

WEBMD CORP /NEW/  
Form 10-K  
March 16, 2005

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**UNITED STATES  
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, 2004**

**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**

*(State of incorporation)*

**94-3236644**

*(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  No

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.

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

As of June 30, 2004, the aggregate market value of the registrant's common stock held by non-affiliates was approximately \$2,742,954,120 (based on the closing price of the common stock of \$9.32 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, 2005, there were 314,783,047

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 2005 Annual Meeting of Stockholders is incorporated by reference into Part III.

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WebMD®, WebMD Health®, dakota imaging™, Digital Office Manager®, DIM<sub>DX</sub>®, Envoy®, ExpressBill®, Image Director<sup>sm</sup>, Intergy®, Medifax®, Medifax-EDI®, Medscape®, MEDPOR®, Physician Flow<sup>sm</sup>, POREX®, Publishers Circle®, The Little Blue Book<sup>®</sup>, The Medical Manager® and ViPS<sup>sm</sup> are trademarks of WebMD Corporation or its subsidiaries.

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**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 phrases. Similarly, 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 73, the following important risks and uncertainties could affect future results, causing those results to differ materially from those expressed in our forward-looking statements:

the failure to achieve sufficient levels of customer utilization and market acceptance of new or updated products and services,

the inability to successfully deploy new or updated applications,

difficulties in forming and maintaining relationships with customers and strategic partners,

the anticipated benefits from acquisitions not being fully realized or not being realized within the expected time frames;

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 73 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.

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**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 Healthcon 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](http://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, WebMD Business Services, WebMD Practice Services and WebMD Health, provide various types of healthcare information services and technology solutions. Our fourth business segment is Porex, which designs and manufactures porous plastic products. The following overview describes our key products, services and markets:

**WebMD Business Services.** WebMD Business Services provides healthcare reimbursement cycle management services for healthcare providers and transaction-related administrative services for healthcare payers, together with related technology solutions. We transmit transactions electronically between healthcare payers and providers and provide healthcare payers with transaction processing technology, decision support and data warehousing solutions, consulting services and outsourcing services. Our services for payers include conversion of paper claims to electronic ones and related document management services, as well as print-and-mail services for the distribution of checks, remittance advice and explanation of benefits. We also provide automated patient billing services to healthcare providers, including statement printing and mailing services. We are focused on continuing to increase the percentage of healthcare transactions that are handled electronically and on providing electronic solutions that can be used by payers and providers to automate the entire reimbursement process.

WebMD Business Services generates revenues 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. Finally, we generate revenue by licensing software and providing information technology consulting services to payers, including governmental payers. We charge healthcare payers annual license fees, which are based on the number of covered members, for use of our software and provide business and information technology consulting services to them on a time and materials basis. The consulting services we provide to certain governmental agencies are typically billed on a cost-plus fee structure. WebMD Business Services revenue was \$686.6 million in 2004 and \$505.7 million in 2003.

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**WebMD Practice Services.** WebMD Practice Services develops and markets information technology systems for healthcare providers, primarily under The Medical Manager, Intergy and WebMD 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. Our systems and services are used by 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. In addition, through WebMD Network Services, we provide integrated access to our WebMD Business Services transaction services for our WebMD Practice Services customers.

We generate revenues from: one-time fees for licenses to our software modules, for system hardware and for implementation services; and 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 WebMD Network Services and some of our WebMD Practice Services products and services are priced on a monthly fee per provider basis or a per transaction basis. WebMD Practice Services revenue was \$296.1 million in 2004 and \$302.6 million in 2003.

**WebMD Health.** WebMD Health provides health information, health and benefit decision-support tools, continuing medical education services, and interactive communications services through its public online portals for consumers and physicians, through syndication and distribution relationships, through customized private portals for employers and payers, and, to a lesser extent, through offline publishing services. Our offerings for consumers help them become more 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 reach over 20 million unique users per month (based on the average during 2004) through [www.webmd.com](http://www.webmd.com), [www.medscape.com](http://www.medscape.com) and our other public portals, as well as other Web sites with which we have relationships. We believe that *Medscape from WebMD*, our portal for healthcare professionals, reaches more physicians than any other physician-targeted Web site. Our private portals provide online health and benefit management services for employer and payer sponsors. These services assist the sponsors employees and members to make informed benefit, provider and treatment choices that help reduce healthcare costs while improving quality of care. We integrate the sponsor's unique health and benefits content with our content and technology platform, to create private portals specific to the eligibility, coverage and health profile of each plan member. We generate revenue by providing healthcare and consumer products companies with opportunities to reach our public portals audience through a variety of content sponsorship formats and advertising products. In addition, we create and distribute accredited online continuing medical education programs funded by grants from a variety of sponsors. We also generate revenues by licensing private portals to employers and payers for use by their employees and members.

We publish specialized physician directories, used by physicians, pharmacists and other healthcare professionals, and professional medical reference textbooks. We generate revenue from sales of subscriptions to our medical reference publications, from sales of physician directories, and from sales of advertisements in those directories.

WebMD Health revenue was \$134.3 million in 2004 and \$110.7 million in 2003.

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**Porex.** 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. Porex revenue from continuing operations was \$77.1 million in 2004 and \$71.9 million in 2003.

During 2004, our revenues were divided among our segments as follows: 59.2% from WebMD Business Services, 25.5% from WebMD Practice Services, 11.6% from WebMD Health and 6.6% from Porex. The sum of these percentages equals 102.9% of our total revenues of \$1,160 million because \$33.8 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 6. Some of our products and services have been developed internally and some have been acquired. For a description of the companies that we acquired in 2004, 2003 and 2002, see Note 2 to the Consolidated Financial Statements included in this Annual Report. 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 in Item 7 of this Annual Report and Note 8 to the Consolidated Financial Statements included in this Annual Report.

For a discussion of key trends in the healthcare marketplace and the strategies we have developed in response, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Trends Affecting our Businesses and Our Healthcare Customers in Item 7.

**Recent Developments**

*Evaluation of WebMD Health Transaction Alternatives.* WebMD is continuing to pursue its previously announced plan to establish WebMD Health as a separate publicly traded company. WebMD's Board of Directors continues to evaluate the two previously announced alternatives it has been considering—a one-step split-off of WebMD Health equity through an exchange offer transaction with WebMD's stockholders or an initial public offering of a minority interest in WebMD Health. In the case of a one-step split-off, all holders of WebMD common stock would have the right, on a pro rata basis, to exchange shares of WebMD common stock for newly-issued shares of WebMD Health common stock at an exchange ratio that would be set by the Board of Directors of WebMD. While the evaluation process is complex, considerable progress has been made in refining the tax analysis of these alternative transactions, preparing the necessary financial statements and Securities and Exchange Commission filings, planning the necessary corporate infrastructure separation and completing the analysis of employee, corporate, third-party contractual and other considerations relevant to these two alternatives. As each alternative offers certain potential advantages for WebMD's stockholders, some of which are dependant on market conditions, the Board will not make a decision as to which alternative to pursue until shortly before WebMD is in a position to make the required registration statement filing with the SEC. WebMD anticipates being in a position to make this SEC filing in April 2005.

*Acquisition of HealthShare Technologies.* On March 14, 2005, WebMD acquired HealthShare Technologies. The purchase price paid at closing was \$31 million in cash. In addition, WebMD has agreed to pay up to an additional \$5 million if certain financial milestones are achieved for calendar year 2005. HealthShare provides health plans and employers, and their members and employees, with online decision support tools that evaluate both hospital care cost and quality to enable users to make more informed decisions. HealthShare also provides professional decision support tools used by health plan executives to develop provider networks, identify centers of excellence, and evaluate comparative hospital quality. HealthShare tools are also used by hospitals to provide online decision support to help enhance quality of care, manage costs and profitability, and better understand market position. The results of operations of HealthShare will be included in our WebMD Health segment.



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**HEALTHCARE INFORMATION SERVICES AND TECHNOLOGY SOLUTIONS**

We provide services that help consumers, physicians and other healthcare providers and health plans navigate the complexities of the healthcare system. Our products and services promote more informed decision-making, streamline administrative and clinical processes, increase efficiency and reduce costs by facilitating information exchange, communication and electronic transactions between healthcare participants.

***WebMD Business Services***

**Overview**

WebMD Business Services provides healthcare reimbursement cycle management services for healthcare providers and transaction-related administrative services for healthcare payers, together with related technology solutions. In addition, we provide information technology, decision support solutions and consulting services to governmental and commercial healthcare payers through ViPS, which we acquired in August 2004.

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. Our services allow providers and payers to replace manual processes, phone calls and faxes with electronic transactions and, by doing so, to save time and money. We provide our payer and provider customers connectivity through an integrated electronic transaction processing system. We refer to these connectivity services as electronic data interchange, or EDI. Customers access our connectivity services through the Internet, through dedicated high speed communications lines and by modem over standard telephone lines. After we receive transactions from providers, they are edited and translated in accordance with payer specifications and sent to the payer's system.

Although these EDI services are an important part of what we do, we have substantially expanded our WebMD Business Services product line in recent years through both acquisitions and internal efforts. We now provide healthcare payers with transaction processing technology, decision support solutions, consulting services and outsourcing services. Our services for payers also include conversion of paper claims to electronic ones and related document management services, as well as print-and-mail services for the distribution of checks, remittance advice and explanation of benefits. Our services for providers also include automated patient billing services, with statement printing and mailing services available. We are focused on continuing to increase the percentage of healthcare transactions that are handled electronically and on providing enhanced capabilities and additional solutions that can be used by payers and providers to automate the entire reimbursement process.

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. ViPS charges healthcare payers annual license fees, which are based on the number of covered members, for use of its software. ViPS also provides business and information technology consulting services to its customers on a time and materials basis. ViPS' contracts with the federal government are typically on a cost-plus award fee structure.

**Customer and Vendor Relationships**

*Customers.* WebMD Business Services' customers 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.

