

# MedPlus, Inc.

OTC: MEDP- \$5.31

(www.medplus.com)

November 14, 2000

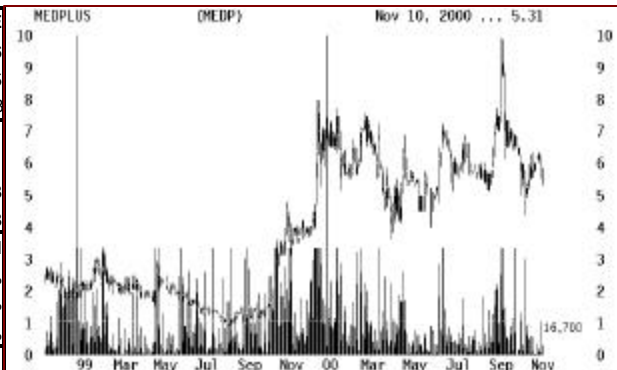
Richard J. Wayman, CFA  
rwayman@researchstock.com

## Initiating Coverage

**Strategically Positioned to Benefit from Proprietary Web-Based Technology, Growing Demand for a Unified Solution, and a Key Alliance with a Major Healthcare Provider.**

Current Data		EPS		P/E
Fiscal Year End:	Jan	2000	\$ (0.95)	-5.6
Current Price	\$ 5.31	2001E	\$ (0.97)	-5.5
52-Week Range	10-3	2002E	\$ 0.02	343.8
Shares Out (Mill)	8.2	Valuation		Current
Ave Volume LTM	16,542	P/E (Next FY)	-5.49	NM-NM
Market Cap. (Mill.)	\$ 43.6	P/B	3.12	12.3-0.8
LTD/Tot Cap	-	Price/Sales	2.88	5.0-1.8
Institutional Holdings	3.8%	Operating Data		This Qtr
Insiders Holdings	69.9%	Sales Growth	49.3%	3.3%
Book Value	\$ 1.70	EBITDA Margin	-69.5%	0.4%
10Yr Bond	5.78%	Net Inc. Growth	-7.0%	30.4%

Source: Baseline, researchstock.com



Source: Baseline

## Key Investment Points

- Proprietary web-based platform helps doctors, hospitals, and labs operate more efficiently.
- Demand for this platform expected to increase as providers are faced with the growing need to reduce costs and meet new government regulations.
- Provides a wide range of information solutions to healthcare community.
- Alliance with Quest Diagnostics expected to be a key competitive advantage.
- Two recent equity investments underscore the Company's potential and eliminated debt.
- Our 12-18 month target price is \$11.00

## Company Description

MedPlus, Inc. ("MEDP") provides healthcare information management systems and is a leading provider of Internet-based solutions. MedPlus systems help healthcare organizations: generate additional revenues; reduce operating costs; comply with government-mandated security and confidentiality regulations; and increase physician productivity. The Company has sold over 140 imaging and electronic patient systems in the US and Canada. In June 2000, MedPlus announced a strategic joint-marketing partnership with Quest Diagnostics (DGX-\$112.88) and that Quest was investing a total of \$10.0 million in MEDP.

## INVESTMENT THESIS

The healthcare information industry is a huge market with some researchers estimating that \$250 billion is spent annually on medical claims paperwork alone. In addition, proposed government regulations could cost over \$20 billion more. However, despite advances in information technology only 10% of the estimated \$30 billion annual healthcare transactions are currently electronic, leaving a \$27 billion untapped market. This lack of automation in the healthcare sector exists because the many legacy systems that have been installed on a piecemeal basis can't talk to each other. This represents a significant opportunity for the provider who can meld these disparate systems in a cost-effective and easy to use way.

While there are many firms in the healthcare information technology ("HIT") sector, we think MedPlus is uniquely positioned to benefit from this environment. The Company is one of the few, if not the only, firm that has a system that focuses on providing physicians with consolidated patient information by linking hospitals, doctors' offices, pharmacies, insurance providers, AND labs. ***The bottom line is that MEDP systems increase operating efficiencies by reducing paperwork, helping hospitals comply with HIPAA and JCAHO requirements, and makes physicians more efficient by allowing them to view patient records, outcomes, and lab results from their own desktop via the Internet.*** The combination of: increased need for a unifying system that reduces costs; growing number of "digital doctors"; and MEDP's solutions are expected to result in significant EPS growth.

## COMPANY OVERVIEW

Since its inception in 1991, MEDP has focused on helping medical organizations cope with the challenges of improving operating efficiencies while complying with increasing government regulations. The company's product line consists of a full range of solutions that are compatible with all legacy systems.

### Product Line

MEDP's product offering consists of Healthcare Solutions (approximately 75% of annual revenues) and Workflow and Content Management (support and consulting services). Because MEDP's price for a typical HIT system ranges between \$0.5 million to \$1.5 million; the sales cycle can take between six to eighteen months. Quarterly revenues can be volatile because the length of the sales cycle and the timing of installations.

### Healthcare Solutions

MEDP designed its healthcare solutions with open architecture and modular functionality to allow them to be compatible with existing systems without requiring support from the legacy vendor(s). Compatible independence allows MEDP to market its solutions without the need to involve third parties, and helps control implementation costs.

The Company has three core solutions ranging from an Internet-based solution to a consulting practice that help organizations re-engineer their HIT systems.

**eMaxx™** is the Company's physician-oriented portal-based product that aggregates critical clinical applications. This ASP (application service provider) version of ChartMaxx (described below) provides clinicians Internet access to historical records, complete charts and the ability to order/review lab tests. The system's key competitive advantage is that it is more inclusive than competing systems that were designed to focus on specific applications such as administration (i.e. payment record-keeping and receivable management) or insurance processing. The key benefit of eMaxx is that it increases

doctors' efficiency by providing remote access from their office desk to hospital records via the Internet (remote chart completion) and is a cost-effective way to implement a sophisticated HIT solution.

In December 1999, MEDP and Quest Diagnostics (NYSE: DGX) executed a 5-year agreement that allows DGX to use eMaxx to transmit and receive lab results. In January 2000, MEDP signed a licensing agreement with Cybear, Inc. (NASDAQ: CYBA) to provide access to eMaxx over the Internet using an ASP format.

**ChartMaxx** is an enterprise-wide, hospital-based electronic information system. As of year-end 1999, there were 20 ChartMaxx contracts nationwide.

The key features of ChartMaxx are:

- Centralized database provides hospitals with a competitive advantage when attempting to gain admitting privileges for high volume physicians;
- Improves outcomes by preventing unnecessary tests, misdiagnosis, improper treatments, and ineffective medications;
- *Patient-centric database* increases ability to evaluate treatments;
- Complies with regulatory mandates (HIPAA, JCAHO accreditation, and DOJ/FTC Statement 8) for confidentiality and security; and
- Increases operating efficiencies by reducing record-keeping costs and improves receivables management.

