ATHENAHEALTH INC
Form 10-Q
July 19, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

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

For the quarterly period ended June 30, 2013
or

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

For the transition period from to
Commission File Number 001-33689
athenahealth, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	04-3387530 (I.R.S. Employer Identification No.)
311 Arsenal Street, Watertown, Massachusetts (Address of principal executive offices)	02472 (Zip Code)

617-402-1000
(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 R 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

At July 17, 2013, the registrant had 36,848,900 shares of common stock, par value $0.01 per share, outstanding.

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PART I - FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements (unaudited).
athenahealth, Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, amounts in thousands, except per-share amounts)

	June 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$33,558	$154,988
Short-term investments	—	38,092
Accounts receivable - net	93,319	61,916
Current portion of restricted cash	—	1,357
Deferred tax assets - net	4,511	6,907
Prepaid expenses and other current assets	19,798	10,924
Total current assets	151,186	274,184
Property and equipment - net	204,728	54,035
Capitalized software costs - net	22,428	16,050
Purchased intangible assets - net	180,382	21,561
Goodwill	196,183	48,090
Deferred tax assets - net	—	11,759
Investments and other assets	4,461	2,773
Total assets	$759,368	$428,452
Liabilities and Stockholders' Equity		
Current liabilities:		
Line of credit	$50,000	$—
Current portion of long-term debt	15,000	—
Accounts payable	6,679	1,733
Accrued compensation	37,108	36,393
Accrued expenses	23,373	19,683
Current portion of deferred revenue	35,064	8,209
Current portion of deferred rent	21	799
Total current liabilities	167,245	66,817
Deferred rent, net of current portion	—	2,854
Long-term debt, net of current portion	181,250	—
Deferred revenue, net of current portion	51,080	45,515
Long-term deferred tax liability - net	20,165	—
Other long-term liabilities	4,912	1,618
Total liabilities	424,652	116,804
Commitments and contingencies (note 7)		
Stockholders' equity:		
Preferred stock, $0.01 par value: 5,000 shares authorized; no shares issued and outstanding at June 30, 2013, and December 31, 2012, respectively	—	—
Common stock, $0.01 par value: 125,000 shares authorized; 38,089 shares issued and 36,811 shares outstanding at June 30, 2013; 37,572 shares issued and 36,294 shares outstanding at December 31, 2012	381	376
Additional paid-in capital	338,457	303,547
Treasury stock, at cost, 1,278 shares	(1,200)	(1,200)
Accumulated other comprehensive loss	(207)	(81)

Retained (accumulated deficit) earnings	(2,715)	9,006
Total stockholders’ equity	334,716	311,648
Total liabilities and stockholders’ equity	$759,368	$428,452

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

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athenahealth, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, amounts in thousands, except per-share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue:				
Business services	$137,919	$100,110	$259,382	$193,659
Implementation and other	8,382	3,405	12,515	6,422
Total revenue	146,301	103,515	271,897	200,081
Expense:				
Direct operating	59,390	41,014	112,575	79,812
Selling and marketing	41,035	27,389	73,957	51,117
Research and development	14,269	8,615	26,213	15,783
General and administrative	24,670	13,961	55,747	30,160
Depreciation and amortization	11,107	5,795	19,448	11,281
Total expense	150,471	96,774	287,940	188,153
Operating (loss) income	(4,170)	6,741	(16,043)	11,928
Other (expense) income:				
Interest expense	(1,001)	(88)	(1,165)	(176)
Other income	63	100	117	322
Total other (expense) income	(938)	12	(1,048)	146
(Loss) income before income tax (provision) benefit	(5,108)	6,753	(17,091)	12,074
Income tax (provision) benefit	(7,313)	(2,599)	5,370	(5,492)
Net (loss) income	$(12,421)	$4,154	$(11,721)	$6,582
Net (loss) income per share – Basic	$(0.34)	$0.12	$(0.32)	$0.18
Net (loss) income per share – Diluted	$(0.34)	$0.11	$(0.32)	$0.18
Weighted average shares used in computing net (loss) income per share:				
Basic	36,760	35,685	36,598	35,713
Diluted	36,760	36,906	36,598	36,951

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

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athenahealth, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, amounts in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net (loss) income	$(12,421)	$4,154	$(11,721)	$6,582
Other comprehensive (loss) income:				
Unrealized (loss) gain on securities, net of tax of $0 and $10 for the three and six months ended June 30, 2013 and 2012, respectively	(20)	(34)	(20)	38
Foreign currency translation adjustment	180	(12)	144	(21)
Total other comprehensive income (loss)	160	(46)	124	17
Comprehensive (loss) income	$(12,261)	$4,108	$(11,597)	$6,599

