HEALTHWATCH INC
Form 10QSB
February 14, 2002

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

FORM 10-QSB

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended	Commission File Number
December 31, 2001	0-11476

HEALTHWATCH, INC.

(Exact Name of Small Business Issuer as Specified in Its Charter)

Minnesota	84-0916792
(State or Other Jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

1100 Johnson Ferry Road, Suite 670, Atlanta, GA 30342

(Address of Principal Executive Offices)

(404) 256-0083

(Issuer's Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act during the past 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 X No ______

Number of registrant's common shares outstanding at January 31, 2002
4,483,782

Transitional Small Business Disclosure Format (check one)
Yes __ No X

PART I.
FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

HEALTHWATCH, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2001
(UNAUDITED)

ASSETS	
CURRENT ASSETS	
Cash	$ 36,835
Accounts receivable	213,498
Note receivable, current portion	55,000
Inventory	19,527
Other current assets	103,421
TOTAL CURRENT ASSETS	428,281
OTHER ASSETS	
Property and equipment, net of accumulated depreciation of $479,297	134,975
Note receivable, net of current portion	335,439
Intangible assets, net of accumulated amortization of $1,440,709	6,097,978
TOTAL OTHER ASSETS	6,568,392
TOTAL ASSETS	$ 6,996,673
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	$1,001,746
Accrued payroll and payroll taxes	96,791
Debentures payable	25,000
Deferred rent obligation	33,246
Note payable to a bank	200,390
TOTAL LIABILITIES (ALL CURRENT)	1,357,173
SHAREHOLDERS' EQUITY	
Cumulative preferred stock, 15,000,000 shares authorized, $.05 par value; $11,132,300 liquidation preference:	
Series P, 66,886 shares issued and outstanding	3,344
Series C, 4,000 shares issued and outstanding	200
Series D, 72,941 shares issued and outstanding	3,648
Common stock, $.05 par value; 50,000,000 shares authorized:	

2,740,718 shares issued and outstanding	137,037
1,743,064 shares to be issued	87,153
Additional paid-in capital	41,776,147
Unearned compensation	(77,520
Accumulated deficit	(36,290,509
TOTAL SHAREHOLDERS' EQUITY	5,639,500
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 6,996,673

The accompanying notes are an integral part of these consolidated financial statements.

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HEALTHWATCH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED DECEMBER 31, 2001 AND 2000

	2001
SALES	$ 259,230
COST OF SALES	9,382
GROSS PROFIT	249,848
OPERATING EXPENSES	
Selling, general and administrative	433,161
Depreciation and amortization	387,043
Research and development	41,975
Total operating expenses	862,179
OPERATING LOSS	(612,331)
OTHER INCOME (EXPENSE)	
Loss from investment in Halis, Inc.	--
Realized loss on marketable securities	--
Interest income	--
Interest expense	(18,413)
Total other income (expense)	(18,413)
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(630,744)
INCOME TAX BENEFIT	157,866

LOSS FROM CONTINUING OPERATIONS	(472,878)	
GAIN ON SALE OF SUBSIDIARY (NET OF INCOME TAX OF $157,866)	236,800	
NET LOSS	$ (236,078)	$
BASIC AND DILUTED NET LOSS PER COMMON SHARE		
Loss from continuing operations	$ (472,878)	$
Less preferred stock dividends (undeclared)	222,646	
Less amortization of beneficial conversion option on Series D and Series P preferred stock	--	
Loss from continuing operations available to common shareholders	(695,524)	
Gain on sale of subsidiary, net of income tax	236,800	
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	$ (458,724)	$
NET LOSS PER COMMON SHARE, BASIC AND DILUTED		
Loss from continuing operations	$ (0.15)	$
Gain on sale of subsidiary, net of income tax	0.05	
Net loss	$ (0.10)	$
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	4,475,032	

The accompanying notes are an integral part of these consolidated financial statements.