**OptiMaxx Archival System** is a customized optical disk storage and retrieval system that increases operating efficiencies by reducing record keeping costs. Hardware and software from third-party providers are combined with proprietary MEDP technology that allows the platform to work seamlessly. A key feature of OptiMaxx is its ability to capture data directly from existing computer storage systems without the need for other software (a "host" MIS) or data manipulation. OptiMaxx acts as a peripheral (like a printer) that stores data and can retrieve it in its native format, without conversion. At year-end 1999, there were over 120 sites with OptiMaxx systems.

#### Workflow and Content Management

Universal Document is a wholly owned subsidiary of MEDP that provides workflow and content management products, including Step2000®. Step2000 provides integrated workflow management system with Web deployment capability that facilitates B-2-B applications. Universal Document's client base consists of Fortune 500 companies such as Mercedes-Benz, Marathon Oil, Boeing North American, Inc., PPG Industries, and Sears.

## INDUSTRY OVERVIEW

It seems that technological advances have improved service levels in all facets of life, except healthcare. An individual can order almost anything online and get it within three days, but it still takes months to resolve medical bills, especially when you go to the hospital (if you can remember why you got billed in the first place). You can log onto your email from anywhere with a phone line, but an Emergency Room doctor in another state can't access your health records while you lie in their Emergency Room. Despite technological advances, the healthcare system remains largely paper-based and a conglomeration of disparate legacy systems that can't communicate.

To be fair, no one party can be blamed for this situation. A healthcare transaction is not like buying a book; there are many more parties involved. An average doctor visit involves the doctor, patient, nurses, insurer, lab, and the government. Add a hospital stay and the situation is even more complicated. Healthcare providers face the challenges of treating a rapidly increasing clientele, rising costs, and a government that mandates reduced revenues. With all these independent parties trying to find the best solution for *their* problems, it is little wonder that the health sector suffers from a Tower of Babel environment.

However, HIT investing by healthcare providers has accelerated, and more is expected. There are three main forces that are driving increased HIT spending:

**Economic:** The need to increase operating efficiencies is forcing providers to invest in new technologies to lower costs. As hospitals merge into citywide systems, the need to integrate and communicate has necessitated HIT upgrades.

**Regulatory:** New government regulations are forcing healthcare providers to improve HIT. Recent major regulations are:

- The proposed Health Insurance Portability and Accountability Act of 1996 (HIPAA) that mandates security protocols for medical records;
- Department of Justice and Federal Trade Commission dictates on how clinical data must be integrated to negotiate managed care contracts on a fee-for-service basis (usually referred to as "Section 8"); and
- The Joint Commission for Accreditation of Healthcare Organizations (JCAHO) is responsible for accrediting all hospitals and mandates performance levels that require integrated data systems.

**Technological:** Advances in telecommunication and computer systems are making it easier and cheaper to upgrade and integrate legacy systems. Solutions can range from implementing an optical storage system to choosing an ASP provider to host the data via the Internet.

We think the market potential is very large, but determining a dollar value is difficult because of the diverse nature of the sector. Research firms have developed market estimates, but we think there could be some overlap. For example;

- The GartnerGroup estimates that revenues from integrated document processing will hit **\$1.9 billion** in 2003;

- DataQuest estimates that the ASP market will grow to **\$22.7 billion** in 2003; and
- The healthcare industry is the largest sector in the US economy with **\$1.2 trillion** of revenues, of which about \$300 billion is spent on healthcare data.

Regardless of this measurement issue, the prospect of growing paperwork and the need to wring savings from the system provide significant incentives to reduce that expense by investing in HIT.

## **COMPETITIVE ADVANTAGES**

MEDP has four major competitive advantages:

- 1. A focus on providing patient-centric solutions to all healthcare professionals.** MEDP is focused on providing patient-centric IT solutions to hospitals, doctors, test labs, and insurers. In contrast, services provided by other firms range from sector-specific solutions (i.e. insurance claims processing) to companies whose business model is to be a web-based vertical portal that links all the parties and is an information resource for individuals. We think MEDP is strategically positioned in the middle of this range. It avoids the limitations of being a single-focus solution while avoiding the trap of trying to be everything to everybody.
- 2. A wide range of services.** The Company's product line ranges from consulting and data imaging to state of the art web-based data sharing. The depth of MEDP's product line allows it to meet any degree of need, be it an initial ROI analysis to implementing an Internet-based integrated solution.
- 3. Proprietary software that is compatible with all legacy systems.** MEDP's software works with any legacy system, and it can be implemented without the need to involve the legacy vendor(s). This means that clients need to work with just MEDP to solve their HIT issues. Compatibility also allows MEDP to joint market their solutions with legacy vendors. The Company currently has strategic selling and preferred vendor agreements with Quest Diagnostics, Quorum Health Resources, Sunquest Information Systems, Inc., Medical Systems Management, Inc., and Lason, Inc., among others.
- 4. The Quest Partnership provides a solid partner and significant brand name awareness.** Quest Diagnostics is the largest reference lab firm in the US and has teamed with MEDP to develop its branded web-based HIT system that allows physicians to order tests and get results over the Internet. This relationship should result in rapid volume growth as doctors transition to ordering and reviewing test results over the Internet. Not only was Quest impressed enough to team with MEDP, but it also invested a total of \$10.0 million in MEDP (with options that could amount to a 30% stake on a fully diluted basis) and a seat on MEDP's Board of Directors.

## MANAGEMENT

### *Richard A. Mahoney, Chairman of the Board and Chief Executive Officer*

Mr. Mahoney has extensive experience in the areas of strategic planning, marketing, and financing for healthcare institutions. In addition, he has lectured on subjects such as managed care, capitation, integrated provider networks, computer-based patient record systems, and regional healthcare alliances. He:

- Has been President of the Company from 1991 until July 2000, and has held the titles of Chairman of the Board and Chief Executive Officer of the Company since November 1995.
- Was, before joining MEDP, president of a company that provided equipment financing for hospitals and related organizations.
- Received his Bachelor of Arts degree in English Literature from Cleveland State University.

