HEALTHEON (NASDAQ: HLTH)

Initiating Coverage: BUY   Aug 13, 1999

KEY CONSIDERATIONS

- Healtheon continues to lead the health-net revolution by providing a variety of products and services to healthcare providers, payers, suppliers, and consumers.

- As the healthcare industry wastes nearly $280 billion on unnecessary care and administrative expenses, there is a strong demand for the quality of care improvements and cost reductions Healtheon suggests it will be able to provide.

- The realization of profits by Healtheon will in a large part be determined by the healthcare community's acceptance of the Internet. Reliability and security continue to be an issue. However, with the increasing number of strategic relationships established daily by Healtheon, it appears that Healtheon's Platform continues to gain favorship.

- Revenue will grow to over 1.5x current levels as an increase in the number of subscribers and transaction volume will help drive the company closer towards positive earnings by the end of 2000.
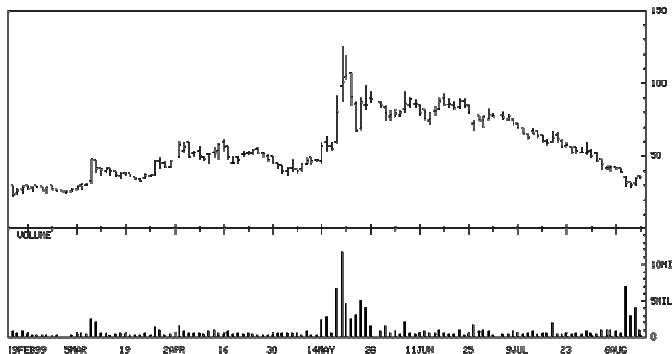
Recent Price	$34.63
52WK High	$126.188
52WK Low	$21.75
P/E	N/A
P/Book	25.65
P/Sales	50.18
Market Capitalization	2.46B
Shares Outstanding	70.98M
Daily Volume (3-month Average)	1.38M

FINANCIALS

Current Ratio	3.39
LT Debt/Equity	0.03
Total Cash	$63.2M

EPS

1998	(1.07)
1999E	(.91)
2000E	(.44)

ONE-YEAR PRICE AND VOLUME GRAPH

Courtesy of Bloomberg, L.P.

COMPANY PROFILE

Healtheon is the leading provider of online healthcare transaction and information services. The Healtheon Platform has helped establish Virtual Healthcare Networks capable of simplifying and expediting the various healthcare interactions and necessary transactions among participants including enrollment, eligibility determination, referrals, lab test ordering, data retrieval, and claims processing. Healtheon's business model incorporates the Internet as a means to combat the increase in healthcare costs and improve the quality of care administered by healthcare providers.

This report was prepared by David R. Rivas, Ph.D., and Scott Morenstein.

PROFILE

Healtheon, headquartered in Santa Clara, California, commenced operations in January 1996. Healtheon's initial public offering was finalized on February 11, 1999. The company, founded by Jim Clark, founder of Netscape, and Pavan Nigam, began as a healthcare information technology firm providing software solutions and consulting services to various healthcare institutions. For about three years, Healtheon's revenues were largely derived from software sales and information technology consulting services. Additional revenues arose from the companies and technologies that they acquired over this time period. As time passed, it became increasingly evident to Jim Clark that the Internet could revolutionize the healthcare industry by providing a means to diminish costs and expedite communications amongst the various participants. However, it was not until the first quarter of 1999 that a significant amount of revenue was directly derived from the company's Internet services. Their revenue can now be attributed to subscription fees, as well as, fees on a per-transaction basis.

The Healtheon Platform has evolved into a highly secure, scalable, available, reliable means to process a wide array of complex healthcare transactions quickly via the Internet. The evolution of the Platform and its increased demand can, to a great extent, be attributed to the acquisitive nature of the company. Healtheon strives to acquire compatible companies and new technologies so that the Virtual Healthcare Networks established can be updated to further extend the ease and reliability of their Internet-based services.

In May 1998, Healtheon acquired ActaMed Corporation and in effect gained access to their, EDI, electronic data interchange, services and a large number of physicians and payers connected to ActaMed. This acquisition helped establish strategic relationships with United Healthcare and SmithKline Beecham Clinical Labs, two very large existing users of Healtheon's Internet-based services. In September 1998, Healtheon acquired Metis LLC, a healthcare consulting and Internet application development firm, significantly increasing its technology and experience developing healthcare Internet solutions. Since then Healtheon has acquired MEDE AMERICA, merged with WebMD, a leader in the transmission of healthcare information services via the Internet, and acquired Greenberg News.

