions on behalf of not just commercial payers, but also Blue Cross Blue Shield payers, Medicare and Medicaid, and the return electronic remittance from the payers back to the originating provider. We plan to continue to expand, through internal development and acquisitions, the transaction services we provide. See Healthcare Information Services and Technology Solutions WebMD Envoy below and Increased Outsourcing by Healthcare Payers above.

The HIPAA Transaction Standards establish format and data content standards for the most common healthcare transactions. In order to implement the Transaction Standards, WebMD Envoy has made significant changes to its systems and the software it uses internally. Similarly, the implementation has required payers and providers to simultaneously implement changes to their systems and/or internal procedures. As a result, this implementation process and related testing has been an immense challenge for the healthcare industry, including WebMD. However, it also represents a great opportunity for the industry and for us, because it encourages payer/provider connectivity to evolve from its current focus on the sending and receiving of claims to automating ancillary transactions, such as eligibility, status or remittance. As a leading clearinghouse for healthcare transactions and a leading vendor of physician office management information systems, WebMD has been the focus of a great deal of scrutiny in the implementation process and has received some criticism for difficulties encountered by our customers and for delays in our correcting some of those problems. Given the nature and scope of the changes being implemented, the large number of healthcare industry participants involved and our position in the industry, we expected that there would be some processing problems and delays. We continue to work diligently to identify and resolve these problems as they occur, while at the same time committing significant resources to keeping the implementation process moving forward. We are also working to foster communication among healthcare industry participants regarding how to achieve the intended benefits of the Transaction Standards with as little disruption to healthcare payment systems as possible. We have been incurring, and expect to continue to incur, significant expenses relating to the Transaction Standards implementation, including for testing, quality assurance and customer service activities. For more information regarding the challenges involved in such implementation and a description of the HIPAA regulations, see Business Government Regulation Health Insurance Portability and Accountability Act of 1996 Transaction Standards below.

Increased Use of the Internet by Physicians and as a Source of Health Information for Consumers. According to a Pew Internet & American Life Project Survey published in December 2003, approximately seven million American consumers look for health information on the Internet each day. WebMD Health is a leading destination on the Internet for these consumers. See Healthcare Information Services and Technology Solutions WebMD Health below. The Internet allows us

Table of Contents

to offer consumers the resources they are looking for, with immediate access to searchable information and dynamic interactive content. As a result, WebMD Health enables its sponsors, including pharmaceutical and medical device companies, to reach targeted consumers when they are looking for answers to healthcare questions and to reach physicians when they are exploring new treatment options. As recently noted by a Commissioner of the United States Food and Drug Administration: The evidence shows that promotions directed to consumers can play an especially important role in helping patients start a discussion with their health care practitioner about conditions that are often unrecognized and therefore undertreated, such as diabetes, high blood pressure, high cholesterol, and depression. Physicians are also increasingly turning to the Internet for professional activities. In 2003, physicians and healthcare professionals earned 629,000 continuing medical education credits at Medscape, an increase of 93% over 2002. Pharmaceutical companies and medical device manufacturers currently spend only a very small portion of their marketing and educational budgets on online media. Our strategy is to seek a greater portion of these budgets.

As discussed above and in the Business section below, we intend to continue to invest in new products and services and in improving our existing products and services, both through internal development activities and, in certain cases, through acquisitions. We make these investments based on our assessments of the needs of our customers and potential customers, including the trends described above. However, the market for healthcare in the United States is highly complicated, and there can be no assurance that the trends identified above will continue or that the intended benefits to WebMD from our responses to those trends will be achieved. In addition, the markets for healthcare information services and technology solutions are highly competitive and not only are our existing competitors seeking to benefit from these same trends, but the trends may also attract additional competitors. See Healthcare Information Services and Technology Solutions Competition for Our Healthcare Information Services and Technology Solutions below.

Recent Developments

On March 4, 2004, WebMD sold $100 million of Convertible Redeemable Exchangeable Preferred Stock in a private transaction to CalPERS/PCG Corporate Partners, LLC. CalPERS/PCG is a private equity fund managed by the Pacific Corporate Group and principally backed by California Public Employees Retirement System, or CalPERS. Transfer of the Preferred Stock is subject to restrictions and holders may not engage in hedging transactions with respect to WebMD common stock.

The Preferred Stock ranks senior to WebMD common stock with respect to rights upon liquidation, winding-up or dissolution. The Preferred Stock has a liquidation preference of $100 million in the aggregate and $10,000 per share. The Preferred Stock is convertible into 10,638,297 shares of WebMD common stock in the aggregate, representing a conversion price of $9.40 per share of common stock. We may not redeem the Preferred Stock prior to March 2007. Thereafter, we may redeem any portion of the Preferred Stock at 105% of its liquidation preference; provided that any redemption by us prior to March 2008 shall be subject to the condition that the average closing sale prices of WebMD common stock is at least $13.16 per share, subject to adjustment. We are required to redeem all shares of the Preferred Stock then outstanding in March 2012, at a redemption price equal to the liquidation preference, payable in cash or, at our option, in shares of WebMD common stock. Upon the occurrence of certain events constituting a change in control of WebMD or certain significant acquisitions by WebMD of businesses that are not related or complementary to its businesses, holders of the Preferred Stock will have the right to put their shares to WebMD at a purchase price equal to the liquidation preference of the Preferred Stock.

If the average closing sales price of WebMD common stock during the three-month period ended on the fourth anniversary of the issuance date is less than $7.50 per share, holders of the Preferred Stock will have a right to exchange the Preferred Stock into WebMD s 10% Subordinated Notes due March 2010. The Notes may be redeemed, in whole or in part, at any time thereafter at WebMD s option at a price equal to 105% of the principal amount of Notes being redeemed.

Table of Contents

Holders of Preferred Stock will not receive any dividends unless the holders of common stock do, in which case holders of Preferred Stock will be entitled to receive ordinary dividends in an amount equal to the ordinary dividends the holders of Preferred Stock would have received had they converted such Preferred Stock into common stock immediately prior to the record date for such dividend distribution. So long as the Preferred Stock remains outstanding, WebMD is required to pay a quarterly fee to CalPERS/PCG of 0.35% of the face amount of the then outstanding Preferred Stock.

We have agreed that we will not, without the prior written consent of holders of 75% of the shares of Preferred Stock then outstanding, issue any additional shares of Preferred Stock or create any other class or series of capital stock that ranks equal or senior to the Preferred Stock. We also have agreed to use our reasonable best efforts to amend our charter at our next Annual Meeting of Stockholders to provide that the holders of the shares of Preferred Stock will have the right to vote, together with the holders of WebMD common stock, on matters that are put to a vote of holders of WebMD common stock, with holders of Preferred Stock having the right to cast the number of votes that could be cast by a holder of the WebMD common stock into which the Preferred Stock would be convertible immediately prior to the record date for the vote.

Holders of the shares of WebMD common stock issued upon conversion of the Preferred Stock and any shares of the WebMD common stock issued upon satisfaction of our right to redeem Preferred Stock will have certain registration rights in respect of their shares of common stock, beginning in March 2006.

WebMD intends to use the net proceeds from the private placement for general corporate purposes, which may include acquisitions.

Table of Contents

HEALTHCARE INFORMATION SERVICES AND TECHNOLOGY SOLUTIONS

There are many types of transactions, information exchanges and other communications that occur between the various participants in the healthcare industry, including physicians, patients, pharmacies, dentists, hospitals, billing services, commercial health insurance companies, pharmacy benefit management companies, managed care organizations, state and federal government agencies and others. We offer a comprehensive suite of transaction and information services and technology solutions to healthcare industry participants. These integrated and stand-alone products and services are designed to facilitate transactions, information exchange and communication among healthcare industry participants and to operate on various platforms, including the Internet, private intranets and other networks.

WebMD Health

Overview

WebMD Health, our Portal Services segment, offers a variety of online resources and services for consumers and healthcare professionals, including:

WebMD Health, our consumer portal, which is located at *www.webmd.com*. WebMD Health provides access to health and wellness content. We also distribute our content, and reach additional consumers, through AOL Health with WebMD and MSN Health with WebMD. In addition, WebMD Health offers paid subscription services that provide consumers with access to interactive tools, personalized in-depth content and expertise from leaders in their fields.

Medscape from WebMD, our portal for physicians and allied healthcare professionals, which is located at *www.medscape.com*. At Medscape, physicians and other healthcare professionals have access to resources that include timely medical news and professional conference coverage, continuing medical education activities, full-text medical journal articles and drug and medical literature databases.

We also license our content to health plans and other healthcare partners for use on their Web sites, in some cases as part of providing a co-branded site and in some cases on a private label basis under the partner s branding.

We reach a large audience of health-involved consumers and clinically active healthcare professionals. We work closely with pharmaceutical, medical device and other healthcare companies to develop innovative online channels of communication to our audience, or specific portions of our audience, that complement their offline education, marketing and customer service programs. These companies can sponsor specific pages or sections of our portals or specific events, programs and newsletters, all of which are clearly labeled as sourced from or sponsored by the specific sponsor. In addition, sponsors can reach specific demographic groups, condition-specific groups or specialty-specific groups through our portals and through newsletters that members have requested based on their interests. Performance of our sponsored programs, including the aggregate number of impressions, visitors and actions taken, is tracked and reported to the sponsor on a regular basis.

Through our WebMD Health Services business, we provide web-based tools and applications to employers and health plans for use by their employees and plan members. These tools and services provide a framework for better decision-making by healthcare consumers and can assist employers and plans in managing demand while improving quality of care.

We generate the majority of our Portal Services revenue by selling sponsorships of specific pages, sections or events on our portals and related e-mailed newsletters, by selling advertising on our portals and the online and offline properties of our strategic partners, and by licensing our content and our online tools and related software and services. Historically, the majority of our Portal Services revenues have come from a small number of companies. Our WebMD Health customers include pharmaceutical, biotech and

Table of Contents

medical device companies, employers and health plans and media distribution companies. WebMD Health also receives a small portion of its revenues from the sale of paid subscription services.

WebMD Health Consumer Portal

General. Consumer interest in convenient and reliable sources of general information on health and wellness topics continues to grow. In addition, consumers increasingly seek to educate themselves about available treatment options for specific health conditions or injuries. We believe that these trends are likely to continue, as consumers are asked to bear an increasingly large share of their healthcare expenditures due to changes in the design of the medical plans and prescription drug plans being offered by payers and employers. Traditional media have sought to meet this demand by introducing magazines focused on health and wellness and by increasing news coverage of healthcare-related issues. The Internet allows us to offer consumers the resources they are looking for, with immediate access to searchable information and dynamic interactive content.

WebMD Health provides access to health and wellness news and information, support communities, interactive tools and opportunities to purchase health-related products and services. There are no membership fees and no general usage charges for the site; however, we do charge usage or subscription fees for some premium content and services. See WebMD Health Subscription Services below.

Content Offerings. The content and service offerings on WebMD Health include:

Original and Licensed Content. We offer proprietary, medically reviewed health and wellness news articles written daily by our staff of journalists. We also offer searchable access to a library of health and wellness articles, reference information and interactive presentations, some of which we own and some of which we have licensed from others. Our articles and other content cover various health-related topics, including: specific diseases and chronic health conditions, medical tests, pregnancy and parenting, diet and nutrition, fitness and sports medicine, and sexuality and relationships.

Membership. Consumers can choose to become members of WebMD Health, which allows them to make use of certain WebMD interactive content and services. Members can also select from more than 32 different e-mail newsletters on health-related topics or specific conditions and have access to our communities and events, as described below. We have built a large consumer membership, most of whom have chosen to receive our clinical alerts, newsletters and reports on specific diseases, conditions and other health and wellness topics.

Communities. Our communities allow our members to participate in real-time discussions in our chat rooms and on our message boards. Members can share experiences and exchange information with other members who share their health condition or concern. Members can also use our Ask the Experts service to post their health questions for experts.

Events. Our events include one-time programs and series in which experts make presentations and answer questions on specific health-related topics. Our events also include WebMD University programs, which are four week courses, live moderated by experts, on specific subjects. WebMD University programs have included: Take Charge of Your Diabetes; Feeding Your Self, Feeding Your Baby; Alive and Well, Taking Charge of Your Breast Cancer Treatments; and Stories of Survivors, Your Breast Cancer Guide.

Interactive Personal Health Management Tools and Other Features. We provide access to interactive tools, calculators, quizzes and illustrated guides and slide shows on health topics. Our interactive tools include a pregnancy calendar, body mass index tool and a calorie counter. Our slide shows cover topics such as mammograms, fetal positions and common visual problems.

Physician Directory and Related Services. WebMD Health also has features that allow consumers to search for a physician or clinic in their area. The WebMD Physician Directory contains information on practicing physicians throughout the U.S. Users can search for a doctor by location

Table of Contents

or specialty and based on HMO or hospital affiliations. The WebMD Physician Directory is provided by The Little Blue Book, which was acquired by WebMD in 2003. See Physician Directory Services below.

WebMD Health Subscription Services. WebMD Health also offers the following paid subscription services, which provide access to exclusive interactive tools, personalized in-depth content and expertise from leaders in their fields:

WebMD Health Manager. We offer, on a subscription basis to individual consumers, a suite of healthcare decision-making tools and related services, which includes some of those we license to health plans and employers for use by their members and employees. See WebMD Health Services Group below.

WebMD Weight Loss Clinic. The WebMD Weight Loss Clinic is a subscription service that provides members with a customized eating plan based on individual food preferences and other information and resources relating to weight loss.

WebMD Fertility Center. The WebMD Fertility Center provides information, tools and personalized e-mail reminders relating to fertility, conception and pregnancy.

Medscape from WebMD

Medscape from WebMD is designed to meet the information needs of medical professionals. *Medscape from WebMD* is organized by medical specialty area, such as hematology-oncology and cardiology, to make it easier for members to access the information most relevant to them. We also have areas organized by profession or interest area, including sites for nurses, pharmacists, medical students, users interested in medical policy and practice management issues, and members with a particular interest in technology and medicine. Our extensive and up-to-date medical content and easy-to-use search capabilities assist medical professionals in keeping abreast of medical advances and obtaining fast, accurate answers to medical questions online. There are no membership fees and no general usage charges for the site; however, we do charge usage or subscription fees for some premium content and services.

Our content and service offerings, a combination of original material and content licensed from major professional publishers, are generally presented by specialty and include:

Continuing Medical Education (CME). More than 30 states and many medical specialty societies require physicians and selected other medical professionals to certify annually that they have accumulated a minimum number of CME hours to maintain licensure or membership. We offer a selection of free, regularly updated CME activities for physicians, registered nurses, pharmacists and other healthcare professionals, including original programs and online multimedia adaptations of live events. In addition, our CME Live offerings provide real time webcasts of CME programs on key topics and conditions, designed to educate healthcare professionals about timely clinical issues. These webcasts combine streaming audio and slide presentations and allow participants to interact with faculty. We also provide services that track CME credits accumulated through our site for our users. Many of our CME-certified programs also carry Continuing Education (CE) credit for nurses and/or pharmacists.

All of our CME activities have been planned and implemented in accordance with the Essential Areas and Policies of the Accreditation Council for Continuing Medical Education, or ACCME, which oversees providers of CME credit, and have been produced in collaboration with ACCME-accredited CME providers. In August 2002, ACCME awarded Medscape a two-year, provisional accreditation as a CME provider, allowing Medscape to certify online CME activities, which Medscape now does for most of its CME programs. We are currently in the process of seeking full accreditation.

In July 2002, Pharmaceutical Research and Manufacturers of America (PhRMA), a trade association of pharmaceutical manufacturers, instituted a new voluntary Code on Interactions with

Table of Contents

Healthcare Professionals, which outlined guidelines for how sales representatives and others involved in marketing pharmaceuticals should interact with healthcare professionals. The PhRMA Code is intended to help ensure that these interactions benefit patients and enhance the practice of medicine and to avoid concerns about inappropriate influence on the prescribing practices of physicians. The PhRMA Code provides that these interactions should not consist of entertainment, dining or recreation, but should focus on informing the healthcare professional about scientific and clinical information and supporting research and education. While providing subsidies directly to healthcare professionals for travel, lodging and other expenses of attending CME or scientific conferences is no longer permitted, sponsorship or underwriting of CME programs or conferences continues to be. We believe that the guidelines contained in this Code are likely to benefit providers of online CME and other online informational materials for healthcare professionals, such as Medscape, as pharmaceutical manufacturers seek efficient, effective and appropriate sponsorships and channels of communication.

Newsletters. Members receive MedPulse, our weekly e-mail newsletter, which is published in more than 25 specialty-specific editions and highlights new information and CME activities on the Medscape site of interest to each particular specialty. We also provide commercially supported Special Reports newsletters, which contain information on specific conditions and treatments.

Medical Conference Coverage. We provide overviews and analysis of key data and presentations from about 150 professional meetings each year, including major conferences in a variety of specialties. This benefits our members who were unable to attend and those who did attend but might not have been able to see all of the presentations of interest to them, as well as the sponsors of the conferences, by increasing the size of the audience exposed to this material. We cover a number of these conferences in collaboration with the societies and organizations that present them.

Medical News and Clinical Alerts. We provide original, daily medical news stories written by our staff of journalists and reviewed by our staff of physicians, in addition to news provided by professional wire services. Our news group also regularly produces analytical reports based on interviews with experts and newsmakers. In addition, we provide real-time alerts on such critical clinical issues as pharmaceutical recalls and product advisories.

Resource Centers. Resource Centers are regularly updated collections of clinical content, selected by Medscape s editors, focused on a specific topic, condition or theme. Content includes news, journal articles, conference coverage, expert columns and CME programs. Medscape currently has more than 60 Resource Centers across multiple specialties.

Electronic Journals. Medscape publishes an original electronic-only journal, *Medscape General Medicine* (*MedGenMed*), indexed in the National Library of Medicine s MEDLINE reference database. *MedGenMed,* the world s first online-only, primary source, peer-reviewed general medical journal, was established in April 1999. As of March 2004, it had published more than 1,100 papers. Since December 2002, *MedGenMed* at www.medgenmed.com has included specialty sections for HIV-AIDS, Gastroenterology, Hematology-Oncology, Pulmonary Medicine, OB-Gyn and Women s Health, Orthopedics and Sports Medicine and Psychiatry/ Mental Health, Neurology, and Technology and Medicine. Medscape also publishes *Topics in Advanced Practice Nursing,* which is indexed in CINAHL, the Cumulative Index of Nursing and Allied Health Literature.

Medscape Publishers Circle. Medscape Publishers Circle is a collection of high-quality clinical information from prominent medical publishers, available free to registered Medscape members.

Medical Reference Applications. Our medical reference applications include access to various medically related databases and abstracts.

Medical Reference Services. These services include the professional medical reference texts *ACP Medicine* (formerly *WebMD Scientific American® Medicine*) and *ACS Surgery: Principles and Practice* (formerly *Scientific American Surgery)*, each available for sale by subscription to individual physicians and to institutions in multiple formats (print, CD-ROM and Online). *ACP Medicine* has

Table of Contents

been a comprehensive and continually updated internal medicine reference for 25 years. *ACP Medicine* and *ACS Surgery* are official publications of the American College of Physicians and the American College of Surgeons, respectively, although wholly owned by WebMD.

Users must register as members to utilize the features of *Medscape from WebMD.* This enables us to deliver targeted medical content based on our members registration profiles. The registration process enables professional members to choose a home page tailored to their medical specialty or interest. For example, a member registered as a cardiologist is automatically directed to Medscape Cardiology, rather than a more generic home page.

WebMD Health Services Group

Through the WebMD Health Services Group, formerly known as WellMed, we provide employers and healthcare plans with a suite of online tools and related services called the WebMD Health Hub. The WebMD Health Hub integrates health and wellness content, a personal medical record, health assessment tools, decision support tools, health improvement programs and targeted messaging. The WebMD Health Hub provides a framework for better decision-making by healthcare consumers and allows employers and health plans to manage demand, while improving the quality of care and reducing administrative and communication costs. We receive fees from employers for use of our applications and services by their employees, and from health plans for use by their members. The WebMD Health Hub is also distributed through relationships with providers of benefits-related services as a part of their own offerings to employers.

WebMD Health Hub applications are integrated into the client s Intranet or Web site and work with the client s specific health and benefit programs, disease management vendors and other health-related systems and content and can be co-branded or customized to match client branding and look and feel. The core products and applications that make up the WebMD Health Hub are Personal Health Manager, Personal Health Insight, Personal Health Decisions and HubX:

Personal Health Manager is a suite of consumer applications that provides a personalized framework to manage health, wellness and benefit information and facilitate healthy behavior, including health risk and condition assessment tools, an online personal health record and health and lifestyle improvement programs.

Personal Health Insight is an online service center that provides specialized decision-support for clients, including aggregated information regarding utilization of the WebMD Health Services platform and results of messaging campaigns. With Personal Health Insight, employers and plans can analyze aggregate health data in real time, address population health risks and proactively implement preventive programs.

Personal Health Decisions is a set of benefit decision-support applications that explain benefit plan choices and facilitate informed selection and use of those benefits.

HubX is a platform that integrates employer or plan applications and data into the WebMD Health Hub. In addition, the HubX Data Interchange option provides functionality to import data, such as healthcare claims and medication claims, for greater personalization and targeted messaging and to export self-reported information from the WebMD Health Hub to care providers.

By educating and encouraging their employees and plan members to take a more active role in their healthcare, employers and plans can realize cost savings from more informed decision-making, while also improving healthcare outcomes. Other potential benefits to an employer or plan include efficiently identifying and enrolling candidates in disease management or other health management programs.

