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MEDIX RESOURCES INC  
Form 10-Q  
August 20, 2002

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002

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

Commission File Number: 0-24768

MEDIX RESOURCES, INC.

(Exact name of issuer as specified in its charter)

Colorado  
(State or other jurisdiction  
of incorporation or organization)

84-1123311  
(I.R.S. Employer  
Identification No.)

420 Lexington Avenue, Suite 1830 New York, New York  
(Address of principal executive offices)

10170  
(Zip Code)

(212) 697-2509

(Issuer's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of August 10, 2002.

Common Stock, \$0.001 par value  
Class

62,923,624  
Number of Shares

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### **MEDIX RESOURCES, INC.**

#### **Consolidated Balance Sheets**

|   | June 30,<br>2002     | December 31,<br>2001 |
|---|----------------------|----------------------|
|   | -----<br>(Unaudited) | -----                |
| Assets  |                      |                      |
| Current assets  |                      |                      |
| Cash and cash equivalents   | \$ 281,000           | \$ 8,000             |
| Accounts receivable, trade  | 80,000               | -                    |
| Prepaid expenses and other  | 340,000              | 344,000              |
|   | -----                | -----                |
| Total current assets  | 701,000              | 352,000              |
| Software development costs, net   | 876,000              | 649,000              |
| Property and equipment, net   | 353,000              | 365,000              |
| Goodwill, net   | 1,735,000            | 1,735,000            |
|   | -----                | -----                |
| Total assets  | \$ 3,665,000         | \$ 3,101,000         |
|   | =====                | =====                |
| Liabilities and Stockholders' Equity  |                      |                      |
| Current liabilities   |                      |                      |
| Notes payable   | \$ 39,000            | \$ 158,000           |
| Convertible note payable  | 1,000,000            | -                    |
| Accounts payable  | 353,000              | 851,000              |
| Accounts payable-related parties  | -                    | 166,000              |
| Accrued expenses  | 389,000              | 450,000              |
| Deferred revenue  | 150,000              | -                    |
| Accrued payroll taxes interest and penalties  | 131,000              | 131,000              |
|   | -----                | -----                |
| Total current liabilities   | 2,062,000            | 1,756,000            |
|   | -----                | -----                |
| Stockholders' equity  |                      |                      |
| 1996 Preferred stock, 10% cumulative convertible, \$1<br>par value; 488 shares authorized; 155 shares issued; |                      |                      |

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|   |              |              |
|---|--------------|--------------|
| 1 share outstanding.  | -            | -            |
| 1999 Series B convertible preferred stock, \$1 par value; 2,000 shares authorized; 1,832 shares issued; 50 shares outstanding           | -            | -            |
| 1999 Series C convertible preferred stock, \$1 par value; 2,000 shares authorized; 1,995 shares issued; 100 and 375 shares outstanding. | -            | -            |
| Common stock, \$.001 par value; 100,000,000 authorized; 62,923,624 and 56,651,409 issued and outstanding.                               | 63,000       | 56,000       |
| Dividends payable with common stock   | 8,000        | 7,000        |
| Additional paid-in capital  | 38,577,000   | 35,341,000   |
| Accumulated deficit   | (37,045,000) | (34,059,000) |
|   | -----        | -----        |
| Total stockholders' equity  | 1,603,000    | 1,345,000    |
|   | -----        | -----        |
| Total liabilities and stockholders' equity  | \$ 3,665,000 | \$ 3,101,000 |
|   | =====        | =====        |

Unaudited Consolidated Statements of Operations

|  | For the<br>Three Months<br>Ended<br>June 30,<br>2002 | For the<br>Three<br>Months<br>Ended<br>June 30,<br>2001 | For the Six<br>Months Ended<br>June 30,<br>2002 | For the Six<br>Months Ended<br>June 30,<br>2001 |
|--|--|---|---|---|
|  | -----  | -----   | -----   | -----   |
| Revenues                                     | \$ -   | \$ -  | \$ 10,000                                       | \$ 30,000                                       |
| Direct costs of services                     | 178,000  | 28,000  | 392,000   | 34,000  |
|  | -----  | -----   | -----   | -----   |
| Gross margin                                 | (178,000)  | (28,000)  | (382,000)                                       | (4,000)   |
|  | -----  | -----   | -----   | -----   |
| Software research and development costs      | 9,000  | 320,000   | 380,000   | 599,000   |
| Selling, general and administrative expenses | 1,078,000  | 1,107,000   | 1,968,000                                       | 3,017,000                                       |
|  | -----  | -----   | -----   | -----   |
| Net loss from operations                     | (1,265,000)  | (1,455,000)   | (2,730,000)                                     | (3,620,000)                                     |
| Other income                                 | 4,000  | -   | 5,000   | -   |
| Financing Costs                              | -  | (167,000)   | (203,000)                                       | (236,000)                                       |
| Interest expense                             | (48,000)   | (13,000)  | (58,000)  | (38,000)  |
|  | -----  | -----   | -----   | -----   |
| Net loss                                     | \$ (1,309,000)                                       | \$ (1,635,000)  | \$ (2,986,000)                                  | \$ (3,894,000)                                  |
|  | =====  | =====   | =====   | =====   |
| Net loss per common share                    | \$ (0.02)  | \$ (0.03)   | \$ (0.05)                                       | \$ (.08)  |