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

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athenahealth, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, amounts in thousands)

	Six Months Ended June 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(11,721)	$6,582
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	26,226	12,861
Amortization of premium on investments	84	681
Provision for uncollectible accounts	453	287
Excess tax benefit from stock-based awards	—	(5,680)
Deferred income tax	(5,492)	(426)
Change in fair value of contingent considerations	—	(1,110)
Stock-based compensation expense	24,042	12,984
Other reconciling adjustments	90	(120)
Changes in operating assets and liabilities:		
Accounts receivable	(8,712)	(2,134)
Prepaid expenses and other current assets	(5,069)	605
Other long-term assets	493	117
Accounts payable	2,864	1,222
Accrued expenses	(796)	1,742
Accrued compensation	(1,307)	(683)
Deferred revenue	2,232	1,108
Deferred rent	(3,632)	(438)
Net cash provided by operating activities	19,755	27,598
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capitalized software development costs	(12,993)	(5,915)
Purchases of property and equipment	(16,601)	(15,657)
Proceeds from sales and maturities of investments	56,245	46,374
Purchases of short-term and long-term investments	—	(30,883)
Payments on acquisitions, net of cash acquired	(410,161)	—
Decrease in restricted cash	1,357	807
Other investing activities	—	172
Net cash used in investing activities	(382,153)	(5,102)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock under stock plans and warrants	12,248	10,905
Taxes paid related to net share settlement of restricted stock units	(9,924)	(3,686)
Excess tax benefit from stock-based awards	—	5,680
Payment of contingent consideration accrued at acquisition date	—	(807)
Debt issuance costs	(1,592)	—
Net settlement of acquired company’s board of directors equity shares	(5,806)	—
Proceeds from long-term debt	200,000	—
Net proceeds from line of credit	155,000	—
Payments from line of credit	(105,000)	
Payments from long-term debt	(3,750)	—
Net cash provided by financing activities	241,176	12,092
Effects of exchange rate changes on cash and cash equivalents	(208)	(39)
Net (decrease) increase in cash and cash equivalents	(121,430)	34,549

Cash and cash equivalents at beginning of period	154,988	57,781
Cash and cash equivalents at end of period	$33,558	$92,330
Non-cash transactions		
Property, equipment and purchased software recorded in accounts payable and accrued expenses	$268	$450
Tax benefit recorded in prepaid expenses and other current assets	$—	$5,651
Fair value of equity awards assumed	$13,028	$—
Additional disclosures		
Cash received for interest	$451	$51
Cash paid for interest	$927	$—
Cash paid for taxes	$994	$3,824

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

athenahealth, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited, amounts in thousands, except per-share amounts)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by athenahealth, Inc. (the "Company" or "we") in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial reporting and as required by Regulation S-X, Rule 10-01. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of the Company's management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of items of a normal and recurring nature) necessary to present fairly the financial position as of June 30, 2013, and the results of operations and cash flows for the six month period ended June 30, 2013, and 2012. The results of operations for the six month period ended June 30, 2013, are not necessarily indicative of the results to be expected for the full year. When preparing financial statements in conformity with GAAP, we must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date of issuance of these financial statements. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012, included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission ("SEC") on February 11, 2013.

Segment Reporting – The Company discloses information about its operating segments based on the way that management organizes the segments within the Company for making operating decisions and assessing financial performance. Operating segments are identified as components of an enterprise about which separate discrete financial information is evaluated by the chief decision-maker ("CODM"), or decision-making group, in making decisions regarding resource allocation and assessing performance. The Company is in the process of analyzing the information that will be prepared and presented to the CODM due to the acquisitions of Epocrates, Inc. and the Arsenal on the Charles during the six months ended June 30, 2013 (see footnote 2). We anticipate that we will have at least two operating segments – athenahealth and Epocrates. Historically, the Company has operated in one segment.

Interim Tax Estimate – Due to the fact that we are projecting a nominal pre-tax income for the year and have significant permanent differences, we cannot reasonably predict our estimated effective tax rate for the year; therefore, we have used a discrete tax approach for the period ended June 30, 2013, in calculating the year-to-date provision.