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HEALTHWATCH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2001 AND 2000

	2001
SALES	$ 589,782
COST OF SALES	26,885
GROSS PROFIT	562,897
OPERATING EXPENSES	
Selling, general and administrative	654,957
Depreciation and amortization	775,199
Research and development	81,707
Total operating expenses	1,511,863
OPERATING LOSS	(948,966)

OTHER INCOME (EXPENSE)	
Loss from investment in Halis, Inc.	--
Realized loss on marketable securities	--
Interest income	68
Interest expense	(20,793)
Total other income (expense)	(20,725)
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(969,691)
INCOME TAX BENEFIT	177,893
LOSS FROM CONTINUING OPERATIONS	(791,798)
INCOME FROM DISCONTINUED OPERATIONS (NET OF INCOME TAX OF $20,027)	30,040
GAIN ON SALE OF SUBSIDIARY (NET OF INCOME TAX OF $157,866)	236,800
NET LOSS	$ (524,958)
BASIC AND DILUTED NET LOSS PER COMMON SHARE	
Loss from continuing operations	$ (791,798)
Less preferred stock dividends (undeclared)	445,292
Less amortization of beneficial conversion option on Series D and Series P preferred stock	763,095
Loss from continuing operations available to common shareholders	(2,000,185)
Income from discontinued operations, net of income tax	30,040
Gain on sale of subsidiary, net of income tax	236,800
NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	$(1,733,345)
NET LOSS PER COMMON SHARE, BASIC AND DILUTED	
Loss from continuing operations	$ (0.45)
Income from discontinued operations, net of income tax	0.01
Gain on sale of subsidiary, net of income tax	0.05
Net loss	$ (0.39)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	4,465,078

The accompanying notes are an integral part of these consolidated financial statements.

HEALTHWATCH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2001 AND 2000

CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss	$ (
Adjustments:	
Depreciation	
Amortization	
Loss from investment in Halis, Inc.	
Loss on sale of marketable securities	
Gain on sale of subsidiary	(
Stock options issued for services	
Changes in assets and liabilities, net of effects of sale of subsidiary:	
Accounts receivable	(
Inventory	
Other current assets	
Other assets	
Accounts payable and accrued expenses	(
Deferred revenue and customer deposits	

Total adjustments	

Net cash used in operating activities	(

CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property and equipment	
Proceeds from sale of marketable securities	
Proceeds from sale of subsidiary	
Decrease in due from Halis, Inc.	
Purchase of intangible assets, capitalized MERAD technology costs and other	

Net cash provided in investing activities	

CASH FLOWS FROM FINANCING ACTIVITIES	
Principal payments on note payable to a bank	

Net cash used by financing activities	

NET INCREASE (DECREASE) IN CASH	
CASH, BEGINNING OF PERIOD	

CASH, END OF PERIOD	$
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The accompanying notes are an integral part of these consolidated financial statements.

HEALTHWATCH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001
(UNAUDITED)

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF PRESENTATION

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the Company's financial position as of December 31, 2001, and its results of operations and cash flows for the three months and six months then ended have been included. However, operating results for the interim periods noted are not necessarily indicative of the results that may be expected for the year ending June 30, 2002. This report should be read in conjunction with the Company's financial statements and notes thereto contained in the Company's annual report on Form 10-KSB for the year ended June 30, 2001.

ORGANIZATION AND NATURE OF BUSINESS

HealthWatch, Inc. ("HealthWatch") and subsidiaries (collectively the "Company") was founded in 1983 and while continuing to be a supplier of parts and services for noninvasive vascular diagnostic medical instruments to hospitals and medical clinics throughout the United States, continues to evolve into primarily a software information technology ("IT") company. The Company's virtual software application utility (the "MERAD Systems") utilizes an advanced multi-media object and relational database which creates knowledge objects that can be used and reused in virtually unlimited numbers of combinations to provide efficient applications that can be accessed in both an Internet and Intranet environment. Headquartered in Atlanta, Georgia, HealthWatch has research and development, marketing, sales and support capabilities in the healthcare IT sector.

The Company's objective is to become a leading provider of enterprise software applications to process and manage transactions for physician offices, hospitals, outpatient clinics, and other healthcare providers. As part of this plan, the Company will offer and market enterprise software solutions, known as the Heal Systems and the HES Systems. The HES Systems and the Heal Systems use proprietary technology to distribute, in a compressed digital format, one system that includes over 30 integrated applications for the management of a healthcare enterprise's resources, patient data, clinical data, and finances. The HES Systems and the Heal Systems were designed and built using the Company's software application utility, MERAD Systems.

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INTANGIBLE ASSETS

Intangible assets are being amortized over five years using the straight-line method.