The wide acceptance and popularity of Healtheon's e-commerce and Internet transaction services is evident by the growing number of users and strategic relationships that have been established. Recently, Healtheon has paired with Merck-Medco Managed Care, PROMINA Health System, and Yahoo!, to improve current technologies and increase customer base. Strategic relationships have been established with Cisco Systems, the TPA, IBM, United Healthcare, SmithKline Beecham Clinical Labs, Beech Street Corporation, Brown and Toland Physician Services Organization, Hill Physicians, and several other prominent hospitals, pharmacies, payers, employers, and government agencies further increasing the number of users, as well as, transaction volumbe. By the end of 1999, the company anticipates that over 500 million transactions will have been processed.

INDUSTRY OUTLOOK

The healthcare industry is very much dependent on the real time flow of information. Presently, healthcare transactions including enrollment, referrals, claims processing, reimbursement, and lab results often do not arrive in a timely fashion. Physicians may wait over a year before they are reimbursed for the treatment they have administered. Patients are not adequately served as they wait days, even weeks, before they can obtain a referral to see a specialist. Claims are entered by payers, the various managed care organizations and insurance companies, multiple times before the information can be accurately processed. What is the common theme here? Care gets delayed, unnecessary costs are incurred, and the overall quality of care declines as physicians become disillusioned and patients grow sicklier.

Previous solutions to diminish the rate of increase of the costs of healthcare have been unsuccessful as an estimated $280 million dollars is wasted on unnecessary or redundant care. There is a great demand for a means to diminish these huge costs while at the same time improve the environment physicians practice in. By

facilitating physicians, Healtheon expects that patients will receive more proper treatment. The Internet can be leveraged to increase the unity of the healthcare industry while cutting the large administrative costs that come from the reliance on manual means of processing transactions. Denied and unpaid claims, authorizations, old information, and redundancy can all be reduced.

Currently, payers, suppliers, providers, and consumers can not efficiently communicate with one another because the majority use different mainframes and client/server systems, forms, and software which are not compatible with one another making the transmission of critical information difficult and sometimes even impossible. Information lies inaccessible trapped in databases, causing physicians to rely primarily on paper documents rather than on information technology solutions.

Healtheon uses the Internet to perform all of the various functions and transactions that were previously performed by proprietary legacy systems that were unable to communicate well with each other. Various Internet sites have been established to provide medical information and transaction services to one of the participants of the healthcare industry, especially physicians. Healtheon remains the only healthcare Internet site that provides information and transaction services to <u>all</u> of the players of the healthcare community. With over 65,000 physicians and nearly 87.5 million target patients, there is an enormous market for such services.

STRATEGY AND SERVICES

Healtheon seeks to be the leading provider of Internet-based transaction and information services serving the healthcare community. Their aim is to provide a secure platform in which information can be exchanged instantaneously. The Platform makes use of CORBA-based middleware designed to scale with an increasing number of users so that access will not be denied as demand is stepped up. Security is often an issue as many consumers fear that their medical information can easily be accessed by other users or employers. With this in mind, Healtheon has designed their system with the highest level of security. The system requires authentication of its users and includes 128 bit encryption, monitoring, physical security, and network security. It has various built in features that keep the site fault tolerant. The Healtheon Platform has been designed to support the majority of existing platforms so that no additional costs will be incurred to update such systems. By continuously developing, acquiring, and updating their Internet-based applications, the Platform can adapt as technology evolves. Furthermore, Healtheon provides consulting services to those participants that choose to use their services so that their systems may be optimized to provide the greatest amount of utility.

The Internet-based systems are designed specifically for each type of healthcare participant. The participants include payers, providers, employers, suppliers and consumers. Payers process claims, establish medical protocols, enroll patients, and approve referrals. Suppliers include professionals at labs and pharmacies that verify diagnoses, analyze tests, and fill prescriptions. Employers choose health plans and benefits for their employees. The consumers are the recipients of care that require services designed to assist them choose physicians, submit claims, and obtain medical information.