### *Philip S. Present II, President and Chief Operating Officer*

Mr. Present oversees all functional areas of the Company. He:

- Joined the Company in April 1995 as Vice President of Corporate Development.
- Was named the Chief Operating Officer of the Company in June 1996, became a Director in December 1997, and was elected President in July 2000.
- Was previously employed by KPMG Peat Marwick LLP (September 1973 to March 1995) and prior to leaving, served as the Partner-in-Charge of the Information Communication and Entertainment Practice for the Ohio Valley and Southeast regions of the United States.
- Received his Bachelor of Science in Business and Master of Business Administration degrees from Miami University

### *Richard Howe, President of e-Health Ventures (an internal reporting division)*

Dr. Howe is responsible for assisting in the development of E-health product and service offerings and developing and advancing business relationships in the business-to-business healthcare market. He:

- Is a nationally recognized expert in healthcare information technology.
- Joined the Company in January 2000 in his current position.
- Was most recently a Senior Vice President at Superior Consultant Company where he served as a member of the Superior Advisory Group of Executives (SAGE), the company's group of nationally recognized healthcare executives.
- Served as Associate Senior Vice President for Information Technology at the University of Cincinnati Medical Center and University Hospital, and Chief Information Officer at the University of Alabama Hospital.
- Has published over 50 technical and scientific articles and is a frequently invited speaker at professional meetings.
- Received his Bachelor of Science degree in Biology from University of Colorado and a Ph.D. in Medical Physiology from University of California - Los Angeles.
- Served as National President of the Healthcare Information and Management Systems Society (HIMSS) for 1996-1997.

### *Paul F. Albrecht, Vice President of Product Development and Chief Technical Officer*

Mr. Albrecht leads all product development within the healthcare division. He:

- Joined the Company in May 1994 as the Director of Electronic Patient Record System Development.
- Was named Vice President of Technology and Chief Technical Officer in May 1997.

- Prior to joining the Company, was Director of the Platform Development Center for Cincinnati Bell Information Systems and oversaw the development of distributed client/server systems for high volume, mission critical applications.
- Was a software engineer and technical manager at AT&T Bell Labs. While at AT&T Bell Labs, he led the development of a healthcare clinical information system and developed core technology for the UNIX operating system.
- Has published technical articles on programming languages, UNIX, neural networks and healthcare applications.
- Received a Bachelor of Arts degree in Math and Computer Science from St. Mary's College in Winona, MN and a Master of Science in Computer Engineering from the University of California - Berkeley.

*Daniel A. Silber, Vice President of Finance and Chief Financial Officer*

Mr. Silber is a CPA and has overall responsibility for all financial reporting, processes and procedures. He:

- Joined the Company in May 1995 as Vice President of Finance and Chief Financial Officer.
- Prior to joining the Company, was Chief Financial Officer of Saturday Knight Ltd., Chief Financial Officer of Tipton Associates, Treasurer of Emery Realty, Inc., and a Senior Accountant with Coopers and Lybrand.
- Received his Bachelor of Science in Management and Master of Business Administration from Miami University.

*Peter W. Stephan, Vice President of Sales*

Mr. Stephan has spent his entire career in sales, with previous experience in the health care field. He:

- Joined the Company in February 2000.
- Was General Manager of Wallace Computer Services, Inc.'s Health Care Division.
- Spent his entire career at Wallace, serving as Divisional Vice-President for West Coast Sales, General Sales Manager-Dallas, and Director of Corporate Marketing.

*Thomas R. Wagner, Vice President of Strategic Planning.*

Mr. Wagner has over twelve years of experience with software development companies. He:

- Joined the Company in June 1999 in his current position.
- Was Chief Technology Officer of DiaLogos from 1997 to 1999.
- Served as Director of Advanced Research and Development with Cincom Systems, Inc. and developed a product that was later voted among the top 10 products of the year by Client-Server Tools Bulletin.

**NEW BOARD MEMEBERS**

During the last year, MEDP was able to add three new members to the Board of Directors that provide significant expertise and contacts in the healthcare field:

*Edward Cahill, Director*

Mr. Cahill joined the Company as a director in June 1999. He:

- Is a founding partner of Cahill, Warnock & Company, a privately-held investment company specializing in private equity and negotiated direct investments in emerging public and private companies.
- Was, prior to founding Cahill, Warnock & Company, a Managing Director at Alex. Brown & Sons. From 1986 to 1995 he headed that firm's Health Care Investment Banking Group and

completed offerings for the first public companies in the home health care, health maintenance organization, ambulatory surgery center and physician practice management industries, as well as several of the leading biopharmaceutical companies.

*Kenneth W. Freeman, Director*

Mr. Freeman has been a director of the Company since June 2000. He:

- Is Quest Diagnostics' President, Chief Executive Officer, a member of the Board of Directors (since 1995) and Chairman since 1996.
- Spent 24 years, prior to joining Quest, at Corning Incorporated, holding several positions including Controller, Senior Vice President, General Manager of the Science Products Division and President and Chief Executive Officer of Corning Asahi Video Products.

*Edward L. Samek, Director*

Mr. Samek became a director of the Company in February 2000. He:

- Currently serves as the Vice Chairman and as a director of MedQuist Inc., the country's largest provider of electronic medical transcription services to hospitals, clinics and group practices.
- Was formerly the Chairman and Chief Executive Officer of The MRC Group, a leading privately held electronic medical transcription company that was acquired by MedQuist in December 1998.
- Also served as President of SecrePhone Ltd., a provider of medical transcription services, Hudson Pharmaceutical Corporation and Childcraft Education Corporation.
- Is a director of the Medical Transcription Industry Alliance, served as president of that organization for two terms (1996-1999).

## **OPERATING RESULTS**

### Historical Review

A historical review is complicated because, in our opinion, MEDP redefined itself during the 1997-8 period. Prior to 1998, MEDP's product line was focused on a bar chart product called IntelliCode, which was the Company's founding technology. MEDP sold IntelliCode in January 1998. In 1997, the Company focused on utilizing emerging software and optical technologies and by making the ChartMaxx and OpitMaxx its core product line. MEDP also changed its fiscal year from December 31 to January 31 effective January 31, 1997. Due to this change in focus, we feel that results prior to January 1997 are not as relevant to analyzing MEDP's long-term investment potential. We will, however, briefly present results for the entire period for perspective.

Figure 1 illustrates the pro-forma trend in sales of MEDP's current core product line and excludes IntelliCode revenues. The 1996-7 bar represents the 12-months ending 1996 excluding IntelliCode results. (We ignored fiscal 1997 because it contained only one month of operations.)

