HEALTHSTREAM INC
Form 10-Q
October 30, 2014
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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 September 30, 2014**

**Commission File No.: 000-27701**

**HealthStream, Inc.**

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Tennessee** | **62-1443555** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **209 10th Avenue South, Suite 450** | **37203** |

**Nashville, Tennessee**
**(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 x 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 x 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 | x |
| 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 Exchange Act). Yes ¨ No x

As of October 27, 2014, there were 27,634,449 shares of the registrant s common stock outstanding.

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## HEALTHSTREAM, INC.

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## PART I. FINANCIAL INFORMATION

**Item 1.** ***Financial Statements***

**HEALTHSTREAM, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands)**

| | September 30, 2014 (Unaudited) | December 31, 2013 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 64,927 | $ 59,537 |
| Marketable securities | 51,495 | 48,659 |
| Accounts receivable, net of allowance for doubtful accounts of $269 and $211 at September 30, 2014 and December 31, 2013, respectively | 28,177 | 25,314 |
| Accounts receivable - unbilled | 1,938 | 1,392 |
| Prepaid royalties, net of amortization | 12,832 | 8,857 |
| Other prepaid expenses and other current assets | 3,566 | 3,365 |
| Total current assets | 162,935 | 147,124 |
| Property and equipment: | | |
| Equipment | 23,850 | 21,631 |
| Leasehold improvements | 5,856 | 5,521 |
| Furniture and fixtures | 4,341 | 3,854 |
| | 34,047 | 31,006 |
| Less accumulated depreciation and amortization | (25,040) | (21,968) |
| | 9,007 | 9,038 |
| Capitalized software development, net of accumulated amortization of $16,884 and $13,910 at September 30, 2014 and December 31, 2013, respectively | 12,303 | 11,077 |
| Goodwill | 42,654 | 35,746 |
| Intangible assets, net of accumulated amortization of $13,179 and $11,389 at September 30, 2014 and December 31, 2013, respectively | 15,450 | 8,870 |
| Other assets | 984 | 739 |
| Total assets | $ 243,333 | $ 212,594 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 799 | $ 2,311 |
| Accrued royalties | 6,622 | 8,435 |

| | | |
|---|---|---|
| Accrued liabilities | 11,762 | 5,503 |
| Accrued compensation and related expenses | 1,727 | 1,614 |
| Deferred tax liabilities, current | 224 | 181 |
| Deferred revenue | 53,303 | 38,168 |
| Total current liabilities | 74,437 | 56,212 |
| Deferred tax liabilities, noncurrent | 5,437 | 6,173 |
| Deferred revenue, noncurrent | 1,507 | |
| Other long term liabilities | 710 | 776 |
| Commitments and contingencies | | |
| Shareholders equity: | | |
| Common stock, no par value, 75,000 shares authorized; 27,634 and 27,327 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively | 170,940 | 166,888 |
| Accumulated deficit | (9,677) | (17,424) |
| Accumulated other comprehensive loss | (21) | (31) |
| Total shareholders equity | 161,242 | 149,433 |
| Total liabilities and shareholders equity | $ 243,333 | $ 212,594 |

See accompanying notes to the condensed consolidated financial statements.

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**HEALTHSTREAM, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

**(In thousands, except per share data)**

| | Three Months Ended September 30, 2014 | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2014 | Nine Months Ended September 30, 2013 |
|---|---|---|---|---|
| Revenues, net | $ 44,525 | $ 33,659 | $ 125,351 | $ 95,224 |
| Operating costs and expenses: | | | | |
| Cost of revenues (excluding depreciation and amortization) | 19,115 | 14,092 | 54,778 | 39,483 |
| Product development | 4,211 | 3,210 | 12,052 | 8,594 |
| Sales and marketing | 7,585 | 5,888 | 21,783 | 16,538 |
| Other general and administrative expenses | 6,058 | 4,551 | 16,651 | 13,640 |
| Depreciation and amortization | 2,815 | 2,039 | 7,938 | 5,812 |
| Total operating costs and expenses | 39,784 | 29,780 | 113,202 | 84,067 |
| Income from operations | 4,741 | 3,879 | 12,149 | 11,157 |
| Other income, net | 49 | 46 | 117 | 121 |
| Income before income tax provision | 4,790 | 3,925 | 12,266 | 11,278 |
| Income tax provision | 1,354 | 1,629 | 4,519 | 4,620 |
| Net income | $ 3,436 | $ 2,296 | $ 7,747 | $ 6,658 |
| Earnings per share: | | | | |
| Basic | $ 0.12 | $ 0.08 | $ 0.28 | $ 0.25 |
| Diluted | $ 0.12 | $ 0.08 | $ 0.28 | $ 0.24 |
| Weighted average shares of common stock outstanding: | | | | |
| Basic | 27,605 | 27,085 | 27,542 | 26,716 |
| Diluted | 28,047 | 27,735 | 27,999 | 27,598 |