Internet-based services include:

- **Healtheon™ Practice -** A common webtop is established by this service that efficiently integrates existing non-Healtheon applications increasing physicians connectivity to payers, suppliers, and other physicians so that mission critical information can be exchanged quickly and securely. A messaging subsystem is provided by this service that allows for the transmission of secure information via e-mail, fax, a network printer, or pager. The system will automate transactions amongst providers and payers saving valuable time and eliminating delayed and inefficient care. Copays and referrals can be requested, eligibility determined, and claims may be filed and processed. This solution will prove superior to ProviderLink which was originally obtained through the acquisition of ActaMed in May 1998.

- **Healtheon™ Dx –** Enables providers to order lab tests and receive the results directly via the Internet from a variety of laboratories. Any previously existing system may be used to select which test must be given and quickly obtain the results of these examinations when they are available. No longer will the patient have to wait nearly a week to learn of the results of their laboratory tests.

- **Healtheon™ DxChange –** Documents and information can be distributed between participants via the Internet with this service. Clinical and administrative information can be obtained anywhere at anytime. The costs involved are significantly lower than those associated with traditional methods of documentation dispersal.

- **Healtheon™ Rx –** Increases connectivity of providers, pharmacists, and payers so that medications can be prescribed and filled more expeditiously. In addition, the medical history of the patient can be exchanged so that the appropriate medication can be administered in light of any allergies or drug-drug interactions that might arise if any information were to be withheld. The service will diminish time previously wasted confirming that the suitable medication was filled and that all potential risks have been avoided. Currently, this service is still being developed.

- **Healtheon™ BenefitCentral-** Primarily used by employers, their employees, and payers so that providers, benefits, and specific health plans may be selected. Employees have the opportunity to choose a wide array of physicians and periodically verify their coverage. Employers are given the chance to select from a variety of plans that plan which will provide the most service to its employees and at the same time be cost efficient for the firm. Many of the large administrative expenses arising from benefits enrollment and physician selection can be reduced as payers will no longer be so reliant on data entry and the exchange of paper documents.

These services will be provided at a lower cost than traditional Internet services. Customers will be charged a minimal subscription fee and thereafter, a charge will be incurred per transaction. The majority of existing Internet sites currently charge much larger initiation fees denying access to many potential customers.

In addition to Healtheon's transaction services, with the recent merger with WebMD, Healtheon/WebMD will become the leading provider of medical news obtained via the Internet. The WebMD merger will greatly increase the number of subscribers and transaction volume, as well as, add brand name recognition to help revenues climb faster.

STRATEGIC RELATIONSHIPS AND CLIENTS

Healtheon will continue to expand its customer base by developing strategic relationships with a variety of regional providers, payers, employers, and suppliers. By gaining command over regional markets, the utilization of these Internet-based services is expected to spread exponentially to the rest of the nation. Healtheon already has a strong command of regional markets in the San Francisco Bay Area, Atlanta, and the state of Texas. Current relationships have been established with the following:

- **Merck-Medco Managed Care, LLC-** On July 20, 1999, Healtheon made an agreement with Merck-Medco, the nation's leading provider of prescription drug plans, to provide online prescription services to physicians whose patients utilize Merck-Medco's prescription plans. Healtheon™ Rx will be used in these particular physicians' offices so that they may more efficiently interact with Merck-Medco to provide better prescription services to patients. Merck-Medco will provide funding for the continued development of Healtheon™ Rx.

- **Cisco Systems, Inc. -** Along with Buck Consultants, a human resources consulting firm, on July 14, 1999 an agreement was reached in which Healtheon will grant access to Healtheon™ BenefitCentral to employees

of Cisco Systems, increasing customer base by 14,000. All of the features of this service including benefit management, physician selection, and enrollment systems will be available to Cisco employees.

- **TPA-** The United States' largest independent healthcare administrator, the TPA, signed a 5-year deal with Healtheon on July 7, 1999 to provide 1 million TPA customers access to Healtheon™ BenefitCentral.

- **PROMINA Health System-** PROMINA, a leading integrated healthcare delivery network, on July 6, 1999 agreed to assist Healtheon in the production of an Internet-based information system which will entitle participating PROMINA physicians the use of Healtheon™ Practice. Physicians will be able to communicate with one another, as well as, process claims, referrals, and perform other administrative tasks at a lower cost and greater efficiency. This agreement will increase Healtheon's physician base by an additional 2,000 by the third quarter of 1999. It will also help Healtheon continue to dominate the Atlanta market.