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|  | =====      | =====      | =====      | =====      |
|--|------------|------------|------------|------------|
| Weighted average shares<br>outstanding | 60,402,930 | 49,196,979 | 59,139,133 | 48,313,235 |
|  | =====      | =====      | =====      | =====      |

Had the Company adopted FAS 142 as of January 1, 2001, the historical amounts previously reported would have been adjusted to the following:

|   |                |                |
|---|----------------|----------------|
| Net (loss) as reported                          | \$ (1,635,000) | \$ (3,894,000) |
| Add back: Goodwill amortization                 | 39,000         | 78,000         |
|   | -----          | -----          |
| Adjusted net loss                               | \$ (1,596,000) | \$ (3,972,000) |
|   | =====          | =====          |
| Basic and diluted loss per share<br>as reported | \$ (0.03)      | \$ (0.08)      |
|   | =====          | =====          |
| Goodwill amortization                           | \$ -           | \$ -           |
|   | =====          | =====          |
| Adjusted loss per share                         | \$ (0.03)      | \$ (0.08)      |
|   | =====          | =====          |

**Unaudited Consolidated Statements of Cash Flows**

|   | For the Six Months Ended June 30, |                |
|---|-----------------------------------|----------------|
|   | 2002                              | 2001           |
|   | -----                             | -----          |
| Cash flows from operating activities  |                                   |                |
| Net loss  | \$ (2,986,000)                    | \$ (3,894,000) |
| Adjustments to reconcile net income (loss) to net<br>cash flows (used in) provided by operating activities                  |                                   |                |
| Depreciation and amortization   | 206,000                           | 252,000        |
| Amortization of discount and warrants-convertible<br>debt   | 70,000                            | 223,000        |
| Options and warrants issued in conjunction with<br>stock issuance, services and for litigation<br>settlements, respectively | 158,000                           | 366,000        |
| Net changes in current assets and current liabilities   | (28,000)                          | 290,000        |
|   | -----                             | -----          |
| Net cash flows (used in) provided by operating<br>activities  | (2,580,000)                       | (2,763,000)    |
|   | -----                             | -----          |
| Cash flows from investing activities  |                                   |                |
| Software development costs incurred   | (373,000)                         | (275,000)      |
| Purchase of property and equipment  | (48,000)                          | (64,000)       |
|   | -----                             | -----          |
| Net cash flows (used in) investing activities   | (421,000)                         | (339,000)      |
|   | -----                             | -----          |
| Cash flows from financing activities  |                                   |                |
| Advances received on convertible note   | 1,000,000                         | 1,500,000      |

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|   |            |           |
|---|------------|-----------|
| Advances (payments) under financing agreement, net                | -          | -         |
| Payments on capital leases and debt                               | (186,000)  | (98,000)  |
| Proceeds from the issuance of common stock, net of offering costs | 2,345,000  | 550,000   |
| Net proceeds from exercise of options and warrants                | 115,000    | 165,000   |
|   | -----      | -----     |
| Net cash flows provided by (used in) financing activities         | 3,274,000  | 2,117,000 |
|   | -----      | -----     |
| Net increase (decrease) in cash and cash equivalents              | 273,000    | (985,000) |
| Cash and cash equivalents at beginning of period                  | 8,000      | 1,007,000 |
|   | -----      | -----     |
| Cash and cash equivalents at end of period                        | \$ 281,000 | \$ 22,000 |
|   | =====      | =====     |

Non-cash and investing and financing activities for the six months ended June 30, 2002:

Options and warrants valued at \$27,000 for services provided.  
Options valued at \$132,000 as financing costs issued to an officer for past financial support.  
An accrued liability of \$590,000 for warrants earned in 2001 was satisfied by issuing the warrants.  
In-the-money conversion feature on convertible debt valued at \$70,000.  
Financed insurance policies of \$65,000 by issuing a note payable.

Non-cash and investing and financing activities for the six months ended June 30, 2001:

Conversion of preferred stock into common stock (Note 3).  
Conversion of \$600,000 note payable into 1,088,534 shares of common stock (Note 3).  
Financed insurance policies of \$3,000 by issuing a note payable.

### Notes to Unaudited Consolidated Financial Statements

#### **Note 1 - Summary of Significant Accounting Policies**

The consolidated financial statements are unaudited and reflect all adjustments (consisting only of normal recurring adjustments), which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The unaudited consolidated financial statements as of June 30, 2002 have been derived from audited financial statements. The unaudited consolidated financial statements contained herein should be read in conjunction with the financial statements and notes thereto contained in the Company's Form 10-K for the fiscal year ended December 31, 2001. The results of operations for the three months ended June 30, 2002 are not necessarily indicative of the results for the entire fiscal year ending December 31, 2002.