See accompanying notes to the condensed consolidated financial statements.

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**HEALTHSTREAM, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

**(In thousands)**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Net income | $ 3,436 | $ 2,296 | $ 7,747 | $ 6,658 |
| Other comprehensive income, net of taxes: | | | | |
| Unrealized gain (loss) on marketable securities | (13) | 6 | 10 | (47) |
| Total other comprehensive income (loss) | (13) | 6 | 10 | (47) |
| Comprehensive income | $ 3,423 | $ 2,302 | $ 7,757 | $ 6,611 |

See accompanying notes to the condensed consolidated financial statements.

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**HEALTHSTREAM, INC.**

**CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)**

**NINE MONTHS ENDED SEPTEMBER 30, 2014**

**(In thousands)**

| | Common Stock Shares | Common Stock Amount | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Shareholders Equity |
|---|---|---|---|---|---|
| Balance at December 31, 2013 | 27,327 | $ 166,888 | $ (17,424) | $ (31) | $ 149,433 |
| Net income | | | 7,747 | | 7,747 |
| Comprehensive income | | | | 10 | 10 |
| Issuance of common stock in acquisition | 82 | 2,247 | | | 2,247 |
| Stock based compensation | | 1,222 | | | 1,222 |
| Tax benefits from equity awards | | (129) | | | (129) |
| Common stock issued under stock plans, net of shares withheld for employee taxes | 225 | 712 | | | 712 |
| Balance at September 30, 2014 | 27,634 | $ 170,940 | $ (9,677) | $ (21) | $ 161,242 |

See accompanying notes to the condensed consolidated financial statements.

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**HEALTHSTREAM, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

**(In thousands)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2014** | **2013** |
| OPERATING ACTIVITIES: | | |
| Net income | $ 7,747 | $ 6,658 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 7,938 | 5,812 |
| Stock based compensation expense | 1,222 | 1,088 |
| Deferred income taxes | 4,519 | 4,560 |
| Excess tax benefits from equity awards | 129 | 72 |
| Provision for doubtful accounts | 170 | 95 |
| Loss on non-marketable equity investments | 34 | 30 |
| Other | 1,082 | 1,163 |
| Changes in operating assets and liabilities: | | |
| Accounts and unbilled receivables | (1,891) | (7,312) |
| Prepaid royalties | (3,975) | (4,509) |
| Other prepaid expenses and other current assets | (260) | (908) |
| Other assets | 79 | 26 |
| Accounts payable | (1,511) | 792 |
| Accrued royalties | (1,814) | 3,037 |
| Accrued liabilities and accrued compensation and related expenses and other long-term liabilities | 288 | 703 |
| Deferred revenue | 14,918 | 11,904 |
| Net cash provided by operating activities | 28,675 | 23,211 |
| INVESTING ACTIVITIES: | | |
| Business combinations, net of cash acquired | (12,298) | (7,362) |
| Proceeds from maturities of investments in marketable securities | 40,418 | 63,722 |
| Proceeds from sales of investments in marketable securities | | 5,062 |
| Purchases of investments in marketable securities | (44,324) | (67,634) |
| Investments in non-marketable equity investments | (325) | (300) |
| Payments associated with capitalized software development | (4,025) | (3,017) |
| Purchases of property and equipment | (3,044) | (2,414) |
| Net cash used in investing activities | (23,598) | (11,943) |
| FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options | 872 | 3,057 |
| Taxes paid related to net settlement of equity awards | (160) | (158) |
| Excess tax benefits from equity awards | (129) | (72) |