2. ACQUISITIONS

Watertown, MA Corporate Headquarters – Arsenal on the Charles

On May 10, 2013, the Company, through its wholly-owned subsidiary Athena Arsenal, LLC ("Athena Arsenal"), completed the acquisition of the real estate commonly known as the Arsenal on the Charles, located in Watertown, Massachusetts. The Arsenal on the Charles is an expansive 29-acre, multi-building, commercial property where the Company was leasing space for its headquarters and related operating activities prior to the transaction. The purpose of this acquisition is to allow for future expansion of the corporate headquarters to accommodate anticipated headcount growth. The purchase price was $168.5 million, subject to working capital adjustments. The fair value of the consideration paid was $167.3 million, all of which was paid in cash.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

Prepaid expenses and other current assets	$685
Property, equipment and buildings	144,071
Purchased intangible assets	25,545

Accrued expenses	(271)
Deferred revenue	(789)
Other long-term liabilities	(1,916)
Total identifiable net assets	$167,325

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The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions and are based on the information that was available as of the date of the acquisition. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as the value of the purchased tangible and intangible assets and certain working capital adjustments to the purchase price may be subject to change as additional information is received about facts and circumstances that existed at the date of acquisition. Thus, the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.
The following table sets forth the preliminary components of the identifiable intangible assets acquired by asset class:

	Fair value
Above market leases	$3,298
Leases in place	22,247
Total intangible assets subject to amortization	$25,545

The value of any in-place lease is estimated to be equal to the property owners' avoidance of costs necessary to release the property for a lease term equal to the remaining primary in-place lease term and the value of investment grade tenancy. The cost avoidance to the property owners' of vacancy/leasing costs necessary to lease the property for a lease term equal to the remaining in-place lease term is derived first by determining the in-place lease term on the subject lease. Then, based on our review of the market, the cost to be borne by a property owner to replicate a market lease to the remaining in-place term was estimated. These costs consist of: (i) rent lost during downtime (i.e., assumed periods of vacancy), (ii) estimated expenses that would be incurred by the property owner during periods of vacancy, (iii) rent concessions (i.e., free rent), (iv) leasing commissions, and (v) tenant improvement allowances. The Company determines these values using our estimates along with third-party appraisals. The Company amortizes the capitalized value of in-place lease intangible assets to expense over the remaining initial term of each lease. The Company amortizes the capitalized value of above market leases to expense over the initial and expected renewal terms of the leases. No amortization period for intangible assets will exceed the remaining depreciable life of the building.
The amounts of revenue and net loss from the Arsenal on the Charles included in the Company's condensed consolidated statements of income from the acquisition date of May 10, 2013, to the period ended June 30, 2013, are $2.2 million and $1.3 million, respectively.
The Company incurred transaction costs in connection with the acquisition of $1.4 million and $2.4 million during the three and six months ended June 30, 2013, respectively, and $3.1 million in total. These costs are included in general and administrative expenses.
Epocrates, Inc.
On March 12, 2013, the Company acquired Epocrates, Inc. ("Epocrates"), a leading provider of essential clinical content, practice tools, and health industry engagement via mobile devices at the point of care. The Company acquired Epocrates for the assembled workforce, expected synergies, and accelerated awareness of athenahealth's services across the physician market and to deliver high-value information to the clinical community. The acquisition date fair value of the consideration transferred for Epocrates, less cash and short-term investments acquired was approximately $237.6 million, which consisted of the following:
Fair value of consideration transferred

Cash payments	$294,632	
Fair value of vested stock options and restricted stock units assumed	13,028	
Fair value of total consideration	307,660	
Less cash acquired	(51,796	)
Less short-term investments acquired	(18,250	)
Total	$237,614	

The value of the share consideration for Epocrates' common stock was based on the average closing sales prices per share of the Company's common stock for the ten trading days ending on the second trading day prior to the closing of the acquisition. The fair value of the stock options and restricted stock units assumed by the Company was determined using the

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Black-Scholes option pricing model. The share conversion ratio of 0.1239 was applied to convert Epocrates options and restricted stock units to the Company's options and restricted stock units.

The Company assumed options and restricted stock units with a fair value of $22.6 million. Of the total consideration, $13.0 million was allocated to the purchase consideration and $9.6 million was allocated to future services and will be expensed over the remaining service periods on a straight-line basis over the remaining service period. In the six months ended June 30, 2013, stock-based compensation expense recognized for stock options and restricted stock units assumed was $6.2 million.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

Accounts receivable	$23,144	
Other current and long-term assets	3,833	
Property, equipment and capitalized software costs	4,168	
Purchased intangible assets	139,900	
Current liabilities	(11,054	)
Deferred tax liabilities, net	(39,811	)
Deferred revenue	(29,400	)
Other long-term liabilities	(1,259	)
Total identifiable net assets	$89,521	
Goodwill	148,093	
	$237,614	