*Healthcare Providers.* For providers, WebMD Business Services can help them automate every step of the reimbursement cycle, including: checking patient coverage eligibility information;

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seeking pre-authorization from a payer for services; submitting and tracking claims; and automated payment posting, credit card billing and patient statement processing. Our EDI connectivity 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. In addition, the use of EDI for eligibility and other coverage-related transactions can save hospital, physician and dentist office staff significant amounts of time compared to phone or other individual verification methods and allow them to provide faster answers to patient questions regarding coverage.

*Healthcare Payers.* For a healthcare payer, the administrative cost of supporting patient medical encounters includes eligibility and benefit information distribution, intake of paper and electronic claims, claim adjudication, payment and explanation of benefits (or EOB) distribution, as well as a wide variety of member and provider service and communication activities. WebMD Business Services provides services that help automate and reduce the cost and improve the accuracy of these processes. Specifically, our electronic transaction services automate the data exchange between healthcare providers and payers for patient eligibility and benefits information, claims transactions, remittance information, referrals, claim status information and other processes. Payers using us as their managed EDI gateway for inbound transactions benefit from improved reliability and improved auto-adjudication rates. Our systems can apply customized payer-specific business rules to these transaction processes to further improve payer auto-adjudication rates (which means the percentage of claims that are adjudicated by the payer's computer systems, without review by payer personnel), which provides additional cost savings to our clients. These automation tools, in conjunction with our imaging and scanning services for inbound transactions and print and mail services for remittances and other outbound communications, allow payers to better focus on their core activities: provider network management, employer marketing and contracting, benefit plan design, and member service. In addition, by outsourcing inbound and outbound transaction processes to us, payers can reduce their capital expenses and operating costs. Our acquisitions of Advanced Business Fulfillment in 2003 and Dakota Imaging in 2004 support our ability to provide more comprehensive business process outsourcing services. For a description of other services that WebMD Business Services provides to healthcare payers, see [ViPS](#) below.

*Information System Vendors.* 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 ours. Most practice management and hospital information systems support, and can be integrated with, our connectivity 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 sales commissions to some of these vendors as an inducement to use WebMD Business Services. We work together with these vendors to increase the percentage of healthcare transactions that are handled electronically.

*Clearinghouses.* Some healthcare transaction clearinghouses also use our services to transmit transactions to payers that they have received from healthcare providers. We pay sales commissions to some of these clearinghouses as an inducement to use WebMD Business Services to complete the transactions submitted through their systems.

**Our Connectivity Services**

*Administrative Solutions.* WebMD Business Services began as a clearinghouse for electronic healthcare claims transactions between physician offices and commercial healthcare payers and continues to be a leader in those services. WebMD Business Services connectivity services have grown to include additional transactions for additional types of providers and payers and other types of transaction-related

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services. WebMD Business Services now 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 also use our services to obtain authorization from payers, at the point of care, for services and referrals to other providers.

Our all-payer 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. The goal is to provide a single source reimbursement cycle management solution for providers and practice management system vendors. A single 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.

*Clinical Solutions.* WebMD Clinician is an Internet-based solution that streamlines the flow of information between providers, pharmacies, payers and labs. This product supports:

electronic ordering of clinical tests and the reporting of test results between healthcare providers and labs, and

electronic prescribing that references medication histories, payer formularies, and drug usage reports at the point of care.

The WebMD Clinician suite of solutions is designed to integrate with most physician practice management systems and electronic medical record systems through virtually any web-enabled device. The result is secure delivery of accurate electronic medical record information into the workflow of the physician when needed for making care decisions. 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.

*Accessing Our Connectivity.* Healthcare 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 formatted and translated in accordance with the payer's specifications and sent to the payer's claims adjudication and/or real-time database systems.

We provide various products designed to assist healthcare providers in managing their claims processes and utilizing our services, including:

*Claim Master.* Through our Claim Master service, providers can securely access our transaction services through the Internet. Claim Master can be used as a stand-alone system or as a complement to a practice management system or hospital information system. Claims are captured from the source healthcare information system and incorporated into the Claim Master relational database to be tracked through event-driven updates. The Claim Master database serves as the repository for all claim management functions including viewing, editing (in real time), correcting, submitting and managing payer responses. During validation, claims are separated into clean

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claims and those needing additional information. Clean claims are passed on to our clearinghouse in a HIPAA-compliant format and then submitted to the appropriate payers. Claims needing additional information are edited, corrected, and then submitted. With Claim Master's wide array of reporting and display options, providers can clearly understand the location and status of any claim or batch of claims at any given time, including the status of all claims in the system, types of claim errors and list of claims sorted by dollar amount, work queue and payer.

*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.

*WebMD Assistant.* WebMD Assistant integrates with hospital information systems to automate various registration activities such as insurance eligibility verification, credit checking and address verification. WebMD 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.

*WebMD Receivable Analysis.* WebMD 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 WebMD payer databases to determine eligibility. WebMD 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.

*WebMD Accupost.* WebMD Accupost automates the posting of payments received from governmental and commercial payers that provide an electronic remittance advice into the providers' financial accounting system. Automated posting is completed in a fraction of the time it takes to perform these same tasks manually and is more accurate.

## **ViPS**

ViPS provides information technology, decision support solutions and consulting services to government, Blue Cross Blue Shield (BCBS) and commercial healthcare payers. ViPS has been a long-time leader in helping the government and healthcare industry manage large data volumes and repositories through information technology. We acquired ViPS, Inc. in August 2004.

*Government Solutions.* ViPS Government Solutions Group provides technology services and project personnel to federal and state agencies, such as the Centers for Medicare and Medicaid Services (CMS) as well as to key information services contractors for those agencies. ViPS personnel provide systems support for data warehousing, claims processing, decision support, and fraud detection. In addition, ViPS consultants assess workflow, design complex database architectures, perform data analysis and analytic reporting functions for agencies and contractors in the public sector. For CMS, ViPS products and services support Medicare Part A, Part B and Durable Medical Equipment claims processing.

Working with Northrop Grumman's Mission Systems Group, ViPS designed and is implementing CMS's Medicare Beneficiary Database, which serves as the foundation for administering the new Medicare prescription drug benefit under the Medicare Prescription Drug, Improvement and Modernization Act, referred to as the MMA. The MMA, signed into law on December 8, 2003, is the most significant change to Medicare since the program's founding in 1965 and is the largest budget increase in a government entitlement program in the past forty years. The new drug benefit will give beneficiaries access to coverage under prescription drug insurance policies in return for a premium of

approximately \$35 per month and, as

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temporary measure until 2006, beneficiaries will have access to drug discount cards. ViPS is currently working on three projects relating to the MMA, including:

*Centralized Medicare Beneficiary Eligibility Transaction System.* This system will be used by healthcare providers and other submitters, network service providers and clearinghouses. ViPS is providing overall program management for this system. For this project, ViPS is working with other WebMD Business Services units and benefiting from their EDI subject matter expertise and is also working with Northrop Grumman Mission Systems.

*System to Support the Retiree Drug Subsidy Provisions of the MMA.* Under the MMA, employers are eligible for a financial subsidy from Medicare if they keep retiree beneficiaries on their prescription drug plan rather than have them move to the new Medicare prescription drug benefit. ViPS is working with Group Health, Inc., Arkansas Blue Cross Blue Shield and Northrop Grumman Mission Systems on this project, which includes responsibility for processing enrollment applications and payment requests, issuing payments and remittance advices to eligible employers, providing a call center, conducting outreach activities, performing fraud analysis and providing related training.

We believe ViPS is well-positioned to play a key role in the implementation of the MMA and to compete for additional related projects.

*Healthpayer Solutions.* ViPS Healthpayer Solutions Group develops and markets software, data warehouses and tools for disease management, predictive modeling, provider performance, HEDIS® quality improvement, healthcare fraud detection and financial management. The products include:

*MCSource.* MCSource is a medical management decision support system that consists of an integrated suite of analytical and Web-based applications designed to give health plans the ability to address critical issues such as medical cost and utilization, provider profiling, disease management, quality improvement and medical review. MCSource's foundation is a high-performance data warehouse that can store all types of administrative healthcare information. MCSource is designed to support the complexities and usage volumes of large, information-driven health plans and has been deployed to more than 20 customers, including the BCBS Federal Employee Program, where it is used to manage a data warehouse covering approximately four million lives and five years of longitudinal member data.

*STARSentinel.* STARSentinel is an early-warning detection system that looks at health plan data and evaluates claims against providers' claims histories, specialty profiles and common, documented fraud schemes. By calling early attention to questionable patterns, STARSentinel helps prioritize cases and helps health plans use their resources with maximum productivity.

ViPS Healthpayer Solutions also provides consulting expertise and outsourcing services to help its customers, including commercial health plans and over 65% of the nation's BCBS plans, monitor clinical and financial results in order to predict risk, determine the most effective treatments and evaluate provider networks.

### **Print-and-Mail Services**

*ABF.* Advanced Business Fulfillment, Inc., which we refer to as ABF, provides healthcare paid-claims communication services for healthcare payers. We acquired ABF in July 2003.

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 explanation of benefits 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

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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.

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 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 Presentment and Payment Services.* Our electronic presentment and payment services offer healthcare providers the ability to present statement and invoice images to patients electronically and to receive payment via the Internet.

## **Sales and Marketing**

Our WebMD Business Services 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 and print-and-mail services for providers 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 to these organizations as an inducement to use WebMD Business Services as the clearinghouse for the transactions made through their systems or by providers with which they have relationships. We also market our EDI and print-and-mail services directly 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.

A team of sales, marketing and account management personnel market our EDI services and other pre- and post-adjudication transaction services directly to healthcare payers. In addition, in the post-adjudication services area, we have established relationships with vendors of claims processing software.

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

A team of account management personnel, supported by professional services representatives, markets our ViPS Government Solutions Group products and services. The Government Solutions Group extends its government sales capabilities through key relationships with leading government contractors, including Computer Sciences Corp., SAIC, BearingPoint and Northrop Grumman.





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ViPS often bids on government projects together with one or more of these companies. ViPS is seeking to extend its government services reach into additional government agencies.