#### **Cost of Services Provided**

Cost of services provided includes amortization of software development costs on projects ready for their intended use, license and data service fees.

#### **Note 2 - Goodwill**

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|   | June 30, 2002 |
|---|---------------|
| Goodwill acquired through the Cymedix acquisition | \$ 2,369,000  |
| Less accumulated amortization                     | (634,000)     |
|   | -----         |
|   | \$ 1,735,000  |
|   | =====         |

The Company has completed step one, impairment review of FAS 142, effective January 1, 2002, and has determined that the fair value of that goodwill associated with its Cymedix reporting unit using a discounted cash flow method had no impairment.

### **Note 3 - Equity Transactions**

The Company received proceeds of \$114,750 from the exercise of stock options resulting in the issuance of 315,000 shares of common stock during the first two quarters of 2002.

#### **Equity Line**

The Company had entered into an Equity Line of Credit Agreement dated as of June 12, 2001, which provided that the Company could put to the provider, subject to certain conditions, the purchase of common stock of the Company at prices calculated from a formula as defined in the agreement. Under the agreement, the providers of the Equity Line of Credit had committed to advance to the Company funds in an amount of up to \$10,000,000, as requested by the Company, over a 24-month period in return for common stock issued by the Company to the providers. The Equity Line of Credit Agreement was terminated by the mutual agreement of the parties on August 6, 2002. In connection with our equity line of credit financing, we had registered 9,500,000 shares with the SEC for sale by the providers of the financing, of which 4,796,763 shares remained available for issuance at the time the equity line of credit financing was terminated. The Company will de-register those shares from registration with the SEC.

During the period January to April 2002, the Company received \$972,000, net of commissions and escrow fees from eight equity line advances, resulting in the issuance of 1,954,715 shares of common stock.

#### **Warrants**

As of February 18, 2002, the Company executed a Amended and Restated Common Stock Purchase Warrant obligating the Company to issue up to 7,000,000 warrants under an agreement with a pharmacy management company for the Company's proprietary software to be interfaced with core medical service providers, in which one of the Company's audit committee members is a related party to the pharmacy management company. The agreement provides for 3,000,000 warrants with an exercise price of \$.30, 3,000,000 warrants with an exercise price of \$.50, and 1,000,000 warrants with an exercise price of \$1.75 all expiring September 8, 2004. The right to exercise the warrants are earned in increments based on certain performance criteria. At December 31, 1999, 1,000,000 of the warrants had been earned. In connection with the 1,000,000 warrants earned, the Company recorded expense of \$1,364,000 valued using the Black-Scholes option pricing model, with assumptions of 132% volatility, no dividend yield and a risk-free rate of 5.5%. No warrants were earned during 2000. During 2001, 850,000 of the warrants had been earned. In connection with the obligation to issue the 850,000 warrants earned, the Company recorded expense of \$590,000 during the third quarter of 2001 valued using the Black-Scholes option pricing model, with assumptions of 132% volatility, no dividend yield and a risk-free rate of 5.5%.

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The Company has the obligation to provide 5,150,000 warrants under the Amended and Restated Common Stock Purchase Warrant in the future if the performance criteria specified are met.

Under the agreement, the current performance criteria in effect provide for the issuance of 600,000 warrants. Had the current performance criteria been met at June 30, 2002, the fair value of the related warrants and resulting expense would have been approximately \$197,000, using the Black-Scholes option pricing model, with assumptions of 121% volatility, no dividend yield and a risk-free rate of 5.5%.

### Convertible Loan

The Company entered into a secured convertible loan agreement with a Company, dated February 19, 2002, pursuant to which we borrowed \$1,000,000 from WellPoint Health Networks Inc., in which a member of the Company's audit committee is a related party. The loan becomes payable on February 19, 2003, if not converted into our common stock. The loan earns annual interest at a floating rate of 300 basis points over prime, as it is adjusted from time to time, which is also payable at maturity and may be converted into common stock. Conversion into common stock is at the option of either WellPoint or Medix at a contingent conversion price. The conversion price will be either (i) at the price at which additional shares are sold to other private placement investors if Medix obtains written commitments for at least an additional \$4,000,000 of equity by the close of business on September 30, 2002, from persons not affiliates of WellPoint, and if such sales are closed by the maturity date of the loan, or (ii) at a price equal to 80% of the then-current Fair Market Value (as defined below) if Medix is unable to obtain a written commitment for the additional equity investment by the close of business on September 30, 2002 or close the sales by the maturity date. For this purpose, "Fair Market Value" shall be the average closing price of Medix common stock for the twenty trading days ending on the day prior to the day of the conversion. The Company has recorded financing costs during the first quarter of 2002 associated with this loan agreement as a result of the in-the-money conversion feature totaling \$70,000. The loan is secured by the grant of a security interest in all Medix's intellectual property, including its patent, copyrights and trademarks. While Medix can cure a default in the repayment of the loan at the fixed maturity date by the forced conversion of the loan into its common stock, a cross default, breach of representation or warranty, and bankruptcy or similar event of default will trigger the foreclosure provision of the security agreement.