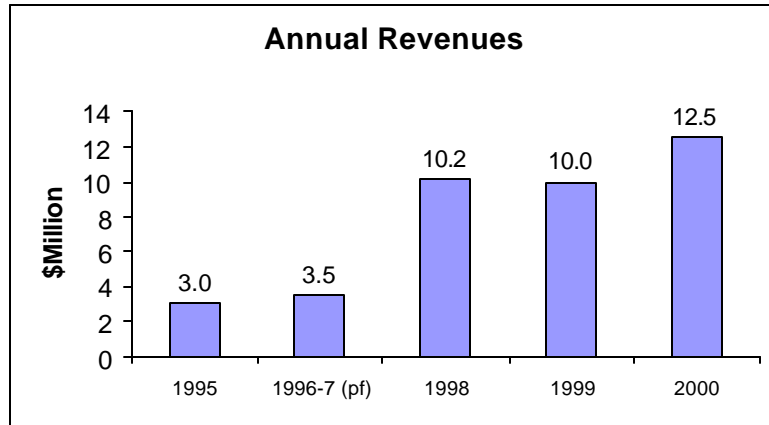


Figure 1

There were other acquisitions and divestitures that impacted operating results from 1997 to 2000:

- DiaLogos: Sold in March 2000. This was an education subsidiary, assisting firms in the integration of enterprise-wide systems using distributed object computing (CORBA and Java technologies) through education and consulting services.
- Synergis: From 1997 to 2000, MEDP attempted to execute a roll-up strategy with certain design automation software resellers. The merged group, to be named Synergis, was to have been spun out via an IPO or private financing. In January 1998, adverse market conditions for IPOs caused the postponement, and eventual cancellation of the plan. MEDP's Universal Document unit was a part of this plan, but was retained and its results are included in continuing operations.

Figure 2 illustrates MEDP's annual operating losses excluding the impact of discontinued operations.

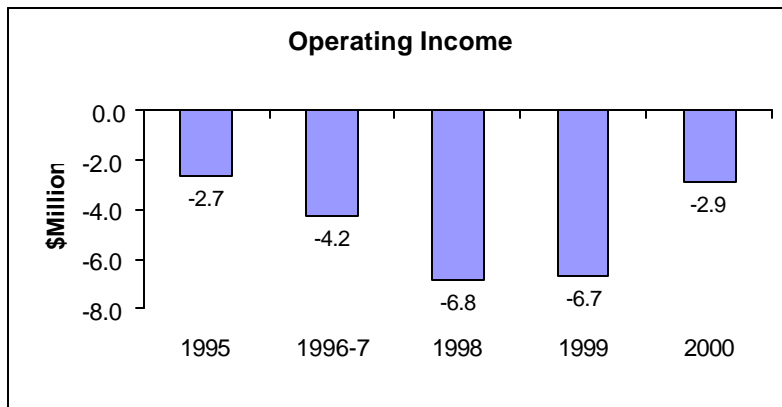


Figure 2

Fiscal Year 2000

Operating results improved significantly during 2000, despite a slowdown caused by Y2K concerns. During the middle of calendar 1999, hospital administrators were focused on Y2K compliance, not HIT integration issues, which effectively suspended MEDP's sales cycle. Despite this hiatus, the Company reported impressive revenue growth as it recognized revenues from existing contracts.

Total revenues increased 26% to \$12.5 million, largely due to being able to recognize more System revenues (which increased 36%).

<b>Table 1: Summary of Annual Operating Results</b>			
(\$ Million)	1999	2000	Change
<b>Revenues</b>			
Systems Support	6.155	8.377	36.1%
Support & Consult	3.804	4.161	9.4%
<b>Total Revenues</b>	<b>9.959</b>	<b>12.538</b>	<b>25.9%</b>
<b>Gross Margins</b>			
Systems Support	44.6%	52.1%	16.8%
Support & Consult	3.0%	21.1%	596.4%
<b>Total GM</b>	<b>28.7%</b>	<b>41.8%</b>	<b>45.5%</b>
<b>Operating Expenses as % Sales</b>			
SG&A	83.7%	51.9%	-38.0%
R&D	12.2%	12.8%	4.8%
<b>Operating Margin</b>	<b>-67.2%</b>	<b>-22.9%</b>	<b>65.9%</b>
<b>Operating Income</b>	<b>-6.695</b>	<b>-2.874</b>	<b>57.1%</b>
<b>Net-Continuing Ops</b>	<b>-6.906</b>	<b>-3.421</b>	<b>50.5%</b>
<b>Net Income</b>	<b>-8.547</b>	<b>-5.178</b>	<b>39.4%</b>
<b>EPS-Basic</b>	<b>\$ (1.40)</b>	<b>\$ (0.95)</b>	<b>32.2%</b>

Figure 3 highlights and compares the seasonality between 1999 and 2000. Note how FY2000 sales declined during the July/October levels.

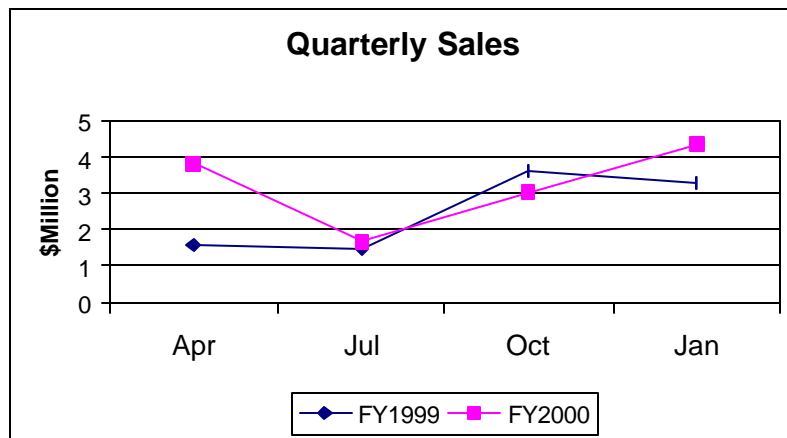


Figure 3

Revenue recognition is an import factor to keep in mind. Revenue growth can be volatile because the ability to recognize revenues is determined by the specifics of each contract, and contracts vary. MEDP may close on five systems in one quarter, but the ability to recognize those revenues may differ significantly from each other as installation criteria vary. Consequently, realized revenues may differ significantly from expectations based upon a linear extrapolation.

Operating margins improved to  $-22.9\%$  from  $-67.2\%$  as MEDP was able to leverage increased sales and reduce SG&A spending. The key factors were:

- **The gross margin expanded to 42% from 29%**, driven largely by the growth in System margins. System margins increased to 52% from 45% as the sales mix included a higher portion of proprietary software relative to lower margin third party software. Support and consulting gross margin also increased to 21% from 3% as the result of a larger installed base and an easy comparison with 1999 when staff was increased in anticipation of business that was slow to materialize.
- **SG&A expenses dropped to 51.9% of revenues from 83.7%** as the Company streamlined operations.
- **R&D remained relatively constant at 13% of sales**, reflecting Management's commitment to maintaining a competitive advantage via product development.

As shown in Figure 2, above, the net loss from continuing operations improved for the second consecutive year despite the fact that offsetting some of the operating improvement was an increase in interest expense that resulted from higher debt levels.

The reported net loss narrowed to \$5.8 million, versus a loss of \$8.5 million in 1999, as operating improvements were somewhat offset by a \$1.7 million loss from discontinued operations (versus \$1.6 in 1999) and expenses related to the issuance of preferred stock. Figure 4 illustrates the trend in net income. (Note: The \$3.1 million net income in 1998 was the result of a \$10.4 million gain from the sale of IntelliCode.)