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions and are based on the information that was available as of the date of the acquisition. The Company believes that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as accounts receivable, purchased intangible assets, current and non-current income taxes payable, deferred taxes, and uncertain tax benefits may be subject to change as additional information is received about facts and circumstances that existed at the date of acquisition and certain tax returns are finalized. Thus, the provisional measurements of fair value set forth above are subject to change. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The following table sets forth the preliminary components of the identifiable intangible assets acquired by asset class and their preliminary estimated useful lives as of the date of acquisition:

	Fair Value	Useful Life
Doctor network	$104,500	14 years
Drug information content	10,000	5 years
Trade name	11,500	10 years
Customer backlog	2,900	1.5 years
Epocrates non-compete agreement	4,500	1.5 years
Developed technology	6,500	3 years
Total intangible assets subject to amortization	$139,900	

We anticipate that we will allocate the acquired doctor network among our operating segments once determined. The Epocrates segment will represent the fair values of the underlying relationships and agreements with Epocrates customers. The doctor network related to the athenahealth segment will represent the fair values of the savings associated with future marketing spend for the athenahealth segment services to the acquired doctor network. Drug information content represents the fair value of the cost to replace the drug information and interaction content used by the doctor's network. The trade name represents the fair value of the brand and name recognition associated with the marketing of Epocrates' service offerings. Developed technology represents the estimated fair value of Epocrates' mobile device platform. All of the purchased intangible assets related to the Epocrates transaction have finite lives. For those purchased intangible assets where an income approach was used, we considered the projected undiscounted cash flows as the best indication of the pattern of economic benefit expected from the asset.

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The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating Epocrates' mobile device platform with the athenahealth service offerings. We anticipate goodwill will be allocated among our operating segments once determined. The goodwill balance is not deductible for U.S. income tax purposes.

The amounts of revenue and net loss of Epocrates included in the Company's condensed consolidated statements of income from the acquisition date of March 12, 2013, to the period ended June 30, 2013, are $20.1 million and $12.7 million, respectively. The net loss includes $6.2 million in stock-based compensation expense primarily related to the acceleration of certain individuals' stock awards upon termination.

The Company incurred transaction costs in connection with the acquisition of $0.2 million and $2.7 million during the three and six months ended June 30, 2013, respectively, and $3.2 million in total. These costs are included in general and administrative expenses.

As part of the integration of Epocrates, the Company communicated to certain employees severance and retention bonuses which total $4.2 million to be paid through the end of 2013. The following table summarizes these amounts on the condensed consolidated statements of income, for the six months ended June 30, 2013:

Summary of roll forward of integration costs

Beginning balance, January 1, 2013	$—
Addition to provision	2,209
Cash outlay	(195)
Ending balance, March 31, 2013	$2,014
Addition to provision	979
Change in estimate	(129)
Cash outlay	(1,122)
Ending balance, June 30, 2013	$1,742

Pro Forma Presentation

The following pro forma financial information summarizes the combined results of operations for the Company as though the acquisitions of Epocrates and the Arsenal on the Charles occurred on January 1, 2012. The unaudited pro forma financial information is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Revenue	$148,035	$131,868	$291,669	$257,840
Net loss	$(13,057)	$(1,202)	$(16,123)	$(10,083)
Net loss per share – Basic	$(0.36)	$(0.03)	$(0.44)	$(0.28)
Net loss per share – Diluted	$(0.36)	$(0.03)	$(0.44)	$(0.27)

The pro forma financial information for all periods presented has been calculated after adjusting the results of Epocrates and the Arsenal on the Charles to reflect the business combination accounting effects resulting from these acquisitions including the amortization expenses from acquired intangible assets, the deprecation expenses from acquired tangible assets, the stock-based compensation expense for unvested stock options and restricted stock units assumed and the related tax effects as though the acquisition occurred as of January 1, 2012. The pro forma financial information is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of the Company's 2012 fiscal year.

