

HEALTHSTREAM INC
Form 10-Q
August 01, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

**Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2011
Commission File No.: 000-27701
HealthStream, Inc.
(Exact name of registrant as specified in its charter)**

Tennessee
(State or other jurisdiction of
incorporation or organization)

62-1443555
(I.R.S. Employer Identification No.)

**209 10th Avenue South, Suite 450
Nashville, Tennessee**

37203

(Address of principal executive offices)

(Zip Code)

(615) 301-3100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

As of July 28, 2011, 22,118,685 shares of the registrant's common stock were outstanding.

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HEALTHSTREAM, INC.**

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 24,447,300	\$ 17,867,860
Investments in short-term marketable securities	2,011,564	5,703,192
Restricted cash	1,380	84,528
Interest receivable	48,870	51,226
Accounts receivable, net of allowance for doubtful accounts of \$146,686 and \$156,723 at June 30, 2011 and December 31, 2010, respectively	12,594,657	11,069,108
Accounts receivable unbilled	1,202,532	1,314,025
Deferred tax assets, current	3,436,671	3,436,671
Prepaid royalties, net of amortization	2,059,751	3,145,297
Other prepaid expenses and other current assets	1,799,378	1,598,874
Total current assets	47,602,103	44,270,781
Property and equipment:		
Equipment	14,958,043	14,347,683
Leasehold improvements	3,713,470	2,737,715
Furniture and fixtures	2,096,734	2,027,535
	20,768,247	19,112,933
Less accumulated depreciation and amortization	(15,857,115)	(15,287,579)
	4,911,132	3,825,354
Capitalized software development, net of accumulated amortization of \$6,995,727 and \$5,886,594 at June 30, 2011 and December 31, 2010, respectively	7,843,957	4,332,705
Goodwill	21,146,864	21,146,864
Intangible assets, net of accumulated amortization of \$8,494,185 and \$8,043,328 at June 30, 2011 and December 31, 2010, respectively	2,392,957	2,843,814
Deferred tax assets, noncurrent	3,274,474	5,346,536
Other assets	137,401	244,649
Total assets	\$ 87,308,888	\$ 82,010,703
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 727,628	\$ 2,374,621
Accrued liabilities	3,879,348	4,120,786
Accrued compensation and related expenses	1,225,007	1,506,245

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Deferred revenue	19,913,709	16,740,454
Capital lease obligations	2,210	4,362
Total current liabilities	25,747,902	24,746,468
Other long-term liabilities	476,779	473,897
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value, 75,000,000 shares authorized; 22,061,685 and 21,805,235 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	98,160,825	97,227,198
Accumulated deficit	(37,075,264)	(40,431,443)
Accumulated other comprehensive loss	(1,354)	(5,417)
Total shareholders' equity	61,084,207	56,790,338
Total liabilities and shareholders' equity	\$ 87,308,888	\$ 82,010,703

See accompanying notes to the condensed consolidated financial statements.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended June 30,	
	2011	2010
Revenues, net	\$ 21,050,859	\$ 16,660,469
Operating costs and expenses:		
Cost of revenues (excluding depreciation and amortization)	7,638,306	5,906,377
Product development	1,911,233	1,722,929
Sales and marketing	4,356,488	3,049,817
Other general and administrative expenses	2,684,318	2,398,065
Depreciation and amortization	1,354,683	1,235,918
Total operating costs and expenses	17,945,028	14,313,106
Income from operations	3,105,831	2,347,363
Other income (expense):		
Interest and other income	8,638	5,784
Interest and other expense	(12,796)	(10,101)
Total other expense, net	(4,158)	(4,317)
Income before income tax provision	3,101,673	2,343,046
Income tax provision	1,271,251	995,337
Net income	\$ 1,830,422	\$ 1,347,709
Net income per share:		
Basic	\$ 0.08	\$ 0.06
Diluted	\$ 0.08	\$ 0.06
Weighted average shares of common stock outstanding:		
Basic	22,001,911	21,795,558
Diluted	23,350,247	22,432,931

See accompanying notes to the condensed consolidated financial statements.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Six Months Ended June 30,	
	2011	2010
Revenues, net	\$ 39,556,594	\$ 31,497,721
Operating costs and expenses:		
Cost of revenues (excluding depreciation and amortization)	14,708,094	11,368,360
Product development	3,697,481	3,249,094
Sales and marketing	7,864,132	6,010,686
Other general and administrative expenses	5,226,489	4,483,934
Depreciation and amortization	2,397,557	2,626,260
Total operating costs and expenses	33,893,753	27,738,334
Income from operations	5,662,841	3,759,387
Other income (expense):		
Interest and other income	38,165	8,499
Interest and other expense	(22,165)	(21,317)
Total other income (expense), net	16,000	(12,818)
Income before income tax provision	5,678,841	3,746,569
Income tax provision	2,322,662	1,591,996
Net income	\$ 3,356,179	\$ 2,154,573
Net income per share:		
Basic	\$ 0.15	\$ 0.10
Diluted	\$ 0.14	\$ 0.10
Weighted average shares of common stock outstanding:		
Basic	21,919,622	21,735,661
Diluted	23,159,827	22,281,538