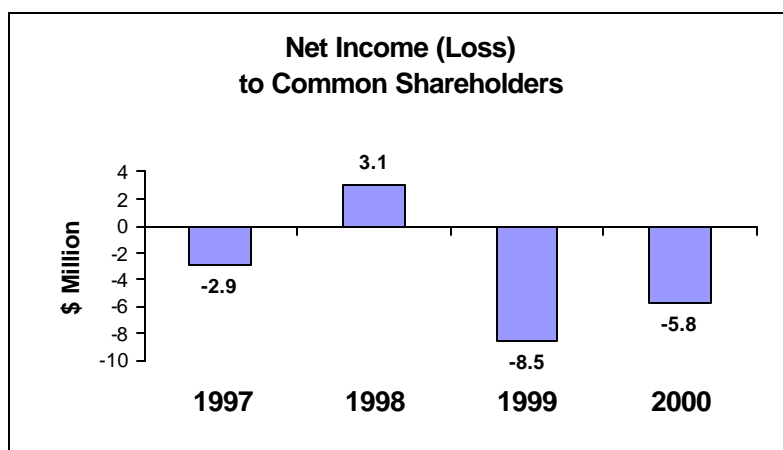


Figure 4

During 2Q00 MEDP issued preferred stock to certain investors that carry an interest rate of 4% for the first three years, increasing to 10% thereafter. However, according to GAAP, the Company must report the preferred dividend at an 8% rate (reflecting the current market rate). Consequently, the extra 4% adversely impacts reported EPS but does not have an impact on cashflow.

The improvement in operations is more accurately reflected in MEDP's cash flows. As shown in Figure 5, MEDP generated \$555,000 cash flow from continuing operations in 2000 versus net cash use of \$7.7 million in 1999. The main contributors to the \$7.2 million swing were:

- \$3.5 million improvement in net from continuing operations, and
- \$2.7 improvement in receivables

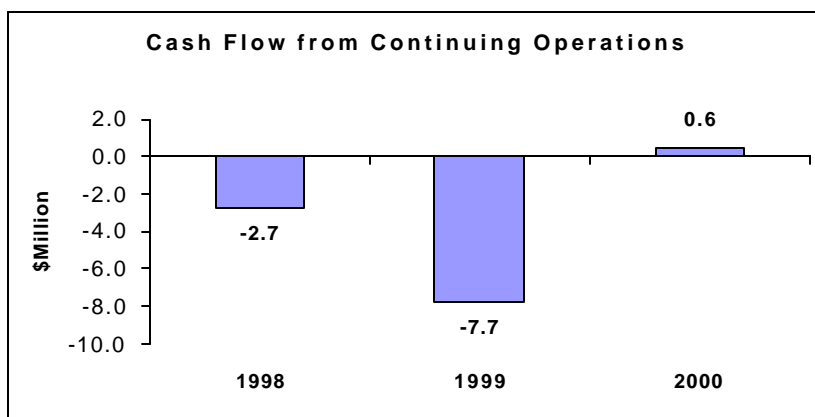


Figure 5

#### Recent Results: Operating Results Continued to Improve in 2Q and First Half 2001

The net loss per share improved to \$0.35 in 2Q01 versus a net loss per share of \$0.41 for 2Q00. The key factors causing these improved results were:

- Increased sales;
- An improved gross margin; and
- A lack of discontinued operations charges
- Offset by an increase in operating expenses related to developing the Company's e-health initiative.

As shown in Figure 6 and discussed above, sequential revenue growth is volatile. The combination of the Y2K issue in mid-1999 and the timing of revenue recognition have resulted in the trailing 12-month sales trend to be relatively flat. However, on a quarter-over quarter basis, the improvement is significant, as shown in Figures 7 and 8.