LONG-LIVED ASSETS

HealthWatch evaluates the carrying value of long-lived assets, including intangibles, whenever events or changes in circumstances indicate that the carrying value of the asset may be impaired. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset, including disposition, is less than the carrying value of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying value exceeds the fair value of the assets, as measured by discounted cash flows over the remaining life of the assets.

SIGNIFICANT ESTIMATES

Management has estimated the undiscounted future cash flows that are expected to result from the use of its technology. These estimates are based on current letters of intent and anticipated future sales. Achieving these estimates depends on the Company's success in implementing its sales plan and penetrating the market with its available resources. Management's estimates of projected cash flows are subject to risks and uncertainties of change affecting the recoverability of the Company's intangible assets. Although management has made its best estimate of these factors based on current conditions and information, it is reasonably possible that changes could occur in the near term which could adversely affect management's estimate of net cash flows expected to be generated from its technology and the need for asset impairment write-downs. As a result, the carrying amount of the Company's intangible assets of approximately $6.1 million may be reduced materially in the near term.

REVENUE RECOGNITION

Revenue consists of software licensing fees, product and supply sales, consulting services, and third party claims processing fees. The Company recognizes revenue from product sales at the time ownership transfers to the customer, principally at shipment. Revenues from licensing agreements are recognized after shipment of the product and fulfillment of acceptance terms, provided no significant obligations remain and collection of resulting receivables are deemed probable. Service revenues are recognized when the services are performed.

NET LOSS PER SHARE

Basic loss per share is calculated as net loss available to common shareholders divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur from common shares issuable through stock options, stock warrants and convertible debt and stock. As the Company's stock options, stock warrants and convertible debt and stock are antidilutive for all periods presented, dilutive loss per share is the same as basic loss per share.

INCOME TAXES

Deferred income tax assets and liabilities are recognized for the estimated tax effects of temporary differences between the financial reporting and tax reporting bases of assets and liabilities and for loss carryforwards based on enacted tax laws and rates. A valuation allowance is used to eliminate deferred income tax assets to the amount that is more likely than not to be utilized.

DEBENTURES PAYABLE

As of December 31, 2001, the Company had outstanding debentures with principal totaling $25,000. The debentures accrue interest at an annual rate of 10%, payable quarterly. The debentures matured on March 1, 1998, and are currently in default as to the payment of principal and past due interest. The debentures, including unpaid accrued interest, could be converted, at the option of the holder, into shares of the Company's common stock. As of December 31, 2001, $17,399 in accrued but unpaid interest was outstanding on the debentures. The Company is attempting to reach an agreement with the remaining debenture holder in an effort to resolve the amounts outstanding or otherwise bring the debentures out of their default status.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized, but are reviewed annually for impairment or more frequently if impairment indicators arise. Separable intangible assets that have finite lives will continue to be amortized over their useful lives. The amortization provisions of SFAS No. 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill and intangible assets acquired prior to July 1, 2001, the Company is required to adopt SFAS No. 142 effective July 1, 2002, but may adopt the new statement beginning July 1, 2001. The Company is currently evaluating the effects that adoption of the provisions of SFAS No. 142 will have on its results of operations and financial position. As of June 30, 2001, the Company has intangible assets, net of accumulated amortization, of approximately $6.1 million, which will be subject to the transitional provisions of SFAS No. 142. Amortization expense was $746,332 and $120,799 for the six months ended December 31, 2002 and 2001, respectively.

NOTE B - OPERATIONS

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, which contemplate the continuation of the Company as a going concern. However, the Company incurred net losses of $524,958 for the six months ended December 31, 2001 and $3,937,367 for the year ended June 30, 2001, and had a working capital deficiency of $928,892 at December 31, 2001. The Company has sustained continuous losses from operations. The Company has used, rather than provided, cash in its operating activities during the six months ended December 31, 2001 and the year ended June 30, 2001 and has deferred payment of certain accounts payable and accrued expenses. Given these results, additional capital and improved operations will be needed to sustain the Company's operations.

Management's operating plan is to fund future operations by licensing the Company's technology assets to organizations that have significant numbers of users. Beginning July 2001, the Company entered into certain letters of intent with these types of organizations. Through these agreements and future agreements, the Company expects to generate sufficient cash flows to cover its operating costs and to improve its financial position. In addition, the Company significantly reduced its operating expenses beginning July 2001.