See accompanying notes to the condensed consolidated financial statements.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2011

	Common Stock		Accumulated	Accumulated Other Comprehensive Income	Total Shareholders
	Shares	Amount	Deficit	(Loss)	Equity
Balance at December 31, 2010	21,805,235	\$ 97,227,198	\$ (40,431,443)	\$ (5,417)	\$ 56,790,338
Net income			3,356,179		3,356,179
Unrealized gain on investments in marketable securities				4,063	4,063
Stock based compensation expense		373,829			373,829
Exercise of stock options	256,450	559,798			559,798
Balance at June 30, 2011	22,061,685	\$ 98,160,825	\$ (37,075,264)	\$ (1,354)	\$ 61,084,207

See accompanying notes to the condensed consolidated financial statements.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30,	
	2011	2010
OPERATING ACTIVITIES:		
Net income	\$ 3,356,179	\$ 2,154,573
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,397,557	2,626,260
Stock based compensation expense	373,829	332,550
Deferred income taxes	2,072,062	1,591,996
Provision for doubtful accounts	20,000	
Changes in operating assets and liabilities:		
Accounts and unbilled receivables	(1,434,056)	(366,881)
Restricted cash	83,148	29,281
Prepaid royalties	1,085,546	610,328
Other prepaid expenses and other current assets	(313,631)	(480,018)
Other assets	179,878	93,740
Accounts payable	(1,646,993)	(1,012,814)
Accrued liabilities and accrued compensation and related expenses and other long-term liabilities	(519,794)	(874,796)
Deferred revenue	3,173,255	3,189,759
Net cash provided by operating activities	8,826,980	7,893,978
INVESTING ACTIVITIES:		
Proceeds from maturities of investments in marketable securities	8,350,868	
Purchases of investments in marketable securities	(4,727,704)	
Payments associated with capitalized software development	(4,620,385)	(1,021,710)
Purchases of property and equipment	(1,807,965)	(509,947)
Net cash used in investing activities	(2,805,186)	(1,531,657)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	559,798	435,050
Payments on note payable		(306,942)
Payments on capital lease obligations	(2,152)	(5,837)
Net cash provided by financing activities	557,646	122,271
Net increase in cash and cash equivalents	6,579,440	6,484,592
Cash and cash equivalents at beginning of period	17,867,860	12,287,059
Cash and cash equivalents at end of period	\$ 24,447,300	\$ 18,771,651

See accompanying notes to the condensed consolidated financial statements.

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The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, condensed consolidated financial statements do not include all of the information and footnotes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated in consolidation. Operating results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The balance sheet at December 31, 2010 is consistent with the audited financial statements at that date but does not include all of the information and footnotes required by US GAAP for a complete set of financial statements. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2010 (included in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 23, 2011).

2. INCOME TAXES

Income taxes are accounted for using the asset and liability method, whereby deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and tax bases of assets and liabilities measured at tax rates that will be in effect for the year in which the differences are expected to affect taxable income. During the six months ended June 30, 2011 and 2010, the Company recorded a provision for income taxes of \$2,322,662 and \$1,591,996, respectively. The Company's effective tax rate for the six months ended June 30, 2011 and 2010 was 41.0% and 42.5%, respectively. The Company's effective tax rate primarily reflects the statutory corporate income tax rate, the net effect of state taxes, and the effect of various immaterial permanent tax differences.

3. STOCK BASED COMPENSATION

The Company maintains two stock incentive plans. The Company accounts for its stock based compensation plans using the fair-value based method for costs related to share-based payments, including stock options. During the six months ended June 30, 2011, the Company granted 354,750 stock options with a weighted average grant date fair value of \$4.66. During the six months ended June 30, 2010, the Company granted 319,000 stock options with a weighted average grant date fair value of \$2.07. The fair value of stock based awards granted during the six months ended June 30, 2011 and 2010 was estimated using the Black Scholes option pricing model, with the assumptions as follows:

	Six Months Ended June 30,	
	2011	2010
Risk-free interest rate	2.37 - 2.39%	2.39 - 2.49%
Expected dividend yield	0.0%	0.0%
Expected life	5 - 7 years	5 - 7 years
Expected forfeiture rate	0-5%	0-10%
Volatility	50%	55%