Physician Directory Services

In 2003, we acquired the company that publishes The Little Blue Book, a leading source of practice contact information for physicians since 1988. The pocket-sized reference book is published annually in 146 distinct metropolitan editions. Physicians utilize it for local and up-to-date physician information. All physicians are listed free of charge in their local metropolitan-area edition, along with their specialties,

Table of Contents

HMO affiliations, hospital affiliations, office addresses, telephone numbers and Medicare-assigned Unique Physician Identification Number (UPIN). The database used to create The Little Blue Book contains practice information on approximately 400,000 practicing physicians. WebMD Health receives revenues from sales of The Little Blue Book, as well as from sponsors and advertisers in those books, most of whom are pharmaceutical companies. Pharmaceutical companies also purchase copies of The Little Blue Book for distribution to physicians. In addition, we use the database to provide physician information on the consumer portal. We also publish and sell to physicians The Little Yellow Book, a directory of physicians fax and e-mail information for 146 metropolitan areas.

Sales and Marketing

A team of sales, marketing and account management personnel represents WebMD Health and *Medscape from WebMD* to pharmaceutical companies, medical device companies, health plans and other healthcare and consumer companies. These individuals work closely with clients and potential clients to develop innovative means of using our portals to bring their companies, and their products and services, to the attention of target groups of consumers and healthcare professionals and to create channels of communication with these audiences.

A separate team of sales, marketing and account management personnel represents WebMD Health Services Group to employers and health plans. These individuals customize our services for each client according to the client s specific plan design and business objectives. We also promote and distribute WebMD Health Services Group through relationships with employee benefits consultants and other companies that assist employers in purchasing or managing employee benefits.

We seek to attract traffic and new members to WebMD Health through a variety of methods, including online and offline media campaigns. The primary focus of our media campaigns has been member registration. We promote WebMD Health s subscription services through our consumer portal and our e-mailed newsletters.

We seek to attract traffic and new members to Medscape through a variety of methods, including advertising on other Internet sites and in medical journals, pharmaceutical and other healthcare publications and other targeted publications. We also promote Medscape at industry conferences, trade shows and medical meetings and by using direct mail.

WebMD Envoy

Overview

To ensure timely reimbursement and comply with managed care requirements, healthcare providers must interact effectively with healthcare payers from the first point of patient contact until final payment has been received. Unfortunately, in these interactions, providers and payers often juggle a confusing combination of electronic and manual processes, phone calls and faxes, and disparate software systems. WebMD Envoy, our Transaction Services segment, provides an electronic link between payers and providers that allows them to conduct medical, pharmacy and dental transactions electronically. However, WebMD Envoy provides much more than just a clearinghouse connection we provide electronic reimbursement cycle management solutions that can be used by payers and providers to automate the entire reimbursement process. In addition, as a complement to our electronic transmission services, our WebMD ExpressBill operations provide print-and-mail services to providers, including patient statement processing, and, through Advanced Business Fulfillment, Inc., which we acquired in July 2003, we provide healthcare paid-claims communications services for third-party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanations of benefits. We also provide connectivity and tools for automating clinical functions.

The customers for WebMD Envoy s services consist of healthcare providers, such as physician offices, dental offices, billing services, national laboratories, pharmacies, hospitals, and healthcare payers, including Medicare and Medicaid agencies, Blue Cross and Blue Shield organizations, pharmacy benefit management companies, commercial health insurance companies and managed care organizations.

Table of Contents

Healthcare payers and providers pay fees to us for our services, generally on a per transaction basis or, in the case of some providers, as a flat rate per month. Transaction fees vary according to the type of transaction and other factors, such as volume level commitments. We may also charge one-time implementation fees to providers and payers. A significant portion of our WebMD Envoy revenues come from the country s leading national and regional healthcare payers.

We work with numerous medical and dental practice management system vendors, hospital information system vendors and other service providers to provide integrated transaction processing between their systems and our clearinghouse. Most practice management and hospital information systems support, and can be integrated with, WebMD Envoy transaction services. Many practice management system vendors, including WebMD Practice Services, market a private label brand of our transaction services that they have integrated with their systems. We pay a sales commission, based on volume, to some of these vendors as an inducement to use WebMD Envoy. We have long-standing relationships with many vendors of practice management systems. Medifax-EDI, which we acquired at the end of 2003, has similar relationships with vendors of hospital information systems. We work together with these vendors to increase the percentage of healthcare transactions that are handled electronically.

EDI Transaction Services

General. We provide our payer and provider customers connectivity and transaction services through an integrated electronic transaction processing system, which includes proprietary software, host computer hardware, network management, switching services and interfaces. We refer to these services as electronic data interchange, or EDI. Our EDI transaction services reduce paperwork and the need for communication by mail, telephone and fax, resulting in cost savings for payers and providers. These services also expedite the reimbursement process, which can result in a lower average number of outstanding accounts receivable days for providers. A further benefit to payers is that they are able to more easily detect fraud and screen for unusual utilization trends.

Providers access our transaction services both directly and through their relationships with integrated delivery networks, clinics, physician and dental practice management system vendors, hospital information management system vendors, and retail pharmacy chains. Providers initiate transactions using our proprietary applications, their practice management systems or other computer systems or networks. Providers submit transactions to our clearinghouse by modem connections using regular telephone lines, using dedicated high speed telecommunications services and over the Internet. At our clearinghouse, the transaction is edited for accuracy, validated for format and completeness, then translated in accordance with the payer s specifications and sent to the payer s claims adjudication and/or real-time database systems.

We maintain direct connections with many healthcare payers, including Medicare contractors and Medicaid agencies, Blue Cross and Blue Shield organizations, commercial health insurance companies, pharmacy benefit management companies and managed care organizations. Our direct payer connectivity facilitates high levels of service by minimizing the number of intermediaries between the provider and the payer. Our direct connections with payers typically consist of dedicated networks between the payer and our clearinghouse. Most transactions are currently transmitted to the payers using our proprietary software and dedicated telephone lines, with some transmitted securely over the Internet. Other clearinghouses also use our services to transmit transactions that they have received from providers to payers. We make payments, based on volume, to some of these clearinghouses as an inducement to use WebMD Envoy to complete the transactions submitted through their systems.

Medical and Dental Administrative Services. Our medical and dental administrative services provide the connectivity and transaction processing services needed for providers and payers in the healthcare

Table of Contents

industry to automate key business functions and communicate with each other. WebMD Envoy provides connectivity throughout the healthcare reimbursement cycle:

beginning with insurance eligibility verification,

continuing through the claim submission process,

followed by tracking the reimbursement through claim status inquiries, and

concluding with electronic remittance information and payment posting.

Providers can submit real-time or batch claims to us for processing and reimbursement by payers and inquire as to the status of claims previously submitted. Most claims are submitted to us as batch claims, which are collected by providers throughout the day and submitted to us in bulk. We then sort, format and edit the claims to meet each particular payer s requirements before transmission to the payer. Providers can receive an electronic remittance advice which provides payer payment information and an explanation of the settlement of a related claim. Providers can also use our services to verify patient enrollment and eligibility and to obtain authorization from payers, at the point of care, for services and referrals to other providers. Our acquisition of Medifax-EDI at the end of 2003 has strengthened our service offerings for these types of transactions.

Our all-payer suite of services includes the capture, validation and routing of claims transactions on behalf of not just commercial payers, but also Blue Cross Blue Shield payers, Medicare and Medicaid. Additionally, our all-payer services include the return of an electronic remittance transaction, which is the equivalent of a paper explanation of benefits, or EOB, from all the payers back to the originating provider. The goal is to provide a single source EDI reimbursement cycle management solution for providers and practice management system vendors. A single EDI solution reduces administrative burdens on the provider office in sending claims transactions and receiving electronic remittance advice transactions and, more importantly, allows us to provide a single report back to the provider office regarding those transactions. That, in turn, allows the provider office to determine more easily whether it has been paid on a particular claim and how much. Provider offices without such a solution typically receive five or more different reports that they then have to reconcile in order to manage their accounts receivable. Implementation of our all-payer services has presented technical, operational and customer service challenges and has resulted in a large increase in the amount of transactions we transmit to Blue Cross Blue Shield payers, Medicare and Medicaid which, in certain cases, has caused service delays. In addition, this implementation, happening together with the implementation of the HIPAA Transaction Standards, has required, and continues to require, system upgrades, additional programming and changes in our processes and procedures. We have been incurring, and expect to continue to incur, significant expenses relating to the all-payer implementation, including system upgrades and testing and related quality assurance activities.

We provide various products designed to assist healthcare providers and payers in utilizing our administrative services, including:

WebMD Office. Through our WebMD Office Internet-based service, providers can securely access our transaction services through either a standard dial-up or high speed DSL or cable modem. WebMD Office can be used as a stand-alone system or as a complement to a practice management system through an import and data management function that allows transactions to be generated from the practice management system and submitted through WebMD Office. In addition, our practice management system vendor partners may elect to market a private-label brand version of WebMD Office.

AccuClaim Plus. Our AccuClaim Plus solution is designed for the claims submission processes of hospitals and large physician practices. AccuClaim Plus interfaces with their existing management systems, importing claim files and subjecting them to payer-specific edits, prompting users to correct claim errors prior to submission to payers in order to minimize the claim rejection rate while increasing the first pass and auto-adjudication rate at the payer s adjudication system.

Table of Contents

WebMD Empower. WebMD Empower is an EDI-enabling software and data hosting solution that gives healthcare payers the ability to automate communication with their providers through our network, using our infrastructure. WebMD Empower takes claims data submitted to the WebMD Envoy clearinghouse, applies value-added editing, including checks against payer-specific business rules and data, and sends it directly to the payer s information system. For real-time transactions, WebMD Empower works by downloading appropriate eligibility, provider, benefit, referral/authorization and claims data from the payer s system onto our server. Downloads are performed periodically or in real time as information in the payer s database is updated.

Medifax Assistant. Medifax Assistant integrates with hospital information systems (HIS) to automate various registration activities such as insurance eligibility verification, credit checking and address verification. Medifax Assistant can be configured to automatically perform real-time tasks during patient registration. This saves the registration staff time by eliminating the need to use separate systems for registration and for eligibility verification. The eligibility response can be automatically stored within the patient record as a permanent reference.

Medifax Receivable Analysis. Medifax Receivable Analysis is an electronic screening service designed to verify Medicaid and other forms of insurance eligibility in an electronic batch format. The healthcare provider submits a file electronically and the file is processed against the Medifax-EDI payer databases to determine eligibility. Medifax customers use this service to identify Medicaid and other forms of eligibility that may apply to patients who have been classified as not having coverage. The resulting reclassification often results in significant reimbursements.

Pharmacy Administrative Services. A typical pharmacy benefit transaction takes place in a real-time setting using a pharmacy management system or other claim submission product. The claim is submitted to WebMD Envoy in a standard format and includes all required information about the prescription. The claim is then routed to the appropriate adjudicating processor where the claim is processed within seconds. Response information includes patient coverage, formulary compliance (specific drug coverage), potential drug interactions, patient s co-payment due and anticipated reimbursement amount due to the pharmacy from the payer. Final dollar amounts due to the pharmacy are typically paid by the payer 15-30 days after claim submission.

Lab Ordering and Reporting Services. We provide clinical lab ordering and reporting services through WebMD Clinician, our Internet-based product. This product supports the ordering of clinical tests and the reporting of test results between healthcare providers and labs. WebMD Clinician reduces costs and improves the quality of patient care by improving order entry accuracy and expediting the delivery of lab results, while enhancing the ability to share those results with multiple physicians. In addition, we provide similar services to practice management system vendors, hospital information system vendors and electronic medical record vendors through an application programming interface known as Clinician eXT.

Other Communications Services

ABF. In July 2003, WebMD Envoy acquired Advanced Business Fulfillment, Inc., which we refer to as ABF, a provider of healthcare paid-claims communication services for healthcare payers. ABF s operations are supported by proprietary software and systems that allow healthcare payers to outsource print-and-mail activities by sending an electronic feed to ABF. By outsourcing these services to ABF, its clients can reduce operating costs and capital expenditures. ABF s systems include a Web-based suite of management tools to facilitate the printing and mailing of checks and remittance advice to providers and EOBs to plan members. These management tools allow clients to control the processes they have outsourced to ABF and to access archived data from their desktops. ABF has worked closely with leading claims processing system vendors to allow its software to interface with their systems. In return for marketing ABF s post-adjudication services and for the creation and maintenance of an ABF-specific data extract, ABF makes periodic payments to vendor partners based on transaction volumes.

Healthpayers USA is ABF s proprietary program to cross-consolidate provider mail in order to create savings in postal costs for its clients. Healthpayers USA screens, sorts and consolidates mail from any

Table of Contents

number of its clients destined for a single provider into one package and automatically produces a recipient cover sheet that itemizes the contents. ABF and its clients share the resulting postal savings.

WebMD ExpressBill. Through WebMD ExpressBill, we provide print-and-mail services to healthcare practitioners, hospitals and high volume commercial customers throughout the United States. WebMD ExpressBill accepts client data via modem or the Internet, generates printed materials and prepares them for mailing. Our WebMD ExpressBill services include:

Patient Mailings. On behalf of healthcare provider customers, we print invoices, account statements, collection letters, recall notices and other communications and mail them to patients.

Paper Claims. Claims that cannot be sent electronically to payers can be sent by healthcare providers electronically to WebMD ExpressBill, where we print and mail them on their behalf.

Payment Processing. We process payments on behalf of providers and other customers, receiving and depositing checks, posting payments and transmitting funds in accordance with customer instructions.

Electronic Payment Services. Our electronic payment services offer healthcare providers the ability to receive payment via the Internet.

HIPAA

Under the Healthcare Insurance Portability and Accountability Act of 1996, or HIPAA, Congress mandated a package of interlocking administrative simplification rules, including rules to establish standards and requirements for the electronic transmission of certain health information, which we refer to as the Transaction Standards. As a supplier of EDI-enabling products and connectivity services to patients, payers, providers and third party vendors, WebMD Envoy is affected by many of the HIPAA provisions, including the Transaction Standards.

In order to implement the Transaction Standards, WebMD Envoy has made and continues to make significant changes to its systems and the software it uses internally. Similarly, the implementation has required payers and providers to simultaneously implement changes to their systems and/or internal procedures. As a result, this implementation process and related testing has been an immense challenge for the healthcare industry, including WebMD. However, it also represents a great opportunity for the industry and for us, because it encourages payer/provider connectivity to evolve from its current focus on the sending and receiving of claims to automating ancillary transactions, such as eligibility, status or remittance.

We believe that, even though the intent of HIPAA was to make electronic transactions more standardized, the use of clearinghouses will continue to be the most efficient way for most providers to send their electronic claims and related transactions to multiple payers. The standardization resulting from implementation of Transaction Standards is only partial: payer systems and requirements continue to vary in certain respects even after HIPAA implementation and will continue to evolve and change in the future. Payers have published approximately 440 Companion Guides setting forth their individual interpretations of the Transaction Standards and that number can be expected to continue to grow. These payer-specific interpretations require us to perform extensive customized programming and related testing. Another source of the implementation challenges resulting from the Transaction Standards is the increase in computing capacity required. The Transaction Standards formats are much larger than the pre-existing ones. We are utilizing more computing capacity than we had anticipated. As a result, our systems have experienced inefficiencies that have resulted in processing delays. Another difficulty for us and our provider customers results from the fact that the Transaction Standards cover not only transaction formats, but also required content, including some content not previously collected by most providers. We continue to work with payers, providers, practice management system vendors and other healthcare participants to implement the Transaction Standards. For more information regarding challenges involved in such implementation and a description of the HIPAA regulations, see Business Government Regulation Health Insurance Portability and Accountability Act of 1996 below.

Table of Contents

Sales and Marketing

Our WebMD Envoy sales and marketing efforts are conducted by sales, marketing and account management personnel located throughout the United States. We participate in trade shows and use direct mail and various advertising media to promote our services.

We promote our EDI services to organizations that have relationships with or access to a large number of providers, such as practice management systems vendors, hospital information systems vendors, practice management companies and other clearinghouses. In certain cases, we agree to pay a sales commission based on transaction volume to these organizations as an inducement to use WebMD Envoy as the clearinghouse for the transactions made through their systems or by providers with which they have relationships.

We also market our EDI services directly to healthcare payers, as well as to small and large physician practices, dentists, hospitals and other healthcare providers. We offer our payer customers the opportunity to work with us in targeted programs to educate physicians and dentists to increase the utilization of electronic services. When a payer agrees to participate in such a program, WebMD utilizes information supplied by the payer to target providers that may not be sending claims electronically.

In the pharmacy EDI area, WebMD Envoy has established relationships with large retail pharmacy chains and pharmacy software vendors.

In the post-adjudication services area, we have established relationships with vendors of claims processing software. Our ABF account management personnel also market directly to healthcare payers and, as part of their sales effort, provide potential clients with an operational audit and identify the efficiencies that we believe we can help them achieve.

WebMD Practice Services

Overview

WebMD Practice Services, our Physician Services segment, develops and markets information technology systems for healthcare providers, primarily under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. Our systems include administrative and financial applications that enable healthcare providers and their administrative personnel to manage their practices more efficiently and clinical applications that assist them in delivering quality patient care. These applications and related services:

automate scheduling, billing, receivables management and other administrative and financial management tasks,

enable providers to maintain electronic medical records and to automate the documentation of patient encounters, and

facilitate the use of electronic data interchange for administrative and clinical healthcare transactions.

We expect that most of our future sales of practice management systems will be Intergy systems. However, we intend to continue to develop and support The Medical Manager system, which is currently the most widely used physician practice management system in the United States.

Healthcare providers pay us a one-time license fee for the purchase of a license to our software or to additional software modules and for system hardware and also pay us recurring fees for the maintenance and support of our software. Many providers also pay us recurring fees for the provision of hardware support and maintenance. Pricing depends on several factors, including the number and type of modules to

Table of Contents

be licensed, the number of users per site, the number of practices, the operating system, the hardware to be supported and the complexity of the installation. Healthcare providers pay us fees for our Medical Manager Network Services transactions services, generally on a per provider per month subscription basis or a per transaction basis.

Practice Management Systems

Intergy. Intergy, our new practice management software product, is the result of a significant, multi-year commitment to engineering and development of a completely new practice management system. The Intergy system s graphical user interface (GUI) packages complex medical practice functions into easy-to-navigate windows with consistent point-and-click drop down menus and buttons. The Intergy software operates on Windows and UNIX based servers, together with Windows based workstations.

Intergy systems are scalable to meet the needs of a wide variety of healthcare provider settings, from small physician groups to large clinics, and across various medical specialties. Customers can purchase a base system and then add additional modules and services over time to expand their use of technology as needed. The Intergy base package allows an office to automate appointment scheduling and recalls, registration, encounter form management, billing, collections and other administrative and financial functions. The Intergy system also has a customizable security system, with access to functions and features that can be defined for each user based on practice policies and procedures.

One of our optional Intergy administrative and financial modules is the managed care system, which provides functions required to track incoming and outgoing referrals to facilities and specialists and to provide risk management capabilities. The managed care system assists providers in automating referral management, capitation payment posting, and contract management and profitability tracking. The system is designed to work in all managed care scenarios, including primary and specialty care. Optional clinical modules include imaging systems, tools that can be used to create and maintain electronic medical records and automate the documentation of patient encounters at the point of care, manage clinical workflow, write and send electronic prescriptions, and request and review laboratory tests and results. We believe that there is a significant opportunity to increase the use by physician practices of electronic medical record systems and are focusing on cross-selling these products and services to our existing customers and as part of our new systems sales. See EMR and Imaging Systems below for descriptions of these products and services. Intergy users can also elect to implement some or all of the integrated products and services described below under Additional Products and Services, including our ULTIA handheld wireless device and our Medical Manager Network Services connectivity services.

The Medical Manager. The Medical Manager system provides physician practices with a broad range of patient care and practice management features. We also offer The Medical Manager system in customized versions to meet the functionality needs of public health and community health markets and family planning clinics and intend to continue to market The Medical Manager system in these formats.

The Medical Manager software s base package serves as the foundation of the system and includes an appointment scheduler, billing system, financial management system and other features. Additional modules containing advanced administrative and financial features are also available, including automated collections, advanced billing and multiple resource scheduling and managed care modules. The Medical Manager system also has optional electronic medical record and document and image management system products. See EMR and Imaging Systems below. The Medical Manager users can elect to implement some or all of the integrated products and services described below under Additional Products and Services, including our ULTIA handheld wireless device and our Medical Manager Network Services connectivity services.

Other Practice Management Systems. Through our acquisitions of various businesses, we have also obtained ownership of other practice management systems with smaller user bases, including the practice management systems previously owned by Physician Computer Network, Inc., or PCN. We currently support these other systems and may provide periodic updates to the users of some of these systems. We face competition for the support services we market to users of these practice management systems. See

Table of Contents

Competition for Our Healthcare Information Services and Technology Solutions below. In addition, although we seek to market our Intergy practice management system to these customers when they are evaluating the purchase of a new system, we face competition from numerous other vendors of practice management systems. If our existing customers choose a practice management system from a competing vendor, they will no longer need support services from us. Loss of a significant number of these customers could have a material adverse effect on our Practice Services revenues.

Medical Manager Network Services

Our practice management systems support integrated use of our WebMD Envoy EDI services through Medical Manager Network Services. For a description of WebMD Envoy s EDI services, see WebMD Envoy above. The administrative transactions supported include electronic claims, claims status inquiry, eligibility verification, electronic referral authorization/status, patient statements and remittances. We also provide connectivity to laboratories, pharmacies, third party connectivity networks and hospitals and credit card authorization services. Users of our practice management systems can also choose third party EDI transaction service providers to transmit their transactions.