In view of the matters described, there is substantial doubt about the Company's ability to continue as a going concern. The recoverability of the recorded assets and satisfaction of the liabilities reflected in the accompanying balance sheet is dependent upon continued operation of the Company, which is in turn dependent upon the Company's ability to meet its financing requirements on a continuing basis and to succeed in its future operations. There can be no assurance that management will be successful in implementing its plans. The financial statements do not include any adjustment that might result from the outcome of this uncertainty.

NOTE C - GAIN ON SALE OF SUBSIDIARY

On October 9, 2001, the Company sold its claims processing subsidiary, ABAS, to a company controlled by the President of ABAS. The sales agreement specifies a maximum purchase price of $1,320,000. This purchase price consists of $265,000 paid at closing, $55,000 to be paid on or before June 1, 2002, and profit sharing revenues of $1,000,000, of which $465,000 is guaranteed through a five-year promissory note. The agreement also includes a marketing and administrative services agreement to jointly pursue certain new technology-based services and share in revenues. The sale resulted in a pre-tax gain of $394,666 ($236,800 after estimated taxes). The non-interest bearing promissory note of $520,000 has been discounted to $390,439 using a rate of 6.75% for five years. The gain was computed using a sales price of $655,439 representing $265,000 paid at closing, a discounted promissory note of $390,439, less net assets of ABAS of $260,773.

The following is a summary of operations of ABAS included in the consolidated financial statements of HealthWatch for the six months ended December 31, 2001 and 2000:

	2001	2000
Sales	$ 1,115,979	$ --
Operating expenses	1,060,232	--
Operating income	55,747	--
Interest expense	(5,680)	--
	$ 50,067	$ --

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward Looking Statements

The following discussion of HealthWatch's financial condition and results of operations contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. These statements include the plans and objectives of HealthWatch for future operations. The forward looking statements included herein are based on current expectations that involve numerous risks and uncertainties. HealthWatch's plans and objectives are based on certain assumptions including, but not limited to, competitive conditions within the healthcare industry will not change materially or adversely and that there will be no material adverse change in HealthWatch's operations or business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, as well as future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond HealthWatch's control. Although HealthWatch believes that the assumptions underlying the forward looking statements included herein are reasonable, the inclusion of such information should not be regarded as a representation by HealthWatch, or any other person, that the objectives and plans of HealthWatch will be achieved.

Financial Condition

Total assets at December 31, 2001 decreased $675,030 to $6,996,673 from $7,671,703 at June 30, 2001. The decrease is primarily due to the amortization of intangibles of $746,332, a reduction of $97,769 in cash used to reduce current liabilities, offset by an increase in receivables of $569,078, of which $390,439 is a note receivable due from the acquirer of ABAS. Current liabilities at December 31, 2001 decreased $171,214 to $1,357,173 from $1,528,387 at June 30, 2001. The decrease is primarily due to the repayment of current liabilities. Shareholders' equity at December 31, 2001 decreased $503,816 to $5,639,500 from $6,143,316 at June 30, 2001. This decrease is primarily due to the net loss for the six months ended December 31, 2001 of $524,958.

Results of Operations

Six months ended December 31, 2001 compared to six months ended December 31, 2000

Revenues increased $406,160, or 221.2% to $589,782 for the six months ended December 31, 2001 from $183,622 during the same period in 2000. The increase results from licensing revenues from the Company's Heal Systems, HES Systems and MERAD Systems.

Cost of products sold decreased $11,003 or 29.0% to $26,885 for the six months ended December 31, 2001 from $37,888 during the same period in 2000. The decrease is primarily due

to the continued shift from product sales to service and support at Healthwatch Technologies.

Gross margins increased to $562,897, 95.4%, for the six months ended December 31, 2001 from $145,734, 79.4%, during the same period in 2000. Higher gross margins were achieved from the revenue generated from the HES System and the continued shift from product sales to service and support at Healthwatch Technologies.

Selling, general and administrative expenses decreased $1,218,720 or 65.0% to $654,959 for the six months ended December 31, 2001 from $1,873,679 during the same period in 2000. This decrease was primarily due to a decrease in compensation expense, the discontinuance of payments to Halis under the business collaboration agreement subsequent to the merger, and general reductions in operating expenses.