Total stock based compensation expense recorded for the three and six months ended June 30, 2011 and 2010, which is recorded in the condensed consolidated statements of income, is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Cost of revenues (excluding depreciation and amortization)	\$ 8,744	\$ 9,634	\$ 19,910	\$ 18,768

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Product development	36,783	31,865	76,346	63,952
Sales and marketing	34,261	42,274	82,197	86,052
Other general and administrative	104,247	85,997	195,376	163,778
Total stock based compensation expense	\$ 184,035	\$ 169,770	\$ 373,829	\$ 332,550

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Table of Contents**HEALTHSTREAM, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****4. NET INCOME PER SHARE**

Basic net income per share is computed by dividing the net income available to common shareholders for the period by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed by dividing the net income for the period by the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares, composed of incremental common shares issuable upon the exercise of stock options and warrants, escrowed or restricted shares, and shares subject to vesting are included in diluted net income per share only to the extent these shares are dilutive. Common equivalent shares are dilutive when the average market price during the period exceeds the exercise price of the underlying shares. The total number of common equivalent shares excluded from the calculations of diluted net income per share, due to their anti-dilutive effect, was approximately 0.4 million for both the three and six months ended June 30, 2011, and approximately 0.4 million and 0.6 million for the three and six months ended June 30, 2010, respectively.

The following table sets forth the computation of basic and diluted net income per share for the three and six months ended June 30, 2011 and 2010:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Numerator:				
Net income	\$ 1,830,422	\$ 1,347,709	\$ 3,356,179	\$ 2,154,573
Denominator:				
Weighted average shares outstanding:				
Basic	22,001,911	21,795,558	21,919,622	21,735,661
Employee stock options	1,348,336	637,373	1,240,205	545,877
Diluted	23,350,247	22,432,931	23,159,827	22,281,538
Net income per share:				
Basic	\$ 0.08	\$ 0.06	\$ 0.15	\$ 0.10
Diluted	\$ 0.08	\$ 0.06	\$ 0.14	\$ 0.10

5. COLLABORATIVE ARRANGEMENT

On June 23, 2010, the Company announced the formation of SimVentures, a collaborative arrangement between HealthStream and Laerdal Medical Corporation (Laerdal Medical). The Company receives 50 percent of the profits or losses generated from the collaborative arrangement. A legal entity was not formed as part of the collaborative arrangement; therefore, the Company accounts for SimVentures as a collaborative arrangement in accordance with applicable accounting guidance. During the first quarter of 2011, the Company acquired fifty percent ownership in Laerdal Medical's Advanced Video System (AVS) product for \$3.5 million in cash. AVS is a product that enables users of advanced patient simulators to easily capture video, audio, data logs, and patient responses. The AVS product is now jointly owned through SimVentures. During the second quarter of 2011, SimVentures launched SimStore, one of the components of SimCenter that offers healthcare providers an opportunity to sample and purchase simulation scenarios to use in their simulation training activities. During the six months ended June 30, 2011, the Company recorded approximately \$148,000 of revenues and \$498,000 of expenses related to the collaborative arrangement. The expenses are primarily recorded in the product development, sales and marketing and depreciation and amortization

categories within the condensed consolidated statements of income. The Company also recorded approximately \$3.9 million of capitalized software development for SimVentures during 2011, comprised of the \$3.5 million paid for the AVS product and \$392,000 associated with SimStore™.

6. BUSINESS SEGMENTS

The Company primarily provides services to healthcare organizations, and to a lesser extent, to pharmaceutical and medical device companies and other members within the healthcare industry. The Company's services are primarily focused on the delivery of education and training products and services (HealthStream Learning), as well as survey and research services (HealthStream Research). The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

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The Company measures segment performance based on operating income before income taxes and prior to the allocation of certain corporate overhead expenses, interest income, interest expense, and depreciation. The following is the Company's business segment information as of and for the three and six months ended June 30, 2011 and 2010.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Revenues				
HealthStream Learning	\$ 14,455,535	\$ 11,239,362	\$ 27,442,483	\$ 21,542,266
HealthStream Research	6,595,324	5,421,107	12,114,111	9,955,455
Total net revenue	\$ 21,050,859	\$ 16,660,469	\$ 39,556,594	\$ 31,497,721
Income from operations				
HealthStream Learning	\$ 4,209,044	\$ 3,947,747	\$ 8,475,578	\$ 7,168,092
HealthStream Research	1,145,505	465,853	1,472,519	625,424
Unallocated	(2,248,718)	(2,066,237)	(4,285,256)	(4,034,129)
Total income from operations	\$ 3,105,831	\$ 2,347,363	\$ 5,662,841	\$ 3,759,387
Segment assets *			June 30, 2011	December 31, 2010
HealthStream Learning			\$ 23,200,454	\$ 18,730,859
HealthStream Research			25,669,354	26,701,566
Unallocated			38,439,080	&nbs