ViPS Healthpayer Solutions Group markets its products and services nationally through a direct sales organization. Because of ViPS long-standing industry relationships, particularly with BCBS plan organizations and other large commercial payers, ViPS is often invited to bid on contracts to be awarded based on competitive bidding procedures.

## **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 healthcare transactions, which we refer to as the Transaction Standards. For a full discussion of HIPAA and the risks and challenges it presents to our businesses, see Government Regulation Health Insurance Portability and Accountability Act of 1996.

## ***WebMD Practice Services***

### **Overview**

WebMD Practice Services develops and markets information technology systems for healthcare providers and related services, primarily under The Medical Manager, Intergy, and WebMD 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 Practice systems.

However, we intend to continue to develop and support The Medical Manager system. We offer our Intergy EHR clinical systems, which can be fully integrated with our Intergy Practice systems and which can also interface with The Medical Manager systems. We are developing additional interfaces to allow our Intergy EHR software to work with other practice management systems.

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

- our WebMD Network Services administrative transactions services, generally on a per provider per month subscription basis or a per transaction basis; and

- our clinical transaction services, on a per provider per month subscription basis.

**Table of Contents****Practice Management Systems**

*Intergy Practice.* We introduced Intergy Practice in 2003. Since that time, most of our new installations of practice management systems have been Intergy Practice systems. Intergy Practice packages complex medical practice functions into easy-to-navigate windows with consistent point-and-click drop down menus and buttons. The Intergy Practice software operates on Windows and UNIX based servers, together with Windows based workstations. The Intergy Practice base package allows an office to automate appointment scheduling and recalls, registration, encounter form management, billing, collections and other administrative and financial functions. Intergy Practice 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. Intergy Practice 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.

We license the Intergy Practice software through several different license models to meet the varying business needs of our customer base. The most common model is the standard practice license, which provides a license to use the Intergy software for the internal business needs of a medical practice or clinic. The Management Service Organization model provides a license to use the Intergy software under one license arrangement that enables a management service organization to manage the financial or billing aspects of its owned and managed practices, while allowing such practices to use our software to manage the administrative and clinical aspects of their offices. The Physician Billing Service model provides an Intergy Practice license to billing service companies enabling them to provide billing services to multiple doctor practices, while also giving them an option (at an additional cost) to allow such practices to use our software to manage the administrative aspects of their offices.

One of our optional Intergy Practice 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. Intergy Practice software users can also elect to implement some or all of the products and services described below under Intergy EHR and Additional Features and Modules below and our administrative and clinical transactions services described below under Transaction Services.

We provide radiology practices with practice management and clinical solutions designed to meet their specific requirements. WebMD Intergy RIS (which means Radiology Information System) offers specialized workflow and administrative tools to manage practice resources, including equipment, technologists, radiologists and examination rooms. We also offer Intergy PACS, a picture archiving and communications solution, as part of our suite of radiology solutions. See Clinical Solutions IntergyPACS below.

*The Medical Manager.* The Medical Manager system provides physician practices with a broad range of patient care and practice management features. Although most of our current sales are of Intergy Practice systems, we offer The Medical Manager system with modules that 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. For The Medical Manager system customers who wish to purchase an electronic medical record product, we are offering an interfaced version of Intergy EHR. See EMR and Imaging Systems below. The Medical Manager software users can also elect to implement some or all of the integrated products and services described below under Additional Features and Modules and our administrative and clinical transactions services described below under Transaction Services.

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*Medware.* Through our acquisition of Medifax in December 2003, we have obtained ownership of Medware, a practice management software package used primarily by small physician practices. Medware has its own programming, sales and support operations that continue to develop, sell and support Medware software.

*Other Practice Management Systems.* Through our acquisitions of various businesses, we have also obtained ownership of other practice management systems. We currently support these other systems and may provide periodic updates to the users of some of these systems. We are developing interfaces between some of these systems and Intergy EHR.

### **Clinical Solutions**

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 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 systems. These systems allow providers to share patient charts and other medical records, access them simultaneously and view them from remote locations. Electronic medical record 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.

*Intergy EHR.* Intergy EHR is a suite of software modules that provides physicians with access to patient information, clinical systems, encounter documentation and outcomes reporting. Intergy EHR fully integrates with Intergy Practice. Intergy EHR software creates an electronic patient chart containing detailed current and historical information regarding the patient. In addition, Intergy EHR offers:

PhysicianFlow technology that enables physicians to access information from a variety of sources including the patient chart, imaging systems, practice management systems, and laboratory systems all from one screen.

clinical encounter forms that guide the creation of documentation and capture structured data to facilitate correct coding and outcomes reporting. Physicians can review and approve coding as they create the encounter note so that billed procedures are appropriately documented. Intergy EHR provides a forms library for major medical specialties, including primary care, pediatrics, obstetrics/gynecology, cardiology, orthopedics and others.

a clinical workflow manager, integrated with the electronic chart, that allows the physician to communicate with staff members and that automatically generates tasks list items for the physician when, for example, a lab report is ready, a transcription needs to be signed or a prescription needs approval.

KnowledgeLink technology to enable physicians to access information from Medscape and other drug and medical reference information. This enables the physician to share education with the patient at the time of care, and document the event in the encounter notes.

a selection of various input devices for physicians, including desktop, laptop and tablet PCs, and handheld personal digital assistant (PDA) devices. Handheld systems can be used for offline charge capture, schedule review and dictation, and tablet PCs for full mobile functionality. Physicians also can assign tasks and access clinical information from Intergy EHR systems connected to the practice over the Internet or over a wireless network.

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 and can be linked to our optional clinical transaction services (see Transaction Services below).



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

Intergy EHR is designed to enable different physicians in the same practice to use the system in different ways, to suit different work styles. For example, a physician's encounter notes can become part of the electronic record whether created by computer, dictation or handwritten notes. We provide technical assistance and support that helps medical practices transition from paper charts to electronic medical records.

*Intergy EHR Imaging.* We offer a document image management (DIM) system that 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.

*Image Director.* Image Director combines bar-coding technology with imaging processes and simplifies moving from paper charts to electronic ones. It also enables additional paper flow from outside the practice to be added as an image into the patient chart without disrupting workflow. Bar codes can be assigned to paper documents using standard printers which eliminate the need for expensive scanners at each workstation. Bar-coded documents can be batch-scanned into patient charts at any time, by any staff member. The bar code assists the practice in inserting each image in the right place, in the right patient chart.

*Intergy PACS.* We market a third party solution, Dynamic Imaging's IntegradWeb PACS, as Intergy PACS, a part of our radiology solutions product offering. Intergy PACS is a picture archiving and communications systems (or PACS) that allows a practice to input, display, archive and transmit X-rays and other diagnostic images electronically. Using a secure, encrypted Web protocol, all users, whether local or remote, can access all of a patient's images and reports, which are always available online. In addition, WebMD is working on a unified desktop application called the WebMD Radiology Navigator that will integrate Dynamic Imaging's IntegradWeb PACS with WebMD Intergy RIS.

*Intergy EHR PDA.* Healthcare providers are becoming increasingly aware of the benefits of using wireless handheld computers in their practices. Intergy EHR PDA, our handheld point-of-care solution for users of Intergy EHR, combines the power of our clinical and administrative systems with the convenience of mobile handheld connectivity. Intergy EHR PDA runs on a handheld device, such as a Compaq® iPaq®. From anywhere in the office, the handheld device can be used 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 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 drug utilization review, or 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 EHR system;

electronic lab ordering and reporting of results that can be viewed using the handheld device;

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.

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Physicians can also use Intergy EHR PDA 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, Intergy EHR PDA 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.

### **Maintenance and Support Services**

We separately sell hardware and software support and 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 most cases, provide customers with periodic releases updating our software.

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.

### **Transaction Services**

*WebMD Network Services.* Both Intergy and The Medical Manager systems support integrated use of our WebMD Business Services' EDI services through WebMD Network Services. For a description of these EDI services, see WebMD Business Services above. The administrative transactions supported include electronic claims, claims status inquiry, eligibility verification, electronic referral authorization/ status, patient statements and remittances. Using Intergy or The Medical Manager systems with WebMD 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 Business Services above. In addition, our systems perform 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.

WebMD 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.

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*Clinical Transaction Services.* We provide clinical transaction services that allow practices to perform DUR screenings, transmit prescriptions electronically to connected pharmacies, and verify formulary compliance with the patient's health plan.

### **Additional Features and Modules**

*Online Access.* Physicians whose offices use the Intergy or The Medical Manager practice management systems can 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.

*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 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.

*Analytics Reporting.* We also provide a business intelligence and reporting application, 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. Our Analytics Reporting solution also provides access to tools to analyze that data and to export it to other applications.

### **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.

## ***WebMD Health***

### **Overview**

WebMD Health provides healthcare information, health and benefit decision-support tools, continuing medical education services, and interactive communications services through its public online portals for consumers and physicians, through syndication and distribution relationships, through customized private portals for employers and payers, and, to a lesser extent, through offline publishing services.

Until recently, quality healthcare information has not been easily accessible. Most consumers relied upon their physicians, conversations with family and friends, their neighborhood library, and magazines when they needed answers to healthcare questions. Physicians relied upon other physicians, medical societies, journals and other publications, reference textbooks, conferences, and industry meetings to keep informed. The Internet has transformed how consumers and physicians find and utilize healthcare information and WebMD Health has been a leader in making this happen.

The healthcare information, decision support and communications services that we provide on our portals:

enable consumers to check symptoms, assess risks, understand diseases and conditions, evaluate treatment options, find healthcare providers, communicate with peers about healthcare issues, and improve their personal health status;

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make it easier for physicians to access clinical reference sources, stay abreast of the latest clinical information, learn about new treatment options, earn continuing medical education credits, and communicate with peers; and

enable employees and health plan members to access health information and decision support tools that help them make informed benefit, provider and treatment choices.