Research and development expenses decreased $16,327 or 16.7% to $81,707 for the six months ended December 31, 2001 as compared to $98,034 during the same period in 2000. The decrease was primarily due to additional development work performed during the six months ended December 31, 2000.

Depreciation and amortization increased $647,286 to $775,197 for the six months ended December 31, 2001 from $127,911 during the same period in 2000. The increase is primarily the result of amortization expense of $600,324 related to intangible assets acquired in the Halis merger which was effective May 31, 2001.

Equity loss from investment in Halis decreased from $127,710 to zero due to the consummation of the Halis merger.

Interest income decreased $95,881 to $68 for the six months ended December 31, 2001 as compared to $95,949 during the same period in 2000. The decrease is due to the sale of marketable securities used for working capital purposes.

Interest expense increased $10,778 to $20,793 for the six months ended December 31, 2001 as compared to $10,015 during the same period in 2000. The increase is due to interest on notes payable to a bank acquired in the Halis merger.

Three months ended September 30, 2001 compared to three months ended September 30, 2000

Revenues increased $179,874, or 226.7% to $259,230 in the second quarter ended December 31, 2001 from $79,356 during the same period in 2000. The increase results from licensing revenues from the Company's Heal Systems, HES Systems and MERAD Systems.

Cost of products sold decreased $5,930 or 38.7% to $9,382 in the second quarter ended December 31, 2001 from $15,312 during the same period in 2000. The decrease is primarily due to the continued shift from product sales to service and support at Healthwatch Technologies.

Gross margins increased to $249,848, 96.4%, in the second quarter ended December 31, 2001

from $64,044, 80.7%, during the same period in 2000. Higher gross margins were achieved from the revenue generated from the HES System and the continued shift from product sales to service and support at Healthwatch Technologies.

Selling, general and administrative expenses decreased $525,179 or 54.8% to $433,161 in the second quarter ended December 31, 2001 from $958,340 during the same period in 2000. This decrease was primarily due to a decrease in compensation expense, the discontinuance of payments to Halis under the business collaboration agreement subsequent to the merger, and general reductions in operating expenses.

Research and development expenses decreased $17,579 or 29.5% to $41,975 in the second quarter ended December 31, 2001 as compared to $59,554 during the same period in 2000. The decrease was primarily due to additional development work performed during the second quarter ended December 31, 2000.

Depreciation and amortization increased $316,841 to $387,043 in the second quarter ended December 31, 2001 from $70,202 during the same period in 2000. The increase is primarily the result of amortization expense of $300,162 related to intangible assets acquired in the Halis merger which was effective May 31, 2001.

Equity loss from investment in Halis decreased from $9,050 to zero due to the consummation of the Halis merger.

Interest income decreased $37,845 in the second quarter ended December 31, 2001 as compared to $37,845 during the same period in 2000. The decrease is due to the sale of Marketable Securities used for working capital purposes.

Interest expense increased $12,012 to $18,413 in the second quarter ended December 31, 2001 as compared to $6,401 during the same period in 2000. The increase is due to interest on notes payable to a bank acquired in the Halis merger.

Liquidity and Capital Resources

At December 31, 2001, HealthWatch had a cash balance of $36,835. During the six months ended December 31, 2001, operating activities consumed $338,569 of cash as compared to $1,677,795 for the same period in 2000. The decrease in cash used in operations is primarily the result of lower expenses, including the discontinuance of payments to Halis under the business collaboration agreement subsequent to the merger, and an increase in license revenues of the Company's HES System.

Investing activities provided $265,000 cash during the six months ended December 31, 2001 representing proceeds from the sale of ABAS. Cash provided for the same period in 2000 of $1,713,615 primarily represents proceeds from the sale of marketable securities of $2,190,143 offset by capitalized MERAD technology costs of $248,597.

Financing activities used $24,200 cash during the six months ended December 31, 2001. In the

first quarter 2001, the Company made principal payments on the note payable to a bank acquired in the Halis merger, which was effective May 31, 2001.

The Company has begun to implement its business plan. Currently, HealthWatch does not have any material commitments outstanding for capital expenditures and does not anticipate making any material capital expenditures in the short term. HealthWatch is not currently generating positive cash flow from its operations, and does not currently have liquid assets necessary to sustain operations over the next twelve months. Management believes that it will be able to provide the necessary operating capital from sales of its products and services. However, if HealthWatch is unable to generate sufficient cash flow from its business it will be necessary to seek additional equity or debt financing. There can be no assurance that the Company will be successful in obtaining additional financing under acceptable terms, if at all.