- **Yahoo! Inc. –** On June 23, 1999, Healtheon and Yahoo! signed an agreement in which Yahoo! will integrate select Healtheon services as part of Yahoo!® Health (http://health.yahoo.com). Healtheon will provide medical information and research to users of Yahoo! In turn, Healtheon will be advertised throughout the Yahoo! network increasing awareness of Healtheon's services and establishing a significant brand name for the company.

- **Medic Computer Systems, Inc. -** Misys plc, the parent company of Medic, a provider of software and e-commerce solutions to physicians, has agreed to integrate its system with Healtheon's web portal. This agreement increased physician users of Healtheon by another 65,000 as of May 20, 1999.

- **Neoforma.com-** Through a deal made with Neoforma.com on May 19, 1999 physicians using Healtheon™ Practice will have free access to Neoforma.com so that medical products may be purchased on-line at lower costs and greater ease.

- **InteliHealth® -** As of April 26, 1999 Healtheon entered into an agreement with InteliHealth in which they will provide health information and online healthcare e-commerce services to users of Healtheon's consumer portal. In addition, the two will begin the development of additional Internet applications designed to enhance consumers' ability to access medical information and purchase medical products.

- **Drugstore.com-** Drugstore.com became a preferred pharmacy on Healtheon's consumer web portal as of April 22, 1999. The alliance improved upon the consumer services offered by Healtheon and served as an example of Healtheon's determination to continue to design their site with the consumers' well being in mind.

- **SmithKline Beecham Clinical Laboratories, Inc. -** A five-year agreement was established between SBCL and Healtheon on February 9, 1999 to expand upon the services Healtheon already offered to SBCL. A partnership was established due to an earlier acquisition of ActaMed. SCAN, a service provided by ActaMed, had previously been the computer software that SmithKline's labs used to receive test orders and provide results. The two organizations are working on finishing Healtheon™ Dx to replace the older SCAN technologies. Healtheon has access to over 60,000 providers through SBCL.

- **IBM-** IBM and Healtheon decided to jointly market their services on January 27, 1999. Users of Healtheon's Internet-based services can also utilize IBM's Health Data Network applications including its Master Person Index, Clinical Data Repositories, and Global Registration services intended to more easily organize patient charts and the registration process. In turn, IBM health customers may make use of Healtheon's e-commerce transaction services.

- **Brown & Toland Medical Group-** On January 20, 1999, Healtheon introduced Healtheon™ Practice to the more than 2,000 physicians who are members of Brown & Toland, the largest independent network of physicians located in San Francisco. Physicians will be directly connected to one another and the Brown & Toland central office so that eligibility, authorizations, and referrals can more easily be processed. This

partnership began in September 1997 when Healtheon became the provider of managed care services and information technology to Brown & Toland.

- **Hill Physicians-** Hill began use of Healtheon's services in August of 1998 for insurance claims processing. On January 6, 1999, Hill put Healtheon's Internet transaction services to the test and Healtheon did not disappoint. Claims processing that had normally taken 7 days was completed in a staggering 30 minutes, further elucidating the rapid speed at which healthcare transactions can be processed with Healtheon's Internet-based applications.

- **United HealthCare Corporation-** The largest HMO in the US, United HealthCare, had established connections with Healtheon after Healtheon's acquisition of ActaMed, the previous healthcare information services provider for United HealthCare. The relationship built has provided Healtheon with 2.5 million transactions per month and significantly increased Healtheon's network across the United States.

- **Beech Street Corporation-** One of the largest Preferred Provider Organizations in America, Beech Street entered into an agreement with Healtheon in December of 1997 that had placed Healtheon in charge of their information technology and healthcare software development increasing Healtheon's reach to another 320,000 locations.

RECENT MERGERS AND ACQUISITIONS

Healtheon has utilized mergers and acquisitions to expand its reach across the United States, acquire the latest Internet technologies and applications, and diversify the services it provides. In May 1998, Healtheon acquired ActaMed and its vast array of networking solutions for the healthcare industry. A significant relationship with United HealthCare arose from this acquisition. An acquisition of Metis, LLC in August 1998 brought strong consulting and Internet development experience to Healtheon. Healtheon has continued in its pursuit of the latest technology and complementary services. The following is a list of more recent mergers and acquisitions undergone by Healtheon:

- **Greenberg News Networks, Inc.-** Healtheon signed an agreement on July 1, 1999 to acquire Greenberg News with an interest in its Medcast Networks, a leading distributor of medical news disseminated via the Internet. The merger will enhance the number of physician users of Healtheon and may help increase transaction volume as more providers become aware of the ease of use and cost reduction capabilities of the services Healtheon provides.