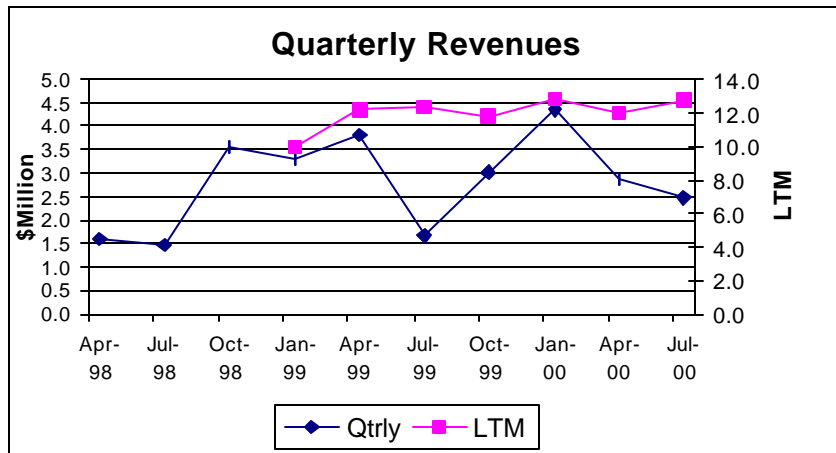


Figure 6

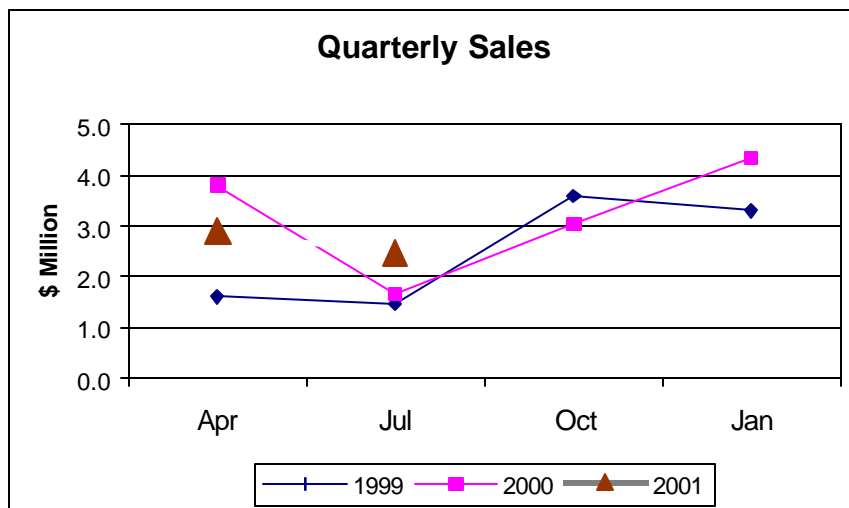


Figure 7

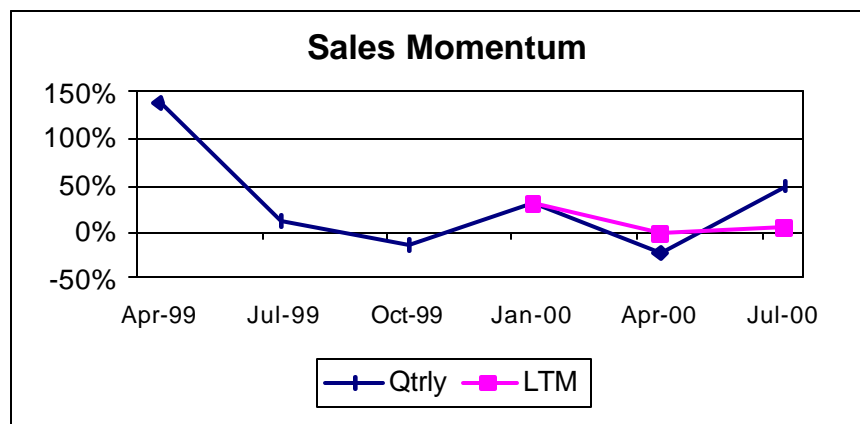


Figure 8

2Q01 revenues increased 49% lead by an 84% jump in System sales and an 18% increase in Support & Consulting (“S&C”) fees (see Table 2, below). The growth in System sales was attributed to revenues recognized from two of the three systems shipped in 2Q01. S&C fees increased as the result of the larger base of installed systems.

<b>Table 2: Comparison of Quarterly Results</b>			
(\$ Million)	<b>Jul-99</b>	<b>Jul-00</b>	<b>Change</b>
<b>Revenues</b>			
Systems	0.799	1.468	84%
Support & Consult	0.871	1.025	18%
<b>Total Revenues</b>	<b>1.67</b>	<b>2.493</b>	<b>49%</b>
<b>Gross Margins</b>			
Systems Support	19%	51%	166%
Support & Consult	4%	8%	107%
<b>Total GM</b>	<b>14%</b>	<b>32%</b>	<b>139%</b>
<b>Operating Expenses</b>			
SG&A	1.470	1.916	30%
R&D	0.385	0.733	90%
<b>Operating Income</b>	<b>-1.629</b>	<b>-2.022</b>	<b>-24%</b>
Interest Expense	0.141	0.070	
<b>Other Inc/Exp</b>	<b>-0.041</b>	<b>0.111</b>	<b>-371%</b>
<b>PreTax Income</b>	<b>-1.729</b>	<b>-2.203</b>	<b>-27%</b>
Discont Ops	-0.330	0	100%
Income Taxes	0	0	
<b>Net Income</b>	<b>-2.059</b>	<b>-2.203</b>	<b>-7%</b>
Prfd Stk Discount	0	0	na
Prefrd Stk Div.	-0.082	-0.082	0%
<b>Net to Comm SH</b>	<b>-2.487</b>	<b>-2.285</b>	<b>8%</b>
<b>EPS</b>	<b>\$ (0.41)</b>	<b>\$ (0.35)</b>	<b>15%</b>
<b>Diluted shares</b>	<b>6.041</b>	<b>6.503</b>	<b>8%</b>

The gross margin improved to 19% from 14% as System sales contained a higher percentage of proprietary software. The gross margin on S&C declined to 3% from 8% due to costs incurred from the development of eMaxx. Excluding the e-Health initiative, S&C gross margins would have been flat.

Offsetting this improvement was a 34% increase in operating expenses that resulted from the Company's continued investment in its e-health product. E-health expenditures comprised 39% of the \$637,000 increase in operating expenses. The other major cost increase was a one-time charge for \$100,000 (recorded in G&A) related to the settlement of a lawsuit. And, while interest expense declined (MEDP repaid all its loans from the equity infusion received from Quest), a one-time charge relating to the capital restructuring (warrant charges and fees related to early debt retirement) increased the pre-tax loss from continuing operations to \$2.2 million from \$1.7 million in 2Q00. A lack of discontinued operating expenses resulted in the net loss improving to \$2.3 million from a loss of \$2.5 million.

A comparison of first half results is illustrative of the volatility caused by revenue recognition policies and the impact of discontinued operations. As shown in Table 3, MEDP's operating loss widened to \$3.1 million from \$2.5 million as the result of the following:

- Total revenues fell 2%, due to a 23% decline in System revenues that was offset by a 41% increase in S&C revenues. System revenues fell due to an inability to recognize revenues in 1Q01. The explosive growth in S&C revenues was due largely to a \$500,000 consulting contract that was signed in 4Q00 and to a lesser extent the increase in the installed base of systems.
- The gross margin increased largely due to the recognition of the referenced S&C consulting contract.
- Operating Expenses increased 19% as the result of MEDP's emphasis on R&D and developing the e-health initiative.

As was the case with 2Q01, the absence of discontinued operating charges helped improve the net loss to \$3.2 million versus \$3.6 million.

<b>Table 3: Comparison of 1H Operating Results</b>			
(\$ Million)	YTD 99	YTD 00	Change
<b>Revenues</b>			
Systems	3.681	2.844	-23%
Support & Consult	1.808	2.549	41%
<b>Total Revenues</b>	<b>5.489</b>	<b>5.393</b>	<b>-2%</b>
<b>Gross Margins</b>			
Systems Support	44%	41%	-7%
Support & Consult	6%	25%	314%
<b>Total GM</b>	<b>31%</b>	<b>34%</b>	<b>7%</b>
<b>Operating Expenses</b>			
SG&A	3.217	3.386	5%
R&D	0.671	1.363	103%
Operating Income	-2.159	-2.919	-35%
Interest Expense	0.208	0.213	2%
Synergis	0.180		
Other Inc/Exp	-0.058	0.064	210%
<b>PreTax Income</b>	<b>-2.489</b>	<b>-3.196</b>	<b>-28%</b>
Discont Ops	-0.649	0	
Income Taxes	0	0	
<b>Net Income</b>	<b>-3.138</b>	<b>-3.196</b>	<b>-2%</b>
Prfd Stk Discount	0	0	
Prefrd Stk Div.	-0.082	-0.164	-100%
<b>Net to Comm SH</b>	<b>-3.22</b>	<b>-3.36</b>	<b>-4%</b>
EPS	\$ (0.59)	\$ (0.52)	11%

Comparing MEDP's operating results against a peer group is complicated by the fact that so many in this sector are relative newcomers. We attempt to make this comparison by looking at firms that we think that investors group in the same sector. As shown in Table 4, three companies (43% of the group) did not have sufficient operating histories to permit a trailing 12-month EPS analysis. *The key point from this presentation is that while MEDP posted minimal revenue growth, trailing 12-month EPS increased 28% versus the median decline of 89% for the peer group.*