Through Medical Manager Network Services, providers have access to EDI functionality that is integrated into their practice management workflow and recordkeeping systems. Integrated EDI allows providers and their staff to send and receive EDI transactions from within the practice management system and to generate reports regarding these transactions, including whether submitted claims have been accepted or rejected. These capabilities can be combined with our all-payer suite of transaction services to provide a single-source electronic reimbursement management solution (see WebMD Envoy above). In addition, our systems allow automated eligibility verification by contacting payers electronically overnight so that the practice can start the day with pre-checked eligibility and benefits for each scheduled patient. This information is stored as part of the patient s record. In addition, eligibility checking for unscheduled patients can be performed in real time.

As discussed more fully under Government Regulation Health Insurance Portability and Accountability Act of 1996 Transaction Standards below, the process of implementing the HIPAA Transaction Standards has been an immense challenge for the healthcare industry, including WebMD. However, it also represents a great opportunity for the industry and for us because it encourages payer/provider connectivity to evolve from its current focus on the sending and receiving of claims to automating ancillary transactions, such as eligibility, status or remittance. Implementation of our all-payer services has also presented technical, operational and customer service challenges. See WebMD Envoy EDI Transaction Services Medical and Dental Administrative Services above. We continue to work diligently to identify and resolve any service problems as they occur. We are also working to foster communication among healthcare industry participants regarding how to achieve the intended benefits of the Transaction Standards with as little disruption to healthcare payment systems as possible. We have been incurring, and expect to continue to incur, significant expenses relating to the Transaction Standards and all-payer implementations, including for testing, quality assurance and customer service activities.

Medical Manager Network Services also provides integrated access to our WebMD ExpressBill print-and-mail services for patient statements, collection notices and recall notices. Practices transmit the required data from Intergy or The Medical Manager systems to our processing center. From there, customized statements, letters and inserts and complete mailing services are provided. Customization options include logos and patient education inserts.

EMR and Imaging Systems

Healthcare providers record, use and share various types of clinical data about their patients, including patient histories, examination notes, lab results, medication orders and referrals. Much of this data is currently recorded in handwritten or printed form on paper records, often referred to as patient charts. As the amount of patient information maintained by a practice increases, so do the logistical challenges of

Table of Contents

moving paper charts from site to site and physician to physician. Many healthcare organizations are finding that the most promising solution to this challenge is the use of electronic medical record, or EMR, and imaging systems. These systems allow providers to share patient charts and other medical records, access them simultaneously and view them from remote locations. EMR systems not only help healthcare providers enhance clinical processes and patient safety, they also assist them in sharing information appropriately and efficiently and in collecting and managing the data necessary to meet the requirements of third-party billing procedures and contractual requirements.

Our suite of EMR applications allows healthcare providers that use Intergy or The Medical Manager practice management systems to computerize their patient records without disrupting the way they practice medicine. We also provide technical assistance and support that helps the practice transition from the paper chart to the fully electronic medical record. Our encounter documentation module automates the documentation of a patient encounter at the point of care. This product allows healthcare providers to generate progress notes and estimated evaluation and management service levels simply by pointing and clicking on the findings appropriate to a patient exam, reducing the need for transcription services and enhancing the accuracy of documentation of care provided. Customization tools allow the practice to create pre-defined, disease-specific templates, with lists of symptoms or other information that can be easily completed at any workstation.

Our EMR suite includes a prescription module that automates the process of writing and tracking prescriptions, providing improved efficiency with both the clinical and administrative aspects of the prescription process. The resulting prescription can be printed or called in to the patient s preferred pharmacy. With optional services through Medical Manager Network Services, practices can perform full drug utilization review (DUR) screenings, transmit prescriptions electronically to connected pharmacies, and verify formulary compliance with the patient s health plan.

Our Laboratory System module allows providers to access, review and maintain all lab results from within the EMR system. Practices may also arrange a sponsorship through national and regional laboratories to place orders and receive accurate and timely lab test results via a direct, bi-directional link with the sponsoring laboratory. Test results are received electronically from the sponsoring laboratory and are stored directly in the patient s file for viewing, printing and analysis.

Using our EMR applications, healthcare providers can locate all tasks needing their attention. For example, items on the provider s clinical task list are automatically generated whenever a lab report is ready, a transcription needs to be signed, or a prescription refill needs approval. Tasks can then be completed using the system or forwarded to another provider in the practice, accompanied by appropriate notes.

We also offer our Document Image Management (DIM) system, which is fully integrated with our Intergy and The Medical Manager practice management systems. The DIM system allows a practice to scan, store, catalog and retrieve documents, images and sound files in electronic form, which then becomes part of the patient s medical record and can be accessed from multiple workstations simultaneously. DIM_{DX}, the diagnostic version of our imaging system, allows a practice to organize and store X-rays and other diagnostic images. Using an imaging system, multiple files can be viewed at the same time making it possible to view diagnostic reports alongside images or compare before-and-after images such as pre- and post-operative X-rays.

Our Digital Office Manager module provides additional capabilities for the scanning and organization of documents that are practice-related rather than patient-specific. Documentation such as contracts and personnel records are easily and efficiently managed with the Digital Office Manager, which can handle video, Adobe® Acrobat® and sound files as well as spreadsheets and word processing documents.

Table of Contents

Additional Products and Services

Maintenance and Support Services. We separately sell software support and maintenance services and hardware maintenance services to our customers. Through our software support and maintenance services, we:

- provide customers with access to our telephone help desk, typically advising customers in the use and operation of our software and services and remotely accessing customers systems to provide support, and
- in some cases, provide periodic releases to our software to customers.

Through our hardware maintenance services, we typically provide customers with on-site hardware technical service and, if necessary, the replacement of hardware components that fail to function properly. Our contracts for maintenance and support services are generally up to one year in duration. Our customers may decide whether or not to purchase maintenance and support services from us. In addition, some of these services are also available from third party providers. See Competition for Our Healthcare Information Services and Technology Solutions below. We cannot provide assurance regarding the levels at which our customers will continue to purchase maintenance and support services after the expiration of existing contracts.

ULTIA Handheld Solution. Healthcare providers are becoming increasingly aware of the benefits of using wireless handheld computers in their practices. ULTIA, our handheld point-of-care solution, combines the power of our clinical and administrative systems with the convenience of mobile handheld connectivity. ULTIA runs on a handheld device, such as a Compaq®iPaq®. From anywhere in the office, healthcare providers can use ULTIA with a wireless local area network, or LAN, to access information stored within, or to enter data into, the Intergy or The Medical Manager system, giving them instant access at the point-of-care to:

- appointment schedules, hospital rounds information and clinical tasks needing the provider s attention;
- a user-friendly electronic prescription writer, with integrated DUR and formulary checking, which electronically submits prescriptions to the patient s chosen pharmacy and, at the same time, adds prescription information directly to the patient s electronic medical record in the Intergy or The Medical Manager software;
- electronic lab ordering and reporting of results that can be viewed using ULTIA, available through the Intergy or The Medical Manager system in the provider s office;
- their patients electronic medical records, including demographic data, progress notes, medications, lab results, procedure histories and other information and transcribed patient documentation; and
- a fully customized encounter form for capturing patient charges, which displays procedure and diagnosis codes in customized checklists and automatically posts charge information to the practice management system.

Physicians can also use ULTIA to digitally record dictation and then send the voice file electronically for transcription, reducing the number of devices the physician has to carry and reducing turn-around time.

In addition, ULTIA provides a range of offsite functionality that can be used at hospitals and other remote locations. Using the wireless LAN connection, up to ten days of hospital rounds and patient data can be downloaded to the handheld device. This information is then accessible to the provider when he or she is working at another location. The provider can enter new data and capture patient charges, all of which are then uploaded to The Medical Manager or Intergy system when the provider returns to the office. Using ULTIA Online, providers can access remotely, using a secure Internet connection, the clinical, administrative and financial data on the Intergy or The Medical Manager system in their office. See ULTIA Online below.

Table of Contents

ULTIA Online. ULTIA Online allows physicians whose offices use the Intergy or The Medical Manager practice management systems to remotely access, via an encrypted Internet connection through our Medscape portal, information contained in their office s practice management system, including daily schedules, patient records and clinical items that need their attention. This enables physicians to view, in a secure manner, information residing on their office-based computer system from any personal or handheld computer with a connection to the Internet. The physician can use this connection to send and receive secure email messages, to write and send electronic prescriptions, or to create laboratory orders and view test results. ULTIA Online also provides access to Medscape health content and related services. See WebMD Health *Medscape from WebMD* above.

Remote Monitoring System. Our Remote Monitoring System, or RMS, allows for a pro-active approach to system support and maintenance. Real-time connections allow us to monitor installations of our Intergy and ULTIA systems for problems that need immediate attention or for potential problems that are likely to need attention in the near future or that are adversely affecting system performance. RMS checks for particular conditions on a fixed schedule. For example, when a server has reached a defined percentage of capacity, an alert is forwarded to us to analyze the situation. This type of monitoring allows the system to be supported regardless of whether our customers become aware of problems or report them. In addition, if a required technical component has failed, we will be alerted to take action without the time it takes for a customer to call our help desk and have a support representative analyze and address the issue. For example, RMS alerts us if a prescription sits in the prescription queue for more than 15 minutes, thus notifying us of a potential system or connection issue. That issue can then be immediately addressed, even if it has not yet come to the attention of, or been reported by, our customer. The RMS infrastructure can also be used as a cost-effective means to deliver software updates and other support.

InfoPOINT and InfoCENTRAL. InfoPOINT, our decision support and reporting application, is designed to provide timely access to practice data for informed managerial decision-making and to automate the process of generating reports using data from The Medical Manager and Intergy systems. InfoPOINT also provides access to tools to analyze that data and to export it to other applications. InfoCENTRAL is a flexible data warehouse solution, designed to support ambulatory healthcare organizations such as group practices, managed care organizations and physician services organizations. InfoCENTRAL consolidates financial, administrative, clinical and other data and manages the interface to the practice management system.

Sales and Marketing

We market and distribute our WebMD Practice Services systems and related services nationally through a direct sales organization, who are also supported by field technicians and training and support personnel. We also participate in trade shows and use direct mail and various advertising media to promote our systems and services. In the past few years, we have acquired a significant number of independent dealers of The Medical Manager software and independent dealers no longer constitute a significant sales and marketing channel for our software. We believe that the acquisition of independent dealers and resellers has enabled us to establish direct relationships with end users of our software products, providing us with an opportunity to offer a wider range of products and services to these end users.

Competition for Our Healthcare Information Services and Technology Solutions

The markets for healthcare information services and technology solutions are intensely competitive, continually evolving and, in some cases, subject to rapid technological change. We have many competitors, including:

- healthcare information system vendors and support providers, including physician practice management system and EMR system vendors and support providers;

Table of Contents

transaction processing companies, including those providing EDI and/or Internet-based services and those providing services through other means, such as paper and fax;

large information technology consulting service providers;

online services, portals or Web sites targeted to the healthcare industry, healthcare consumers and/or physicians generally, including both commercial sites and not-for-profit sites;

consortiums of health insurance companies and of pharmacy benefit management companies that have announced that they are developing electronic transaction services for use by their members and other potential customers;

publishers and distributors of traditional offline media, including those targeted to healthcare professionals, many of which have established or may establish their own Web sites or partner with other Web sites;

general purpose consumer online services and portals and other high-traffic Web sites that provide access to healthcare-related content and services;

public sector and non-profit Web sites that provide healthcare information without advertising or commercial sponsorships; and

vendors of healthcare information, products and services distributed through other means, including direct sales, mail and fax messaging.

We also compete, in some cases, with alliances formed by the above competitors. Major software, hardware and information systems companies, both with and without healthcare companies as their partners, offer or have announced their intention to offer products or services that are competitive with some of ours. Competitors for one or more of our healthcare information services and technology solutions include, among others, Amicore (a joint venture of IBM Corporation, Microsoft Corporation and Pfizer, Inc.), Allscripts Healthcare Solutions, Eclipsys Corporation, First Consulting Group, Inc., General Electric Corporation, IDX Systems Corporation, iVillage Inc., McKesson Corporation, Misys plc, NDCHealth Corporation, Per-Se Technologies, Inc., ProxyMed, Inc., Quality Systems, Inc., Siemens Corporation, TriZetto Group, Inc. and VitalWorks Inc. Many of our competitors have greater financial, technical, product development, marketing and other resources than we do. These organizations may be better known than we are and have more customers than we do. We cannot provide assurance that we will be able to compete successfully against these organizations or any alliances they have formed or may form.

Some of our existing payer and provider customers and some of our strategic partners may compete with us or plan to do so or belong to alliances that compete with us or plan to do so. For example, some payers currently offer, through affiliated clearinghouses, Web portals and other means, electronic data transmission services to healthcare providers that allow the provider to have a direct connection to the payer, bypassing third party EDI service providers such as WebMD Envoy. Any significant increase in the utilization of direct links between healthcare providers and payers could have a material adverse effect on our business and results of operations. We cannot provide assurance that we will be able to maintain our existing links to payers or develop new connections on satisfactory terms, if at all. In addition, some of our other services allow healthcare payers to outsource business processes that they have been or could be performing for themselves and, in order for us to be able to compete, use of our services must be more efficient than use of internal resources.

WebMD Health faces competition both in attracting members and visitor traffic and in generating revenue from sponsors and others. We compete with numerous companies and organizations for the attention of healthcare professionals and consumers including traditional offline media such as network and cable television, print journals, conferences, continuing medical education programs and symposia. We also face significant competition from online information resources. There are many healthcare-related Web sites on the Internet. In addition, there are many companies that provide non- Internet based marketing and advertising services to the healthcare industry. These competitors include advertising agencies, consulting firms, marketing and communications companies and contract sales and marketing organiza-

Table of Contents

tions. In addition, to the extent that we are successful in increasing revenue from our portals, competition for our portals audience and the potential sources of revenue are likely to increase.

WebMD Practices Services faces competition for the support services it markets to owners of The Medical Manager and Intergy practice management systems, as well as for similar services that we market to owners of certain other practice management systems that we have acquired. See WebMD Practice Services Additional Products and Services Maintenance and Support Services and WebMD Practice Services Practice Management Systems Other Practice Management Systems above. Physician practices may seek such support from third parties, including businesses that support or manage information technology for various types of clients and businesses that specialize in physician office management systems, some of whom may formerly have been independent dealers of The Medical Manager software or of practice management systems we have acquired. We cannot provide assurance that we will be able to compete successfully against these service providers. In addition, some physician practices, especially larger ones, may use their own employees and other internal resources to support their practice management systems.

POREX

Overview

Our plastic technologies segment is known as Porex. Through Porex, we develop, manufacture and distribute proprietary porous plastic products and components used in healthcare, industrial and consumer applications. Porex also works with porous structures using other materials such as fiber and membranes. Our Porex customers include both end-users of its finished products as well as manufacturers that include our components in their products, which we refer to as original equipment manufacturers or OEMs.

Porex is an international business with manufacturing operations in North America, Europe and Asia. Porex s global sales and customer service network markets its products to customers in more than 65 countries. In 2003, Porex derived approximately 57% of its revenues from the United States, approximately 29% from Europe, approximately 11% from Asia and approximately 3% from Canada and Latin America.

Porex Products

Porous Plastics. Porous plastics are permeable plastic structures having omni-directional (porous in all directions) inter-connecting pores to permit the flow of fluids and gases. These pores, depending upon the number and size, control the flow of liquids and gases. We manufacture porous plastics with pore sizes between approximately 1 and 500 micrometers. One micrometer is equal to one-millionth of a meter; an object of 40 micrometers in size is about as small as can be discerned by the naked eye. Our ability to control pore size provides the opportunity to serve numerous applications, including:

Filtering. In filtration applications, the pore structure acts as both a surface filter and a depth filter. The structure acts as a surface filter by trapping particles larger than its average pore size and as a depth filter by trapping much smaller particles deep in its complex channels. Unlike the direct passages in woven synthetic materials and metal screens, the pores in porous plastics join to form many tortuous paths. Examples of these applications include: filters for drinking water purification, air filters, fuel filters for power tools and appliances and other liquid filters for clarification of drugs, blood separation and chemicals.

Venting. In venting applications, the pore structure allows gases to easily escape while retaining fluids. Examples of these applications include: vents for medical devices, printers and automotive batteries; and caps and closures.

Wicking. When used as a wicking device, the pore structure creates capillary channels for liquid transfer allowing fluid to flow, or wick, from a reservoir. Examples of these applications include: nibs or tips for writing instruments, such as highlighters and coloring markers; fluid delivery components for printers and copiers; fragrance wicks; and absorbent media for diagnostic testing.

Table of Contents

Diffusing. When used in diffusion applications, porous plastic components emit a multitude of small, evenly distributed bubbles. Examples of these applications include air diffusers for fermentation, metal finishing and plating.

Muffling. In muffling applications, exhaust air is channeled through a tortuous path, causing significant sound reduction by breaking up and diffusing the sound waves. Examples of these applications include industrial mufflers for pneumatic equipment.

We produce porous plastic components and products in our own manufacturing facilities, which are equipped to manufacture products for our customers in custom-molded shapes, sheets, tubes or rods, depending on customer needs.

Other Porous Media. We believe that, in some applications, fiber and other porous membranes are preferred over our standard porous plastic materials. We use fiber technology for applications requiring high flow rates. Based on the same principles used in making our standard porous plastic products, fibers are thermally bonded into a matrix. This fiber material is well-suited for use in filtration and wicking applications, including our products for the consumer fragrance market. We also use sub-micron porous polytetrafluoroethylene, or PTFE, membranes to serve product markets where porous plastics do not have the physical properties to meet application demands. PTFE material is commonly known as Teflon®.

Markets for Our Porous Plastic Products. Our porous plastic products are used in healthcare, consumer and industrial applications, including the following:

Healthcare Products. We manufacture a variety of porous plastic components for the healthcare industry that are incorporated into the products of other manufacturers. These components are used to vent or diffuse gases or fluids and are used as membrane supports, including catheter vents, self-sealing valves in surgical vacuum canisters, fluid filtration components and components for diagnostic devices.

We also use proprietary porous plastic technology to produce Medpor® implants for use in aesthetic and reconstructive surgery of the head and face. These permanent implants, which are composed of biocompatible porous high-density plastics, allow for rapid growth of the patient s tissue and capillary blood vessels. Since the initial product introduction in 1985, we have continued to introduce new products to meet the market s needs for a variety of shapes, sizes and uses of porous plastic implants.

Consumer Products. Our porous plastics are used in a variety of office and home products. These products include writing instrument tips, or nibs, which we supply to manufacturers of highlighting pens and children s coloring markers. The porous nib conducts the ink stored in the pen barrel to the writing surface by capillary action. Our porous plastic components are also found in products such as air fresheners, power tool dust canisters and computer printers. We also produce a variety of porous plastic water filters used to improve the taste and safety of drinking water.

Industrial Products. We manufactures a variety of custom porous plastic components for industrial applications, designed to customer specifications as to size, rigidity, porosity and other needs, including automobile battery vents and various types of filters and filtration components.

Operating Room Products. We also produce two product lines for the operating room supplies market: surgical markers and surgical drainage systems.

Competition

Porex operates in competitive markets and its products are, in general, used in applications that are affected by technological change and product obsolescence. The competitors for Porex s porous plastic products include other producers of porous plastic materials as well as companies that manufacture and sell products made from materials other than porous plastics that can be used for the same purposes as Porex s products. For example, Porex s porous plastic pen nibs compete with felt and fiber tips manufactured by a variety of suppliers worldwide. Other Porex porous plastic products compete, depending

Table of Contents

on the application, with membrane material, porous metals, metal screens, fiberglass tubes, pleated paper, resin-impregnated felt, ceramics and other substances and devices. Porex s competitors include, among others, Pall Corporation, Millipore Corporation, Filtrona (a division of Bunzl plc), Porvair plc and Whatman plc. The MEDPOR® Biomaterial products compete for surgical use against autogenous and allograph materials and alloplastic biomaterials. Porex s surgical drains and markers compete against a variety of products from several manufacturers.

Some of Porex s competitors may have greater financial, technical, product development, marketing and other resources than Porex does. We cannot provide assurance that Porex will be able to compete successfully against these companies or against particular products and services they provide or may provide in the future.

Raw Materials

The principal raw materials used by Porex include a variety of plastic resins that are generally available from a number of suppliers. Some of Porex s products also require high-grade plastic resins with specific properties as raw materials. While Porex has not experienced any material difficulty in obtaining adequate supplies of high-grade plastic resins that meet its requirements, it relies on a limited number of sources for some of these plastic resins. If Porex experiences a reduction or interruption in supply from these sources, it may not be able to access alternative sources of supply within a reasonable period of time or at commercially reasonable rates, which could have a material adverse effect on its business and financial results.

Marketing

Sales and marketing of our porous plastic products are conducted by a sales and marketing team of professionals with in-depth knowledge of plastic technologies. Marketing activities include advertising in various trade publications and directories and participating at tradeshows. Sales to OEM customers in the United States of our porous plastic products are made directly by our sales and marketing team. Internationally, these products are sold by our sales and marketing team and through independent distributors and agents.

We sell our MEDPOR Biomaterial products directly to medical centers, trauma centers, hospitals and private practice surgeons using independent and direct sales representatives. Internationally, these products are sold in over 40 countries through local stock distributors. We provide training, materials and other support to the sales representatives and distributors. Market awareness is primarily achieved through exhibitions in conjunction with medical specialty meetings, presentations by surgeons at medical meetings, journal publication of clinical papers, a group sponsored visiting speaker program and direct mail programs. Journal advertising is placed on a selected basis and we maintain an active database of contacts for targeted direct mail programs.

EMPLOYEES

As of December 31, 2003, we had approximately 5,635 employees, of which approximately 175 work in our corporate headquarters or related functions, approximately 2,230 are WebMD Envoy employees, approximately 430 are WebMD Health employees, approximately 2,200 are WebMD Practice Services employees and approximately 600 are Porex employees.