Our in-depth content and timely reporting have made our Web sites leading Internet destinations for consumers, physicians and healthcare professionals. Our dedication to quality and editorial integrity have made the WebMD brand among the most recognized and trusted in healthcare. We believe that we are well-positioned to meet consumer demand for up-to-date, objective, reliable and relevant health information and the information resource needs of busy healthcare professionals.

We generate revenue by providing healthcare and consumer products companies with opportunities to reach our public portal audiences through a variety of content sponsorship formats and advertising products. In addition, we create and distribute accredited online continuing medical education programs, which are funded by grants from a variety of sponsors. We also generate revenues by licensing our customized private portals to employers and payers for use by their employees and members. Our private portals carry no advertising or sponsorship programs. Finally, we generate revenue from sales of subscriptions to our medical reference publications, from sales of physician directories, and from sales of advertisements in those directories.

For information about our previously announced plan to establish WebMD Health as a separate publicly traded company, see *Recent Developments* *Evaluation of WebMD Health Transaction Alternatives* above.

### **Online Services**

We utilize our health information content, decision support applications and interactive communications services across our public and private portals. Within each portal, the specific content, applications and services provided are tailored and organized in a manner designed to fulfill the specific objectives for which that portal was created.

#### ***Portals for Consumers***

*Introduction.* The Internet is rapidly displacing traditional sources of information as a result of its ease of access, breadth of information, and anonymity. According to a 2004 study by Manhattan Research, a healthcare market research firm, consumer satisfaction with the Internet for healthcare information is greater than for alternative sources such as television news, health magazines, and television and magazine ads. A study published in 2003 by the Pew Internet and American Life Project estimated that approximately half of all American adults in the United States have accessed the Internet for health information, with nearly three-quarters of those who use the Internet reporting use of the Internet for health information. In addition to traditionally strong public interest in health, wellness and quality of life issues, consumers increasingly seek to educate themselves about available treatment options for specific health conditions, motivated in part by the larger share of their healthcare expenditures they are being asked to bear due to changes in the design of the health plans being offered by insurance companies and employers. The Internet allows consumers to have immediate access to searchable information and dynamic interactive content.

*Content.* Our flagship portal for serving consumers is WebMD Health located at *www.webmd.com*. Our goal is to provide an objective, credible and trusted source of consumer healthcare information that helps consumers play an active role in managing their own health. We offer consumers 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 decision support tools, 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, drug



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information, medical tests, pregnancy and parenting, diet and nutrition, fitness and sports medicine, and sexuality and relationships. WebMD Health also has features that allow consumers to search for a physician or group practice in their area.

*Membership.* Consumers can choose to become members of WebMD Health, which allows them to make use of additional WebMD content, decision support and communications services. Members can also opt to receive e-mail newsletters on health-related topics or specific conditions and to access our communities and events. Our online 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. We have built a large database of consumers who have expressed interest in receiving our clinical alerts, newsletters and reports on specific diseases, conditions and other health and wellness topics. There are no membership fees and no general usage charges for our consumer portals; however, we do offer consumers paid subscription services that provide consumers with access to exclusive interactive tools, personalized in-depth content and expertise from leaders in their fields.

***Portals for Physicians and Other Healthcare Professionals***

*Introduction.* The Internet has become a primary source of information for physicians and is growing relative to other sources, such as conferences, meetings and offline journals. According to a study done by Manhattan Research in early 2004, approximately 97% of physicians use the Internet, and approximately 99% of these physicians use the Internet in relation to their practice. In particular, approximately 63% of physicians read e-journals and approximately 46% complete continuing medical education, or CME, programs online on at least a monthly basis. We believe that *Medscape from WebMD*, our Web site for physicians and other healthcare professionals, located at [www.medscape.com](http://www.medscape.com), reaches more physicians than any other physician-targeted Web site and is well-positioned to increase usage by its existing members and to gain additional membership.

*Content.* Our goal is to enable physicians and other healthcare professionals to stay abreast of the latest clinical information through access to resources that include timely medical news and coverage of professional conferences, continuing medical education activities, full-text medical journal articles and drug and medical literature databases. We provide original, daily medical news stories that are written by our staff of journalists and reviewed by our staff of physicians, as well as news provided by professional wire services. Our news group also regularly produces in-depth interviews with experts and newsmakers. In addition, we provide alerts on critical clinical issues, including pharmaceutical recalls and product advisories. We also publish 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 medical journal, was established in April 1999. Visitors to [www.medgenmed.com](http://www.medgenmed.com) also can access specialty sections for HIV-AIDS, Gastroenterology, Hematology-Oncology, Pulmonary Medicine, OB-Gyn and Women's Health, Orthopedics and Sports Medicine and Psychiatry/ Mental Health.

*Membership.* Users must register to access the content and features of *Medscape from WebMD*. This enables us to deliver targeted medical content based on our members' registration profiles. We have areas organized by profession or interest area, including sites for nurses, pharmacists, medical students, and members interested in medical policy and practice management issues. The registration process enables professional members to choose a Medscape 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. Every member, however, regardless of medical specialty or professional status, has access to Medscape's full suite of original and licensed content through a uniform, easy-to-use interface. There are no membership fees and no general usage charges for the site. Members receive MedPulse®, our weekly e-mail newsletter, which is published in more than 35 specialty-specific editions and highlights new information and CME activities on the Medscape site. We also provide Special Reports e-mail newsletters, which contain information on specific conditions and treatments.

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*CME.* Medscape is a leading distributor of online CME to physicians and other healthcare professionals, offering a wide selection of free, regularly updated online CME activities designed to educate healthcare professionals about important diagnostic and therapeutic issues. Our CME programs include original programs and online multimedia adaptations of live events. In addition, our CME Live offerings provide real-time Webcasts of continuing education programs on key topics and conditions. These live Webcasts combine streaming audio and slide presentations and allow participants to interact with faculty. In 2004, approximately 927,000 physicians and healthcare professional participants earned approximately 827,000 CME credits at Medscape, an increase of 59% and 31%, respectively, over 2003. We provide services that automatically track CME credits accumulated through our site for our users.

We have organized the operations of our physician portals to provide for appropriate separation of education and promotion. Our educational activities for healthcare professionals are managed within Medscape, LLC, our professional education subsidiary. Individuals who work on educational matters within Medscape, LLC are not involved with promotional programs.

Our CME activities are 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 other applicable accreditation standards. In addition, some of our programs have been produced in collaboration with other ACCME-accredited CME providers. Medscape received provisional ACCME accreditation as a CME provider in July 2002 and full accreditation, for the maximum six-year period, beginning in July 2004. Such accreditation allows Medscape to continue to certify online CME activities. In September 2004, ACCME revised its standards for commercial support of CME. The revised standards are intended to ensure that CME activities of ACCME-accredited providers are independent of providers of healthcare goods and services that fund the development of CME. ACCME expects accredited providers to implement these standards by May 2005. Implementation has required additional disclosures to CME participants about those in a position to influence content and other adjustments to the management and operations of our CME programs. We believe that we have modified our procedures as appropriate to meet the revised standards. However, we cannot be certain whether these adjustments will ensure that we meet the new standards or predict whether ACCME may impose additional requirements.

***Private Online Portals***

*Introduction.* In response to increases in healthcare costs, employers and payers have been changing benefit plan designs and taking other steps to motivate their members and employees to use healthcare services in a cost-effective manner. As employees are being asked to bear additional healthcare costs, many employers and payers seek to provide information and tools that help their employees and members become more knowledgeable healthcare consumers and that help them choose among offered benefit plan structures. We expect these trends to continue and believe that WebMD Health is well-positioned to provide a cost-effective, outsourced solution to employers and payers that complements their existing benefit-related services and offline educational efforts. We believe that by educating and encouraging employees and plan members to lower health risks and to take a more active role in their healthcare, WebMD Health can help employers and payers realize cost savings from more informed decision-making, while also improving healthcare outcomes for their employees and health plan members. Other potential benefits to an employer or plan include:

lowering benefits administration and communication costs for employers and payers;

increasing effectiveness of communications by delivering targeted, personalized messages; and

efficiently identifying and enrolling candidates in disease management or other health management programs.

We provide health and benefit management services through private online portals that we host for employer and healthcare payer clients. Through these portals, employees and plan members can access much of the same online health and wellness content that is available on our public portals, along with

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proprietary content of our clients, as well as a suite of health assessment, health management and cost and benefit comparison tools. These tools combine information provided by the employer or payer, such as plan design and eligibility information, with self-reported information from employees or members. By making the information and tools available through a convenient and easy-to-use online service, employers and payers can assist their employees and plan members in making informed benefit, provider and treatment choices.

*Content.* We integrate our health and benefits applications into the client's intranet or Web site and health and benefit programs and provide secure access for employees and plan members. We are able to co-brand and customize our private portals to match client branding and look and feel. We are also able to integrate health and benefit applications with existing health and benefit intranets, health plan sites and pharmacy benefit manager sites, creating a seamless experience for the end-user based on a single registration process. Health and benefits information is presented to each employee or health plan member as a personal home page, with direct access to content, tools and other resources relevant to his or her needs.

Our WebMD Health and Benefits Manager private portals include the following:

*Health Manager.* Health Manager provides a user-friendly experience that enables employees to access and manage health and benefits information and decision support tools relevant to their individual needs, risks and interests in one place. Health Manager includes The WebMD Personal Health Record, a secure online personal health record that allows employees to store and manage health information for themselves and their family members. We also enable employers to target employees with information, programs or messages specific to the individual employee's needs. Finally, Health Manager makes available online lifestyle modification programs, including programs for smoking cessation, nutrition and fitness.

*Benefit Manager.* Benefit Manager is a set of benefit decision-support applications that explain health plan benefit choices and facilitate informed selection and use of those benefits options. For example, CostCompare allows an employee to forecast and model their individual premium and out-of-pocket costs for the different types of benefit programs their plan sponsor may offer.

*Site Manager.* Site Manager is our online service and administrative suite of applications that provides specialized decision support for our WebMD Health and Benefits Manager clients. With Site Manager, employers and health plans are able to analyze aggregate health data, address population health risks more effectively and proactively implement preventive programs. Site Manager's messaging capabilities also allow employers to streamline their communication with their employees.