### Private Placement

During April 2002, the Company initiated a private placement of its \$.001 par value common stock. A total of 3,452,500 units were placed, each consisting of one share of common stock and one warrant. Subscribers purchased each unit for \$0.40 and are entitled to exercise warrant rights to purchase one share of the common stock of the company at a purchase price of \$.0.50 per share for a five year period on or after September 1, 2002 and prior to September 1, 2007. The Company received a total of \$1,381,000 from this private placement. The Company has committed to register the above underlying shares in a registration statement with the Securities and Exchange Commission within 90 days of completion of the offering.

### **Note 4 - Stock Options**

During the first six months of 2002, the Company granted options to purchase 1,099,500 shares at exercise- prices of \$.59 to \$.94 per share to current employees and directors and consultants of the Company, under the Company's 1999 Stock Option Plan. During the first six months of 2002, 315,000 stock options

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were exercised.

### **Note 5 - Related Party Transactions**

The Company received advances from a related party in 2001 that totaled \$166,000 at December 31, 2001. The entire amount was repaid during February 2002.

The Company has also entered into transactions and agreements with Wellpoint Health Networks, Inc., in which a member of the Company's audit committee is a related party. (See Note 3, Warrants and Convertible Loan.)

### **Note 6 - Litigation**

August 7, 2001, a former officer of the Company filed an action, entitled Barry J. McDonald v. Medix Resources, Inc., f/k/a International Nursing Services, Inc., and John Yeros, CN 01CV2119, in the District Court of Arapahoe County, Colorado, against the Company and its former President and CEO. The plaintiff alleged (1) breach of an employment agreement, a stock option agreement and the related stock option plan, (2) a duty of good faith and fair dealing, and (3) violation of the Colorado Wage Claim Act. On August 13, 2002, we reached an agreement in principal with the plaintiff to settle the litigation by paying plaintiff \$25,000 on or before October 1, 2002, with no admission of liability on our part. This settlement is subject to the negotiation and execution of a final settlement agreement.

On December 17, 2001, Vision Management Consulting, L.L.C., filed suit against us in the Superior Court of New Jersey, Law Division - Essex County, in an action entitled Vision Management Consulting, L.L.C. v. Medix Resources, Inc., Docket No. ESX-L-11438-01. The complaint filed by Vision alleged breach of contract, unjust enrichment, breach of the duty of good faith and fair dealing and misrepresentation on the part of Medix in connection with our performance under a negotiated settlement agreement which we had entered into to resolve certain claims that existed between the parties and that arose out of the termination of operations of our Automated Design Concepts division earlier in 2001. On August 12, 2002, we reached an agreement in principal with Vision to settle this litigation by payment from us to Vision of \$55,000, to be paid over the next three months, with no admission of liability on our part. This settlement is subject to the negotiation and execution of a final settlement agreement.

## **Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

We are an information technology company headquartered in New York City, with offices in Agoura Hills, California, Greenwood Village, Colorado and Marietta, Georgia. We specialize in the development, marketing and management of connectivity solutions for clinical and business transactions within the healthcare industry. Through our wholly owned subsidiary, Cymedix Lynx Corporation, a Colorado corporation, we have developed Cymedix(R), a unique healthcare communication technology product. Created by a team of healthcare professionals, Cymedix software provides healthcare institutions, such as health plans, insurers and hospitals, as well as practicing physicians, with a set of non-invasive technology tools to enable Internet-based health care transactions among all parties.

Implementation of the Cymedix(R) products suite promises to speed and improve the efficacy of daily interactions between health caregivers and their staffs, other



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ancillary providers (such as labs or pharmacy benefit managers), insurance companies, hospitals, Integrated Delivery Networks (IDNs) and Health Management Organizations (HMOs). We believe that the market for robust and practical healthcare solutions will grow rapidly, and that segment growth will continue to accelerate as the joined emphases of consumer choice, quality, administrative service and cost containment ratchets up demand for ever more efficient and user-friendly methods of delivering quality healthcare.

### **Forward-Looking Statements and Associated Risks**

This Report contains forward-looking statements, which mean that such statements relate to events or transactions that have not yet occurred, our expectations or estimates for our future operations and economic performance, our growth strategies or business plans or other events that have not yet occurred. Such statements can be identified by the use of forward-looking terminology such as "might," "may," "will," "could," "expect," "anticipate," "estimate," "likely," "believe," or "continue" or the negative thereof or other variations thereon or comparable terminology. The following paragraphs contain discussions of important factors that should be considered by prospective investors for their potential impact on forward-looking statements included in this Report. These important factors, among others, may cause actual results to differ materially and adversely from the results expressed or implied by the forward-looking statements.