DEVELOPMENT AND ENGINEERING

We have developed internally and acquired through acquisitions healthcare information services and technology solutions products and services. Our development and engineering expense totaled $43.0 million in 2003, $43.5 million in 2002 and $43.6 million in 2001.

Table of Contents

The markets for some of our products and services are characterized by rapid change and technological advances. Our future success will depend, in part, upon our ability to enhance our existing products and services, to respond effectively to technological changes, and to introduce new and newly integrated applications and technologies that address the changing needs of our customers. Accordingly, we intend to continue to make investments in development and engineering and to recruit and hire experienced development personnel. However, we cannot provide assurance that we will be able to successfully complete the development of new products or services, enhancements to existing products or services. Further, there can be no assurance that products or technologies developed by others will not adversely affect our competitive position or render our products, services or technologies noncompetitive or obsolete.

INTELLECTUAL PROPERTY

We rely upon a combination of patent, trade secret, copyright and trademark laws, license agreements, confidentiality procedures, employee and client nondisclosure agreements and technical measures to protect the intellectual property used in our businesses.

We use numerous trademarks, trade names and service marks for healthcare information services and technology solutions, including WebMD®, Web-MD®, WebMD Health®, Digital Office Manager®, DIM_{DX}®, Envoy®, ExpressBill®, Intergy®, Medifax®, Medifax-EDI®, Medscape®, Medpulse®, Publishers Circle®, The Little Blue Book™, The Little Yellow Book™, The Medical Manager®, ULTIA™ and WellMed®. In addition, Porex uses trademarks and trade names, including POREX®, Lateral-Flo™, MEDPOR®, SQUEEZE-MARK®, and TLS®. We also use numerous other registered and unregistered trademarks and service marks for our various products and services. In addition to our trademark registrations and applications, we have registered the domain names webmd.com, my.webmd.com and medscape.com and numerous other domain names that either are or may be relevant to conducting our business. Our inability to protect our marks and domain names adequately could have a material adverse effect on our business and hurt us in establishing and maintaining our brands.

We also rely on a variety of intellectual property rights that we license from third parties, including our Internet server software and healthcare content used on our Web sites, as well as various products incorporated into our physician practice management systems. These third party licenses may not continue to be available to us on commercially reasonable terms. Our loss of or inability to maintain or obtain upgrades to any of these licenses could significantly harm us. In addition, because we license content from third parties, we may be exposed to copyright infringement actions if these parties are subject to claims regarding the origin and ownership of that content.

The steps we have taken to protect our proprietary rights may not be adequate, and we may not be able to secure trademark or service mark registrations for marks in the United States or in foreign countries. Third parties may infringe upon or misappropriate our copyrights, trademarks, service marks and similar proprietary rights. In addition, effective copyright and trademark protection may be unavailable or limited in many foreign countries, and the global nature of the Internet makes it impossible to control the ultimate destination of our services. It is possible that competitors or others will adopt product or service names similar to our names, which could impede our efforts to build brand identity and possibly lead to customer confusion. Moreover, because domain names derive value from the individual s ability to remember such names, our domain name will lose its value if, for example, users begin to rely on mechanisms other than domain names to access online resources. Our inability to protect our marks and domain names adequately would hurt our ability to establish and maintain our brands. In the future, litigation may be necessary to enforce and protect our trade secrets, copyrights and other intellectual property rights. Litigation would divert management resources and be expensive and may not effectively protect our intellectual property.

Substantial litigation regarding intellectual property rights exists in the software industry, and we expect that software products may be increasingly subject to third party infringement claims as the number of competitors in our industry grows and the functionality of products overlaps. Although we believe that

Table of Contents

our products do not infringe on the intellectual property rights of others, we cannot provide assurance that such a claim will not be asserted against us in the future, or that a license or similar agreement will be available on reasonable terms in the event of an unfavorable ruling on any such claim.

We have several patents covering our software technology. Due to the nature of our application software, we believe that patent protection is less significant than our ability to further develop, enhance and modify our current services and products. However, any infringement or misappropriation of our proprietary software and databases could disadvantage us in our efforts to attract and retain customers in a highly competitive market and could cause us to lose revenue or incur substantial litigation expense. Moreover, in recent years, there have been a large number of patents issued in general and numerous patents issued related to Internet business methods. While we are unaware of any patent the loss of which would impact our ability to conduct our business, defense of a patent infringement claim against us could divert management and monetary resources, and an adverse judgment in any such matter may negatively impact our ability to conduct our business in the manner we desire.

Porex relies upon a combination of patent and trade secret laws, license agreements, confidentiality procedures, employee and client nondisclosure agreements and technical measures in its efforts to protect its intellectual property and proprietary rights. For example, Porex seeks to protect its proprietary manufacturing technology by designing and fabricating its own manufacturing equipment and molds. In addition, in some cases, Porex has patented specific products and processes and intends to do so in some instances in the future. The majority of Porex s patents relate to porous plastics and medical devices and medical device components. Porex seeks to take appropriate steps to protect its intellectual property and proprietary rights and intends to defend those rights as may be necessary. However, we cannot provide assurance that the steps it has taken to protect these rights are adequate. In the future, litigation may be necessary to enforce and protect those rights, which would divert management resources, may be expensive and may not effectively protect those rights.

GOVERNMENT REGULATION

The healthcare industry is highly regulated and is subject to changing political, regulatory and other influences. These factors affect the purchasing practices and operations of healthcare organizations as well as the behavior and attitudes of consumers. Federal and state legislatures and agencies periodically consider programs to reform or revise the United States healthcare system. These programs may contain proposals to increase governmental involvement in healthcare, lower reimbursement rates or otherwise change the environment in which healthcare industry participants operate. Healthcare industry participants may respond by reducing their investments or postponing investment decisions, including investments in our products and services. We are unable to predict future proposals with any certainty or to predict the effect they would have on our businesses.

Existing laws and regulations could also create liability, cause us to incur additional cost and restrict our operations. Many healthcare laws are complex, applied broadly and subject to interpretation by courts and other governmental authorities. In addition, many existing healthcare laws and regulations, when enacted, did not anticipate the healthcare information services and technology solutions that we provide. However, these laws and regulations may nonetheless be applied to our products and services. Our failure, or the failure of our business partners, to accurately anticipate the application of these healthcare laws and regulations, or other failure to comply, could create liability for us, result in adverse publicity and negatively affect our businesses.

Health Insurance Portability and Accountability Act of 1996

General. Under the Health Insurance Portability and Accountability Act of 1996, or HIPAA, Congress mandated a package of interlocking administrative simplification rules to establish standards and

Table of Contents

requirements for the electronic transmission of certain health information. The five rules published in final form are:

the Standards for Electronic Transactions, published August 17, 2000, which we refer to as the Transaction Standards;

the Standards for Privacy of Individually Identifiable Health Information, published December 28, 2000, which we refer to as the Privacy Standards;

the Standard Unique Employer Identifier, published May 31, 2002;

the Health Insurance Reform: Security Standards, published February 20, 2003, which we refer to as the Security Standards; and

the Standard Unique Health Identifier for Health Care Providers, published January 23, 2004, which we refer to as the NPI Standard.

These rules took or will take effect on October 16, 2000, April 14, 2001, July 30, 2002, April 21, 2003 and May 23, 2005, respectively, with compliance by healthcare providers, healthcare clearinghouses and large health plans required under the rules two years following the respective effective dates. Small health plans are given an additional year to comply. On December 27, 2001, President Bush signed into law a one-year extension, to October 16, 2003, of the date for complying with the HIPAA Transaction Standards for any covered entity that submitted to the Secretary of the United States Department of Health and Human Services, or HHS, a plan of how the entity would come into compliance with the requirements by that deadline.

Transaction Standards. The Transaction Standards establish format and data content standards for the most common healthcare transactions, using technical standards promulgated by recognized standards publishing organizations. These transactions include healthcare claims, enrollment, payment and eligibility. The Transaction Standards were intended to make it easier for payers and providers to send and receive healthcare transactions electronically, using specified formats. The Transaction Standards are applicable to that portion of our business involving the processing of healthcare transactions among physicians, payers, patients and other healthcare industry participants, including WebMD Envoy and Medical Manager Network Services.

October 16, 2003 was the deadline for covered entities to comply with the Transaction Standards. Failure to comply with the Transaction Standards may subject covered entities, including our WebMD Envoy clearinghouse, to civil monetary penalties and possibly to criminal penalties. However, the ability of each covered entity to comply is dependent on compliance efforts by numerous other covered entities. The Centers for Medicare & Medicaid Services, or CMS, is responsible for enforcing the Transaction Standards. On July 24, 2003, in response to concerns communicated to CMS regarding the readiness of a significant portion of the covered entities for the October 16 deadline and the consequences to the healthcare industry if significant claim processing problems occur at that time, CMS released its Guidance on Compliance with HIPAA Transactions and Code Sets After the October 16, 2003 Implementation Deadline (which we refer to as the CMS Guidance). In addition, on July 24, 2003, CMS officials participated in an Open Door Forum teleconference during which they provided additional clarification on planned enforcement practices. CMS also urged the adoption of contingency plans to help prevent disruptions in the healthcare payment system. Under CMS s contingency plan for Medicare, it will continue to accept claims in both HIPAA standard and legacy formats, with the legacy formats to be accepted for a period to be determined by CMS based upon a regular reassessment of the readiness of its electronic trading partners. In response, WebMD Envoy announced a contingency plan, pursuant to which it continues to process HIPAA standard transactions and, for a limited period of time, will also process legacy transactions as appropriate based on the needs of our business partners.

On February 27, 2004, CMS modified its Medicare contingency plan to delay the payment of electronic claims that are not HIPAA-compliant. Specifically, effective July 1, 2004, only claims that are compliant with the Transaction Standards are to be reported as electronic media claims (EMC), which

Table of Contents

may be paid no earlier than after a 13 day waiting period. All other claims (including both electronic claims that are not compliant with the Transaction Standards, as well as paper claims) may be paid no earlier than after a 26 day waiting period. Calling it a measured step toward ending the contingency plan entirely, CMS implemented the change to encourage providers to move more quickly with their efforts to achieve HIPAA compliance. This policy may provide an incentive for providers who cannot send HIPAA standard claims from their desktop to use a clearinghouse, such as WebMD Envoy, to do so.

CMS has made clear that it expects each party to every transaction to be accountable for compliance with the new standards as of October 16, 2003. However, the CMS Guidance provides for a flexible, complaint-driven enforcement strategy. CMS indicated that it will respond to complaints regarding non-compliant transactions submitted to it in writing and that, upon receipt of a complaint, CMS will notify the entity that a complaint has been filed and provide an opportunity for the entity to demonstrate compliance or to document its good faith effort to comply with the standards. In evaluating good faith efforts, CMS stated that it will consider not only the entity s efforts on behalf of itself, but its efforts through outreach and testing to ensure that its trading partners are also in compliance. CMS also noted that its expectations regarding compliance efforts will vary with the size and type of covered entity. We understand that CMS expects that larger organizations will have more sophisticated compliance efforts and outreach to their smaller trading partners.

We believe that the CMS enforcement approach assisted in reducing disruptions in the flow of electronic transactions that otherwise could have occurred in connection with the October 16, 2003 deadline and that a smoother transition benefits our company and the entire healthcare industry. We continue to work with payers, providers, practice management system vendors and other healthcare participants to implement the Transaction Standards. Transaction clearinghouses can provide a great deal of support for the healthcare industry in addressing the requirements of the Transaction Standards and in overcoming other connectivity challenges that HIPAA does not eliminate. Even though the goal of HIPAA was to make electronic transactions more standardized, the use of clearinghouses will continue to be the most efficient way for most providers to send their electronic claims and related transactions to multiple payers. The standardization resulting from implementation of HIPAA is only partial: payer systems and requirements continue to vary in certain respects even after HIPAA implementation and will continue to evolve and change in the future. Payers have published approximately 440 Companion Guides setting forth their individual interpretations of the Transaction Standards and that number can be expected to continue to grow. These payer-specific interpretations require us to perform extensive customized programming and related testing.

Healthcare payers and providers who are unable to exchange data in the required standard formats can achieve Transaction Standards compliance by contracting with a clearinghouse, like WebMD Envoy, to translate between standard and non-standard formats. As a result, use of a clearinghouse allows numerous providers and payers to move to the Transaction Standards independently and at different times, reducing transition costs and risks. As various healthcare entities are in different stages of migration during the transition, WebMD Envoy is working to translate claim information from non-standard to standard formats and vice versa. In addition, the Transaction Standards require healthcare providers to collect and supply more information than they have in the past in order to submit a healthcare claim. From October 16, 2003 to the date of this Annual Report, a large majority of the claims we have received from submitters used legacy formats and very few contained the additional data content provided for in the Transaction Standards. Some providers who can submit claims in the HIPAA standard formats cannot yet collect all of the data payers may require to process the claim. In order to assist in claims processing, our clearinghouse software edits the information submitted in a claim using logic, mapping and defaults. A small number of our submitters currently send some additional HIPAA data content that does not yet pass through our clearinghouse.

We cannot provide assurance regarding how CMS will regulate clearinghouses in general or WebMD Envoy in particular. In addition, even though major disruptions in the flow of electronic transactions may be less likely in light of CMS s current approach to enforcement of the Transaction Standards, we have

Table of Contents

experienced isolated disruptions and some delays and we expect there will continue to be some problems for a period of time.

Implementation of the Transaction Standards has presented us with significant technical and operational challenges. For example, we are working with our trading partners to complete quality assurance and testing on our enhanced clearinghouse data services for transmitting additional HIPAA data content. We do not plan to place these services into full production until both our systems and payers adjudication systems are capable of handling the production volume of transactions with the additional data content. As with any highly complex data transition involving significant modifications to trading partner systems, we are experiencing some problems during this process. Another aspect of the implementation challenges resulting from the Transaction Standards is the increase in computing capacity required. The Transaction Standards formats are much larger than the pre-existing ones. We are utilizing more computing capacity than we had anticipated. As a result, our systems have experienced inefficiencies that have resulted in processing delays. We seek to resolve all such problems when identified, but testing continues with numerous submitters and payers, and no assurance can be given that we will identify all problems promptly or that we will not continue to experience problems that delay the full implementation of these enhanced data services. The costs to us of dealing with those problems are inherently difficult to estimate and may be more than we expect and/or continue for longer than anticipated. In addition, most of our trading partners are currently operating under their own contingency plans and, accordingly, we would expect that there will be further disruptions during the adjustment period that occurs once CMS requires all applicable parties to perform in accordance with the Transaction Standards. We may not have enough technicians, programmers and customer service personnel to meet the demands placed on those functions by our customers and partners during the adjustment period, which could adversely affect our relationships with them.

Privacy Standards. The Privacy Standards establish a set of basic national privacy standards and fair information practices for the protection by health plans, healthcare clearinghouses, healthcare providers and their business associates of individually identifiable health information. This rule became effective on April 14, 2001 and the compliance date for most entities was April 14, 2003. The Privacy Standards apply to the portions of our business that process healthcare transactions or provide certain technical services to other participants in the healthcare industry, and certain of our portal services may be affected through contractual relationships. This rule provides for civil and criminal liability for its breach and requires us, our customers and our partners to use health information in a highly restricted manner, to establish policies and procedures to safeguard the information, to obtain individual authorizations for some activities, and to provide certain access rights to individuals. This rule may require us to incur significant costs to change our products and services, may restrict the manner in which we transmit and use the information, and may adversely affect our ability to generate revenue from the provision of de-identified information to third parties. The effect of the Privacy Standards on our business is difficult to predict and there can be no assurances that we will adequately address the risks created by the Privacy Standards and their implementation or that we will be able to take advantage of any resulting opportunities. In addition, we are unable to predict what changes to the Privacy Standards might be made in the future or how those changes could affect our business.

Unique Employer Identifier Standard. The Unique Employer Identifier Standard establishes a standard for identifying employers in healthcare transactions where information about the employer is transmitted electronically, as well as requirements concerning its use by covered entities. This rule requires the use of an employer identification number (EIN) as assigned by the IRS on all standard transactions that require an employer identifier to identify a person or entity as an employer. This standard applies to the portions of our business that process healthcare transactions or provide certain technical services to other participants in the healthcare industry, and certain of our portal services may be affected through contractual relationships. Most participants in the healthcare industry must be in compliance with the Unique Employer Identifier Standard by July 30, 2004. The effect of the Unique Employer Identifier Standard on our business is difficult to predict and there can be no assurances that we will adequately

Table of Contents

address the risks created by the Unique Employer Identifier Standard and its implementation or that we will be able to take advantage of any resulting opportunities.

Security Standards. On February 20, 2003, HHS published the final Security Standards. The Security Standards establish detailed requirements for safeguarding patient information that is electronically transmitted or electronically stored. The rule establishes 42 implementation specifications, 20 of which are required, meaning they must be implemented as specified in the rule. Twenty-two are addressable. Complying with addressable implementation specifications requires a business to assess whether they constitute a reasonable and appropriate safeguard for the particular business; if not, an alternative approach must be designed and implemented to achieve the particular standard. The Security Standards apply to the portions of our business that process healthcare transactions, that provide certain technical services to other participants in the healthcare industry, or that enable electronic communications of patient information among healthcare industry participants, and certain of our portal services may be affected through contractual relationships. Most participants in the healthcare industry must be in compliance with the Security Standards by April 21, 2005. Some of the Security Standards are technical in nature, while others may be addressed through policies and procedures for using information systems. The Security Standards may require us to incur significant costs in evaluating our products and in establishing that our systems meet the 42 specifications. We are unable to predict what changes might be made to the Security Standards prior to the 2005 implementation deadline or how those changes might help or hinder our business. The effect of the Security Standards on our business is difficult to predict and there can be no assurances that we will adequately address the risks created by the Security Standards and their implementation or that we will be able to take advantage of any resulting opportunities.

NPI Standard. On January 23, 2004, HHS published the final HIPAA standard for a unique health identifier for health care providers, commonly referred to as the National Provider Identifier (NPI) Standard. The NPI Standard requires health care providers that transmit any health information in electronic form in connection with a HIPAA covered transaction to obtain a single, 10 position all-numeric NPI from the National Provider System (NPS), and to use the NPI in standard transactions where a provider identifier is required. The NPI Standard requires health plans and health care clearinghouses to use a provider s NPI to identify the provider on all standard transactions where that provider s identifier is required. The NPI Standard is effective May 23, 2005. Most participants in the healthcare industry must be in compliance with the NPI Standard by May 23, 2007. The effect of the NPI Standard is difficult to predict and there can be no assurances that we will adequately address any business risks created by the NPI rule and its implementation or that we will be able to take advantage of any resulting business opportunities.

Other Restrictions Regarding Confidentiality and Privacy of Patient Information

Numerous state and federal laws other than HIPAA govern the collection, dissemination, use, access to and confidentiality of patient health information. In addition, some states are considering new laws and regulations that further protect the confidentiality of medical records or medical information. These state laws are not in most cases preempted by the HIPAA Privacy Standard and may be subject to interpretation by various courts and other governmental authorities, thus creating potentially complex compliance issues for us and our customers and strategic partners. Definitions in the various state and federal laws concerning what constitutes individually identifiable data sometimes differ and sometimes are not provided, creating further complexity. In addition, determining whether data has been sufficiently de-identified may require complex factual and statistical analyses. The HIPAA Privacy Standards contain a restrictive definition of de-identified information, which is information that is not individually identifiable, that could create a new standard of care for the industry. These other privacy laws at a state or federal level, or new interpretations of these laws, could create liability for us, could impose additional operational requirements on our business, could affect the manner in which we use and transmit patient information and could increase our cost of doing business. In addition, parties may also have contractual rights that provide additional limits on our collection, dissemination, use, access to and confidentiality of patient health information. Claims of violations of privacy rights or contractual breaches, even if we are not found

Table of Contents

liable, could be expensive and time-consuming to defend and could result in adverse publicity that could harm our business.

Other Regulation of Transaction Services

Other state and federal statutes and regulations governing transmission of healthcare information may affect our operations. For example, Medicaid rules require some processing services and eligibility verification to be maintained as separate and distinct operations. Furthermore, the recently-enacted Medicare Prescription Drug, Improvement and Modernization Act of 2003 authorizes the development of an electronic prescription drug program that specifies standards for electronically transmitted prescriptions and other required information related to Medicare-covered prescription drugs. We carefully review our practices with regulatory experts in an effort to ensure that we are in compliance with all applicable state and federal laws. These laws, though, are complex and changing, and the courts and other governmental authorities may take positions that are inconsistent with our practices. See also Regulation of Healthcare Relationships below.

International Data Regulation

Other countries also have, or are developing, their own laws governing the collection, use, storage and dissemination of personal information or patient data. These laws could create liability for us, impose additional operational requirements or restrictions on our business, affect the manner in which we use or transmit data and increase our cost of doing business.

Regulation of Healthcare Relationships

Anti-kickback Laws. There are federal and state laws that govern patient referrals, physician financial relationships and inducements to beneficiaries of federal healthcare programs. The federal healthcare programs anti-kickback law prohibits any person or entity from offering, paying, soliciting or receiving anything of value, directly or indirectly, for the referral of patients covered by Medicare, Medicaid and other federal healthcare programs or the leasing, purchasing, ordering or arranging for or recommending the lease, purchase or order of any item, good, facility or service covered by these programs. Many states also have similar anti-kickback laws that are not necessarily limited to items or services for which payment is made by a federal healthcare program. In 2002, the Office of the Inspector General, or OIG, of HHS, the federal government agency responsible for interpreting the federal anti-kickback law, issued an advisory opinion that concluded that the sale of advertising and sponsorships to healthcare providers and vendors by Web-based information services, such as us, implicates the federal anti-kickback law. However, the advisory opinion suggests that enforcement action will not result if the fees paid represent fair market value for the advertising/sponsorship arrangements, the fees do not vary based on the volume or value of business generated by the advertising and the advertising/sponsorship relationships are clearly identified as such to users. We carefully review our practices with regulatory experts in an effort to ensure that we comply with all applicable laws. However, the laws in this area are both broad and vague and it is often difficult or impossible to determine precisely how the laws will be applied, particularly to new services. Penalties for violating the federal anti-kickback law include imprisonment, fines and exclusion from participating, directly or indirectly, in Medicare, Medicaid and other federal healthcare programs. Any determination by a state or federal regulatory agency that any of our practices violate any of these laws could subject us to civil or criminal penalties and require us to change or terminate some portions of our business. Even an unsuccessful challenge by regulatory authorities of our practices could cause us adverse publicity and be costly for us to respond to.