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athenahealth, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited, amounts in thousands, except per-share amounts)

3. NET (LOSS) INCOME PER SHARE
Basic net (loss) income per share is computed by dividing net (loss) income by the weighted average number of common shares outstanding during the period. Diluted net (loss) income per share is computed by dividing net (loss) income by the weighted average number of common shares outstanding and potentially dilutive securities outstanding during the period under the treasury stock method. Potentially dilutive securities include stock options, restricted stock units, and shares to be purchased under the employee stock purchase plan. Under the treasury stock method, dilutive securities are assumed to be exercised at the beginning of the period and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Securities are excluded from the computations of diluted net income per share if their effect would be anti-dilutive to earnings per share.
The following table reconciles the weighted average shares outstanding for basic and diluted net (loss) income per share for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net (loss) income	$(12,421)	$4,154	$(11,721)	$6,582
Weighted average shares used in computing basic net (loss) income per share	36,760	35,685	36,598	35,713
Net (loss) income per share – Basic	$(0.34)	$0.12	$(0.32)	$0.18
Net (loss) income	$(12,421)	$4,154	$(11,721)	$6,582
Weighted average shares used in computing basic net (loss) income per share	36,760	35,685	36,598	35,713
Effect of dilutive securities	—	1,221	—	1,238
Weighted average shares used in computing diluted net (loss) income per share	36,760	36,906	36,598	36,951
Net (loss) income per share – Diluted	$(0.34)	$0.11	$(0.32)	$0.18

The computation of diluted net income per share does not include 0.4 million and 0.4 million of stock options and restricted stock units for the three and six months ended June 30, 2012, respectively, because their inclusion would have an anti-dilutive effect on net income per share.
4. FAIR VALUE OF FINANCIAL INSTRUMENTS
As of June 30, 2013, and December 31, 2012, the carrying amounts of cash and cash equivalents, restricted cash, receivables, accounts payable and accrued expenses approximated their estimated fair values because of the short-term nature of these financial instruments. Included in cash and cash equivalents as of June 30, 2013, and December 31, 2012, are money market fund investments of $0.1 million and $59.4 million, respectively, which are reported at fair value. As of June 30, 2013, the Company had $246.3 million outstanding on its credit facility (refer to Note 6) which approximates fair value based on the timing of when we entered into the credit facility. As of December 31, 2012, the Company had no outstanding debt.

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athenahealth, Inc.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited, amounts in thousands, except per-share amounts)

The following table presents information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2013, and December 31, 2012, and indicates the fair value hierarchy of the valuation techniques the Company utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities and fair values determined by Level 2 inputs utilize quoted prices (unadjusted) in active markets for similar assets or liabilities. The fair values determined by Level 3 inputs are unobservable values which are supported by little or no market activity.

	Fair Value Measurements At June 30, 2013, Using			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market	$128	$—	$—	$128
Total assets	$128	$—	$—	$128
Accrued contingent consideration	$—	$—	$(448)	$(448)
Total liabilities	$—	$—	$(448)	$(448)

	Fair Value Measurements as of December 31, 2012, Using			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market	$89,480	$—	$—	$89,480
Available-for-sale investments:				
Commercial paper	—	11,748	—	11,748
Corporate bonds	—	20,334	—	20,334
Certificate of deposit	—	6,010	—	6,010
Total assets	$89,480	$38,092	$—	$127,572
Accrued contingent consideration	$—	$—	$(448)	$(448)
Total liabilities	$—	$—	$(448)	$(448)

Money market funds, certificates of deposit, corporate bonds and commercial paper are valued using a market approach based upon the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in inactive markets or similar securities. It is the Company's policy to recognize transfers between levels of the fair value hierarchy, if any, at the end of the reporting period; however, there have been no such transfers during any periods presented.

Contingent consideration is recorded at fair value as an element of consideration paid with subsequent adjustments recognized in the consolidated statement of income. At the acquisition date and reporting date, the fair value of the accrued contingent consideration was determined using a probability-weighted income approach based on upside, downside and base case scenarios. This approach is based on significant inputs that are not observable in the market, which are referred to as Level 3 inputs. The outstanding potential contingent consideration related to the Company's acquisition of Proxsys in 2011 ranges from zero to $5.0 million and is payable in quarterly installments based upon the cross-selling of the Company's athenaCollector services into Proxsys' new and acquired customer and physician sender base, from the acquisition date to the second year anniversary of the acquisition in the third quarter of 2013. As of June 30, 2013 and December 31, 2012, the Company has a probability adjusted level of 60% for the base case and 20% for the upside and downside scenarios. The Company estimates the fair value of the contingent consideration at June 30, 2013 to be $0.4 million, primarily related to how much has been earned and the amount of time left to earn the additional consideration.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited, amounts in thousands, except per-share amounts)

The reconciliations for the fair values of financial instruments determined by Level 3 for the periods presented, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Balance beginning of period	$448	$8,143	$448	$8,176
Payments	—	(703)	—	(807)
Change in fair value (included in general and administrative expenses)	—	(1,181		