- **WebMD, Inc. –** On May 20, 1999, Healtheon and WebMD, the leading provider of Internet medical information services, had agreed to merge. 1.815 Healtheon shares will be exchanged for each WebMD share as each company will hold 50% of the others fully diluted shares. Jeff Arnold current CEO of WebMD became the Chief Executive Officer of Healtheon/WebMD while the CEO of Healtheon, W. Michael Long, has become the Chief Operating Officer. The merger will help establish what has been termed the first end-to-end online healthcare solution. Healtheon's established transaction services along with WebMD's large subscriber base and brand name will help build a very powerful force in the healthcare information technology and e-commerce industry. The merger has been so compelling that a number of organizations have provided funding and advertising contracts including Microsoft, Covad, Excite, Intel, Softbank, and Superior Consultant, in addition to a prior commitment by DuPont.

- **MEDE AMERICA CORPORATION –** On April 21, 1999, Healtheon agreed to acquire MEDE AMERICA, previously a formidable competitor offering similar healthcare transaction solutions. An exchange of 0.6953 shares of Healtheon stock for each share of MEDE AMERICA will take place. The acquisition will help increase Healtheon's transaction volume as MEDE AMERICA had previously averaged approximately 350 million e-health transactions per year.

KEY RISK FACTORS

Short-term:

- On August 10, the holding period ended. Insiders were free to trade millions of shares obtained through the company's recent public offering and several acquisitions. The stock's price sunk as insiders took profits. A similar situation may occur sometime in September when another holding period ends on other shares. In the long-term, this will have little effect on the stock's price.

Long-term:

- The first quarter of 1999 was the first time that the company's revenues could be attributed to Internet services. In the past, the majority of revenue had come from the various companies that had been acquired, as well as, non-Internet services including consulting and information technology development. The business model has only truly been tested for a quarter and can not be considered convincing until more time has expired.

- United HealthCare is currently negotiating with Healtheon on a new contract in which charges for subscriptions and transactions will reportedly be reduced in comparison to the current prices the organization is paying for similar services. This may have a significant impact on total revenue as over 10% of Healtheon's revenue is derived from United HealthCare's employment of their services.

- The healthcare industry is very reluctant to make change. It remains to be seen whether Healtheon will be accepted as a solution to current inefficient methods of transacting in the healthcare arena. Medical records are highly confidential and until providers and patients can be assured of the secure nature of Healtheon's Internet-based applications, a significant portion of the healthcare community will continue to rely on documents and word of mouth transactions.

- In order to continue to lead the e-healthcare revolution, Healtheon will be required to remain acquisitive. Purchasing the latest technologies and companies is necessary to increase customer base, yet, financing these acquisitions may prove costly, as well as, may deteriorate the current unity among management and the organization as a whole.

- The healthcare industry is continually evolving and transforming. The compelling force to decrease the increasing rate of the cost of care may actually indirectly diminish Healtheon's revenues. On the one hand, one would expect revenues to escalate as this cost reduction theme seems to warrant the services provided by Healtheon. However, alternative methods to cut costs like Clinton's Medicare Reform Proposal may indirectly slash revenues.

- Y2K compliance, although only a minor issue for Healtheon itself, may still affect the companies that Healtheon has partnered with. Healtheon expects that it will only have to expend several million dollars updating some of its older systems to avoid any Y2K complications. However, a large number of hospitals and healthcare institutions operate with outdated computer systems that have not been re-programmed for Y2K. Previously installed Healtheon applications on these older systems may become inoperable decreasing subscriber base and transaction volume. It is still not evident how great an impact Y2K will have on the healthcare industry and business, in general.

COMPETITION

It may appear that competition is on the rise with several large healthcare Internet sites and applications developers having been established recently including Dr. Koop.com and MedCare Online. However, there is not a competitor that provides a greater mix of services to a larger variety of healthcare participants. Healtheon,

especially after the recent merger with WebMD, has a stronghold in the Internet healthcare transaction and information services markets. The demand for its diversified set of services will lead it ahead of any competition.