| | | | | |
|---|---|---|---|---|
| Payment of earn-outs related to acquisitions | | (270) | | (357) |
| Net cash provided by financing activities | | 313 | | 2,470 |
| Net increase in cash and cash equivalents | | 5,390 | | 13,738 |
| Cash and cash equivalents at beginning of period | | 59,537 | | 41,365 |
| Cash and cash equivalents at end of period | $ | 64,927 | $ | 55,103 |
| NON-CASH INVESTING AND FINANCING ACTIVITIES: | | | | |
| Issuance of common stock in connection with acquisition | $ | 2,247 | $ | 534 |

See accompanying notes to the condensed consolidated financial statements.

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**HEALTHSTREAM, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## 1. BASIS OF PRESENTATION

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 nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The balance sheet at December 31, 2013 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, 2013 (included in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 4, 2014).

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific revenue recognition guidance throughout the Industry Topics of the Accounting Standards Codification. The updated guidance states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also provides for additional disclosures with respect to revenues and cash flows arising from contracts with customers. The standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2016, and early adoption is not permitted. The Company is currently reviewing this standard to assess the impact on its future consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements - Going Concern (Subtopic 205-40); Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern*, which requires management of the Company to evaluate whether there is substantial doubt about the Company s ability to continue as a going concern. The standard will be effective for the annual reporting period ending after December 15, 2016, with early adoption permitted. The Company does not expect the adoption of the standard to have a material impact on the Company s consolidated financial statements.

## 3. 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 nine months ended September 30, 2014 and 2013, the Company recorded a provision for income taxes of approximately $4.5 million and $4.6 million respectively. The Company s effective tax rate for the nine months ended September 30, 2014 and 2013 was 36.8% and 41.0%, 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 permanent tax differences. During the three months ended September 30, 2014, the Company recognized approximately $670,000 of tax benefits primarily from research and development tax credits, which resulted in a lower effective tax rate for both the three and nine months ended September 30, 2014.

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**HEALTHSTREAM, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## 4. 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 and restricted share units (RSUs). During the nine months ended September 30, 2014, the Company issued 70,080 RSUs with a weighted average grant date fair value of $28.71 per share, measured based on the closing fair market value of the Company s stock on the date of grant. During the nine months ended September 30, 2013, the Company issued 80,250 RSUs with a weighted average grant date fair value of $22.02 per share, measured based on the closing fair market value of the Company s stock on the date of grant.

Total stock based compensation expense recorded for the three and nine months ended September 30, 2014 and 2013, which is recorded in the condensed consolidated statements of income, is as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Cost of revenues (excluding depreciation and amortization) | $ 23 | $ 22 | $ 62 | $ 61 |
| Product development | 53 | 45 | 150 | 124 |
| Sales and marketing | 69 | 45 | 172 | 124 |
| Other general and administrative | 243 | 266 | 838 | 779 |
| Total stock based compensation expense | $ 388 | $ 378 | $ 1,222 | $ 1,088 |

## 5. EARNINGS PER SHARE

Basic earnings 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 earnings per share is computed by dividing the net income available to common shareholders for the period by the weighted average number of potentially dilutive common and common equivalent shares outstanding during the period. Common equivalent shares are composed of incremental common shares issuable upon the exercise of stock options and restricted share units subject to vesting. The dilutive effect of common equivalent shares is included in diluted earnings per share by application of the treasury stock method. The total number of common equivalent shares excluded from the calculations of diluted earnings per share, due to their anti-dilutive effect, was approximately 41,000 and 6,000 for the three months ended September 30, 2014 and 2013, respectively, and approximately 93,000 and 92,000 for the nine months ended September 30, 2014 and 2013, respectively.