False Claims Laws. We currently provide transaction services to healthcare providers and, therefore, may be subject to state and federal laws that govern the submission of claims for medical expense reimbursement. These laws generally prohibit an individual or entity from knowingly presenting or causing to be presented a claim for payment from Medicare, Medicaid or other third party payers that is false or fraudulent, or is for an item or service that was not provided as claimed. These laws also provide civil and criminal penalties for noncompliance, and can be enforced by individuals through qui tam actions. We

Table of Contents

cannot guarantee that state and federal agencies will regard billing errors processed by us as inadvertent and not in violation of these laws. In addition, changes in these laws could also require us to incur costs or restrict our business operations. As part of our data transmission and claims submission services, we may employ certain edits, using logic, mapping and defaults, when submitting claims to third party payers. Such edits are utilized when the information received from providers is insufficient to complete individual data elements requests by payers for reimbursement claims. We believe our editing processes are consistent with industry practice. However, it is possible that a court or governmental agency might view such practices in a manner that could result in liability and adversely affect our business.

Regulation of Medical Devices

Overview. We manufacture and market medical devices subject to extensive regulation by the Food and Drug Administration, or FDA, under the Federal Food, Drug, and Cosmetic Act, or the FDC Act. The FDA s regulations govern, among other things, product development, testing, manufacturing, labeling, storage, premarket clearance (referred to as 510(k) clearance), premarket approval (referred to as PMA approval), advertising and promotion, and sales and distribution. If the FDA finds that we have failed to comply, the agency can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as: fines, injunctions, and civil penalties; recall or seizure of our products; issuance of public notices or warnings; operating restrictions, partial suspension or total shutdown of production; refusal of our requests for 510(k) clearance or PMA approval of new products, withdrawal of 510(k) clearance or PMA approvals already granted, and criminal prosecution.

Access to U.S. Market. Each medical device that we wish to commercially distribute in the U.S. will likely require either 510(k) clearance or PMA approval from the FDA prior to commercial distribution, unless exempt. Devices deemed to pose relatively less risk are placed in either class I or II, which requires the manufacturer to submit a premarket notification requesting 510(k) clearance. Some low risk devices are exempted from this requirement. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed not substantially equivalent to a previously 510(k) cleared device or to a preamendment class III device (in commercial distribution before May 28, 1976) for which PMA applications have not been called, are placed in Class III requiring PMA approval.

510(k) Clearance Process. To obtain 510(k) clearance, we must submit a premarket notification demonstrating that the proposed device is substantially equivalent in intended use and in safety and effectiveness to a predicate device either a previously 510(k) cleared class I or class II device or a preamendment class III device for which the FDA has not called for PMA applications. The FDA s 510(k) clearance process usually takes from four to 12 months, but it can last longer. After a device receives 510(k) clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, requires a new 510(k) clearance or could even require a PMA approval. The FDA requires each manufacturer to make this determination in the first instance, but the FDA can review any such decision. If the FDA disagrees with it, the agency may retroactively require the manufacturer to seek 510(k) clearance or PMA approval. The FDA also can require the manufacturer to cease marketing and/or recall the modified device until 510(k) clearance or PMA approval is obtained.

PMA Approval Process. If a product is not eligible for 510(k) clearance, the product is placed in class III and must follow the PMA approval process, which requires proof of the safety and effectiveness of the device to the FDA s satisfaction. A PMA approval application must provide extensive preclinical and clinical trial data and also information about the device and its components regarding, among other things, device design, manufacturing and labeling. As part of the PMA approval application review, the FDA will inspect the manufacturer s facilities for compliance with the Quality System Regulation, which requires manufacturers to follow elaborate design, testing, control, documentation and other quality assurance procedures during the manufacturing process. The PMA approval pathway is costly, lengthy and uncertain. It generally takes from one to three years or longer. After approval of a PMA approval application, a new PMA

Table of Contents

approval or PMA supplement approval may be required in the event of a modification to the device, its labeling or its manufacturing process.

Clinical Studies. A clinical study is generally required to support a PMA approval application and is sometimes required for a 510(k) premarket notification. For significant risk devices, such studies generally require submission of an application for an Investigational Device Exemption, or IDE. The IDE application must be supported by appropriate data, such as animal and laboratory testing results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. The IDE must be approved in advance by the FDA for a specified number of patients. Clinical studies may begin once the IDE application is approved by the FDA and the appropriate institutional review boards at the study sites. For nonsignificant risk devices, one or more institutional review boards must review the study, but submission of an IDE application to the FDA for advance approval is not required. Both types of studies are subject to record keeping, reporting and other IDE regulation requirements.

Post-market Regulation. After the FDA permits a device to enter commercial distribution, numerous regulatory requirements apply. These include the Quality System Regulation, labeling regulations, the FDA s general prohibition against promoting products for unapproved or off-label uses, and the Medical Device Reporting regulation, which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur.

Products. Certain of Porex s products are FDA-regulated medical devices, such as plastic and reconstructive surgical implants, blood filters, and tissue expanders. In addition, the FDA regulates WebMD Practice Services DIM$_{DX}$ System as a medical image management device. It received 510(k) clearance on August 25, 2000. Subsequently, we have made modifications to certain of Porex s products and to the DIM$_{DX}$ System that we believe do not require new 510(k) clearance. If the FDA disagrees with our decisions, it can retroactively require new 510(k) clearance or PMA approval. The FDA also can require us to cease marketing and/or recall the modified device until 510(k) clearance or PMA approval is obtained. Because Porex s medical devices and the DIM$_{DX}$ System are in commercial distribution, we are subject to inspection and market surveillance by the FDA to determine compliance with all regulatory requirements. Compliance with these requirements can be costly and time-consuming. Our failure to comply could subject us to FDA enforcement action and sanctions.

The FDA has a long-standing draft software policy exempting computer software products from active regulation as medical devices if they are decision support systems intended to involve competent human intervention before any impact on human health occurs (in other words, where clinical judgment and experience can be used to check, interpret and potentially challenge a system s output). Except for the cleared DIM$_{DX}$ System, we believe that, under the draft software policy, the Intergy and The Medical Manager practice management systems are subject to limited FDA regulation and do not require 510(k) clearance or PMA approval. WebMD Practice Services has created an interface between the Intergy and The Medical Manager practice management systems and the image device. We are marketing the interface and the image device as the DIM$_{DX}$ System. We believe that the sale of our practice management systems with the DIM$_{DX}$ System does not require a new 510(k) clearance or PMA approval. Our ULTIA handheld solution permits access to the Intergy and The Medical Manager practice management systems and makes it available in a wireless handheld format, including allowing access to the medical images stored in the DIM$_{DX}$ System. Because any displayed medical images are not intended for diagnostic use, we believe that ULTIA s ability to access such medical images does not subject it to a 510(k) clearance or PMA approval requirement. We cannot assure you, however, that the FDA would agree with any of these conclusions. If the FDA does not agree, we may be required to obtain 510(k) clearance or PMA approval for these products and may be required to cease marketing and/or recall such products until 510(k) clearance or PMA approval is obtained.

The FDA s draft software policy has been under review for several years. A risk exists that the Intergy or The Medical Manager practice management system or other of our software or hardware

Table of Contents

components could in the future become subject to some or all of the medical device regulation requirements. In addition, the FDA may take the position that other products and services we offer, such as ULTIA, are subject to FDA regulation. We also may expand our services in the future to areas that subject us to FDA regulation. Except with respect to WebMD Practice Services and Porex, we have no experience in complying with FDA regulations. We believe that complying with FDA regulations is time consuming, burdensome and expensive and could delay our introduction of new applications or services.

FDA and FTC Regulation of Drug and Medical Device Advertising and Promotion

The FDA and the FTC regulate the form, content and dissemination of labeling, advertising and promotional materials, including direct-to-consumer prescription drug and medical device advertising, prepared by, or for, pharmaceutical or medical device companies. The FTC regulates over-the-counter drug advertising and, in some cases, medical device advertising, as well as general product or service advertising. Generally, based on FDA requirements, regulated companies must limit their advertising and promotional materials to discussions of FDA-approved claims. In limited circumstances, regulated companies may disseminate non-promotional scientific information regarding products or claims not yet approved by the FDA.

Any information that promotes the use of pharmaceutical products or medical devices that is put on our Web site is subject to the full array of the FDA and FTC requirements and enforcement actions and any information regarding other products and services is subject to FTC requirements. Areas of our Web site that could be the primary focus of the FDA and FTC include pages and programs that discuss use of an FDA-regulated product or that the regulators believe may lack editorial independence from the influence of sponsoring pharmaceutical or medical device companies. Television broadcast advertisements by WebMD may also be subject to FTC regulation and FDA regulation depending on the content. The FDA and the FTC place the principal burden of compliance with advertising and promotional regulations on the company that advertises on our Web site to make truthful, substantiated claims. If the FDA or the FTC finds that any information on our Web site violates FDA or FTC regulations, they may take regulatory or judicial action against us or the advertiser or sponsor of that information.

Drug Advertising. The FDC Act requires that prescription drugs (including biological products) be approved for a specific medical indication by the FDA prior to their marketing in interstate commerce. It is a violation of the Act and of FDA regulations to market, advertise or otherwise commercialize such products prior to approval. The FDA does allow for preapproval exchange of scientific information, provided it is nonpromotional in nature and does not draw conclusions regarding the ultimate safety or effectiveness of the unapproved drug. Upon approval, the FDA s regulatory authority extends to the labeling and advertising of prescription drugs offered in interstate commerce. Such products may only be promoted and advertised for their approved indications. In addition, the labeling and advertising can be neither false nor misleading, and must present all material information in a balanced manner. Labeling and advertising that violate these legal standards are subject to FDA enforcement action.

The FDA regulates the safety, efficacy, and labeling of over-the-counter drugs or OTC drugs under the FDC Act either through specific product approvals or through regulations that define approved claims for specific categories of such products. The FTC regulates the advertising of OTC drugs under the section of the Federal Trade Commission Act that prohibits unfair or deceptive trade practices. Together, the FDA and FTC regulatory framework requires that OTC drugs be formulated and labeled in accordance with FDA approvals or regulations and promoted in a manner that is truthful, adequately substantiated, and consistent with the labeled uses. OTC drugs that do not meet these requirements are subject to FDA or FTC enforcement action depending on the nature of the violation.

Continuing Medical Education. Activities and information provided in the context of a medical or scientific educational program, often referred to as continuing medical education or CME, usually are treated as nonpromotional and fall outside the FDA s jurisdiction. The FDA does however evaluate such CME activities to determine whether they are independent of the promotional influence of the drug or medical device sponsor or whether they are promotional activities subject to FDA s advertising and

Table of Contents

labeling requirements. In order to determine whether a company s activities are sufficiently independent, the FDA looks at a number of factors related to the planning, content, speakers and audience selection of such activities. To the extent that the FDA concludes that such activities are not independent from a manufacturer, such content must fully comply with the FDA s requirements.

There are several administrative, civil and criminal sanctions available to the FDA for violations of the FDC Act or FDA regulations as they relate to labeling and advertising. Administrative sanctions may include a written request that violative advertising or promotion cease and/or that corrective action be taken, such as requiring a company to provide to healthcare providers and/or consumers information to correct misinformation previously conveyed. In addition, the FDA may use publicity, such as press releases, to warn the public about false and misleading information concerning a drug or medical device product. More serious civil sanctions include seizures, as well as injunctions and their resulting consent decrees. Such measures could prevent a company from introducing or maintaining its product in the marketplace. Criminal penalties for severe violations can result in a prison term and/or substantial fines.

Any increase in FDA regulation of the Internet or other media for direct-to-consumer advertisements of prescription drugs could make it more difficult for WebMD Health to obtain advertising and sponsorship revenue. In the last 15 years, the FDA has gradually relaxed its formerly restrictive policies on direct-to-consumer advertising of prescription drugs. Companies can now advertise prescription drugs for serious conditions to consumers in any medium. However, physician groups and others have criticized the FDA s current policies, and have called for restrictions on any advertising of prescription drugs to consumers and increased FDA enforcement. These critics point to both public health concerns and to the laws of many other countries that make direct-to-consumer advertising of prescription drugs a criminal offense. In response to these critics, the FDA or the FTC may alter its present policies on the direct-to-consumer advertising of prescription drugs or medical devices in a way that would materially reduce our advertising and sponsorship revenues. FDA recently issued three draft guidance documents intended to improve communication of: (1) risk information in direct-to-consumer print advertisements, (2) disease awareness information, and (3) risk information in direct-to-consumer advertising of restricted medical devices. These draft guidance documents do not alter existing FDA regulatory requirements, but may lead to future policy changes.

Medical Professional Regulation

The practice of most healthcare professions requires licensing under applicable state law. In addition, the laws in some states prohibit business entities from practicing medicine, which is referred to as the prohibition against the corporate practice of medicine. We do not believe that we engage in the practice of medicine and we have attempted to structure our Web site, strategic relationships and other operations to avoid violating these state licensing and professional practice laws. A state, however, may determine that some portion of our business violates these laws and may seek to have us discontinue those portions or subject us to penalties or licensure requirements. We provide Web site capabilities for our physician customers. Many states regulate the ability of medical professionals to advertise or maintain referral services. We do not represent that a physician s use of our Web site will comply with these or other state laws regulating professional practice and we do not monitor or control the content that physicians post on their individual practice Web sites using our Web site application. It is possible a state or a court may determine we are responsible for any non-compliance with these laws, which could affect our ability to offer this service to our customers. We employ and contract with physicians who provide only medical information to consumers, and we have no intention to provide medical care or advice. Any determination that we are a healthcare provider and acted improperly as a healthcare provider may result in liability to us.

Consumer Protection Regulation

General. Advertising and promotional activities presented to consumers on our Web sites are subject to Federal and state consumer protection laws which regulate unfair and deceptive practices. We are also subject to various other federal and state consumer protection laws, including the ones described below.

Table of Contents

Can-Spam Act. Effective January 1, 2004, the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, or the Can-Spam Act, became effective. The Can-Spam Act regulates commercial emails and provides a right on the part of the recipient to request the sender to stop sending messages, and establishes penalties for the sending of email messages which are intended to deceive the recipient as to source or content. Under the Can-Spam Act, senders of commercial emails are required to make sure that these do not contain false or misleading transmission information. Commercial emails are required to include a valid return email address and other subject heading information so that the sender and the Internet location from which the message has been sent are accurately identified. Recipients must be furnished with an electronic method of informing the sender of the recipient s decision to not receive further commercial emails. In addition, the email must include a postal address of the sender and notice that the email is an advertisement. We believe that our email practices comply with the requirements of the Can-Spam Act.

Regulation of Advertisements Sent by Fax. A recent modification to the Telephone Consumer Protection Act was issued by the Federal Communication Commission that affects advertisements sent to telephone facsimile (fax) machines. Under this new regulation, which is effective as of January 1, 2005, advertisements which advertise the commercial availability or quality of a product or service cannot be sent to the fax machine of a recipient unless the recipient has signed a written statement that includes the fax number to which these advertisements may be sent and clearly indicates the recipient s consent to receive these advertisements by fax from the sender. We do not send advertisements to fax machines in any significant portions of our business. However, in those areas in which we do send advertisements to a recipient s fax machine that are the subject of this new regulation, we intend to be in compliance with this new regulation in advance of January 1, 2005.

COPPA. The Children s Online Privacy Protection Act, or COPPA, extends to operators of commercial Web sites and online services directed to U.S. children under the age of 13 that collect personal information from children, and operators of general audience sites with actual knowledge that they are collecting information from U.S. children under 13. WebMD s sites are not directed at children and its general audience site, WebMD Health, states that no one under the applicable age is entitled to use the site. In addition, WebMD Health employs a kick-out procedure whereby anyone identifying themselves as being under the age of 13 during the registration process is not allowed to register for the site s member only services, such as message boards and live chat events. COPPA, however, is a relatively new law, can be applied broadly and is subject to interpretation by courts and other governmental authorities. The failure to accurately anticipate the application or interpretation of this law could create liability to us, result in adverse publicity and negatively affect our business.

Other Consumer Protection Regulation. The Federal Trade Commission, or FTC, and many state attorneys general are applying federal and state consumer protection laws to require that the online collection, use and dissemination of data, and the presentation of Web site content, comply with certain standards for notice, choice, security and access. Courts may also adopt these developing standards. In many cases, the specific limitations imposed by these standards are subject to interpretation by courts and other governmental authorities. We believe that we are in compliance with these consumer protection standards, but a determination by a state or federal agency or court that any of our practices do not meet these standards could result in liability and adversely affect our business. New interpretations of these standards could also require us to incur additional costs and restrict our business operations.

In addition, several foreign governments have regulations dealing with the collection and use of personal information obtained from their citizens. Those governments may attempt to apply such laws extraterritorially or through treaties or other arrangements with U.S. governmental entities. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future. Any such developments (or developments stemming from enactment or modification of other laws) or the failure to accurately anticipate the application or interpretation of these laws could create liability to us, result in adverse publicity and negatively affect our businesses.

Table of Contents

Item 2. ***Properties***

We believe that the offices and other facilities described are, in general, in good operating condition and adequate for our current operations.

Headquarters

We lease our corporate headquarters offices in Elmwood Park, New Jersey, which consists of approximately 45,000 square feet of space, under leases that expire in, or prior to, March 2006.

WebMD Envoy, WebMD Health and WebMD Practice Services

We lease important facilities in:

Nashville, Tennessee for WebMD Envoy s headquarters and primary data and call centers and Medifax s operations;

St. Louis, Missouri for Advanced Business Fulfillment s operations;

Scottsdale, Arizona and Toledo, Ohio for ExpressBill s operations;

Tampa, Florida for WebMD Practice Services headquarters and Alachua, Florida for its development and engineering operations; and

New York, New York for WebMD Health s headquarters and its editorial and marketing operations.

We also use facilities in approximately 130 additional locations throughout the United States, 11 of which are owned and the rest of which are leased. These locations include sales and other offices, production centers, data centers and call centers.

Porex

We use approximately 380,000 square feet for Porex s headquarters and for office and manufacturing operations related to its porous plastics and other porous media product lines, including: the Porex headquarters and largest plant, which are located in property that we own in Fairburn, Georgia, a suburb of Atlanta; space that we own in Newnan, Georgia, College Park, Georgia and Bautzen, Germany; and space that we lease in Selangor, Malaysia and Alness, Scotland.

Item 3. ***Legal Proceedings***

Envoy Securities Litigation

Several years prior to our acquisition of Envoy Corporation, Envoy and some of its officers were named as defendants in three identical lawsuits filed in the United States District Court for the Middle District of Tennessee, Nashville Division. In 1998, the District Court ordered the three cases consolidated under the caption In re Envoy Corporation Securities Litigation.

Plaintiffs alleged that the defendants made material misrepresentations and omissions in Envoy s public filings and public statements concerning Envoy s financial statements and Envoy s accounting for some charges taken in connection with acquisitions. In addition, plaintiffs alleged that, as a result of defendants alleged actions, Envoy s reported earnings during the class period were overstated and the price for Envoy s common stock was artificially inflated.

In April 2002, the court certified a class of plaintiffs consisting of all persons, other than defendants, who purchased shares of Envoy common stock between February 27, 1997 and August 18, 1998.

As previously disclosed, on September 18, 2003, Envoy entered into a definitive Stipulation of Settlement regarding the settlement of this litigation, as contemplated by a Memorandum of Understanding dated July 11, 2003. Pursuant to the Stipulation of Settlement, the defendants

paid into a settlement fund the amount of $11 million in settlement of the claims asserted in the action and the

Table of Contents

Stipulation of Settlement. On December 17, 2003, the United States District Court for the Middle District of Tennessee, following a hearing, entered an Order granting final approval of the settlement of this litigation on the terms contained in the Stipulation of Settlement. Pursuant to the Court s Order, all members of the plaintiff class released defendants and the litigation was dismissed with prejudice. No appeal from the Court s Order was taken and the Order became final and non-appealable on January 17, 2004. Defendants have denied and continue to deny the allegations asserted in the lawsuit and agreed to the settlement in order to eliminate the burden and expense of further litigation. As previously disclosed, the settlement of this litigation was funded entirely with the proceeds of Envoy s insurance policy.

Litigation Regarding Distribution of Shares in Healtheon Initial Public Offering

In the summer and fall of 2001, seven purported class action lawsuits were filed against Morgan Stanley & Co. Incorporated and Goldman Sachs & Co., underwriters of the initial public offering of the Company (then known as Healtheon) in the United States District Court for the Southern District of New York. Three of these suits also named WebMD and certain former officers and directors of WebMD as defendants. These suits were filed in the wake of reports of governmental investigations of the underwriters practices in the distribution of shares in certain initial public offerings. Similar suits were filed in connection with over 300 other initial public offerings that occurred in 1999, 2000 and 2001.

The complaints against WebMD and its former officers and directors alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 under that Act and Section 11 of the Securities Act of 1933 because of failure to disclose certain practices alleged to have occurred in connection with the distribution of shares in the Healtheon IPO. Claims under Section 12(a)(2) of the Securities Act of 1933 were also brought against the underwriters. These claims were consolidated, along with claims relating to over 300 other initial public offerings, in the Southern District of New York.