PART II.
OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the quarter ended December 31, 2001, the Company issued 26,834 shares of common stock as a result of the conversion of 939 shares of Series D preferred stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

On March 1, 1998, $580,000 principal amount of the Company's 10% secured convertible debentures ("Debentures") were due and payable. The Company was unable to pay the Debentures in accordance with their terms and the Company obtained no further extension of the maturity date from the holders. During fiscal 1999, $100,000 in principal of the Debentures was paid to the holders thereof. In January and February 2000, the Debenture holders converted $455,000 of their Debentures and related accrued interest of $139,357 into 316,990 shares of common stock of the Company. As of December 31, 2001, a principal balance of $25,000 remains outstanding.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the Company's shareholders during the second quarter ended December 31, 2001.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS. The following exhibits are filed with or incorporated by reference into this report:

2.1 Agreement and Plan of Merger by and among Halis, Inc., HealthWatch Merger Sub, Inc. and HealthWatch, Inc. dated as of June 29, 2000 (1).
2.2 Amendment to the Agreement and Plan of Merger dated as of September 29, 2000 (1).
2.3 Letter of Intent between HealthWatch, Inc. and Halis, Inc. dated March 8, 2000 (1).
2.4 Amendment to the Financing Option between HealthWatch, Inc. and Halis, Inc. dated July 28, 2000 (1).
2.5 Second Amendment to the Agreement and Plan of Merger, dated as of January 31, 2001 (1).
3.1 Articles of Incorporation of HealthWatch, Inc., dated June 10, 1983 (1).
3.2 Certificate of Amendment of Articles of Incorporation of HealthWatch, Inc., dated October 20, 1987(1)
3.3 Articles of Amendment of Articles of Incorporation of HealthWatch, Inc., dated December 5, 1989 (1).
3.4 Articles of Amendment of Articles of Incorporation of HealthWatch, Inc., dated December 8, 1999 (1).
3.5 Bylaws of HealthWatch, Inc. (1).
3.13 Certification of Designation, Preferences, Rights and Limitations of the 6% Series A Convertible Preferred Stock of HealthWatch, Inc. dated June 9, 1998 (1).
3.14 Amended and Restated Certification of Designation, Preferences, Rights and Limitations of the Series P Preferred Stock of HealthWatch, Inc. dated March 22, 2000 (1).
3.15 Certification of Designation, Preferences, Rights and Limitations of the Series C 8% Convertible Preferred Stock of HealthWatch, Inc. dated March 20, 2000 (1).
3.16 Certification of Designation, Preferences, Rights and Limitations of the Series D 8% Convertible Preferred Stock of HealthWatch, Inc. dated March 20, 2000 (1).
4.1 Specimen form of the Company's Common Stock certificate (2)
4.8 Subscription and Purchase Agreement dated as of the 14th day of August 1992 between the Company and the Purchasers of the Company's 10% convertible senior debentures due 1997 (including as an appendix thereto the form of the debenture certificate) (3)
10.1 Business Collaboration Agreement dated as of October 10, 1997 between HealthWatch, Inc. and Halis, Inc. (1)
10.6 Form of Warrant Certificate of HealthWatch, Inc. (1)
10.8 Amended and Restated Agency Agreement between Commonwealth Associates, L.P. and HealthWatch, Inc. dated February 7, 2000 (1).
10.9 HealthWatch, Inc. 2000 Stock Option Plan, adopted as of May 8, 2000, approved by HealthWatch stockholders July 14 2000 (1).
10.10 Form of Stock Option Agreement (1).
10.11 Amendment to the Business Collaboration Agreement dated September 20, 2000 between Halis, Inc. and HealthWatch, Inc. (1)
10.12 Finders Agreement between HealthWatch, Inc. and Commonwealth

Associates, L.P., dated March 21, 2000 (1)

21.1 Subsidiaries of HealthWatch, Inc. (1).

(b) REPORTS ON FORM 8-K. The following reports on Form 8-K were filed during the quarter ended December 31, 2001.

None.

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(1) Incorporated herein by reference to the Company's Registration Statement on Form S-4, as amended, originally filed on October 24, 2000 (File No. 333-48546).

(2) Incorporated herein by reference to Registration Statement on Form S-18 (File No. 2-85688D).