MEDE AMERICA posed a formidable challenge to Healtheon, however, Healtheon has acquired MEDE AMERICA as of April 21, 1999. The only existing competitor to mimic such transaction and information services is Medcare Online. However, Medcare Online is targeting only physicians and consumers via the Internet. Medcare Online has made a commitment to develop transaction services, yet, it is not evident if they will be successful as their site is still under construction.

Dr. Koop.com has gotten a lot of press recently, however, the site only provides medical news and information to consumers. The site does not yet support any transaction services. WebMD's customer base and brand name are much more established. The diversified services which target all of the participants of the healthcare industry will lead Healtheon ahead of any competitors that have established a niche in one area of healthcare information technology and not diversified. Healtheon is the only end-to-end Internet healthcare and e-commerce company that provides services to all members of the healthcare community. Healtheon is far and away the leader of the health-net revolution. Barriers to entry, including Healtheon's acquisition of almost all existing technology required to provide healthcare transaction services will keep Healtheon ahead for some time.

The following table illustrates the major competitors of Healtheon:

Table 1	Publicly Traded Competitors 7/29/99						
	Healtheon	**McKesson HBOC**	**Dr. Koop.com**	**Medcare Online**	**IDX Systems**	**Infocure**	**Computer Sciences**
Symbol	HLTH	MCK	KOOP	MCAR	IDXC	INCX	CSC
Services	Internet-based transaction and information services and information technology consulting	Healthcare applications and software	Internet based medical news service	Medical products sold via the Internet, developing Physician Virtual Office	Software products tailored to physicians needs	Practice Management Software for physicians	Healthcare and information technology consulting
Strength	End-to-End Internet Services dedicated to all participants	Brand name, healthcare software, diversified set of products	AOL supported medical information services	Developing Internet transaction services for physicians	Strong healthcare software	Strong healthcare software solutions	Healthcare consulting services to support technology
Weakness	Internet services still under development	Under financial investigation, no Internet exposure	Not diversified, only provides information, no transaction services	Still under development only provides services to physicians and consumers and ignores other participants	Not diversified, do not pose significant competition as Healtheon doesn't derive revenues from software	Do not target enough of the participants and only produce software	Strong consulting services but not diversified and not a strong presence in software development

ANALYSIS OF FINANCIALS

Revenues- The first quarter marked the first time since the inception of Healtheon that significant revenues were derived from Internet services, in addition to, revenue from providing network applications and consulting

services. Healtheon earns revenue from their Internet services by charging subscription fees and thereafter, on a per transaction basis. In the past, United HealthCare, SmithKline Labs, Beech Street, and Brown & Toland each made up more than 10% of total revenue posing a large amount of financial risk if one of the four clients should decide to terminate the usage of Healtheon's services. This has begun to change as Healtheon continues to partner with a greater number of healthcare companies. Total revenue increased to $22.7 million in the first quarter of 1999.

Gross Profit– As revenues continue their ascent with an increasing number of users and transactions, gross profits will also increase. The cost of services will decline as the increase in customers will help spread out the large fixed costs. Gross Profit for the years ending December 31, 1999 and 2000 will double prior years' numbers.

Operating Expenses- Development and engineering expenses will continue to grow at a steady small rate as Healtheon continues to acquire and develop new technologies and hire additional engineering professionals. Selling, general, and administrative expenses will increase slightly as the Healtheon name must be established by advertising and marketing forces. Acquisition costs will also increase as intangible assets from the purchases made by Healtheon will be amortized over a 3-5 year period.

Net Income- Net Income after taxes will decline slightly in 1999 due to increasing development, advertising, and acquisition expenses. But, in 2000, net income will increase with an increasing number of new clients subscribing and transacting on the website. Healtheon will move significantly closer to reporting positive earnings.

Cash- Healtheon has $63.2 million in available cash, a substantial amount to fund acquisitions in the near future, as well as, pay off any outstanding debt.

Number of Shares Outstanding- Roughly 70 million shares are outstanding and this number will not vacillate to a great extent unless the company decides that it must issue additional shares to finance a greater number of acquisitions than expected.

Valuation

Internet Sector- Healtheon had moved in line with the rest of the Internet sector until the announcement of its acquisition of MEDE AMERICA in April and later the stock soared in May and June around the time the WebMD merger was announced. The price of the stock has fallen dramatically from its 52-week high at 126.188, as has the Internet sector in general. The price may come down a little in the short term if insiders decide to trade their shares when the holding period on the sale of shares obtained in the initial public offering ends in August and September. As revenue numbers and earnings come out for the second quarter and client base continues to increase, the stock price should begin its ascent again.