We have reported net losses of (\$10,636,000), (\$5,415,000) and (\$4,847,000) for the years ended December 31, 2001, 2000 and 1999, respectively. At June 30, 2002 we had an accumulated deficit of (\$36,925,000) and a negative net working capital deficit of \$(1,362,000). These losses and negative operating cash flow have caused our accountants to include a "going concern" qualification in their report in connection with their audit of our financial statements for the year ended December 31, 2001.

We expect to continue to experience losses, in the near term, as our connectivity products are not yet deployed in full-scale transaction production and therefore are not generating significant revenue. Working capital is required to support the ongoing development and marketing of the Cymedix(R) service products until such time as revenue generation can support the Company financially. To address this need, we are presently in negotiations with institutional sources regarding debt and equity instruments to fund the Company. While there can be no assurance that additional investments or financings will be available to us as needed, management fully expects to conclude the necessary financing in the near term. Failure to obtain such capital on a timely basis could result in lost business opportunities, the sale of the Cymedix(R) business at a distressed price or the financial failure of our Company.

We have recently entered into a secured financing arrangement. The use of secured borrowings increases the risk of loss of the assets used to secure the borrowing. If an event of default occurs under the security agreement, the lender will be able to foreclose on the assets used to secure the borrowing and sell those assets to the highest bidder. In addition, it is generally believed that foreclosure sales, which are "distress sales", will not maximize the proceeds that are paid for the assets being sold. The loan we entered into is secured by the grant of a security interest in all Medix's intellectual property, including its patent, copyrights and trademarks. While Medix can cure a payment default by the forced conversion of the loan into its common stock, a bankruptcy or similar event of default will trigger the foreclosure provision of the security agreement.

We are still in the process of gaining experience in marketing technology-based service products, providing support services, evaluating demand for products, financing a technology business and dealing with government regulation of

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various products. While we are putting together a team of experienced executives, they have come from different backgrounds and may require some time to develop an efficient operating structure and corporate culture for our company. We believe our structure of multiple offices serves our customers well, but it does present an additional challenge in building our corporate culture and operating structure.

Our products are in the integration and deployment stages, and have proven their effectiveness with some sponsors. We have not yet proven our technology with a significant number of physicians. As a developer of service products, we will be required to anticipate and adapt to evolving industry standards and new technological developments. The market for our connectivity products and services is characterized by continued and rapid technological advances in both hardware and software development, requiring ongoing expenditures for research and development, and timely introduction of new products and enhancements to existing products. The establishment of standards is largely a function of user acceptance. Therefore, such standards are subject to change. Our future success, if any, will depend in part upon our ability to enhance existing products, to respond effectively to technology changes, and to introduce new products and technologies to meet the evolving needs of its clients in the healthcare information systems market.

The success of our products and services in generating revenue may be subject to the quality and completeness of the data that is generated and stored by the physician or other healthcare professional and entered into our interconnectivity systems, including the failure to input appropriate or accurate information. Failure or unwillingness by the healthcare professional to accommodate the required information quality may result in the payor refusing to pay Medix for its services.

The introduction of connectivity products in that market has been slow due to the large number of small practitioners who are resistant to change, as well as the financial investment or workflow interruptions associated with change, particularly in a period of rising pressure to reduce costs in the market. We are currently devoting significant resources toward the development of products. There can be no assurance that we will successfully complete the development of these products in a timely fashion or that our current or future products will satisfy the needs of the healthcare information systems market. Further, there can be no assurance that products or technologies developed by others will not adversely affect our competitive position or render our products or technologies noncompetitive or obsolete.

Certain of our products provide applications that relate to patient medication histories and treatment plans. Any failure by our products to provide accurate, secure and timely information could result in product liability claims against us by our clients or their affiliates or patients. We maintain insurance that we believe currently is adequate to protect against claims associated with the use of our products, but there can be no assurance that our insurance coverage would adequately cover any claim asserted against us. The limits of that coverage are \$2,000,000 in the aggregate and \$1,000,000 per occurrence. A successful claim brought against us in excess of our insurance coverage could have a material adverse effect on our results of operations, financial condition or business. Even unsuccessful claims could result in the expenditure of funds in litigation, as well as diversion of management time and resources.

We have been granted certain patent rights, trademarks and copyrights relating to its software business. However, patent and intellectual property legal issues for software programs, such as the Cymedix products, are complex and currently evolving. Since patent applications are secret until patents are issued, in the United States, or published, in other countries, we cannot be sure that we are first to file any patent application. In addition, there can be no assurance that competitors, many of which have far greater resources than we do, will not

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apply for and obtain patents that will interfere with our ability to develop or market product ideas that we have originated. Further, the laws of certain foreign countries do not provide the protection to intellectual property that is provided in the United States, and may limit our ability to market our products overseas. We cannot give any assurance that the scope of the rights we have are broad enough to fully protect our Cymedix software from infringement.