*Integration Services:* We offer a proprietary suite of applications that allows us to integrate third party applications and data.

*Membership.* Membership for each of our private portals is limited to the employees and members of the respective employer and health plan clients. Each member must initially register on the private portal provided to them, at which point they are given a unique user identification name and passcode that they must utilize to achieve a secure sign-on each time they enter the private portal.

### ***Advertising and Sponsorship***

*General.* We compete in the market for healthcare advertising and education services targeted to consumers and physicians. We believe that our public portals offer a very efficient and effective means for sponsors to reach large audiences of health-involved consumers and clinically active physicians. We attract sponsors and advertisers whose products and services are targeted toward these audiences, including pharmaceutical, biotech, medical device and consumer products companies. Pharmaceutical companies and medical device manufacturers currently spend only a very small portion of their marketing and educational budgets on online media. However, we expect this portion to increase and believe that, because of existing sponsorship relationships with those companies and the reach of our portals, we are well-positioned to



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benefit from the expected increase. Our sponsors also include consumer products companies that provide health-related products, and we are actively pursuing additional opportunities in that market.

*The WebMD Health Network.* Although television and magazine advertising are likely to remain the largest sectors in the healthcare-related advertising market for the next several years, marketers are expected to increase their spending for online marketing, including Web advertising, search, e-mail and promotions. We offer advertisers and sponsors an effective and efficient network that reaches a broad audience of health-involved consumers and physicians, as well as the ability to reach specific portions of our audience.

The *WebMD Health Network* consists of the following WebMD-owned sites:

*WebMD Health*, our flagship consumer portal, which is located at [www.webmd.com](http://www.webmd.com);

*MedicineNet*, a health information site for consumers produced and written by practicing physicians, which is located at [www.medicinenet.com](http://www.medicinenet.com);

*RxList*, an online drug directory with information on over 1,400 pharmaceutical products, which is located at [www.rxlist.com](http://www.rxlist.com) and which is also used by healthcare professionals; and

*Medscape from WebMD*, our online Web site for physicians and healthcare professionals, which is located at [www.medscape.com](http://www.medscape.com).

In addition, we have increased the reach of the *WebMD Health Network* through relationships with leading news and information sources, including:

our content and distribution alliance with AOL, pursuant to which we are the primary provider of healthcare content, tools and services for AOL properties and provide related co-branded services for AOL members; and

our relationships with Fox News Online and CBS News Online, which distribute health content from WebMD through their online health channels.

Key benefits that we offer healthcare advertisers and other sponsors include:

our reach of over 20 million unique users per month (based on the monthly average during 2004), which we believe is much larger than the number of unique users of any other sponsor supported health-oriented Web portal;

our ability to attract health-involved consumers and clinically active physicians who view approximately 165 million of our Web pages of content per month (based on the monthly average during 2004);

our ability to help advertisers and sponsors reach specific groups of consumers and physicians by specialty, product, disease or wellness topic, which typically produces a more efficient and productive marketing campaign; and

our ability to provide advertisers and other sponsors with objective measures of the effectiveness of their online marketing.

We provide healthcare advertisers and other sponsors with the means to communicate with targeted groups of consumers and physicians by offering placements and programs at designated locations on our portals. The following are some of the types of placements and programs we offer to advertisers and sponsors:

*Media Solutions.* These are traditional online advertising solutions such as banners, buttons and badges used to reach health-involved consumers. In addition, clients can sponsor a variety of condition-specific or specialty-specific email newsletters, keyword searches and specific educational programs.

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*Sponsored Content Solutions.* These are customized collections of articles, topics, and decision support tools, sponsored by clients and distributed within WebMD environments.

*Patient Education Centers.* Patient education centers are sponsored destinations on Medscape for physicians to access patient education materials on a particular topic or condition.

We do not place advertising or accept sponsorship on private portals we develop and host for employers and payers for use by their employees and members.

### ***Grant-Based Programs***

We receive revenue for CME and other educational programs from pharmaceutical and medical device companies, as well as foundations and government agencies. The following are some of the CME products for which we receive funding:

*Conference Coverage.* Medscape provides coverage of major medical conferences.

*CME Circle.* CME Circle provides online multimedia extensions of sponsor-supported CME activities, including symposia, monographs and CD-ROMs.

*CME Live.* These are original Medscape online events featuring live streaming video, audio and synchronized visual presentation by experts.

*CME Cases.* These are original CME activities presented by healthcare professionals in a patient case format.

*Resource Centers.* Resource centers are grant-based sponsored disease or condition-specific areas, for conditions such as congestive heart failure or breast cancers. These centers include news, expert columns, guidelines and reference material.

### **Publishing Services Group: Offline Publications**

WebMD Health's Publishing Services Group is a complementary business to our online services and extends the reach of our brand and our influence with health-involved consumers and clinically active physicians.

*The Little Blue Book.* In 2003, we acquired the company that publishes *The Little Blue Book*, a leading source of medical practice contact information for physicians since 1988. The pocket-sized reference book is published annually in 146 local editions. We also use the information used to produce *The Little Blue Book* to generate both online and offline directory and information products. Physicians utilize *The Little Blue Book* for local and up-to-date physician, pharmacy and hospital contact information. Physicians are listed free of charge in their local metropolitan-area edition, along with their specialties, HMO affiliations, hospital affiliations, office addresses, telephone numbers and Medicare-assigned Unique Physician Identification Number. WebMD Health receives revenue from sales of *The Little Blue Book*, as well as from sponsors and advertisers in *The Little Blue Book*, most of which are pharmaceutical companies.

*Reference Publications.* WebMD also publishes medical reference publications, including the reference texts *ACP Medicine* and *ACP Surgery: Principles and Practice*. *ACP Medicine* and *ACP Surgery* are official publications of the American College of Physicians and the American College of Surgeons, respectively, although the rights are wholly owned by WebMD Health. They are available for sale by subscription to individual physicians and to institutions in multiple formats (print, CD-ROM and Online). *ACP Medicine* has been a comprehensive and regularly updated internal medicine reference for over 25 years.

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### **Editorial, Privacy, Education and Advertising and Promotion Policies**

*General.* We have adopted internal policies and practices relating to, among other things, content standards and user privacy, designed to foster our relationships with our users. Some of those policies are described below. In addition, we participate in the following external, independent verification programs:

*URAC.* WebMD has been awarded e-Health accreditation from URAC, an independent accrediting body that has reviewed and approved the WebMD.com site for compliance with its more than 50 quality and ethics standards.

*TRUSTe.* WebMD is a licensee of the TRUSTe Privacy Program. TRUSTe is an independent, non-profit organization whose goal is to build users' trust and confidence in the Internet. In January 2005 a panel of privacy experts, sponsored by TRUSTe, ranked WebMD among the ten most trusted companies in America for privacy.

*Health on the Net Foundation.* Our WebMD.com and Medicinet.com sites comply with the principles of the HON Code of Conduct established by the Health on the Net Foundation.

*Editorial Practices.* Our news stories and other original content and reporting presented on our portals are based on our editors' selections of the most important and relevant health events occurring on any given day, obtained from an array of sources, including peer-reviewed medical journals, medical conferences, federal or state government actions and enterprise material derived from interviews with medical experts. We also focus on: seasonal interests, including programs such as Healthy Holidays, Fourth of July Safety and Allergy Seasons; public health awareness, such as Breast Cancer Awareness Month and Diabetes Awareness Month; and emerging health trends such as the latest in nutrition, fitness, aging and healthy living. Each news story is reviewed by a medical editor for accuracy, appropriateness of medical language and proper characterization of the findings. We also license health and wellness content from third parties for publication on our Web sites and, prior to its publication, confirm that the third party has applied appropriate editorial policies.

*Privacy Policies.* WebMD understands how important the privacy of personal information is to our users. Our Privacy Policies are posted on our Web sites and tell users what information we collect about them and about their use of WebMD Health and its services. Our Privacy Policies also explain the choices they have about how their personal information is used and how we protect that information.

*Continuing Medical Education Services.* Our CME activities are planned and implemented in accordance with the policies of the Accreditation Council for Continuing Medical Education (ACCME), which oversees providers of CME credits and other applicable accreditation standards.

*Advertising and Promotion Policies.* All advertisements, sponsorships and promotions that appear on our Web sites are displayed in compliance with our advertising and promotions policies. Among other things, as a matter of policy, we have sole discretion for determining the types of advertising that we accept, and under no circumstances would we accept advertising that, in our opinion, is not factually accurate or not undertaken in good taste. We also recognize and maintain a distinct separation between advertising content that appears on our Web site and editorial content that we publish. We take meaningful steps to ensure that our users can easily distinguish between sponsored content and our news reporting and other editorial content.

### **Technological Infrastructure**

Our Internet-based services are delivered through Web sites designed to address the healthcare information needs of consumers and healthcare professionals with easy-to-use interfaces, search functions and navigation capabilities. We use customized content management and publishing technology to develop, edit, publish, manage, and organize the content for our Web sites. We use ad serving technology to store, manage and serve online advertisements in a contextually relevant manner to the extent possible. We also use specialized software for delivering personalized content through the WebMD Health and Benefits Manager and, for registered members, through our public Web sites. WebMD Health has invested and

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intends to continue to invest in software and systems that allow it to meet the demands of our users and sponsors.

Continued development of our technological infrastructure is critical to our success. Our development teams work closely with marketing and account management employees to create content management capabilities, interactive tools and other applications for use across all of our portals. The goal of WebMD Health's current and planned investments is to further develop a unified content and technology platform serving various end-users, including consumers and physicians, and to create innovative services that provide value for healthcare advertisers, employers, payers, and other sponsors.

### **Sales and Marketing**

A dedicated team of sales, marketing and account management personnel represents our public online portals 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 public portals to bring their companies, and their products and services, to the attention of targeted groups of consumers and healthcare professionals, and to create channels of communication with these audiences.

We market our private online portals to employers and health plans through a dedicated sales, marketing and account management team and through relationships with employee benefits consultants and other companies that assist employers in purchasing or managing employee benefits, including Fidelity Employer Services Company.