The plaintiffs have dismissed the claims against the four former officers and directors of WebMD without prejudice, pursuant to Reservation of Rights and Tolling Agreements with those individuals.

On July 15, 2002, the issuer defendants in the consolidated action, including WebMD, filed a joint motion to dismiss the consolidated complaints. On February 18, 2003, the District Court denied, with certain exceptions not relevant to WebMD, the issuer defendants motion to dismiss.

After a lengthy mediation under the auspices of former United States District Judge Nicholas Politan, the issuer defendants in the consolidated action (including WebMD), the affected insurance companies and the plaintiffs reached an agreement on a settlement to resolve the matter among the participating issuer defendants, their insurers and the plaintiffs. The settlement is embodied in a Memorandum of Understanding and a number of related agreements that together set out a comprehensive framework for settlement of the consolidated actions among these parties. The settlement calls for the participating issuers insurers jointly to guarantee that plaintiffs recover a certain amount in the IPO litigation and certain related litigation from the underwriters and other non-settling defendants. Accordingly, in the event that the guarantee becomes payable, the agreement calls for WebMD s insurance carriers, not WebMD, to pay WebMD s pro rata share.

WebMD has approved the settlement, and we understand that virtually all of the approximately 260 other issuer defendants who are eligible have also elected to participate in the settlement. Although WebMD believes that the claims alleged in the lawsuits were primarily directed at the underwriters and, as they relate to WebMD, were without merit, we believe that the settlement is beneficial to WebMD because it reduces the time, expense and risks of further litigation, particularly since virtually all of the other issuer defendants will participate and our insurance carriers strongly support the settlement.

In order for the settlement to become final, the Memorandum of Understanding must be reduced to a separate settlement agreement as to each issuer, each of which must be approved by the court. Accordingly, we anticipate, though we cannot guarantee, that this settlement will resolve the IPO allocation securities litigation between the plaintiffs and WebMD.

Table of Contents

Merrill Lynch Fundamental Growth Fund, Inc. et al. v. McKesson HBOC, Inc., et al.

WebMD has been named as a defendant in the action *Merrill Lynch Fundamental Growth Fund, Inc., et al. v. McKesson HBOC, Inc., et al.*, Case No. 405792, in the San Francisco Superior Court. The original complaint in this matter alleged that McKesson HBOC, HBO and Company (which we refer to as HBOC), certain officers and directors of those firms, Arthur Andersen LLP, and Bear Stearns & Co. engaged in a number of practices whereby HBOC and later McKesson HBOC improperly recognized revenues. When these practices were discovered, McKesson HBOC eliminated more than $327 million in revenues that HBOC had recognized over the prior three years. Plaintiffs claim to have lost more than $150 million as a result of the decline in McKesson HBOC s share value after the accounting practices came to light in April 1999.

On September 4, 2003, the plaintiffs filed a fourth amended complaint, naming WebMD and two other defendants, General Electric Capital Corporation, Inc. and Computer Associates International, Inc., for the first time. The complaint alleges that WebMD aided and abetted alleged fraud by certain defendants and conspired with those defendants in relation to HBOC s and McKesson HBOC s alleged improper recognition of approximately $14 million in revenue on two software transactions. Plaintiffs also allege that WebMD made certain negligent misrepresentations with respect to these transactions.

Plaintiffs allege that WebMD, Inc. (then a separate private company and now a subsidiary of WebMD), through its participation in certain transactions with HBOC and McKesson HBOC, learned that officers of HBOC and/or McKesson HBOC, HBOC and McKesson HBOC were breaching duties owed to McKesson HBOC shareholders by making material misstatements and suppressing or omitting facts with respect to HBOC s and McKesson HBOC s financial results for the periods ending December 31, 1998 and March 31, 1999 and that WebMD, Inc. aided and abetted and conspired with these defendants. One of the officers became an officer of WebMD, Inc. on December 1, 1998, after having served as HBOC s representative on the board of WebMD, Inc. and was dismissed by WebMD, Inc. after the accounting fraud at HBOC was disclosed. The other officer served as HBOC s representative on the Board of WebMD, Inc. and ceased to be a director of WebMD, Inc. upon dismissal by McKesson HBOC. Plaintiffs seek unspecified damages against WebMD. The complaint alleges numerous instances of improper accounting by HBOC unrelated to the transactions between WebMD, Inc. and HBOC and/or McKesson HBOC.

WebMD intends to vigorously defend against the plaintiffs claims against WebMD and WebMD, Inc. On December 16, 2003, WebMD filed a demurrer, seeking dismissal of the two claims against it. This demurrer is pending with the Court.

Investigations by United States Attorney for the District of South Carolina and the SEC

The United States Attorney for the District of South Carolina is conducting an investigation of our company, which we first learned about on September 3, 2003. On that date, Federal Bureau of Investigation and Internal Revenue Service agents executed search warrants at our corporate headquarters in Elmwood Park, New Jersey and the offices of Medical Manager Health Systems in Tampa, Florida and Alachua, Florida and delivered subpoenas for documents and financial records. Based on the information available to us as of the date of this Annual Report, we believe that the investigation relates principally to issues of financial reporting for Medical Manager Corporation, a predecessor of WebMD (by its merger into WebMD in September 2000), and our Medical Manager Health Systems subsidiary; however, we cannot be sure of the investigation s exact scope or how long it will continue. Included among the materials removed or subject to subpoena are records relating to a $5.5 million restatement of revenue by Medical Manager Corporation in August 1999 and to acquisitions by our Medical Manager Health Systems subsidiary of other companies, most of which were dealers of Medical Manager products and services. In August 1999, Medical Manager Corporation announced that it would restate previously reported results of Medical Manager Health Systems, which it had acquired in July 1999, for the six months ended immediately prior to the acquisition. Medical Manager Corporation determined at the time that the accounting treatment previously accorded to five transactions involving the bulk sales of software licenses entered into concurrently with business combinations and other related transactions should be

Table of Contents

restated to reflect the software license revenues as a reduction of the acquisition price of the related transactions. At the time, Medical Manager Corporation also noted that the transactions represented $5,532,000 of revenue and $3,502,000 of net income for the six months ended June 30, 1999. WebMD understands that the SEC is also conducting a formal investigation into this matter.

WebMD intends to continue to fully cooperate with the authorities in this matter and our Board of Directors has formed a special committee consisting solely of independent directors to oversee this matter. The special committee has retained independent legal counsel to advise it.

While WebMD is not able to estimate, at this time, the amount of the expenses that it will incur in connection with the investigations, it expects that they may be significant. For the year ended December 31, 2003, those expenses are reflected as Legal Expenses in the Consolidated Statements of Operations included in this Annual Report.

At Home Corporation General Unsecured Creditors Trust

In 1999, WebMD, Inc. entered into an agreement with Excite Corp. concerning placing WebMD content on Excite Corp. s consumer internet portal. In 2001, WebMD and Excite Corp. s successor, AtHome Corp., entered into a revised agreement, which terminated the 1999 agreement and included a release of claims under the 1999 agreement. AtHome Corp. later filed for bankruptcy.

On December 4, 2003, WebMD was served with a complaint in an adversary proceeding in the Bankruptcy Court for the Northern District of California brought by the trustee for the At Home Corporation General Unsecured Creditors Trust. The plaintiff alleges that the 2001 agreement provided AtHome Corp. less than reasonably equivalent value for its rights under the 1999 agreement and that the 2001 agreement should be avoided as a fraudulent transfer. The plaintiff also alleges that WebMD breached the 1999 agreement by failing to make required cash payments, and failed to pay AtHome Corp. fair and reasonable value for services that AtHome Corp. provided. The plaintiff has claimed that its damages are in excess of $8 million. WebMD intends to vigorously defend against the plaintiff s claims.

Porex Mammary Implant Litigation

From 1988 through 1990, Porex distributed silicone mammary implants in the United States pursuant to a distribution arrangement with a Japanese manufacturer. Porex believes that, after accounting for implants returned to Porex, the aggregate number of persons who received implants distributed by Porex totals approximately 2,500. Since March 1991, Porex has been named as one of many co-defendants in a number of actions brought by recipients of mammary implants. The typical case or claim alleges that the individual s mammary implants caused one or more of a wide range of ailments. These implant cases and claims generally raise difficult and complex factual and legal issues and are subject to many uncertainties and complexities, including, but not limited to, the facts and circumstances of each particular case or claim, the jurisdiction in which each suit is brought, and differences in applicable law. Porex does not have sufficient information to evaluate each case and claim.

Certain of the actions against Porex have been dismissed, where it was determined that the implant in question was not distributed by Porex. In addition, as of March 10, 2004, approximately 300 actions have been settled by the manufacturer, or by Porex s insurance carriers, without material cost to Porex. As of March 10, 2004, no implant-related claims were pending against Porex. During calendar year 2003, there were no implant-related claims made against Porex by individuals, as compared to two claims during each of 2002, 2001 and 2000, 39 claims during 1999 and nine claims during 1998. The majority of claims made during 1999 were claims that were filed by individuals following a court ruling in 1999 that cases filed in earlier years would not proceed as class actions, as a result of which such individuals would not be members of a class in such cases.

In 1994, Porex was notified that its insurance carrier would not renew its then-existing insurance coverage after December 31, 1994 with respect to actions and claims arising out of its distribution of implants. However, Porex exercised its right, under such policy, to purchase extended reporting period coverage with respect to such actions and claims. Such coverage provides insurance subject to existing policy limits, but for an unlimited time period with respect to actions and claims made after December 31,

Table of Contents

1994 based on events that occurred during the policy period. In addition, Porex has purchased extended reporting period coverage with respect to other excess insurance. This coverage also extends indefinitely, replacing coverage that would, by its terms, have otherwise expired by December 31, 1997. Porex will continue to evaluate the need to purchase further extended reporting period coverage from excess insurers to the extent such coverage is reasonably available.

Porex believes that its present coverage, together with its insurance policies in effect on or before December 31, 1994, should provide adequate coverage against liabilities that could result from actions or claims arising out of Porex s distribution of silicone mammary implants. However, Porex cannot be certain that particular cases and claims will not result in liability that is greater than expected based on Porex s prior experience. If so, Porex s liability could exceed the amount of its insurance coverage. Furthermore, certain actions and claims seek punitive and compensatory damages arising out of alleged intentional torts. If these claims are successful, such damages may or may not be covered, in whole or in part, by Porex s insurance policies.

Other Legal Proceedings

In the normal course of business, we are involved in various other claims and legal proceedings. While the ultimate resolution of these matters, and those discussed above, has yet to be determined, we do not believe that their outcome will have a material adverse effect on our financial position or results of operations.

Item 4. ***Submission of Matters to a Vote of Security Holders***

During the fourth quarter of 2003, no matters were submitted to a vote of security holders of WebMD.

Table of Contents

PART II

Item 5. ***Market for Registrant s Common Equity and Related Stockholder Matters***

We completed the initial public offering of our common stock on February 10, 1999. Our common stock has been traded on the Nasdaq National Market under the symbol HLTH since February 11, 1999.

The high and low prices for each quarterly period during the last two fiscal years are as follows:

	High	Low
2002		
First quarter	$ 8.86	$6.25
Second quarter	7.78	5.05
Third quarter	6.23	4.25
Fourth quarter	9.30	4.54
2003		
First quarter	$10.28	$8.25
Second quarter	12.00	8.28
Third quarter	12.49	8.20
Fourth quarter	9.32	7.59

On March 1, 2004, there were approximately 4,470 holders of record of our common stock. Because many of these shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

The market price of our common stock has fluctuated since the date of our initial public offering and is likely to fluctuate in the future. Changes in the market price of our common stock and other securities may result from, among other things:

quarter-to-quarter variations in operating results

operating results being less than analysts estimates

changes in analysts earnings estimates

announcements of new technologies, products and services or pricing policies by us or our competitors

announcements of acquisitions or strategic partnerships by us or our competitors

developments in existing customer or strategic relationships

actual or perceived changes in our business strategy

developments in new or pending litigation and claims

sales of large amounts of our common stock

changes in market conditions in the healthcare, information technology, Internet or plastic industries

changes in general economic conditions

fluctuations in the securities markets in general.

In addition, the market prices of Internet and healthcare information technology stocks in general, and of our common stock in particular, have experienced large fluctuations, sometimes quite rapidly. These fluctuations often may be unrelated or disproportionate to the operating performance of these companies.

Table of Contents

Any negative change in the public s perception of the prospects of these companies, as well as other broad market and industry factors, may result in changes in the price of our common stock.

We have never declared or paid any cash dividends on our common stock, and we do not anticipate paying cash dividends in the foreseeable future. We intend to retain earnings to finance the expansion of our operations.

Sales of Unregistered Securities During the Fourth Quarter of 2003

On December 12, 2003, WebMD issued 288 shares of WebMD common stock to an individual in a transaction exempt from registration under Section 3(a)(9) of the Securities Act. The shares were issued upon exercise of an outstanding warrant originally issued to Gleacher & Co. and transferred by it to the individual.

Table of Contents

Item 6. ***Selected Financial Data***

The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and with the consolidated financial statements and notes thereto, which are included elsewhere in this Annual Report. On August 1, 2003, we completed the sale of two operating units of our Plastic Technologies segment. Accordingly, the following selected consolidated financial data has been reclassified to reflect the historical results of these two operating units as discontinued operations.

	Years Ended December 31,				
	2003	2002	2001	2000	1999
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenue	$963,980	$871,696	$ 842,020	$ 574,524	$ 102,149
Costs and expenses:					
Cost of operations	564,939	509,744	568,321	430,296	88,576
Development and engineering	42,985	43,467	43,572	59,867	29,669
Sales, marketing, general and administrative	282,482	283,424	448,082	535,462	82,315
Depreciation, amortization and other	62,434	125,593	2,394,857	2,188,461	193,067
Legal expense	3,959				
Impairment of long-lived and other assets			3,816,115		
Restructuring and integration (benefit) charge		(5,850)	266,755	452,919	
(Gain) loss on investments	(1,659)	(6,547)		40,365	
Interest income	22,901	19,590	30,409	51,467	4,013
Interest expense	15,214	8,491	507	735	527
Other income, net	4,218	3,844			
Income (loss) from continuing operations before income tax provision (benefit)	20,745	(63,192)	(6,665,780)	(3,082,114)	(287,992)
Income tax provision (benefit)	4,140	(10,079)	2,588	790	
Income (loss) from continuing operations	16,605	(53,113)	(6,668,368)	(3,082,904)	(287,992)
Income (loss) from discontinued operations, net of income taxes	(33,611)	3,411	(3,950)	1,296	
Net loss	$ (17,006)	$ (49,702)	$(6,672,318)	$(3,081,608)	$(287,992)
Basic loss per common share:					
Income (loss) from continuing operations	$ 0.05	$ (0.17)	$ (19.13)	$ (12.60)	$ (3.58)
Income (loss) from discontinued operations	(0.11)	0.01	(0.01)	0.01	
Net loss	$ (0.06)	$ (0.16)	$ (19.14)	$ (12.59)	$ (3.58)
Diluted loss per common share:					
Income (loss) from continuing operations	$ 0.05	$ (0.17)	$ (19.13)	$ (12.60)	$ (3.58)

Income (loss) from discontinued operations	(0.10)	0.01	(0.01)	0.01	
Net loss	$ (0.05)	$ (0.16)	$ (19.14)	$ (12.59)	$ (3.58)
Weighted-average shares outstanding used in computing income (loss) per common share:					
Basic	304,858	304,168	348,570	244,688	80,367
Diluted	325,811	304,168	348,570	244,688	80,367

Table of Contents

	As of December 31,				
	2003	2002	2001	2000	1999
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 270,681	$ 186,484	$ 378,762	$ 505,793	$ 291,286
Long-term marketable securities	456,034	456,716	18,769	222,774	
Working capital	202,573	193,031	360,429	528,136	216,304
Total assets	2,135,306	1,766,248	1,601,454	8,487,108	4,123,668
Convertible subordinated notes	649,999	300,000			
Other long-term liabilities	1,182	498	1,226	15,279	2,695
Convertible redeemable preferred stock			10,000	10,000	
Convertible preferred stock				710,746	
Stockholders equity	1,178,597	1,153,801	1,255,512	8,097,435	3,973,672

Table of Contents

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

This Item 7 contains forward-looking statements with respect to possible events, outcomes or results that are, and are expected to continue to be, subject to risks, uncertainties and contingencies, including those identified in this Item. See Cautionary Statement Regarding Forward-Looking Statements on page 2.

Overview

Management s discussion and analysis of financial condition and results of operations, or MD&A, is provided as a supplement to the consolidated financial statements and notes thereto included elsewhere in this Annual Report and to provide an understanding of our results of operations, financial condition, and changes in financial condition. Our MD&A is organized as follows:

Introduction. This section provides a general description of our business, a brief discussion of our operating segments, summarizes the acquisitions we completed during the last two years and describes the restructuring and integration plans we undertook to eliminate duplication and redundancies that resulted from acquisitions we have made.

Critical Accounting Policies and Estimates. This section discusses those accounting policies that both are considered important to our financial condition and results of operations, and require us to exercise subjective or complex judgments in their application. In addition, all of our significant accounting policies, including our critical accounting policies, are summarized in Note 1 to our consolidated financial statements.

Results of Operations and Results of Operations by Operating Segment. These sections provide our analysis and outlook for the significant line items on our consolidated statements of operations, on both a company-wide and a segment-by-segment basis.

Liquidity and Capital Resources. This section provides an analysis of our liquidity and cash flows, as well as a discussion of our outstanding debt and commitments, that existed as of December 31, 2003.

Factors That May Affect Our Future Financial Condition or Results of Operations. This section describes circumstances or events that could have a negative effect on our financial results or operations or that could change, for the worse, existing trends in some or all of our businesses. The factors discussed in this section are in addition to factors that may be described elsewhere in this Annual Report.

Introduction

WebMD Corporation is a Delaware corporation that was incorporated in December 1995 and commenced operations in January 1996 as Healtheon Corporation. We changed our name to Healtheon/ WebMD Corporation in November 1999 and to WebMD Corporation in September 2000. Our common stock has traded on the Nasdaq National Market under the symbol HLTH since February 11, 1999.

On August 1, 2003, we completed the sale of two operating units of our Plastic Technologies segment. Accordingly, the historical results of these two operating units, including the loss related to the divestitures, have been reclassified as discontinued operations in our financial statements.

Operating Segments

We have aligned our business into four operating segments as follows:

Transaction Services or WebMD Envoy. We provide healthcare reimbursement cycle management services, including transmission of transactions between healthcare payers and physicians, pharmacies, dentists, hospitals, laboratory companies and other healthcare providers using dial-up, Internet and dedicated communication methods. Our services assist our customers in automating

Table of Contents

key administrative and clinical functions. In addition, we provide automated patient billing services to providers, including statement printing and mailing services, and provide paid-claims communication services to third party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanation of benefits.

Physician Services or WebMD Practice Services. We develop and market integrated physician practice management systems, including administrative, financial and clinical applications and services, under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. These systems and services allow physician offices to automate their scheduling, billing and other administrative tasks, to transmit transactions electronically, to maintain electronic medical records and to automate documentation of patient encounters.

Portal Services or WebMD Health. We provide online healthcare information, educational services and related resources for consumers and healthcare professionals, both directly and through our relationships with leading general consumer Internet portals. We also provide online content for use by media and healthcare partners in their Web sites. We develop and sell online and offline channels of communication and sponsorship programs to pharmaceutical, biotech, medical device and consumer products companies, particularly those who are interested in influencing healthcare decisions. In addition, we provide a suite of online tools and related services to employers and health plans for use by their employees and plan members.

Plastic Technologies or Porex. We develop, manufacture and distribute proprietary porous plastic products and components used in healthcare, industrial and consumer applications, as well as in finished products used in the medical device and surgical markets.

Acquisitions

In 2003, we completed 12 acquisitions. Our Portal Services segment acquired two companies for a total purchase consideration of approximately $14,612, comprised of $14,400 in cash and $212 of estimated acquisition costs. We will pay an additional $2,500 if certain financial milestones are achieved. In connection with the preliminary allocation of the purchase price, we recorded goodwill of $12,731 and intangible assets of $3,525, with estimated useful lives of three to seven years. Our Transaction Services segment acquired three companies for a total purchase price of $399,138, comprised of $390,238 in cash and $8,900 in estimated acquisition costs. Additionally, we will pay up to an additional $154,200 if certain milestones are achieved in the future. In connection with the preliminary allocation of the purchase price of these three acquisitions, we recorded goodwill of $244,021 and intangibles assets of $142,092, with estimated useful lives ranging from nine months to fifteen years. Also, during 2003, our Physician Services segment acquired seven companies for a total cost of $2,182, which was paid in cash. We will pay an additional $675 if certain of the acquired companies meet certain financial milestones. In connection with the preliminary allocation of the purchase prices, goodwill of $1,469 and intangible assets subject to amortization of $1,054 were recorded. The intangible assets have estimated useful lives from three to nine years.

In 2002, we completed 22 acquisitions. On October 31, 2002, our Portal Services segment acquired one company. The total purchase consideration for this acquisition was approximately $19,031, comprised of $18,781 in cash and estimated acquisition costs of $250. In connection with the allocation of the purchase price, we recorded goodwill of $18,380 and an intangible asset of $2,700 with an estimated useful life of three years. Also, throughout 2002, our Physician Services segment acquired 21 companies for a total cost of $14,400 which was paid in cash. In connection with the allocation of the purchase price, goodwill of $11,784 and intangible assets subject to amortization of $4,049 were recorded. The intangible assets have estimated useful lives of one to nine years.