Litigation or regulatory proceedings may be necessary to protect our intellectual property rights, such as the scope of our patent. In fact, the computer software industry in general is characterized by substantial litigation. Such litigation and regulatory proceedings are very expensive and could be a significant drain on our resources and divert resources from product development. There is no assurance that we will have the financial resources to defend our patent rights or other intellectual property from infringement or claims of invalidity. We have been notified by a party that it believes our pharmacy product may infringe on patents that it holds. We have retained patent counsel who made an investigation and determined, in its opinion, that our pharmacy product does not infringe on the identified patent. We have responded to the initial notice based on our counsel's opinion. At this time, no legal action has been instituted.

We also rely upon unpatented proprietary technology and no assurance can be given that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to or disclose our proprietary technology or that we can meaningfully protect our rights in such unpatented proprietary technology. We will use our best efforts to protect such information and techniques, however, no assurance can be given that such efforts will be successful. The failure to protect our intellectual property could cause us to lose substantial revenues and to fail to reach our financial potential over the long term.

The healthcare and medical services industry in the United States is in a period of rapid change and uncertainty. Governmental programs have been proposed, and some adopted, from time to time, to reform various aspects of the U.S. healthcare delivery system. Some of these programs contain proposals to increase government involvement in healthcare, lower reimbursement rates and otherwise change the operating environment for our customers. Particularly, HIPAA and the regulations that are being promulgated thereunder are causing the healthcare industry to change its procedures and incur substantial cost in doing so. Although we expect these regulations to have the beneficial effect of spurring adoption of our software products, we cannot predict with any certainty what impact, if any, these and future healthcare reforms might have on our software business.

As of August 10, 2002, we had 62,923,624 shares of common stock outstanding. As of that date, approximately 28,928,312 shares were issuable upon the exercise of outstanding options, warrants or other rights, and the conversion of preferred stock. Most of these shares will be immediately saleable upon exercise or conversion under registration statements we have filed with the SEC. The exercise prices of options, warrants or other rights to acquire common stock presently outstanding range from \$0.19 per share to \$4.97 per share. During the respective terms of the outstanding options, warrants, preferred stock and other outstanding derivative securities, the holders are given the opportunity to profit from a rise in the market price of the common stock, and the exercise of any options, warrants or other rights may dilute the book value per share of the common stock and put downward pressure on the price of the common stock. The existence of the options, conversion rights, or any outstanding warrants may adversely affect the terms on which we may obtain additional equity financing. Moreover, the holders of such securities are likely to exercise their rights to acquire common stock at a time when we would otherwise be able to obtain capital on terms more favorable than could be obtained through the exercise or conversion of such securities. Any agreement to sell, or convert debt or equity

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securities into, common stock at a future date and at a price based on the then current market price will provide an incentive to the investor or third parties to sell the common stock short to decrease the price and increase the number of shares they may receive in a future purchase, whether directly from us or in the market. Both our equity line of credit was priced and our outstanding \$1,000,000 convertible promissory note is priced at a discount to the market price at the time of a future draw or conversion.

As with any business, growth in absolute amounts of selling, general and administrative expenses or the occurrence of extraordinary events could cause actual results to vary materially and adversely from the results contemplated by the forward-looking statements. Budgeting and other management decisions are subjective in many respects and thus susceptible to incorrect decisions and periodic revisions based on actual experience and business developments, the impact of which may cause us to alter our marketing, capital expenditures or other budgets, which may, in turn, affect our results of operation. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate, and therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

In light of the significant uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives or plans for the Company will be achieved.

### **Results of Operation**

#### *Comparison of These Three Months Ended June 30, 2002 and June 30, 2001*

Direct costs increased \$150,000 from \$28,000 at June 30, 2001 to \$178,000 at June 30, 2002. The increase reflects expenses incurred by the company for licenses and service fees incurred in 2002 related to establishment of infrastructure necessary to provide connectivity services to our customers.

Research and development costs decreased approximately \$311,000 or 97% for the three months ended June 30, 2001, to the three months ended June 30, 2002. This decrease represents the Company's capitalization of software development costs for products where the preliminary project stage has been completed, management has committed to funding the project and completion and use of the software for its intended use is probable.

Selling, general, and administrative expenses decreased approximately \$29,000 from \$1,107,000 for the three months ended June 30, 2001, to \$1,078,000 for the three months ended June 30, 2002.

Net loss from operations decreased approximately \$190,000 from \$1,455,000 for the three months ended June 30, 2001, to \$1,265,000 for the three months ended June 30, 2002, due to all of the reasons discussed above.

Financing costs decreased in 2002 due to financing costs incurred in 2001 of \$167,000 related to a \$2.5 million convertible debt credit facility available that did not exist in 2002.

Interest expense increased \$35,000 from June 30, 2001 to June 30, 2002 due to interest accrued on the convertible note issued by the company during February 2002.