		Sales		EBIDTA					%
		(Mill.)	Growth	(Mill.)	Margin	CFPS	EPS		Growth
IDX SYSTEMS	IDXC	\$ 332.0	1.0%	-0.08	0.0%	NM	\$ (0.60)		-529.0
E-MEDSOFT.COM	MED	\$ 81.0	na	-0.07	-0.1%	NM	\$ (0.17)		-
HEALTHCARE.COM	HCDC	\$ 42.0	58.0%	-0.02	-0.1%	\$ 0.17	\$ 0.07		178.0
MEDICALOGIC	MDLI	\$ 38.0	105.0%	-5.64	-14.8%	NM	\$ (4.95)		-
QUALITY SYSTEMS	QSII	\$ 36.0	-3.0%	0.18	0.5%	\$ 0.74	\$ 0.39		-7.0
DATA CRITICAL	DCCA	\$ 17.0	na	-1.37	-8.1%	NM	\$ (0.72)		-
AHT	AHTC	\$ 1.2	-93.0%	-19.27	-1606.1%	NM	\$ (2.19)		1.0
Peer Group Average			13.6%		-232.7%		\$ (1.17)		-89.3
<b>MEDPLUS</b>	<b>MEDP</b>	<b>\$ 12.0</b>	<b>1.0%</b>	<b>-0.11</b>	<b>-0.9%</b>	<b>NM</b>	<b>\$ (0.69)</b>		<b>28.0</b>

Source: Baseline

## FINANCIAL CONDITION

During the last 18 months, there were two events that significantly improved MEDP's financial condition and, in our opinion, represent a vote of confidence in the Company's strategic business plan.

During 1Q00, three funds (two of which are managed by Cahill, Warnock Partners) invested \$6.1 million in MEDP in exchange for convertible preferred shares, subordinated debentures, and warrants (1 million shares at an exercise price of \$1.66). In addition to the ownership interest, the funds received a seat on MEDP's Board of Directors. After the Quest investment (discussed below), the Funds have the potential to own an estimated 21% on a fully diluted basis.

In June 2000, MEDP received approximately \$9.5 million in an equity injection from Quest Diagnostics. In return for the funds, Quest received stock and warrants that amount to a 30% stake (fully diluted) and a seat on the Board of Directors. With the proceeds MEDP was able to repay all of its senior debt, repurchased the subordinated debentures it issued to the funds, finance operations and still have \$6.4 million in cash at the end of the period.

## OUTLOOK

We think that MEDP is in the right place at the right time with the right solution. However, forecasting revenue growth is challenging due to revenue recognition as well as the difficulty in estimating the adoption rate among healthcare providers. While administrators may be early adopters, doctors are typically harder to convert, especially the older they are. Our forecast assumes that the eMaxx business will start to accelerate in the second half of calendar 2001 as:

- Doctors are forced to find ways to increase efficiencies;
- Healthcare providers must comply with HIPAA and other regulations; and
- As the number of digital-friendly doctors increase.

In our model, revenue growth is driven by the following key assumptions:

- Average ChartMaxx system sales of 4-5 per quarter at an average price of \$1.4 million;
- These sales are recognized as revenues over the following year at 25% per quarter;
- eMaxx revenues are based upon the number of doctors using the system for ordering an average of five lab tests per day at a fixed charge per request;
- MEDP's dictation service is implemented in 4Q01 and the adoption rate is similar to the eMaxx rate.

Based on these expectations, we forecast MEDP to post net losses per basic share of \$0.97 and \$0.02 in FY2001 and FY2002, respectively. We expect a decline in FY2001 sales as the result of the timing issues discussed above and as the Company devotes resources to developing the eMaxx sales pipeline. In FY 2003, we expect the Company to earn between \$0.86 (estimated diluted EPS) and \$0.97 (basic). Our earnings model is contained in Table 5.

<b>Table 5: Annual Forecast</b>						
(\$ Million)	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>Revenues</b>						
Systems	7.91	6.16	8.38	<b>5.24</b>	<b>18.95</b>	<b>60.59</b>
Support & Consult	2.29	3.80	4.16	<b>4.99</b>	<b>10.55</b>	<b>22.46</b>
<b>Total Revenues</b>	<b>10.20</b>	<b>9.96</b>	<b>12.54</b>	<b>10.23</b>	<b>29.50</b>	<b>83.05</b>
<b>Gross Margins</b>						
Systems Support	34.6%	44.6%	52.1%	<b>44.3%</b>	<b>47.1%</b>	<b>44.8%</b>
Support & Consult	10.2%	3.0%	21.1%	<b>33.1%</b>	<b>43.2%</b>	<b>43.5%</b>
<b>Total GM</b>	<b>29.2%</b>	<b>28.7%</b>	<b>41.8%</b>	<b>38.8%</b>	<b>45.7%</b>	<b>44.5%</b>
<b>Operating Expenses</b>						
SG&A	9.10	8.34	6.51	<b>7.11</b>	<b>8.54</b>	<b>19.40</b>
R&D	0.71	1.22	1.61	<b>3.26</b>	<b>4.50</b>	<b>9.00</b>
<b>Operating Income</b>	<b>-6.84</b>	<b>-6.70</b>	<b>-2.87</b>	<b>-6.40</b>	<b>0.44</b>	<b>8.53</b>
Interest Expense	0.35	0.13	0.52	<b>0.25</b>	<b>0.00</b>	<b>0.27</b>
Synergis	3.71	2.07	0.18	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
Other Inc/Exp	-0.11	-0.38	-0.14	<b>0.06</b>	<b>0.00</b>	<b>0.00</b>
<b>PreTax Income</b>	<b>-10.78</b>	<b>-8.52</b>	<b>-3.43</b>	<b>-6.72</b>	<b>0.44</b>	<b>8.26</b>
Discont Ops	10.41	-1.64	-1.76	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
Income Taxes	3.48	1.62	0.01	<b>0.00</b>	<b>0.01</b>	<b>0.00</b>
<b>Net Income</b>	<b>3.10</b>	<b>-8.55</b>	<b>-5.18</b>	<b>-6.72</b>	<b>0.45</b>	<b>8.26</b>
Prefrd Stk Dividend			-0.59	<b>-0.33</b>	<b>-0.33</b>	<b>-0.33</b>
<b>Net to Comm SH</b>	<b>3.10</b>	<b>-8.55</b>	<b>-5.77</b>	<b>-7.05</b>	<b>0.13</b>	<b>7.93</b>
<b>EPS-Basic</b>	<b>\$ 0.52</b>	<b>\$ (1.40)</b>	<b>\$ (0.95)</b>	<b>\$ (0.97)</b>	<b>\$ 0.02</b>	<b>\$ 0.97</b>
Basic shares (Mill)	5.9	6.1	6.1	<b>7.3</b>	<b>8.2</b>	<b>8.2</b>
<b>EPS-Diluted</b>					<b>\$ 0.86</b>	
Diluted shares						<b>9.2</b>
<b>Boldfaced data are estimates.</b>						

## VALUATION ANALYSIS

Our 12 -18 month target price is \$11.00 and is based upon our forecast for 2002 and valuation multiples based on current peer group levels and our expectations for MEDP beyond 2002. A technical analysis indicates that the shares could encounter resistance at \$8.00 and \$10.00.