Courtesy of BigCharts

Revenue Growth- We expect that revenue will continue to rapidly increase by approximately 89% by the end of the fiscal year 1999 as new clients are added and the business model becomes proven. Revenues will also increase as transaction volume and customer base increases through the acquisition of MEDE AMERICA and the merger with WebMD. Revenue will continue to grow at a fast pace through 2000. The little competition that does exist will have a relatively small effect on Healtheon's revenues unless these competitors are able to develop similar Internet-based transaction services. Healtheon, however, still must add new clients and increase transaction volume to continue to boost revenues, otherwise, revenues may decline as United HealthCare negotiates for lower prices.

Price to Sales Ratio- Due to the fact that most emerging Internet companies including Healtheon do not post positive earnings, the price to earnings ratio can not be used to predict future performance. We turn to the price to sales ratio to evaluate the stock's valuation. Currently, Healtheon's price to sales ratio is a lofty 50.18. But, it is difficult to use this figure to evaluate the price of the stock because Internet-based revenues are just beginning to grow. If we look towards the future, the stock is trading at roughly 15X expected year 2000 revenues, a slightly more reasonable number.

Table 2		**Value Comparison 8/13/99**			
Company	$ Price	Market Cap in Millions	Gross Margin	Trailing 12 Month Sales in Millions	Price/Sales
Healtheon	34.63	2,460	4.00%	49.00	50.18
McKesson HBOC	29.50	8,292	0.30%	30,382.00	0.25
Dr. Koop.com	17.38	478	NA	Negligible	NA
Medcare Online	3.63	28	NA	1.00	19.11
IDX Systems Corp.	19.38	536	2.60%	321.00	1.67
Infocure	47.50	642	4.80%	115.00	5.59
CSC	65.69	10,454	4.50%	7,970.00	1.31

The value comparison above comparing Healtheon to other healthcare information services companies is not especially helpful because Healtheon really does not have a competitor among this list that can be used for comparison.

Table 3		**Value Comparison 8/13/99**			
Company	$ Price	Market Cap in Millions	Gross Margin	Trailing 12 Month Sales in Millions	Price/Sales
Healtheon (HLTH)	34.63	2,460	4.00%	49.00	50.18
Ticketmaster.com (TMCS)	29.81	2,158	-38.50%	52.00	41.99
Priceline.com (PCLN)	66.50	9,464	4.82%	35.00	266.00
Vertical Networks (VERT)	33.06	1,238	14.77%	3.00	405.89
Net.B@nk (NTBK)	20.38	526	22.10%	24.00	21.45

Above is a listing of various companies that are more comparable to Healtheon in the sense that they provide internet-based services. They however, are obviously not providers of healthcare e-services and thus, do not represent direct competitors of Healtheon.

The price to sales ratios of these four companies above are much more revealing than the companies that operate in the same industry as Healtheon. Ticketmaster and Net.B@nk both demonstrate price to sales figures lower than that of Healtheon. This might, at first glance, lead one to believe that Healtheon may be overvalued. However, both companies have significant competition. There are other competing Internet sites

which present a similar set of services, namely ticket sales and online banking. Vertical Networks and Priceline.com, two very novel sites, both garner price to sales multiples far in excess of Healtheon's 50.18. Healtheon, like these two websites, provides unique services. With a price to sales of 5.3x less than Priceline.com and 8x less than Vertical Networks, Healtheon appears to be rather undervalued, in fact.

Gross Margins- Present gross margins are not very indicative of what the future has in store for Healtheon. Gross margins are expected to increase significantly as customer base and transaction volume increase and average fixed costs decline. Year 2000 estimates project gross margins of 38.1%.

Investment Opinion

We believe that in the long term, Healtheon will continue to increase revenues and decrease costs causing an appreciation in the stock's price. Even though the price to sales ratio is higher than usual, the company's valuation is justified considering its strong business model, lack of competition, and increasing growth in revenue and gross margins. The recent WebMD merger will help increase customer base and add brand name recognition. The stock's price has fallen dramatically from its 52-day high and this, in combination with the factors mentioned above, are the reasons that lead us to give Healtheon a BUY recommendation.