Total net loss decreased approximately \$326,000 from \$1,635,000 for the three

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months ended June 30, 2001, to \$1,309,000 for the three months ended June 30, 2002, also due to the reasons discussed above.

### *Comparison of The Six Months Ended June 30, 2002 and June 30, 2001*

Total revenues for the six months ended June 30, 2002, were \$10,000 compared with \$30,000 for the six months ended June 30, 2001.

Direct costs increased \$358,000 from \$34,000 at June 30, 2001 to \$392,000 at June 30, 2002. The increase reflects expenses incurred by the company for licenses and service fees incurred in 2002 related to establishment of infrastructure necessary to provide connectivity services to our customers.

Research and development costs decreased approximately \$219,000 or 37% for the six months ended June 30, 2001, to the six months ended June 30, 2002. This decrease represents the Company's capitalization of software development costs for products where the preliminary project stage has been completed, management has committed to funding the project and completion and use of the software for its intended use is probable.

Selling, general, and administrative expenses decreased approximately \$1,049,000 or 35% from \$3,017,000 for the six months ended June 30, 2001, to \$1,968,000 for the six months ended June 30, 2002. The decrease is due to cost cutting measures implemented by the company during 2001, which resulted in the following decreases at June 30, 2002 compared to June 30, 2001:

- o Salaries and wages, \$(463,000).
- o Travel and entertainment, \$(27,000)
- o Consulting fees, \$(105,000)
- o Legal fees, \$(11,000)
- o Black Scholes expense related to options and warrants granted to non-employees for services, \$(245,000).
- o Settlements (of lawsuits), \$(119,000)
- o Goodwill amortization, \$(78,000)
- o Shareholder relations, \$(58,000)

Those decreases were partially offset by the following increases:

- o Rent expense, \$151,000, due to terminating the New Jersey lease with a penalty of \$34,000 and increased rent for consolidating our offices in New York City
- o Insurance, \$74,000, due to increased rates

Net loss from operations decreased approximately \$890,000 from \$3,620,000 for the six months ended June 30, 2001, to \$2,730,000 for the six months ended June 30, 2002, due to all of the reasons discussed above.

Financing costs decreased in 2002 due to financing costs incurred in 2001 of \$236,000 related to a \$2.5 million convertible debt credit facility available that did not exist in 2002, offset by financing costs of \$70,000 incurred in February 2002 related to a \$1,000,000 convertible debt facility, and \$133,000 in financing costs related to warrants issued to an officer of the company for loans he had made to the company during 2001.

Interest expense increased \$20,000 from June 30, 2001 to June 30, 2002 due to interest accrued on the convertible note issued by the company during February 2002, as compared to interest accrued on the \$2.5 million convertible debt facility in 2001.

Net loss decreased approximately \$908,000 from \$3,894,000 for the six months ended June 30, 2001, to \$2,986,000 for the six months ended June 30, 2002, due to the reasons discussed above.

### **Liquidity and Capital Resources**

We have \$281,000 in cash as of June 30, 2002 with net working capital deficit of \$(1,362,000) at June 30, 2002. During the six months ended June 30, 2002, net cash used in operating activities was \$2,580,000. During the six months ended June 30, 2002, we raised \$3,460,000 from the exercise of options and warrants, and the issuance of common stock and issuance of convertible debt. The additional cash generated allowed us to pay down outstanding accounts payable outstanding at December 31, 2001. We have been delinquent, from time to time, in the payment of our current obligations, including payments of withholding and other tax obligations. From time to time, members of senior management have made short-term loans to us to meet payroll obligations. However, there is no commitment to continue that practice. As noted above, we are presently in negotiations with institutional sources regarding debt and equity instruments to fund the Company. While there can be no assurance that additional investments or financings will be available to us as needed, management fully expects to conclude the necessary financing in the near term. Failure to obtain such capital on a timely basis could result in lost business opportunities, the sale of the Cymedix(R)business at a distressed price or the financial failure of Medix.

The Company entered into a secured convertible loan agreement with a Company, dated February 19, 2002, pursuant to which we borrowed \$1,000,000 from WellPoint Health Networks Inc. The loan becomes payable on February 19, 2003, if not converted into our common stock. Interest is at a floating rate of 300 basis points over prime, as it is adjusted. Conversion into common stock is at the option of either WellPoint or Medix at a contingent conversion price. The loan is secured by the grant of a security interest in all Medix's intellectual property, including its patent, copyrights and trademarks. See footnote 3 to the Financial Statements.