We seek to attract traffic and new members to our consumer Web sites through a variety of methods, including online and offline media campaigns. We promote WebMD Health's subscription services through our consumer portals 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.

### ***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;

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

health insurance companies, pharmacy benefit management companies and pharmacies that provide or are developing electronic transaction services for use by their members and 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;



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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, AMICAS, Inc., Amicore (a joint venture of IBM Corporation, Microsoft Corporation and Pfizer, Inc.), Allscripts Healthcare Solutions, Cerner Corporation, Computer Sciences Corp., Electronic Data Systems Corporation, Eclipsys Corporation, First Consulting Group, Inc., General Electric Corporation, IBM Corporation, IDX Systems Corporation, iVillage Inc., McKesson Corporation, Microsoft Corporation, Misys plc, NDCHealth Corporation, Per-Se Technologies, Inc., ProxyMed, Inc., Quality Systems, Inc., RxHub, Siemens Corporation, SureScripts, and TriZetto Group, 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 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 Business Services. 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 for them than use of their 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. In addition, many of these providers of offline healthcare information resources, particularly the larger ones, have also established Web sites that compete with us or have partnered with competitor sites. We also face significant competition from the numerous healthcare-related Web sites on the Internet competing for users' attention and, since there are no substantial barriers to entry, expect additional competitors to continue to enter the market. Healthcare information for consumers is provided, free of charge and without advertising, on sites provided by hospitals, HMOs, managed care organizations, insurance companies and other healthcare providers and payers that offer healthcare information to their customers or members. The competition we face may result in advertising and sponsorship price reductions, reduced margins or loss of market share, any of which could adversely affect our financial results.

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 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



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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**

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 2004, Porex derived approximately 57% of its revenues from the United States, approximately 31% from Europe, approximately 9% 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.

*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.

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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® Biomaterial implantable products for use in reconstructive and aesthetic surgery of the head and face. These permanent implants, which are composed of biocompatible porous high-density plastics, are biomaterial alternatives for replacement or augmentation of bone and cartilage. Their unique porous structure allows for rapid in growth of the patient's tissue and capillary blood vessels. Since the initial product introduction in 1985, we have continued to introduce new shapes and sizes of MEDPOR products to meet surgeons' needs.

*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 manufacture 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 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 implantable products compete for surgical use against autogenous and allograft materials and other alloplastic biomaterials. Porex's surgical drains and markers compete against a variety of products from several manufacturers.



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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. Many 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 in 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 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, 2004, we had approximately 5,940 employees, of which approximately 180 work in our corporate headquarters or related functions, approximately 2,690 are WebMD Business Services employees, approximately 1,960 are WebMD Practice Services employees, approximately 510 are WebMD Health 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 \$54.2 million in 2004, \$43.0 million in 2003, and \$43.5 million in 2002.

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 updated 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 or of enhancements to existing products or services.

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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®, dakota imaging™, Digital Office Manager®, DIM<sub>dx</sub>®, Envoy®, ExpressBill®, Image Director<sup>sm</sup>, Intergy®, Medifax®, Medifax-EDI®, Medscape®, Publishers Circle®, The Little Blue Book™, The Medical Manager®, and ViPS<sup>sm</sup>. 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. 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 industries in which we participate, and we expect that this may continue to increase as the number of competitors grows and the functionality of products overlaps. Although we believe that 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 to incur substantial litigation expense. Moreover, numerous patents have been issued relating 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

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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. 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**

### **Introduction**

*General.* This section of the Annual Report contains a description of laws and regulations applicable to our businesses, either directly or through their effect on our healthcare industry customers. Existing and new laws and regulations affecting the healthcare, information technology, Internet and plastic industries could create unexpected liabilities for us, cause us to incur additional costs and could restrict our operations. Many of the laws that affect us, and particularly those applying to healthcare, are very complex and may be subject to varying interpretations by courts and other governmental authorities. Our failure, or the failure of our business partners, to accurately anticipate the application of these laws and regulations, or other failure to comply, could create liability for us, result in adverse publicity and negatively affect our businesses.

*Healthcare Regulation.* Most of our revenue is either from the healthcare industry or could be affected by changes affecting healthcare spending. 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 aspects of 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.

Many healthcare laws are complex and their application to specific products and services may not be clear. In particular, 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.

*Other Regulation.* This section of the Annual Report also contains a description of other laws and regulations, including general consumer protection laws and Internet-related laws, that affect some of our businesses. Laws and regulations have been adopted, and may be adopted in the future, that address Internet-related issues, including online content, privacy, online marketing, unsolicited commercial e-mail, taxation, pricing, and quality of products and services. Some of these laws and regulations, particularly those that relate specifically to the Internet, were adopted relatively recently and their scope and application may still be subject to uncertainties. Interpretations of these laws, as well as any new or revised law or regulation, could decrease demand for our services, increase our cost of doing business, or otherwise cause our business to suffer.



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**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 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, the compliance date for the Transaction Standards was extended to October 16, 2003 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. 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 Business Services and Medical Manager Network Services.

October 16, 2003 was the deadline for covered entities to comply with HIPAA's Transaction Standards. Failure to comply with the Transaction Standards may subject covered entities, including WebMD Business Services, to civil monetary penalties and possibly to criminal penalties. 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 were to 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 its contingency plan for Medicare, CMS continues 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 Business Services 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



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Standards are reported as electronic media claims, which 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.

CMS has made clear that it expects each party to every transaction to be accountable for compliance with the new standards. However, the CMS Guidance provides for a flexible, complaint-driven enforcement strategy that will take into consideration good faith efforts to comply with the Transaction 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 cannot provide assurance regarding how CMS will regulate clearinghouses in general or WebMD Business Services in particular. We continue to work with payers, providers, practice management system vendors and other healthcare participants to implement the Transaction Standards. Implementation of the Transaction Standards has presented us with significant technical and operational challenges. As with any highly complex transition involving significant modifications to trading partner systems, we have experienced some problems during this process. We seek to resolve all such problems when identified, but no assurance can be given that we will identify and resolve all problems promptly.

As various healthcare entities are in different stages of migration during the transition, WebMD Business Services 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. A majority of the claims we currently receive from submitters continue to use legacy formats and, of those claims submitted to us in HIPAA-standard formats, many do not contain 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.

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. 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 Business Services, to translate between standard and non-standard formats. As a result, use of a clearinghouse has allowed numerous providers and payers to move to the Transaction Standards independently and at different times, reducing transition costs and risks. In addition, the standardization of formats and data standards envisioned by the Transaction Standards has only partially occurred. Multiple versions of a HIPAA standard claim have emerged as each payer defines for itself what constitutes a HIPAA-compliant claim. Payers have published more than 600 different companion documents setting forth their individual interpretations and implementation of the government guidelines. We believe that use of clearinghouses will continue to be the most efficient way for most providers to transact electronically with multiple payers. Nonetheless, the Transaction Standards may facilitate use of direct EDI links for transmission of such transactions without a clearinghouse between some payers and providers. Any significant increase in the utilization of links between healthcare providers and payers without use of a third party clearinghouse could have a material adverse effect on WebMD Business Services' transaction volume and financial results. In addition, any increase in the ability of payers to bypass third party EDI service providers may adversely affect the terms and conditions we are able to negotiate in our agreements with them, which could also have a material adverse impact on WebMD Business Services' business and financial results.

WebMD has taken a leadership role in efforts to bring healthcare constituencies together to seek ways to achieve the reductions in healthcare administrative costs promised by HIPAA. However, our

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technological and strategic responses to the Transaction Standards may result in conflicts with or other adverse changes in our relationships with, some healthcare industry participants, including some who are existing or potential customers for our products and services or existing or potential strategic partners.

*Privacy Standards.* The Privacy Standards establish a set of basic national privacy standards 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, either directly or through our contractual relationships, to the portions of our business that process healthcare transactions, that provide certain information technology and data management services for other participants in the healthcare industry, or that enable electronic communications of patient information among healthcare industry participants. In addition, WebMD Practice Services provides information technology products designed to assist physician offices in their compliance with the Privacy Standards. Some of our businesses may use, as permitted by the Privacy Standards, health information which has been de-identified. Although determining whether data has been sufficiently de-identified may require complex factual and statistical analyses and may be subject to interpretation, we believe that our use of such information is in accordance with the Privacy Standards.

The Privacy Standards provide for civil and criminal liability for their breach and require 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. There can be no assurances that we will adequately address the risks created by the Privacy Standards 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 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. The compliance date for most participants in the healthcare industry for the Unique Employer Identifier Standard was 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 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, either directly or through our contractual relationships, to the portions of our business that process healthcare transactions, that provide certain information technology and data management services for other participants in the healthcare industry, or that enable electronic communications of patient information among healthcare industry participants. In addition, WebMD Practice Services provides products designed to assist physician offices in their compliance with the Security Standards.

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. As of the date of this Annual Report, we

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expect that our infrastructure and processes will be in compliance with the Security Standards by the April 21, 2005 deadline. However, we are unable to predict what changes might be made to the Security Standards prior to or after the 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 healthcare providers, commonly referred to as the National Provider Identifier (NPI) Standard. The NPI Standard requires healthcare 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, and to use the NPI in standard transactions where a provider identifier is required. The NPI Standard requires health plans and healthcare 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**

In addition to HIPAA, numerous other state and federal laws 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. In many cases, these state laws are not 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. These 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 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 services to be maintained as separate and distinct operations. Furthermore, the 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.

**Table of Contents****Regulation of Healthcare Relationships**

*Anti-kickback Laws.* There are federal and state laws that govern patient referrals, physician financial relationships and inducements to healthcare providers and patients. 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. These laws are applicable to manufacturers and distributors and, therefore, may restrict how we and some of our customers market products to healthcare providers. Also, 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 WebMD Health, 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, as a result, 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. Some of these laws also provide civil and criminal penalties for noncompliance, and can be enforced by individuals through qui tam actions. We 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 requested by payers. 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

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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 that decision, 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 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





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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 reconstructive and aesthetic surgical implants and post-surgical drains. In addition, the FDA regulates WebMD Practice Services' DIM<sub>X</sub> 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<sub>X</sub> 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<sub>X</sub> 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<sub>X</sub> 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<sub>DX</sub> System. We believe that the sale of our practice management systems with the DIM<sub>DX</sub> System does not require a new 510(k) clearance or PMA approval. We cannot assure you, however, that the FDA would agree with this. 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.