Restructuring and Integration Initiatives

After the mergers with Medical Manager Corporation, CareInsite, Inc. and OnHealth Network Company in 2000, our Board of Directors approved a restructuring and integration plan, with the objective

Table of Contents

of eliminating duplication and redundancies that resulted from these and certain prior acquisitions and consolidating our operational infrastructure into a common platform to more efficiently serve our customers.

Our restructuring and integration efforts continued in 2001, and a plan to include the impact of eliminating functions resulting from our acquisition of Medscape in December 2001 was initiated.

We have substantially completed our restructuring and integration efforts related to the 2000 and 2001 restructuring plans, with the primary exception being remaining lease payments of previously vacated facilities.

Critical Accounting Policies and Estimates

Our discussion and analysis of WebMD s financial condition and results of operations are based upon our Consolidated Financial Statements and Notes to Consolidated Financial Statements, which were prepared in conformity with accounting principles generally accepted in the United States. The preparation of the consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. We base our estimates on historical experience, current business factors, and various other assumptions that we believe are necessary to form a basis for making judgments about the carrying values of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

We evaluate our estimates on an ongoing basis, including those related to revenue recognition, short-term and long-term investments, deferred tax assets, income taxes, collectibility of customer receivables, prepaid content and distribution services, long-lived assets including goodwill and other intangible assets, certain accrued expenses, accruals related to our restructuring program, contingencies and litigation.

We believe the following reflect our critical accounting policies and our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Our revenue recognition policies for each reportable segment are as follows:

Transaction Services or WebMD Envoy. Healthcare payers and providers pay us fees for our services, generally on a per transaction basis or monthly basis. We recognize revenue as we perform the service. Healthcare payers and providers also pay us one-time implementation and annual maintenance fees. We recognize revenue from these fees ratably over the term of the respective agreements.

Physician Services or WebMD Practice Services. Healthcare providers pay us one-time fees for the purchase of our practice management systems. We recognize revenue from these one-time fees when we enter into noncancelable agreements with our customers, the products have been delivered and there are no uncertainties regarding product acceptance and delivery, no significant future performance obligations exist, fees are fixed and determinable and collectability is probable. Amounts received in advance of meeting these criteria are deferred until we meet these criteria. Revenue from multiple-element software arrangements is recognized using the residual method as vendor specific objective evidence (VSOE) of fair value exists for the undelivered elements, but not for all of the delivered elements. The residual method requires revenue to be allocated to the undelivered elements based on the fair value of such elements, as indicated by VSOE. VSOE is based on the price charged when an element is sold separately. Healthcare providers also pay us fees for maintenance and support of their practice management system, including the hardware and software. We recognize revenue from these fees ratably over the contract period, typically in one year or less. Healthcare providers also pay us fees for transmitting transactions to payers and patients. We recognize revenue from these fees, which are generally paid on a monthly or per transaction basis, as we provide the service.

Portal Services or WebMD Health. Customers pay us for advertising, sponsorship, healthcare management tools, continuing medical education (CME), content syndication and distribution,

Table of Contents

and e-commerce transactions related to our online distribution channels and the online and offline distribution channels of our strategic partners. Revenue from advertising is recognized as advertisements are delivered. Revenues from sponsorship arrangements and healthcare management tools are recognized ratably over the term of the applicable agreement. Revenue from CME arrangements is recognized over the period we satisfy the minimum credit hour requirements of the applicable agreements. Revenue from fixed fee content license or carriage fees is recognized ratably over the term of the applicable agreement. E-commerce revenue is recognized when a subscriber or consumer utilizes our Internet-based services or purchases goods or services through our Web site or co-branded Web site with one of our strategic partners. Subscription revenue, including subscription revenue from sponsorship arrangements, is recognized over the subscription period. When contractual arrangements contain multiple elements, revenue is allocated to the elements based on their relative fair values, determined using prices charged when elements are sold separately.

Plastic Technologies or Porex. We develop, manufacture and distribute porous plastic products and components. For standard products, we recognize revenue upon shipment of product, net of sales returns and allowances. For sales of certain custom products, we recognize revenue upon completion and customer acceptance. Recognition of amounts received in advance of meeting these criteria is deferred until we meet these criteria.

Long-Lived Assets Our long-lived assets consist of property and equipment, goodwill and other intangible assets. Goodwill and other intangible assets arise from the acquisitions we have made. The amount assigned to intangible assets is subjective and based on our estimates of the future benefit of the intangible asset using accepted valuation techniques, such as discounted cash flow and replacement cost models. Our long-lived assets are amortized over their estimated useful lives, which we determine based on the consideration of several factors, including the period of time the asset is expected to remain in service. We evaluate the carrying value and remaining useful lives of long-lived assets, excluding goodwill, whenever indicators of impairment are present. We evaluate the carrying value of goodwill annually. We use a discounted cash flow approach to determine the fair value of goodwill. During 2001, we identified certain indicators of possible impairment of our long-lived assets, primarily goodwill and other intangible assets. We evaluated our long-lived assets for impairment by determining identifiable cash flows to related asset groupings, and compared the projected undiscounted cash flows for each asset grouping to its carrying value. Once we determined there was an impairment, we quantified the impairment based on projected discounted cash flows. As a result of this analysis in 2001, we recorded an impairment charge of approximately $3.8 billion. There was no impairment of goodwill noted as a result of our impairment testing in 2003 or 2002. Other unknown future indications of possible impairment charges, such as a significant downturn in one of our business segments or reporting units or general economic conditions, could result in an additional assessment of our long-lived assets for impairment and could result in an additional impairment charge in the future.

Investments Our investments, at December 31, 2003, consisted principally of certificates of deposit, municipal bonds, asset backed securities, Federal Agency Notes, U.S. Treasury Notes and an equity investment in a publicly traded company. For each reporting period, we evaluate the carrying value of our investments and record a loss on investments when we believe an investment has experienced a decline in value that is other than temporary. We do not recognize a gain on an investment until sold. Future changes in market or economic conditions or operating results of our investments could result in gains or losses or an inability to recover the carrying value of the investments that may not be reflected in an investment s carrying value.

Deferred Tax Assets Our deferred tax assets are comprised primarily of net operating loss carryforwards. At December 31, 2003, we had net operating loss carryforwards of approximately $1.9 billion. These loss carryforwards may be used to offset taxable income in future periods, reducing the amount of taxes we might otherwise be required to pay. Due to a lack of a history of generating taxable income, we record a valuation allowance equal to 100% of our net deferred tax

Table of Contents

assets. In the event that we are able to generate taxable earnings in the future and determine it is more likely than not that we can realize our deferred tax assets, an adjustment to the valuation allowance would be made which may increase income in the period that such determination was made.

Restructuring and Integration In connection with our restructuring and integration efforts, modifications to our strategic relationship with News Corporation resulted in a change in the carrying value of advertising services we have the rights to, classified as prepaid content and distribution services. We estimated the fair value of our rights under the new agreement using a discounted cash flow approach. This estimate also affects the amortization of this asset in future periods over the contractual term. Also, in connection with our restructuring and integration efforts, we recorded charges for estimated future lease obligations and lease cancellation penalties related to exited facilities based on many different variables, such as the term to expiration, contractual rights under the lease agreement and current real estate market conditions. Future changes in any of these variables, such as a change in real estate market conditions, could have an impact on these estimates.

Results of Operations

The following table sets forth our consolidated statements of operations data and expresses that data as a percentage of revenue for the periods presented (amounts in thousands):

	Years Ended December 31,					
	2003		2002		2001	
	$	%	$	%	$	%
Revenue	963,980	100.0	871,696	100.0	842,020	100.0
Costs and expenses:						
Cost of operations	564,939	58.6	509,744	58.5	568,321	67.5
Development and engineering	42,985	4.5	43,467	5.0	43,572	5.2
Sales, marketing, general and administrative	282,482	29.3	283,424	32.5	448,082	53.2
Depreciation, amortization and other	62,434	6.5	125,593	14.4	2,394,857	284.4
Legal expense	3,959	0.4				
Impairment of long-lived and other assets					3,816,115	453.2
Restructuring and integration (benefit) charge			(5,850)	(0.7)	266,755	31.7
Gain on investments	1,659	0.2	6,547	0.8		
Interest income	22,901	2.4	19,590	2.3	30,409	3.6
Interest expense	15,214	1.6	8,491	1.0	507	0.0
Other income, net	4,218	0.4	3,844	0.4		
Income (loss) from continuing operations before income tax provision (benefit)	20,745	2.1	(63,192)	(7.2)	(6,665,780)	(791.6)
Income tax provision (benefit)	4,140	0.4	(10,079)	(1.1)	2,588	0.3
Income (loss) from continuing operations	16,605	1.7	(53,113)	(6.1)	(6,668,368)	(791.9)
Income (loss) from discontinued operations, net of income taxes	(33,611)	(3.5)	3,411	0.4	(3,950)	(0.5)
Net loss	(17,006)	(1.8)	(49,702)	(5.7)	(6,672,318)	(792.4)

Revenue is derived from our four business segments: Transaction Services, Physician Services, Portal Services and Plastic Technologies. Our Transaction Services include administrative services, such as transaction processing for medical, dental and pharmacy claims, automated patient statements and clinical

55

Table of Contents

lab and reporting services, such as lab test orders and results. A significant portion of Transaction Services revenues is generated from the country s largest national and regional healthcare payers. Our Physician Services include sales of practice management systems, including administrative, financial and clinical applications and services, under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. We also sell support and maintenance services related to the hardware and software associated with our practice management systems. Portal Services include advertising, sponsorship, continuing medical education, content syndication and distribution, and e-commerce transactions through our online distribution channels and the online and offline distribution channels of our strategic partners. The majority of Portal Services revenues are derived from a small number of customers. Our customers include pharmaceutical companies, biotech companies, medical device companies and media companies. Our Plastic Technologies revenue includes the sale of porous plastic components used to control the flow of fluids and gases for use in healthcare, industrial and consumer applications, as well as in finished products used in the medical device and surgical markets.

Cost of operations consists of costs related to services and products we provide to customers and costs associated with the operation and maintenance of our networks. These costs include salaries and related expenses for network operations personnel and customer support personnel, telecommunication costs, maintenance of network equipment, cost of hardware related to the sale of practice management systems, a portion of facilities expenses, leased personnel and facilities costs, sales commissions paid to certain distributors of our Transaction Services products, non-cash expenses related to content and distribution services. In addition, cost of operations includes raw materials, direct labor and manufacturing overhead, such as fringe benefits and indirect labor related to our Plastic Technologies segment.

Development and engineering expense consists primarily of salaries and related expenses associated with the development of applications and services. Expenses include compensation paid to development and engineering personnel, fees to outside contractors and consultants, and the maintenance of capital equipment used in the development process.

Sales, marketing, general and administrative expense consists primarily of advertising, product and brand promotion, salaries and related expenses for sales, administrative, finance, legal, information technology, human resources and executive personnel. These expenses include items related to account management and marketing personnel, commissions, costs and expenses for marketing programs and trade shows, and fees for professional marketing and advertising services, as well as fees for professional services, costs of general insurance and costs of accounting and internal control systems to support our operations. Also included are non-cash expenses related to content and distribution services acquired in exchange for our equity securities and stock compensation expense primarily related to the amortization of deferred compensation. Content and distribution services consist of advertising, promotion and distribution services from our arrangements with News Corporation, Microsoft, AOL and other partners. Stock compensation primarily relates to deferred compensation associated with the intrinsic value of the vested portion of stock options issued in exchange for outstanding stock options of companies we acquired in 2000, and the excess of the market price over the exercise price of options granted to employees.

2003 and 2002

Revenue

Our total revenues increased to $963,980 in 2003 from $871,696 in 2002. Transaction Services, Physician Services, Portal Services and Plastic Technologies accounted for $38,919, $27,334, $26,369 and $6,129, respectively, of the revenue increase. This revenue increase was partially offset by an increase in inter-segment eliminations of $6,467.

Revenue from customers acquired through the 2003 Acquisitions and 2002 Acquisitions contributed $55,629 to the overall increase in revenue for 2003 of $92,284. For purposes of this discussion, only revenue from existing customers of the acquired business on the date of the acquisition is considered to be revenue from acquired customers. We integrate acquisitions as quickly as practicable, and only revenue

Table of Contents

recognized during the first twelve months following the quarter in which the acquisitions closed is considered to be revenue from acquired customers.

Costs and Expenses

Cost of Operations. Cost of operations increased to $564,939 in 2003 from $509,744 in 2002. Our cost of operations represented 58.6% of revenues in 2003, compared to 58.5% in 2002. While cost of operations as a percentage of revenue has remained relatively consistent from 2003 to 2002, cost of operations increased due to our July 17, 2003 acquisition of ABF, whose products have a lower gross margin. Additionally, cost of operations increased due to higher sales commissions paid to our channel partners and due to higher consulting and personnel costs related to our implementation of the Health Insurance Portability and Accountability Act of 1996, or HIPAA. These increases were offset by lower data communication costs and the costs associated with the lower margin terminated products and relationships exited in May 2002. Cost of operations for 2003 and 2002 includes approximately $2,356 and $4,765, respectively, of non-cash expenses related to content and distribution services.

Development and Engineering. Development and engineering expense was $42,985 and $43,467 in 2003 and 2002, respectively. Development and engineering expense was relatively flat in 2003 compared to 2002, both in the aggregate and at the segment level, reflecting relatively consistent spending throughout all operating segments.

Sales, Marketing, General and Administrative. Sales, marketing, general and administrative expense decreased to $282,482 in 2003, from $283,424 in 2002, which represents a decrease of $942. Included in sales, marketing, general and administrative expense are non-cash expenses related to content and distribution services and stock compensation. Non-cash expenses related to content and distribution services were $21,942 in 2003, compared to $20,941 in 2002. Non-cash stock compensation was $12,449 in 2003, compared to $25,265 in 2002. The decrease in non-cash stock compensation is primarily related to the vesting schedules of options issued and assumed in connection with our 2000 acquisitions. Sales, marketing, general and administrative expense excluding the non-cash expenses discussed above, were $248,091, or 25.7% of revenue in 2003, compared to $237,218, or 27.2% of revenue in 2002. The decrease in sales, marketing, general and administrative expense, excluding the non-cash expenses discussed above, as a percentage of revenue, is due to the fixed cost leverage of our increased revenues as well as lower sales and marketing costs, partially offset by higher consulting and personnel costs related to our implementation efforts with respect to the HIPAA Transaction Standards and our all-payer services, higher professional services expenses, and higher insurance expenses.

Depreciation, Amortization and Other. Depreciation, amortization and other expense decreased to $62,434 in 2003 from $125,593 in 2002. The decrease was primarily the result of intangible assets relating to certain acquisitions made in 1999 and 2000 becoming fully amortized since the beginning of the prior year period.

Legal Expense. Legal expense in 2003 was $3,959 and represents the costs and expenses incurred related to the investigation by the United States Attorney for the District of South Carolina initiated on September 3, 2003. Over the course of the investigation, we expect that these costs and expenses may be significant.

Impairment of Long-Lived and Other Assets. During 2003 and 2002, we performed the impairment tests of goodwill, as required by Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets . There was no impairment resulting from these tests.

Restructuring and Integration (Benefit) Charge. In connection with our restructuring and integration efforts, we recorded a benefit of $5,850 in 2002, which related to the settlement of certain contractual obligations. There were no restructuring or integration charges recorded during 2003.

Gain on Investments. During 2003, the gain on investments in the amount of $1,659 consisted of a gain of $2,973 related to the sale of a portion of our investments in marketable equity securities, offset by a loss of $1,314 related to the sale of our investments in marketable debt securities. During 2002, we

Table of Contents

recognized a gain on investments of $6,547, which is comprised of a gain of $5,866 and $681 related to the sale of our investment in an available-for-sale and an early redemption call of a held-to-maturity security, respectively.

Interest Income. Interest income increased to $22,901 in 2003, from $19,590 in 2002. This increase was mainly due to higher average investment balances, partially offset by lower average rates of return, during 2003 as compared to 2002. The higher average investment balances in 2003 were primarily attributable to the proceeds from the issuance of our $300,000 3 1/4% Convertible Subordinated Notes in April 2002, and the issuance of our $350,000 1.75% Convertible Subordinated Notes in June and July 2003.

Interest Expense. Interest expense increased to $15,214 in 2003, from $8,491 in 2002, due to the inclusion of a full year of interest expense and amortization of debt issuance costs related to our $300,000 3 1/4% Convertible Subordinated Notes issued in April 2002 and the interest expense and amortization of debt issuance costs related to our $350,000 1.75% Convertible Subordinated Notes issued in June and July of 2003.

Other Income, Net. Other income for 2003 of $4,218 is comprised of a gain of $3,100 for the sale of property in California and Ohio and a benefit of $1,118 from a state tax refund which applied to a pre-acquisition tax year of a company we acquired. Other income of $3,844 in 2002 includes $5,223 for the settlement of various pre-acquisition issues related to certain companies acquired in 1998 through 2000, partially offset by $1,379 in expenses related to our disposition plan for our Plastic Technologies business.

Income Tax Provision (Benefit). Income tax provision (benefit) in 2003 and 2002 primarily represents taxes from profitable operations in certain states and foreign countries in which we do not have net operating losses to offset that income. Accordingly, we provided for taxes of $4,140 and $2,808 related to foreign, state and other jurisdictions during 2003 and 2002, respectively. Also included in the 2002 income tax provision (benefit) is a $12,887 benefit reflecting the carryback of net operating losses to the prior periods of certain acquired subsidiaries, in which those subsidiaries generated taxable income. The carryback was allowed as a result of the Job Creation and Worker Assistance Act of 2002 that was enacted on March 9, 2002.

Discontinued Operations. Loss from discontinued operations in 2003 represents the operating results of the discontinued units of the Plastic Technologies segment as well as the loss of $3,491 recognized in connection with their disposal on August 1, 2003. Also included in the loss from discontinued operations in 2003 was an impairment charge of $33,113 to reduce the long-lived assets of the discontinued units to fair value. The income from discontinued operations in 2002 includes the operating results of the discontinued units.

2002 and 2001

Revenue

Our total revenues increased to $871,696 in 2002 from $842,020 in 2001. Transaction Services, Physician Services, Portal Services and Plastic Technologies accounted for $9,362, $15,097, $9,670 and $3,794, respectively, of the revenue increase. This revenue increase was partially offset by an increase in inter-segment eliminations and other of $8,247 which included revenue related to technology outsourcing and consulting relationships and other non-core products that the Company exited in 2002 and 2001.

Costs and Expenses

Cost of Operations. Cost of operations decreased to $509,744 in 2002 from $568,321 in 2001. Our cost of operations represented 58.5% of revenues in 2002, compared to 67.5% in 2001. This decrease was primarily due to the elimination of costs as a result of our restructuring and integration initiatives, primarily reduced personnel and facilities related costs from consolidating data center operations in our Transaction Services segment as well as in our Portal Services segment. Also contributing to the decrease was the elimination of direct costs associated with residual revenue from technology outsourcing and

Table of Contents

consulting relationships and other non-core products that were exited in 2002 and 2001. Cost of operations for 2002 and 2001 includes approximately $4,765 and $1,531, respectively, in non-cash expenses related to content and distribution services.

Development and Engineering. Development and engineering expense was $43,467 in 2002 and $43,572 in 2001. During 2002, we increased our investment in product offerings in both the Transaction Services and Physician Services segments, which was predominantly offset by the impact of cost reductions resulting from our restructuring and integration efforts.

Sales, Marketing, General and Administrative. Sales, marketing, general and administrative expense decreased to $283,424 in 2002 from $448,082 in 2001, which represents a decrease of 36.7% or $164,658. Included in sales, marketing, general and administrative expense are non-cash expenses related to content and distribution services and stock compensation. Non-cash expenses related to content and distribution services were $20,941 in 2002, compared to $43,943 in 2001. This decrease was primarily due to the expiration of certain content and distribution alliance agreements. Non-cash stock compensation was $25,265 in 2002, compared to $78,451 in 2001. The decrease in non-cash stock compensation was primarily related to the vesting schedules of options issued and assumed in connection with our 2000 acquisitions. Sales, marketing, general and administrative expense excluding the non-cash expenses discussed above, decreased to $237,218 in 2002 from $325,688 in 2001. This decrease was primarily due to the elimination of costs as a result of our restructuring and integration efforts and, to a lesser extent, due to reduced advertising expenses related to the elimination of barter arrangements and distribution costs in our Portal Services segment, as well as lower personnel related costs and lower bad debt expense.

Depreciation, Amortization and Other. Depreciation, amortization and other expense decreased to $125,593 in 2002 from $2.4 billion in 2001. The decrease was primarily attributable to the adoption of SFAS No. 142 on January 1, 2002, which eliminates amortization expenses related to goodwill and certain intangibles and requires these assets to be tested for impairment at least annually. We recorded goodwill and intangible amortization of $2.2 billion in 2001, related to goodwill and certain intangible assets that were not subject to amortization in 2002.

Impairment of Long-Lived and Other Assets. During 2002, we performed both the transitional and annual impairment tests of goodwill, as required by SFAS No. 142. There was no impairment resulting from these tests. During 2001, we identified certain indicators of possible impairment of long-lived assets, primarily goodwill and other acquired intangible assets. These indicators included a further decline in the price of our common stock to its lowest price in the previous twelve months accompanied by a significant decline in the volatility of our stock price, a sustained decline in valuations in the e-health, technology and Internet sectors, and the impact of recent trends in general economic conditions. Based on these indicators, we reviewed substantially all of our long-lived assets for impairment. As a result of this review, we determined that our long-lived and other assets, primarily goodwill and other acquired intangibles, were impaired and recorded a write-down of $3.8 billion during 2001.

Restructuring and Integration (Benefit) Charge. In connection with our restructuring and integration efforts, we recorded a net benefit of $5,850 in 2002, which was primarily due to the settlements of certain contractual obligations. During 2001, we continued our restructuring efforts that began in 2000, with the intention of eliminating duplication and redundancy that resulted from 2000 and 2001 acquisitions. These restructuring efforts resulted in a charge of $266,755 in 2001.