(3) Incorporated herein by reference to Registration Statement on Form SB-2 (File No. 33-73462).

SIGNATURES

In accordance with the Exchange Act, the registrant caused this report to be signed by the undersigned, thereunto duly authorized.

HEALTHWATCH, INC.

Date: February 14, 2002

/s/ Paul W. Harrison

Paul W. Harrison

Chairman, President and Chief Executive Officer

Date: February 14, 2002

/s/ Thomas C. Ridenour

Chief Financial Officer and Principal Accounting Officer

EXHIBIT INDEX

Number	Description
2.1	Agreement and Plan of Merger by and among Halis, Inc., HealthWatch Merger Sub, Inc. and HealthWatch, Inc. dated as of June 29, 2000 (1).
2.2	Amendment to the Agreement and Plan of Merger dated as of September 29, 2000 (1).
2.3	Letter of Intent between HealthWatch, Inc. and Halis, Inc. dated March 8, 2000 (1).
2.4	Amendment to the Financing Option between HealthWatch, Inc. and Halis, Inc. dated July 28, 2000 (1).

2.5 Second Amendment to the Agreement and Plan of Merger, dated as of January 31, 2001 (1).
2.6 Third Amendment to the Agreement and Plan of Merger, dated as of February 16, 2001 (1).
2.7 Fourth Amendment to the Agreement and Plan of Merger, dated as of March 28, 2001 (1).
2.8 Fifth Amendment to the Agreement and Plan of Merger, dated as of April 26, 2001 (1).
3.1 Articles of Incorporation of HealthWatch, Inc., dated June 10, 1983 (1).
3.2 Certificate of Amendment of Articles of Incorporation of HealthWatch, Inc., dated October 20, 1987(1)
3.3 Articles of Amendment of Articles of Incorporation of HealthWatch, Inc., dated December 5, 1989 (1).
3.4 Articles of Amendment of Articles of Incorporation of HealthWatch, Inc., dated December 8, 1999 (1).
3.5 Bylaws of HealthWatch, Inc. (1).
3.13 Certification of Designation, Preferences, Rights and Limitations of the 6% Series A Convertible Preferred Stock of HealthWatch, Inc. dated June 9, 1998 (1).
3.14 Amended and Restated Certification of Designation, Preferences, Rights and Limitations of the Series P Preferred Stock of HealthWatch, Inc. dated March 22, 2000 (1).
3.15 Certification of Designation, Preferences, Rights and Limitations of the Series C 8% Convertible Preferred Stock of HealthWatch, Inc. dated March 20, 2000 (1).
3.16 Certification of Designation, Preferences, Rights and Limitations of the Series D 8% Convertible Preferred Stock of HealthWatch, Inc. dated March 20, 2000 (1). 4.1 Specimen form of the Company's Common Stock certificate (2) 4.8 Subscription and Purchase Agreement dated as of the 14th day of August 1992 between the Company and the Purchasers of the Company's 10% convertible senior debentures due 1997 (including as an appendix thereto the form of the debenture certificate) (3)
10.1 Business Collaboration Agreement dated as of October 10, 1997 between HealthWatch, Inc. and Halis, Inc. (1)
10.6 Form of Warrant Certificate of HealthWatch, Inc. (1)
10.8 Amended and Restated Agency Agreement between Commonwealth Associates, L.P. and HealthWatch, Inc. dated February 7, 2000 (1).
10.9 HealthWatch, Inc. 2000 Stock Option Plan, adopted as of May 8, 2000, approved by HealthWatch stockholders July 14 2000 (1).
10.10 Form of Stock Option Agreement (1).
10.11 Amendment to the Business Collaboration Agreement dated September 20, 2000 between Halis, Inc. and HealthWatch, Inc. (1)
10.12 Finders Agreement between HealthWatch, Inc. and Commonwealth Associates, L.P., dated March 21, 2000 (1)

21.1 Subsidiaries of HealthWatch, Inc. (1)

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(1) Incorporated herein by reference to the Company's Registration Statement on Form S-4, as amended, originally filed on October 24, 2000 (File No. 333-48546).
(2) Incorporated herein by reference to Registration Statement on Form S-18 (File No. 2-85688D).

(3) Incorporated herein by reference to Registration Statement on Form SB-2 (File No. 33-73462).