Healtheon												
Statements of Operations												
($000, except per share data)			1Q98	2Q98	3Q98	4Q98	FY98	1Q99	2Q99	3Q99E	4Q99E	FY99E	FY00E
Net Sales			$9,754	$10,899	$12,578	$15,607	$48,838	$17,555	$22,698	$24,126	$28,132	92,511	$153,032
Cost of Services			7,948	10,139	13,807	15,300	47,194	16,860	17,914	19,031	20,743	74,548	94,762
Gross Profit			1,806	760	(1,229)	307	1,644	695	4,784	5,095	7,389	17,963	58,270
Operating Expenses:													
Development and engineering			3,919	4,413	4,704	6,848	19,884	7,341	7,220	6,375	6,210	27,146	38,347
Sales, general and administrative			4,966	7,157	4,918	7,190	24,231	9,022	10,886	9,074	9,330	38,312	40,509
Amortization of Intangible Assets			1,949	1,989	2,765	3,154	9,857	3,459	4,867	3,832	3,463	15,621	12,795
Writeoff of offering costs			--	--	--	1,620	1,620	--					
Total Operating Expenses:			10,834	13,559	12,387	18,812	55,592	19,822	22,973	19,281	19,003	81,079	91,651
Loss from Operations:			(9,028)	(12,799)	(13,616)	(18,505)	(53,948)	(19,127)	(18,189)	(14,186)	(11,614)	(63,116)	(33,381)
Net Interest Income (Expense)			(648)	144	87	317	(100)	558	624	215	125	1,522	1543
Net Loss			(9,676)	(12,655)	(13,529)	(18,188)	(54,048)	(18,569)	(17,565)	(13,971)	(11,489)	(61,594)	(31,838)
Operating Loss Per Share			-0.19	-0.26	-0.26	-0.35	-1.07	-0.31	-0.26	-0.20	-0.16	-0.93	-0.47
Diluted Loss Per Share			-0.21	-0.26	-0.26	-0.34	-1.07	-0.30	-0.25	-0.20	-0.16	-0.91	-0.44
Diluted Shares Outstanding			46,467	49,561	52,260	53,145	50,358	62,665	69,907	70,120	70,770	273,462	71,760
Margin Analysis (% of Sales)													
Gross Margin			18.5%	7.0%	-9.8%	2.0%	3.4%	4.0%	21.1%	21.1%	26.3%	19.4%	38.1%
Development and engineering expense			40.2%	40.5%	37.4%	43.9%	40.7%	41.8%	31.8%	26.4%	22.1%	29.3%	25.1%
Sales, general and admin expense			50.9%	65.7%	39.1%	46.1%	49.6%	51.4%	48.0%	37.6%	33.2%	41.4%	26.5%
Operating Losses													
Profit (Loss)			-92.6%	-117.4%	-108.3%	-118.6%	-110.5%	-109.0%	-80.1%	-58.8%	-41.3%	-68.2%	-21.8%
Net Income			-99.2%	-116.1%	-107.6%	-116.5%	-110.7%	-105.8%	-77.4%	-57.9%	-40.8%	-66.6%	-20.8%
Growth (sequential)													
Net Sales (sequential)			52.6%	11.7%	15.4%	24.1%	NA	12.5%	29.3%	6.3%	16.6%	NA	NA
Net Sales (yr. over yr.)			NA	NA	NA	NA	264.7%	80.0%	108.3%	91.8%	80.3%	89.4%	65.4%
Cost of Revenue			64.9%	27.6%	36.2%	10.8%	NA	10.2%	6.3%	6.2%	15.8%	58.0%	21.3%
Gross Profit			15.0%	-57.9%	-261.7%	125.0%	NA	126.4%	588.3%	6.5%	45.0%	992.6%	224.4%
Development and engineering			18.6%	12.6%	6.6%	45.6%	NA	7.2%	-1.6%	-11.7%	-2.6%	36.5%	41.3%
Sales, general and admin			39.7%	44.1%	-31.3%	46.2%	NA	25.5%	20.7%	-16.6%	2.8%	58.1%	5.7%
Total Operating Expenses:			-15.0%	25.2%	-8.6%	51.9%	NA	5.4%	15.9%	-16.1%	-1.4%	45.8%	13.0%
Loss from Operations:			42.2%	41.8%	6.4%	35.9%	NA	3.4%	-4.9%	-22.0%	-18.1%	17.0%	-47.1%
Net Loss			43.7%	30.8%	6.9%	34.4%	NA	2.1%	-5.4%	-20.5%	-17.8%	14.0%	-48.3%