Gain on Investments. Gain on investments of $6,547 in 2002 represented a $5,866 gain related to the sale of one of our investments in available-for-sale securities and a $681 gain related to one of our investments in held-to-maturity securities that was called for early redemption.

Interest Income. Interest income decreased to $19,590 in 2002, from $30,409 in 2001. This decrease is due to lower average balances available for investment as a result of cash used to settle certain contracts with certain of our strategic partners, repurchases of our stock, acquisitions during 2002 and payments made under our restructuring and integration program combined with lower available rates of return, offset

Table of Contents

in part by interest income related to the $292,000 of net proceeds received from the issuance of our $300,000 3 1/4% Convertible Subordinated Notes in April 2002.

Interest Expense. Interest expense increased to $8,491 in 2002 from $507 in 2001, as a result of interest expense and amortization of debt issuance costs related to our $300,000 3 1/4% Convertible Subordinated Notes issued in April 2002.

Other Income, Net. Other income of $3,844 in 2002 included $5,223 for the settlement of various preacquisition issues related to certain companies acquired in 1998 through 2000. This income was partially offset by $1,379 in expenses related to our disposition plan for our Plastic Technologies business.

Income Tax Provision (Benefit). Income tax provision (benefit) in 2002 included a $12,887 benefit reflecting the carryback of net operating losses to the prior periods of certain acquired subsidiaries, in which those subsidiaries generated taxable income. The carryback was allowed as a result of the Job Creation and Worker Assistance Act of 2002 that was enacted on March 9, 2002. In addition, we have operations that are profitable in certain states and foreign countries in which we do not have net operating losses to offset that income. Accordingly, we provided for taxes of $2,808 and $2,588 related to foreign, state and other jurisdictions during 2002 and 2001, respectively.

Discontinued Operations. Income from discontinued operations in 2002 represents the operating results of the discontinued units of the Plastic Technologies segment. The loss from discontinued operations in 2001 includes the operating results of the discontinued operating units as well as an impairment charge of $10,778 representing the difference between the carrying value and fair value of the discontinued operating units assets.

Results of Operations by Operating Segment

We evaluate the performance of our business segments based upon income or loss before restructuring, taxes, non-cash and other items. Non-cash and other items include depreciation, amortization, accretion of preferred stock, impairment charges, costs and expenses related to the investigation by the United States Attorney for the District of South Carolina and the SEC (legal expense), gain on investments, other income, non-cash expenses related to content, advertising and distribution services acquired in exchange for our equity securities in acquisitions and strategic alliances, and stock compensation primarily related to stock options issued and assumed in connection with acquisitions. The accounting policies of the segments are the same as the accounting policies for the consolidated company. We record inter-segment revenues at rates comparable to those charged to third parties for comparable services. Inter-segment revenues are eliminated in consolidation.

The following table presents the results of our operations for each of our reportable segments (amounts in thousands):

	Years Ended December 31,		
	2003	2002	2001
Revenues			
Transaction services	$505,729	$466,810	$457,448
Physician services	302,640	275,306	260,209
Portal services	110,665	84,296	74,626
Plastic technologies	71,940	65,811	62,017
Eliminations and other, net	(26,994)	(20,527)	(12,280)(a)
	$963,980	$871,696	$842,020
Income (loss) before restructuring, taxes, non-cash and other items			
Transaction services	$ 94,218	$ 85,154	$ 41,987
Physician services	20,924	26,685	20,827

Table of Contents

	Years Ended December 31,		
	2003	2002	2001
Portal services	24,898	5,574	(79,437)
Plastic technologies	20,532	19,891	17,406
Corporate and other	(50,251)	(51,272)	(94,813)
Interest income	22,901	19,590	30,409
Interest expense	(15,214)	(8,491)	(507)
	$118,008	$ 97,131	$ (64,128)
Restructuring, taxes, non-cash and other items			
Depreciation, amortization and other	$ (62,434)	$(125,593)	$(2,394,857)
Non-cash content and distribution services and stock compensation	(36,747)	(50,971)	(123,925)
Impairment of long-lived and other assets			(3,816,115)
Restructuring and integration benefit (charge)		5,850	(266,755)
Legal expense	(3,959)		
Gain on investments	1,659	6,547	
Other income, net	4,218	3,844	
Income tax benefit (provision)	(4,140)	10,079	(2,588)
Income (loss) from continuing operations	16,605	(53,113)	(6,668,368)
Income (loss) from discontinued operations, net of income taxes	(33,611)	3,411	(3,950)
Net loss	$ (17,006)	$ (49,702)	$(6,672,318)

(a) In 2001, includes revenues related to technology outsourcing and consulting relationships and other non-core products that we decided to exit as a result of restructuring and integration efforts that commenced in the third quarter of 2000, as well as the elimination of inter-segment revenues of $14,061.

2003 and 2002

Transaction Services. Revenues were $505,729 in 2003, an increase of $38,919 or 8.3% from 2002. Revenues from customers acquired through the 2003 Acquisitions contributed $37,870 to the increase in Transaction Services revenue. Additionally, revenues for 2002 include $7,460 of revenues associated with terminated laboratory connectivity products and relationships exited. Excluding the impact of the 2003 Acquisitions and terminated products and relationships, revenues for 2003 increased by $8,509, primarily the result of a postal rate increase that went into effect on July 1, 2002.

Income before restructuring, taxes, non-cash and other items was $94,218 in 2003, an increase of $9,064 or 10.6% from 2002. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 18.6% in 2003, compared to 18.2% in 2002. The slight improvement in income as a percentage of revenue was due to lower data communication costs and the elimination of costs associated with the terminated products and relationship discussed above, offset by higher sales commissions paid to our channel partners, and increased costs related to our implementation efforts with respect to the HIPAA Transaction Standards and our all-payer network services.

Physician Services. Revenues were $302,640 in 2003, an increase of $27,334 or 9.9% from 2002. The increase was primarily attributable to an increase in Network Services revenues. Systems sales and maintenance revenues also increased, primarily as a result of revenues from customers acquired. Those customers contributed $8,180 to the increase in revenues in 2003.

Table of Contents

Income before restructuring, taxes, non-cash and other items was $20,924 in 2003, a decrease of $5,761 from 2002. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 6.9% in 2003, compared to 9.7% in 2002. This decrease in income as a percentage of revenue was primarily attributable to increased costs related to our implementation efforts with respect to the HIPAA Transaction Standards and our all-payer network services, as well as a shift in sales focus to larger accounts in 2003, which generally carry lower margins as a percentage of sales.

Portal Services. Revenues were $110,665 in 2003, an increase of $26,369 or 31.3% from 2002. Revenues from customers acquired through 2003 Acquisitions and 2002 Acquisitions contributed $9,579 to the increase in Portal Service revenue for 2003. Excluding the 2003 Acquisitions and 2002 Acquisitions, the increase was primarily attributable to growth in advertising and sponsorship revenues on our consumer and professional sites, and, to a lesser extent, an increase in revenues from health plans and employers.

Income before restructuring, taxes, non-cash and other items in 2003 was $24,898, compared to $5,574 in 2002. As a percentage of revenue, the income before restructuring, taxes, non-cash and other items improved to 22.5% in 2003, compared to 6.6% in 2002. This improvement was the result of fixed cost leverage related to the increased revenues discussed above and reduced sales and marketing related costs during 2003 compared to 2002. Also included in income before restructuring, taxes, non-cash and other items in 2003 was $1,863 of expense related to the acquisition of certain resources of Physicians Online.

Plastic Technologies. Revenues were $71,940 in 2003, an increase of $6,129 or 9.3% from 2002. The increase was primarily due to a favorable impact of foreign exchange rates, higher sales of our computer printing and writing instrument components and higher sales of our surgical products.

Income before restructuring, taxes, non-cash and other items in 2003 was $20,532, an increase of $641 from 2002. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 28.5% in 2003, compared to 30.2% in 2002. This decrease in income as a percentage of revenue was due to higher sales and marketing and product development expenses.

Corporate and Other. Corporate and other includes expenses shared across all segments, such as executive personnel, corporate finance, legal, human resources and risk management. Corporate and other expenses declined to $50,251 or 5.2% of consolidated revenue in 2003 from $51,272 or 5.9% of consolidated revenue in 2002 due to lower personnel and facility costs, partially offset by higher insurance expenses and higher professional services expenses.

Eliminations and Other, Net. The increase of $6,467 in inter-segment eliminations from 2002 resulted from higher sales of Transaction Services products into the Physician Services customer base.

2002 and 2001

Transaction Services. Revenues were $466,810 in 2002, an increase of $9,362 from 2001. The increase was due to higher transaction volumes and the impact of the postal rate increase that was effective July 1, 2002. These increases were partially offset by the net reduction in revenues of $22,511 in 2002, when compared to 2001. This reduction in revenue related to certain terminated products and relationships, such as hospital and laboratory connectivity relationships and consolidation of duplicate product offerings in 2001 and 2002.

Income before restructuring, taxes, non-cash and other items in 2002 increased by $43,167 or 102.8% from 2001. As a percentage of revenue, income before restructuring, taxes, non-cash and other items improved to 18.2% in 2002, from 9.2% in 2001. The improvement was a result of our consolidation and integration efforts which resulted in lower personnel and occupancy-related expenses and the elimination of certain unprofitable products and relationships.

Physician Services. Revenues were $275,306 in 2002, an increase of $15,097 from 2001. The increase was primarily attributable to an increase in Network Services revenues, as well as higher systems sales and maintenance revenues. The higher sales in 2002 reflect the impact of the June 2002 release of Intergy. Revenues from customers acquired through 2002 Acquisitions and 2001 Acquisitions contributed $6,781 to the increase in revenues in 2002.

Table of Contents

Income before restructuring, taxes, non-cash and other items increased by $5,858 in 2002 from 2001. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 9.7% in 2002, compared to 8.0% in 2001. This improvement related to changes in the mix of revenues offset by roll-out costs related to our new products.

Portal Services. Revenues were $84,296 in 2002, an increase of $9,670 from 2001. The increase was a result of higher levels of sponsorship from our customers, the acquisition of Medscape in late 2001 and WellMed in late 2002, which contributed an aggregate of $23,449 in revenues during 2002, partially offset by the elimination of arrangements which generated barter revenue of $19,009 in 2001. No barter revenue was recognized during 2002. Revenue from related parties was $3,000 in 2001. These revenues consist of services provided to News Corporation. Revenue from News Corporation ceased being considered from a related party as of February 15, 2001 when News Corporation surrendered our Series A Convertible Preferred Stock.

Income before restructuring, taxes, non-cash and other items in 2002 was $5,574, compared to a loss of $79,437 in 2001. As a percentage of revenue, the income (loss) before restructuring, taxes, non-cash and other items improved to 6.6% in 2002, compared to (106.4)% in 2001. Our restructuring, integration and cost containment efforts have resulted in substantial reductions in personnel, marketing, advertising, content, distribution and other expenses.

Plastic Technologies. Revenues were $65,811 in 2002, an increase of $3,794 from 2001. The increase was primarily due to higher sales of medical OEM components, surgical products and computer printing components.

Income before restructuring, taxes, non-cash and other items in 2002 was $19,891, an increase of $2,485 from 2001. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 30.2% in 2002 compared to 28.1% in 2001. This increase was due to higher sales discussed above, partially offset by an increase in certain direct manufacturing and other costs.

Corporate and Other includes expenses shared across all segments, such as executive personnel, corporate finance, legal, human resources and risk management as well as the residual costs during the prior year periods related to the exit of discontinued products resulting from our restructuring and integration efforts. Corporate and other expenses declined to $51,272 in 2002 from $94,813 in 2001 as a result of consolidating many duplicative corporate functions and the elimination of residual expenses related to discontinued products. These efforts resulted in reduced expenses in occupancy, personnel, outside services and other operating expenses.

Eliminations and Other, Net. The increase of $8,247 in inter-segment eliminations from 2001 resulted from higher sales of Transaction Services products into the Physician Services customer base, offset by the elimination of $1,781 in revenues from technology outsourcing and consulting relationships and other non-core products exited in 2001.

Liquidity and Capital Resources

We have incurred significant operating and net losses since we began operations and, as of December 31, 2003, we had an accumulated deficit of $10.2 billion. We plan to continue to invest in acquisitions, strategic relationships, infrastructure and product development.

As of December 31, 2003, we had approximately $270,681 in cash and cash equivalents and short-term investments and working capital of $202,573. Additionally, we had long-term investments of $451,290 in marketable debt securities and $4,744 in marketable equity securities. We invest our excess cash principally in U.S. Treasury obligations and federal agency notes and expect to do so in the future. During 2003, we reviewed the classification of our marketable securities between available-for-sale and held-to-maturity. As a result of our review, we reclassified all remaining held-to-maturity securities to available-for-sale.

Cash provided by operating activities was $82,239 in 2003, compared to cash provided by operating activities of $93,097 in 2002. The cash provided by operating activities in 2003 was primarily attributable to the net loss of $17,006 and a net decrease in operating assets and liabilities of $36,164, offset by non-

Table of Contents

cash charges of $101,427 and the loss from discontinued operations of $33,611. The impact of changes in operating assets and liabilities may change in future periods, depending on the timing of each period end in relation to items such as internal payroll and billing cycles, payments from customers, payments to vendors, interest payments relating to our 3 1/4% Convertible Subordinated Notes and our 1.75% Convertible Subordinated Notes and interest receipts relating to our investments in marketable securities. The cash provided by operating activities in 2002 was primarily attributable to a net loss of $49,702 and a net decrease in operating assets and liabilities of $34,828, offset by non-cash charges of $177,673. The non-cash charges consist of depreciation and amortization, non-cash expenses related to content and distribution services and stock compensation and amortization of debt issuance costs.

Cash used in investing activities was $556,526 in 2003, compared to cash used in investing activities of $402,663 in 2002. Cash used in investing activities during 2003 included $598,367 of purchases of held-to-maturity and available-for-sale securities, partially offset by $405,213 of proceeds from the maturities, sales and redemptions of available-for-sale and held-to-maturity securities. Cash used in investing activities in 2002 primarily related to purchases of held-to-maturity and available-for-sale securities. The 2003 Acquisitions consumed cash of $400,491, net of cash acquired, primarily related to the Medifax and ABF acquisitions. Cash paid for the 2002 Acquisitions was $33,471 and related to the Medscape and Physician Services acquisitions. Investments in property and equipment were $18,385 in 2003, compared to $26,267 in 2002. Additionally we received proceeds of $56,279 related to the sale of our discontinued operations and the sale of certain property, primarily land and buildings.

Cash provided by financing activities was $356,621 in 2003 compared to cash provided by financing activities of $201,751 in 2002. Cash provided by financing activities for 2003 principally relates to net proceeds of $339,125 from the issuance of the 1.75% Convertible Subordinated Notes on June 25, 2003 and July 7, 2003, and $44,719 related to the issuance of common stock, primarily due to exercises of employee stock options. Cash provided by financing activities for 2002 primarily related to $292,000 of net proceeds related to the issuance of our 3 1/4% Convertible Subordinated Notes on April 1, 2002. During 2003 and 2002, $20,316 and $104,960, respectively, was used for repurchases of our common stock.

As of December 31, 2003, we did not have any material commitments for capital expenditures. Our principal commitments at December 31, 2003 consisted primarily of our commitments related to the $350,000 of 1.75% Convertible Subordinated Notes due in June of 2023 and the $299,999 of 3 1/4% Convertible Subordinated Notes due in April of 2007, obligations under operating leases and potential earnout payments of up to an aggregate of $157,375 related to completed acquisitions. The following table summarizes our principal commitments as of December 31, 2003, as well as management s estimates of the timing of the cash flows associated with these commitments. Management s estimates of the timing of future cash flows are largely based on historical experience, and accordingly, actual timing of cash flows may vary from these estimates. The potential earnout payments of up to $157,375 have not been included in the table below as it is impracticable to estimate the timing or amount of any payments related to these commitments.

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
			(In thousands)		
Leases	$119,508	$24,082	$36,038	$ 26,547	$ 32,841
Strategic Relationships	2,641	1,262	1,254	125	
Long-Term Debt	649,999			299,999	350,000
Purchase Obligations	35,485	20,886	14,599		
Other Long-Term Liabilities	1,182		727	51	404
Total	$808,815	$46,230	$52,618	$326,722	$383,245

Purchase obligations include amounts committed under legally enforceable contracts or purchase orders for goods and services with defined terms as to price, quantity and delivery.

Table of Contents

The lease amounts include leases identified in our restructuring and integration efforts and are net of sublease income. Other long-term liabilities primarily include those amounts on the Company s December 31, 2003 balance sheet representing the long term portion of capital leases.

We believe that, for the foreseeable future, we will have sufficient cash resources to meet the commitments described above and our currently anticipated working capital and capital expenditure requirements, including the capital requirements related to the roll-out of new or updated products in 2004 and 2005. Our future liquidity and capital requirements will depend upon numerous factors, including the success of the integration of our businesses, retention of customers at current volume and revenue levels, our existing and new application and service offerings, competing technological and market developments, potential future acquisitions and additional repurchases of our common stock. In addition, we have been incurring, and expect to continue to incur, costs relating to our own implementation of the HIPAA Transaction Standards and for assistance we provide to our customers in their implementation efforts. Our ability to perform our services in compliance with HIPAA and the cost to us of doing so will depend on, among other things, the status of the compliance efforts of our payer and provider customers and the extent of the need to adjust our systems and procedures in response to changes in their systems and procedures. We may need to raise additional funds to support expansion, develop new or enhanced applications and services, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities. If required, we may raise such additional funds through public or private debt or equity financing, strategic relationships or other arrangements. There can be no assurance that such financing will be available on acceptable terms, if at all, or that such financing will not be dilutive to our stockholders.

Recent Accounting Pronouncements

In May 2003, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity (SFAS No. 150). SFAS No. 150 requires that certain financial instruments, which under previous guidance were accounted for as equity, must now be accounted for as liabilities. The financial instruments affected include mandatorily redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock. SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003 and must be applied to our existing financial instruments effective July 1, 2003, the beginning of the first fiscal period after June 15, 2003. The adoption of SFAS No. 150 on June 1, 2003 did not have any effect on our consolidated financial position or results of operations.

In November 2002, the Emerging Issues Task Force issued a final consensus on issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables (EITF 00-21) which addresses how to account for arrangements that may involve the delivery or performance of multiple products, services, and/or rights to use assets. EITF 00-21 is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003. Companies may also elect to apply the provisions of EITF 00-21 to existing arrangements and record the operating statement impact as the cumulative effect of a change in accounting principle. We have adopted EITF 00-21 prospectively for contracts beginning after June 30, 2003. The adoption of EITF 00-21 did not have a material impact on our consolidated financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). The interpretation elaborates on the disclosures to be made in our interim and annual financial statements about obligations under certain guarantees. It also requires us to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002. The initial measurement and recognition provisions are required to be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on our consolidated financial position or results of operations.

Table of Contents

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146). SFAS No. 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management s commitment to an exit plan, which is generally before an actual liability has been incurred. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. SFAS No. 146 will have an impact on the timing of the recording of any future restructuring charges.

Factors That May Affect Our Future Financial Condition or Results of Operations

This section describes circumstances or events that could have a negative effect on our financial results or operations or that could change, for the worse, existing trends in some or all of our businesses. The occurrence of one or more of the circumstances or events described below could have a material adverse effect on our financial condition, results of operations and cash flows or on the trading prices of the common stock and convertible notes that we have issued. The risks and uncertainties described below are not the only ones facing WebMD. Additional risks and uncertainties that are not currently known to us or that we currently believe are immaterial may also adversely affect our business and operations.

Risks Related to Our Relationships with Customers and Strategic Partners

WebMD Envoy s transaction volume and financial results could be adversely affected if we do not maintain relationships with practice management system vendors and large submitters of healthcare electronic data interchange, or EDI, transactions

We have developed relationships with practice management system vendors and large submitters of healthcare claims to increase the usage of our WebMD Envoy transaction services. WebMD Practice Services is a competitor of these practice management system vendors. These vendors, as a result of our ownership of WebMD Practice Services or for other reasons, may choose in the future to diminish or terminate their relationships with WebMD Envoy. Some other large submitters of claims compete with, or may have significant relationships with entities that compete with, WebMD Envoy or WebMD Health. To the extent that we are not able to maintain mutually satisfactory relationships with the larger practice management system vendors and large submitters of healthcare EDI transactions, WebMD Envoy s transaction volume and financial results could be adversely affected.

WebMD Envoy s transaction volume and financial results could be adversely affected if payers and providers conduct EDI transactions without using a clearinghouse

There can be no assurance that healthcare payers and providers will continue to use WebMD Envoy and other independent companies to transmit healthcare transactions. Some payers currently offer electronic data transmission services to healthcare providers that establish a direct link between the provider and payer, bypassing third-party EDI service providers such as WebMD Envoy. We cannot provide assurance that we will be able to maintain our existing links to payers and providers or develop new connections on satisfactory terms, if at all. Although the standardization of formats and data standards required by HIPAA is only partial and we believe that use of clearinghouses will continue to be the most efficient way for most providers to transact electronically with multiple payers, such standardization may facilitate additional use of direct EDI links for transmission of transactions between a greater number of healthcare payers and providers without use of a clearinghouse. Any significant increase in the utilization of direct links between healthcare providers and payers could have a material adverse effect on WebMD Envoy s transaction volume and financial results.

Table of Contents

Loss of a small number of sponsors could have a material adverse effect on WebMD Health s revenues

A substantial portion of WebMD Health s revenues come from a relatively small number of companies. Thus, the loss of a small number of these relationships or a reduction in the purchases by a portion of these spons