We distribute the IntegradWeb PACS product for the input, display, archiving, and transmission of X-rays and other diagnostic images. The 510(k) clearance for the IntegradWeb PACS product is currently held by the manufacturer, Dynamic Imaging, which is primarily responsible for Quality System Regulation compliance and other FDA regulatory compliance related to this product.

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 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 Intergy EHR PDA, 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.

**Regulation of Drug and Medical Device Advertising and Promotion**

With limited exceptions, 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 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.

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Information that promotes the use of pharmaceutical products or medical devices that is put on our Web sites is subject to the full array of the FDA and FTC requirements and enforcement actions and information regarding other products and services is subject to FTC requirements. Areas of our Web sites 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 advertisers and sponsors 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. State attorneys general may also take similar action based on their state's consumer protection statutes.

*Drug Advertising.* The FDC Act requires that prescription drugs (including biological products) be approved for a specific medical indication by the FDA prior to marketing in interstate commerce. It is a violation of the FDC 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 approved indications. In addition, the labeling and advertising can be neither false nor misleading, and must present all material information, including risk 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. In addition, state attorneys general can also bring enforcement actions for alleged unfair or deceptive advertising.

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. State attorneys general have similar investigative tools and sanctions available to them as well. The National Association of Attorneys General has formed a Prescription Drug Task Force that has taken a very proactive position in addressing issues related to prescription drugs.

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



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offense. Scrutiny of direct-to-consumer advertising increased after Vioxx® was withdrawn from the market due to potential safety concerns in September 2004. Critics have proposed postponing direct-to-consumer advertising for a new drug until the drug has been safely marketed commercially for one or two years. In response to these criticisms, 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. In early 2004, the FDA 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.

*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 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. During the past two years, the independence of information provided during CME programs has been subject to increased scrutiny. If any CME activity provided on our Web site is considered promotional, there may be regulatory or judicial action against us and/or the sponsor of the CME program.

**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. We do not believe we provide professional medical advice, diagnosis or treatment. We employ and contract with physicians who provide only medical information to consumers, and we have no intention to provide medical care or advice. 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. Any determination that we are a healthcare provider and acted improperly as a healthcare provider may result in liability to us. 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.

**Consumer Protection Regulation**

*General.* Advertising and promotional activities presented to visitors 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.

*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 (and other persons who initiate those emails) are required to make sure that those emails do not contain

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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. The CAN-SPAM Act may apply to the e-newsletters that WebMD's public portals distribute to members and to some of our other commercial email communications. However, there may be additional FTC regulations indicating that our e-newsletters are outside the scope of CAN-SPAM. At this time, we are applying the CAN-SPAM requirements to these email communications, and believe that our email practices comply with the requirements of the CAN-SPAM Act.

*Regulation of Advertisements Sent by Fax.* In 2004, the Federal Communication Commission (FCC) issued a new interpretation of a section of the Telephone Consumer Protection Act that affects advertisements sent to telephone facsimile (fax) machines. Under this new interpretation, unsolicited 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. Previously, these advertisements could be sent without permission to entities with whom a current business relationship exists. However, the FCC has delayed the effective date of the new interpretation until June 30, 2005. We do not send advertisements to fax machines in any significant portions of our business. We intend to comply with the FCC's new interpretation effective as of the deadline.

*COPPA.* The Children's Online Privacy Protection Act, or COPPA, applies 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 the age of 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.

*Regulation of Contests and Sweepstakes.* We conduct contests and sweepstakes in some of our marketing channels. The federal Deceptive Mail Prevention and Enforcement Act and some state prize, gift or sweepstakes statutes may apply to these promotions. We believe that we are in compliance with any applicable law or regulation when we run these promotions.

*Other Consumer Protection Regulation.* The 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

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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.

### **Item 2. *Properties***

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

#### **Headquarters**

We lease approximately 45,000 square feet of office space for our corporate headquarters in Elmwood Park, New Jersey. The leases for that space expire in March 2006.

#### **WebMD Business Services, WebMD Health and WebMD Practice Services**

WebMD Business Services leases office space and operational facilities in:

Nashville, Tennessee for WebMD Business Services headquarters and primary data and call centers and Medifax's operations;

Towson, Maryland;

Columbia, Maryland;

St. Louis, Missouri;

Costa Rica;

Waterloo, Iowa;

Scottsdale, Arizona; and

Toledo, Ohio.

WebMD Practice Services leases office space in Tampa, Florida for its headquarters and in Alachua, Florida for its development and engineering operations.

WebMD Health leases office space in New York, New York for its headquarters and its editorial and marketing operations and in Atlanta, Georgia and Portland, Oregon for related operations.

We also use facilities in approximately 100 additional locations throughout the United States, eight 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***

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

As previously disclosed, 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, currently

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known as WebMD Practice Services, Inc. (a subsidiary of WebMD Corporation), in Tampa, Florida and Alachua, Florida and delivered subpoenas for documents and financial records. Based on the information available to us, we believe that the investigation relates principally to issues of financial accounting improprieties for Medical Manager Corporation, a predecessor of WebMD (by its merger into WebMD in September 2000), and our WebMD Practice Services 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 WebMD Practice Services subsidiary of other companies, most of which were dealers of Medical Manager products and services.

In connection with this matter, WebMD has uncovered evidence that, prior to Medical Manager's acquisition by WebMD Corporation in September 2000, Medical Manager's dealer acquisition program was improperly used to artificially inflate the revenue, earnings and goodwill of Medical Manager. Also, as we have stated in the past, WebMD has evidence of kickback payments by former dealers to certain former employees of Medical Manager who were responsible for the acquisition program. WebMD has commenced lawsuits against two of those former employees. These kickback payments appear to have continued until sometime in 2002.

It is our understanding that the investigation by the U.S. Attorney's Office also relates to allegations of improper revenue recognition practices in connection with system sales in the Medical Manager business. WebMD has identified evidence that some employees had in the past engaged in practices to improperly recognize revenue in connection with system sales.

The United States Attorney for the District of South Carolina announced on January 10, 2005, that three former employees of WebMD Practice Services, Inc. have each agreed to plead guilty to one count of mail fraud and that one such employee has also agreed to plead guilty to one count of tax evasion for acts committed while they were employed by WebMD Practice Services, Inc. and its predecessor. The three former employees include a Vice President of WebMD Practice Services responsible for acquisitions who was terminated for cause in January 2003; an executive who served in various accounting roles at WebMD Practice Services until his resignation in March 2002; and a former independent Medical Manager dealer who was a paid consultant to Medical Manager until the termination of his services in 2002.

According to the Informations, Plea Agreements and Factual Summaries filed by the United States Attorney in, and available from, the District Court of the United States for the District of South Carolina - Beaufort Division, on January 7, 2005, the three former employees and other as yet unnamed co-schemers were engaged in schemes between 1997 and 2002 that included causing companies acquired by Medical Manager to pay the former vice president in charge of acquisitions and co-schemers kickbacks which were funded through increases in the purchase price paid by Medical Manager to the acquired company and that included fraudulent accounting practices to inflate artificially the quarterly revenues and earnings of WebMD Practice Services, Inc., when it was an independent public company called Medical Manager Corporation from 1997 through 1999, when and after it became acquired by Syntec, Inc. in July 1999 and when and after it became a subsidiary of WebMD Corporation in September 2000. Medical Manager Corporation ceased being a separate public company on September 12, 2000 and filed its last quarterly report with the Securities and Exchange Commission for the quarter ended March 31, 2000.

To date, in light of the information obtained by WebMD, including that contained in the court documents filed by the United States Attorney in South Carolina, WebMD has not uncovered information that it believes would require a restatement for any of the years covered by its financial statements. In addition, WebMD believes that the amounts of the kickback payments referred to in the court documents have already been reflected in the financial statements of WebMD to the extent required.

The fraudulent accounting practices cited by the government in the January 7, 2005 District Court filings included: causing companies acquired by Medical Manager to reclassify previously recognized sales revenue as deferred income so that such deferred income could subsequently be reported as revenue by Medical Manager and its parents in later periods; fabricating deferred revenue entries which could be used

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to inflate earnings when Medical Manager acquired companies; causing companies acquired by Medical Manager to inflate reserve accounts so that these reserves could be reversed in later reporting periods in order to artificially inflate earnings for Medical Manager and its parents; accounting for numerous acquisitions through the pooling of interests method in order to fraudulently inflate Medical Manager's quarterly earnings, when the individuals involved knew the transactions failed to qualify for such treatment; causing companies acquired by Medical Manager to enter into sham purchases of software from Medical Manager in connection with the acquisition which purchases were funded by increasing the purchase price paid by Medical Manager to the acquired company and using these round trip sales to create fraudulent revenue for Medical Manager and its parents; and causing Medical Manager to book and record sales and training revenue before the revenue process was complete in accordance with Generally Accepted Accounting Principles and thereby fraudulently inflating Medical Manager's reported revenues and earnings. According to the Informations to which the former employees have plead guilty, the fraudulent accounting practices resulted in the reported revenues of Medical Manager being overstated materially between June 1997 and at least December 31, 2001, and reported quarterly earnings per share for Medical Manager being overstated by at least one cent per share in every quarter during that period.