During April 2002, the Company initiated a private placement of its \$.001 par value common stock. A total of 3,452,500 units were placed through May 14, 2002, each consisting of one share of common stock and one warrant. Subscribers purchased each unit for \$0.40 and are entitled to exercise warrant rights to purchase one share of the common stock of the company at a purchase price of \$.0.50 per share for a five year period on or after September 1, 2002 and prior to September 1, 2007. The Company received a total of \$1,381,000 from this private placement. The Company has committed to register the above underlying shares in a registration statement with the Securities and Exchange Commission within 90 days of completion of the offering.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

On December 17, 2001, Vision Management Consulting, L.L.C., filed suit against us in the Superior Court of New Jersey, Law Division - Essex County, in an action entitled Vision Management Consulting, L.L.C. v. Medix Resources, Inc., Docket No. ESX-L-11438-01. The complaint filed by Vision alleged breach of contract, unjust enrichment, breach of the duty of good faith and fair dealing and misrepresentation on the part of Medix in connection with our performance under a negotiated settlement agreement which we had entered into to resolve certain claims that existed between the parties and that arose out of the termination of operations of our Automated Design Concepts division earlier in 2001. On August 12, 2002, we reached an agreement in principal with Vision to settle this litigation by payment from us to Vision of \$55,000, to be paid over the next three months, with no admission of liability on our part. This settlement is subject to the negotiation and execution of a final settlement

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agreement.

From time to time, the Company is involved in claims and litigation that arise out of the normal course of business. Currently, other than as discussed above, there are no pending matters that in Management's judgment might be considered potentially material to us. Management does not believe that any of the litigation described above will have a material adverse effect on the Company.

### Item 2. Changes in Securities and Use of Proceeds

Set forth below are the unregistered sales of securities by the Company for the quarter reported on. See Note 6 to the unaudited consolidated financial statements elsewhere herein for a description of the terms of the Units of Preferred Stock and warrants.

| Security Issued | Date       | Number of Shares | Consideration | Purchasers  | Exemption Claimed                      |
|-----------------|------------|------------------|---------------|---|--|
| Common Stock    | April 2002 | 234,608          | \$88,956      | Cornell Capital partners, LP and Dutchess Private Equities Fund, LP | Section 4(2); Rule 506 of Regulation D |
| Common Stock    | May 2002   | 3,452,500        | \$1,381,000   | A total of 47 individual investors                                  | Section 4(2); Rule 506 of Regulation D |
| Common Stock    | April 2002 | 100,000          | \$25,000      | Option exercise   | Section 4(2)                           |

### Item 3. Defaults Upon Senior Securities

None.

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

None.

### Item 5. Other Information

None.

### Item 6. Exhibits and Reports on Form 8-K

#### a. Exhibits

Included as exhibits are the items listed on the Exhibit Index. The Registrant will furnish a copy of any of the exhibits listed below upon payment of \$5.00 per exhibit to cover the costs to the Registrant of furnishing such exhibit.

10.1 Binding Letter of Intent for Pilot and Production Programs, dated September 8, 1999 between Cymedix and Professional Claims Services, Inc. (d/b/a WellPoint Pharmacy management).

10.2 Pilot Agreement, dated as of December 28, 1999 between Cymedix and Professional Claims Services, Inc. (d/b/a WellPoint Pharmacy Management, Inc).

10.3 Employment Agreement between the Company and Mr. Mark W.

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Lerner, dated as of July 1, 2002.

10.4 Employment Agreement between the Company and Patricia A. Minicucci dated as of February 15, 2002.

10.5 Employment Agreement between the Company and Louis E. Hyman dated as of May 14, 2002.

10.6 Employment Agreement between the Company and Bryan R. Ellacott dated as of March 1, 2002.

99.1 Certification by John R. Prufeta, President and CEO under Section 906 of the Sarbanes-Oxley Act of 2002

99.2 Certification by Mark W. Lerner, Executive Vice President and CFO under Section 906 of the Sarbanes-Oxley Act of 2002

b. Reports on Form 8-K during the quarter reported on:

1) Form 8-K, filed with the Commission on April 12, 2002, reporting in Item 5 a press release announcing that its latest version of its Cymedix(R) product suite, Cymedix III, is now complete, and is available to be deployed in target markets.

2) Form 8-K, filed with the Commission on May 24, 2002, reporting in Item 5 a press release announcing the completion of a private placement of securities raising \$1,381,000.

3) Form 8-K, filed with the Commission on June 4, 2002, reporting in Item 5 a press release announcing the formal launch of market activities in the state of Georgia.

4) Form 8-K, filed with the Commission on June 14, 2002, reporting in Item 5 a press release announcing that the Company would provide a telephonic progress report.

5) Form 8-K, filed with the Commission on June 14, 2002, reporting in Item 5 a press release announcing an agreement to expand its relationship with Express Scripts, Inc., one of the nation's leading pharmacy benefit managers.

6) Form 8-K, filed with the Commission on June 26, 2002, reporting in Item 5 a press release announcing that effective July 1, 2002, Mark W. Lerner will replace Gary L. Smith as the Company's Chief Financial Officer and Secretary.

### **SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 19, 2002

MEDIX RESOURCES, INC.  
(Registrant)



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/s/ Mark W. Lerner

Mark W. Lerner

Executive Vice President and Chief  
Financial Officer

(Principal Financial and Accounting Officer)