We arrived at our target price by using the valuation metrics shown in Table 6. The table shows the: average multiples on a trailing 12-month basis; our assumed range for the next 12-18 months; our forecast for each variable; and the derived target price for the range based upon the variable. The assumed ranges are based upon current peer group values and our expectation of what they might be if the Company performs as expected. We arrive at our target range by averaging the high and low values for each ratio.

	Ranges		Forecast 2002	Price Range
	LTM	Assumed		
<b>Price/Sales</b>	<b>Sales/Share</b>			
High	4.0	4.0	\$ 3.60	\$ 14.39
Low	2.1	3.0		\$ 10.79
<b>Price/Book</b>	<b>BVPS</b>			
High	9.5	12.0	\$ 0.97	\$ 11.70
Low	5.1	5.0		\$ 4.87
<b>Price/EPS</b>	<b>EPS</b>			
High	-7.8	25.0	\$ 0.02	\$ 0.39
Low	-4.2	5.0		\$ 0.08
	Average	High		\$ 8.82
		Low		\$ 5.25

Our target price is at the high end of the range because we give greater weight to the Price/Sales and Price/Book metrics and because we expect the valuation multiples to expand as sales and earnings growth become more visible (assuming the Company performs as forecast).

Table 7 illustrates MEDP's relative undervaluation despite the fact that the shares have appreciated 50% year-to-date versus an average decline of 4% for the peer group. While a size and share liquidity discount is applicable, we feel there is still some upside to MEDP's multiples from these levels. The peer group is comprised of companies in the same sector (HIM), who may or may not be viewed as direct competitors.

Table 7: Valuation Comparison		% LTM					CY P/E			
		Price	Change	Market Cap	P/B	P/S	1999	2000	2001	2002
IDX SYSTEMS	IDXC	\$ 29.38	65.5	827.0	4.3	2.5	-209.8	-37.7	1468.8	49.8
MEDICALOGIC	MDLI	\$ 3.06	-	169.2	4.8	4.5	-1.0	-0.5	-0.5	-0.6
HEALTHCARE.COM	HCDC	\$ 1.94	10.7	54.4	3.4	1.3	-12.9	16.1	9.7	na
DATA CRITICAL	DCCA	\$ 5.00	-62.3	61.8	1.7	3.6	-6.3	-7.0	35.7	10.0
QUALITY SYSTEMS	QSII	\$ 7.88	16.7	48.9	1.5	1.3	-3.6	17.9	na	na
AHT	AHTC	\$ 0.44	-92	4.9	1.6	4.0	-0.2	na	na	na
E-MEDSOFT.COM	MED	\$ 1.75	-47.7	138.2	0.6	1.7	-11.7	-5.6	na	na
Peer Group Average		\$ 7.06	-18.2		3.6	3.0	-57.5	-7.3	378.4	19.7
<b>MEDPLUS</b>	<b>MEDP</b>	<b>\$ 5.31</b>	<b>46.6</b>	<b>33.1</b>	<b>3.1</b>	<b>2.7</b>	<b>-8.2</b>	<b>-5.5</b>	<b>343.8</b>	<b>6.2</b>

Source: Baseline

## Risk Consideration

Investors need to consider the following risks before investing:

The shares are not very liquid and are vulnerable to significant volatility. Average daily volume for the last year has been 17,000 shares and for the last 30 days has been about 11,000 shares.

While MEDP has developed its software internally, it is not patent protected. As is typical in the software sector, the Company has decided to use confidentiality agreements instead of patents in order to keep the code as secret as possible. The risk is that the software could be slightly modified and used by competitors.

The Company has incurred net losses since 1995, except for 1998 when they sold IntelliCode and netted over \$10 million. While we currently forecast net earnings in FY2003, there is not assurance that the Company will meet our expectations.

The Company is not widely followed by Wall Street analysts (we are initiating coverage with this report). Consequently, it is possible that valuations differential could persist due to a lack of analyst support.

This report contains "forward looking" statements within the meaning of U.S. federal securities laws. Forward-looking statements regarding the Company's performance inherently involve risks and uncertainties that could cause actual results to differ from such forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to, continued acceptance of the subject Company's products/services in the marketplace; acceptance in the marketplace of the subject Company's new product lines/services; competitive factors; new product/service introductions by others; technological changes; dependence upon third party vendors; year 2000 issues; and other risks discussed in the subject Company's periodic report filings, including interim reports, with the Securities and Exchange Commission. By making these forward looking statements, researchstock.com, Inc. undertakes no obligation to update these statements for revisions or changes after the date of this report.

NEITHER RESEARCHSTOCK.COM NOR ANY PROVIDERS OF INFORMATION MAKE ANY WARRANTIES, EXPRESS OR IMPLIED, AS TO RESULTS TO BE OBTAINED FROM USING THIS INFORMATION AND MAKE NO EXPRESS OR IMPLIED WARRANTIES OF MERCHANTABILITY OF FITNESS FOR A PARTICULAR USE.

researchstock.com, Inc. is an independent research firm that publishes research reports on companies that may, or may not be clients. researchstom.com, Inc. derives most of its compensation from investment research and financial advisory services, and has been compensated for the preparation of this report. researchstock.com, Inc.'s monthly retainer fee is \$2,500.00. This information is solely for informative purposes and is not solicitation or an offer to buy or sell any security. It is not intended as being a complete description of the securities, markets or developments referred to in the material. The information contained herein is subject to change without notice, and we assume no responsibility to update the information in this report. Any sales or earnings forecasts contained in this report were independently prepared by researchstock.com, Inc., unless otherwise stated, and are not endorsed by the Management of the company which is the subject of this report. All expressions of opinion are subject to change without notice. The information contained herein was obtained from sources, which we consider reliable, but we have not independently verified such information and thus do not guarantee that it is accurate or complete. Additional information is available upon request. researchstock.com, Inc. and/or its officers and directors, stockholders, and employees, and/or members of their families may have a long/short position in the securities mentioned in this report and may make purchases and or sales for their own account of those securities as principal or agent in the open market or otherwise. researchstock.com, Inc. or one of its affiliates may from time to time perform investment banking or other services for, or solicits investment banking or other business from, any company mentioned in this report. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors should obtain individual financial advice based on their own particular circumstances before making investment decisions on the basis of this report.