The documents filed by the United States Attorney state that the former employees engaged in their fraudulent conduct in concert with senior management, and at the direction of senior Medical Manager officers. In its statement the United States Attorney for the District of South Carolina stated that the senior management and officers referred to in the Court documents were members of senior management of the Medical Manager subsidiary during the relevant time period. Based on the information it has obtained to date, WebMD does not believe that any member of its senior management whose duties were not primarily related to the operations of WebMD Practice Services during the relevant time periods engaged in the alleged improprieties. WebMD understands, however, that in light of the nature of the allegations involved, the U.S. Attorney's office has been investigating all levels of WebMD management. As part of its responsibilities, the Special Committee of the Board of Directors that is overseeing this matter is evaluating whether members of senior management whose duties were primarily related to the operations of WebMD Practice Services during the relevant time periods engaged in the alleged improprieties, and will continue to evaluate as information becomes available to it whether any other member of WebMD's senior management engaged in improprieties in connection with any matter being investigated by the United States Attorney.

WebMD has been cooperating and intends to continue to cooperate fully with the U.S. Attorney's Office. As previously reported, our Board of Directors has formed a special committee consisting solely of independent directors to oversee this matter with the sole authority to direct WebMD's response to the allegations that have been raised. The Special Committee has retained independent legal counsel to advise it. WebMD has retained counsel to advise it in connection with the investigation and such counsel reports directly to the Special Committee.

As previously disclosed, WebMD understands that the SEC is also conducting a formal investigation into this matter.

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 continue to be significant. For the years ended December 31, 2004 and 2003, those expenses are reflected as Legal Expense in the Consolidated Statements of Operations included in this Annual Report.

**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



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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 Healthon 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 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 and 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.

On June 10, 2004, plaintiffs submitted to the court a Stipulation and Agreement of Settlement with Defendant Issuers and Individuals. On February 15, 2005, the court certified the proposed settlement class and preliminarily approved the settlement, subject to certain modifications by the parties. Assuming these modifications are made, notice of the settlement will be provided to the class members and the Court will schedule a hearing for final approval of the settlement.

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

WebMD was 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 (now known as McKesson Corp.), 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 alleged 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 alleged that WebMD made certain negligent misrepresentations with respect to these transactions.

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Plaintiffs alleged that 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. The complaint was based on alleged conduct by WebMD, Inc., then a separate private company and now a subsidiary of WebMD. One of the HBOC 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.

On December 16, 2003, WebMD filed a demurrer, seeking dismissal of the plaintiffs' two claims against it. On July 22, 2004, the Court sustained that demurrer, finding that the plaintiffs' claims were time barred. On October 8, 2004, the Court dismissed plaintiffs' Fourth Amended Complaint with prejudice as to California, but without prejudice with respect to filing in another jurisdiction. On November 17, 2004, plaintiffs filed a notice of appeal of the Court's order in favor of WebMD. On November 30, 2004, WebMD filed a cross-appeal for the purpose of challenging the form of the order. Those appeals have not yet been briefed.

In March 2004, McKesson Corp. filed cross-complaints against General Electric Capital Corporation, Inc., Computer Associates International, Inc., and WebMD for declaratory relief and indemnification, alleging that each of these cross-defendants is obligated to indemnify McKesson if McKesson is compelled to pay any sum as the result of any damages, judgment or other awards recovered by the plaintiffs against McKesson. McKesson sought judicial determinations of the comparative fault of McKesson and each cross-defendant for damages claimed by the plaintiffs, if any such damages are found to exist, and declarations of the amount that each cross-defendant is obligated to indemnify McKesson if McKesson is compelled to pay any sum as the result of any damages, judgment or other awards recovered by the plaintiffs against McKesson.

On June 8, 2004, WebMD filed a demurrer, seeking dismissal of McKesson's claims. On September 10, 2004, the Court sustained the demurrer to McKesson's claims against WebMD. On December 7, 2004, the Court dismissed McKesson's cross-complaint with prejudice and ordered entry of judgment in favor of WebMD. On January 27, 2005, McKesson filed a notice of appeal of the Court's order in favor of WebMD. That appeal has not yet been briefed.

On August 12, 2004, the original plaintiffs in the California lawsuit, Merrill Lynch Fundamental Growth Fund, Inc. and Merrill Lynch Global Value Fund, Inc., filed a separate lawsuit in Superior Court in New Jersey, Middlesex County, alleging substantially the same issues and claims as they did in the California lawsuit. In response to WebMD's motion to dismiss, plaintiffs filed a First Amended Complaint on January 4, 2005, dropping claims against WebMD Corporation, but asserting the same claims against its subsidiary WebMD, Inc., the company that engaged in the two software transactions. On February 4, 2005, the New Jersey court dismissed WebMD Corporation from the action without prejudice, and stayed the New Jersey action until the California action is resolved, subject to WebMD Corporation's entering into a tolling agreement with plaintiffs, which WebMD Corporation has done.

WebMD intends to vigorously defend against the plaintiffs' and McKesson's claims against WebMD and WebMD, Inc.

**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

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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 1 2005, approximately 300 actions have been settled by the manufacturer, or by Porex's insurance carriers, without material cost to Porex. As of March 1, 2005, no implant-related claims were pending against Porex. During calendar years 2004 and 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, 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 may 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, results of operations or liquidity.

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

During the fourth quarter of 2004, 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, Related Stockholder Matters and Issuer Purchases of Equity Securities**

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:

	<b>High</b>	<b>Low</b>
<b>2003</b>		
First quarter	\$ 10.28	\$ 8.25
Second quarter	12.00	8.28
Third quarter	12.49	8.20
Fourth quarter	9.32	7.59
<b>2004</b>		
First quarter	\$ 10.23	\$ 8.26
Second quarter	9.65	8.26
Third quarter	9.28	6.68
Fourth quarter	8.33	6.46

On March 1, 2005, there were approximately 4,300 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; and

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.

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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.

For information about our previously announced plan to establish WebMD Health as a separate publicly traded company, see Recent Developments Evaluation of WebMD Health Transaction Alternatives above. As part of either of the alternatives being considered, WebMD Health will become a separate public company. In the case of a one-step split-off, all holders of WebMD common stock would have the right, on a pro rata basis, to exchange shares of WebMD common stock for newly-issued shares of WebMD Health common stock at an exchange ratio that would be set by the Board of Directors of WebMD. We are not able to predict what the market prices of the common stock of the two companies would be after either alternative transaction and we cannot provide assurance that either of the alternative transactions will produce any increase, for our stockholders, in the market value of their holdings. In addition, the market prices of WebMD Corporation common stock and WebMD Health common stock could be highly volatile for several months after either alternative transaction and may each continue to be more volatile than WebMD Corporation common stock would have been if a transaction had not occurred.

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.

**Repurchases of Equity Securities During the Fourth Quarter of 2004**

The following table provides information about purchases by WebMD during the three months ended December 31, 2004 of equity securities that are registered by us pursuant to Section 12 of the Securities Act:

**Issuer Purchases of Equity Securities**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</b>
10/01/04-10/31/04	1,371,424(2)	\$ 6.70	1,190,124	\$ 63,392,577
11/01/04-11/30/04	264,900	\$ 7.02	264,900	\$ 61,531,935
12/01/04-12/31/04				\$ 61,531,935
<b>Total</b>	<b>1,636,324</b>	<b>\$ 6.75</b>	<b>1,455,024</b>	<b>\$ 61,531,935</b>

- (1) These repurchases were made pursuant to the repurchase program that we announced on March 29, 2001 where WebMD was originally authorized to use up to \$50 million to purchase shares of its common stock from time to time beginning on April 2, 2001. On November 2, 2001, the maximum aggregate amount of purchases under the Program was increased to \$100 million; on November 7, 2002, it was increased to \$150 million; and on August, 19, 2004, it was increased to \$200 million.
- (2) Includes 181,300 previously owned shares tendered to WebMD to pay the withholding taxes due upon exercise of employee stock options. The value of these shares was determined based on the closing fair market value of

WebMD common stock on the date of exercise.

**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 Porex segment. Accordingly, the following selected consolidated financial data has been reclassified to reflect the historical results of these two operating units as discontinued operations.

	<b>Years Ended December 31,</b>				
	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
	<b>(In thousands, except per share data)</b>				
<b>Consolidated Statements of Operations Data:</b>					
Revenue	\$ 1,160,351	\$ 963,980	\$ 871,696	\$ 842,020	\$ 574,524
Costs and expenses:					
Cost of operations	666,431	564,939	509,744	568,321	430,296
Development and engineering	54,161	42,985	43,467	43,572	59,867
Sales, marketing, general and administrative	324,027	282,482	283,424	448,082	535,462
Depreciation, amortization and other	57,765	62,434	125,593	2,394,857	2,188,461
Legal expense	9,230	3,959			
Impairment of long-lived and other assets				3,816,115	
Restructuring and integration charge (benefit)	4,535		(5,850)	266,755	452,919
Gain (loss) on investments	457	1,659	6,547		(40,365)
Interest income	18,717	22,901	19,590	30,409	51,467
Interest expense	19,253	15,214	8,491	507	735
Other income, net	121	4,218	3,844		
Income (loss) from continuing operations before income tax provision (benefit)	44,244	20,745	(63,192)	(6,665,780)	(3,082,114)
Income tax provision (benefit)	4,910	4,140	(10,079)	2,588	790
Income (loss) from continuing operations	39,334	16,605	(53,113)	(6,668,368)	(3,082,904)
Income (loss) from discontinued operations, net of income taxes		(33,611)	3,411	(3,950)	1,296
Net income (loss)	\$ 39,334	\$ (17,006)	\$ (49,702)	\$ (6,672,318)	\$ (3,081,608)
Basic income (loss) per common share:					
	\$ 0.12	\$ 0.05	\$ (0.17)	\$ (19.13)	\$ (12.60)



Income (loss) from continuing operations								
Income (loss) from discontinued operations			(0.11)	0.01	(0.01)	0.01		
Net income (loss)	\$	0.12	\$	(0.06)	\$	(0.16)	\$	(12.59)
Diluted income (loss) per common share:								
Income (loss) from continuing operations	\$	0.12	\$	0.05	\$	(0.17)	\$	(12.60)
Income (loss) from discontinued operations			(0.10)	0.01	(0.01)	0.01		
Net income (loss)	\$	0.12	\$	(0.05)	\$	(0.16)	\$	(12.59)