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2014 and 2013 (in thousands, except per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Numerator: | | | | |
| Net income | $ 3,436 | $ 2,296 | $ 7,747 | $ 6,658 |
| Denominator: | | | | |
| Weighted-average shares outstanding | 27,605 | 27,085 | 27,542 | 26,716 |
| Effect of dilutive shares | 442 | 650 | 457 | 882 |
| Weighted-average diluted shares | 28,047 | 27,735 | 27,999 | 27,598 |
| Basic earnings per share | $ 0.12 | $ 0.08 | $ 0.28 | $ 0.25 |
| Diluted earnings per share | $ 0.12 | $ 0.08 | $ 0.28 | $ 0.24 |

**HEALTHSTREAM, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

### 6. MARKETABLE SECURITIES

At September 30, 2014 and December 31, 2013, the fair value of marketable securities, which were all classified as available for sale, included the following (in thousands):

| | September 30, 2014 | | | |
|---|---|---|---|---|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Level 2: | | | | |
| Certificates of deposit | $ 6,271 | $ | $ | $ 6,271 |
| Corporate debt securities | 45,245 | 2 | (23) | 45,224 |
| Subtotal | 51,516 | 2 | (23) | 51,495 |
| Total | $ 51,516 | $ 2 | $ (23) | $ 51,495 |

| | December 31, 2013 | | | |
|---|---|---|---|---|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Level 2: | | | | |
| Certificates of deposit | $ 2,260 | $ | $ | $ 2,260 |
| Corporate debt securities | 46,430 | | (31) | 46,399 |
| Subtotal | 48,690 | | (31) | 48,659 |
| Total | $ 48,690 | $ | $ (31) | $ 48,659 |

The carrying amounts reported in the condensed consolidated balance sheet approximate the fair value based on quoted market prices or alternative pricing sources and models utilizing market observable inputs. As of September 30, 2014, the Company does not consider any of its marketable securities to be other than temporarily impaired. During the nine months ended September 30, 2014 and 2013, the Company did not reclassify any material items out of accumulated other comprehensive income to net income. All investments in marketable securities are classified as a current asset on the balance sheet because the underlying securities mature within one year from the balance sheet date.

### 7. BUSINESS COMBINATION

On March 3, 2014, the Company acquired all of the stock of Health Care Compliance Strategies, Inc. (HCCS), a Jericho, New York based company that specializes in healthcare compliance solutions and services. The Company acquired HCCS to further advance its suite of workforce development solutions, including its offering of compliance solutions. The consideration paid for HCCS consisted of approximately $12.8 million in cash (taking into account a working capital adjustment) and 81,614 shares of our common stock. The Company may make additional payments of up to $750,000, contingent upon the achievement of certain performance milestones within one year post-closing. The Company incurred approximately $515,000 in transaction costs associated with the acquisition, of which $365,000 were incurred during the nine months ended September 30, 2014 and $150,000 were incurred during the year ended December 31, 2013. The transaction costs were recorded in other general and administrative expenses in the condensed consolidated statement of income. In allocating the purchase price, the Company has preliminarily recorded approximately $6.9 million of goodwill, $8.4 million of identifiable intangible assets, $2.4 million of tangible assets, and $2.1 million of liabilities. The goodwill balance is primarily attributed to assembled workforce, additional market opportunities of HCCS s compliance solutions, and expected synergies from integrating HCCS s products into our platform. The goodwill balance is deductible for U.S. income tax purposes. The allocation of purchase price is preliminary and may be subject to change within the measurement period of one year from the acquisition date. The primary area of the preliminary purchase price allocation that is not finalized includes goodwill associated with final working capital adjustments. The net tangible assets include deferred revenue, which was adjusted down from a book value at the acquisition date of $3.2 million to an estimated fair value of $1.7 million. The $1.5 million write-down of deferred revenue will result in lower revenues than would have otherwise been recognized for such services. The results of operations for HCCS have been included in the Company s condensed consolidated financial statements from the date of acquisition, and are also included in the HealthStream Workforce Development Solutions segment.

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**HEALTHSTREAM, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**7. BUSINESS COMBINATION (continued)**

During the second quarter of 2014, the Company determined the presentation of contingent consideration payments, or earn-outs, in connection with business combinations should be classified as a financing activity within the statement of cash flows. The Company previously classified such payments as an operating activity within the statement of cash flows. The Company has adjusted the statement of cash flows for the nine-month period ended September 30, 2013 and will adjust the statement of cash flows for the year ended December 31, 2013 when those financial statements are presented comparatively for the corresponding periods in 2014. The Company considers the adjustments to all aforementioned periods to be immaterial corrections of errors.

The effect of the immaterial adjustments on the consolidated statement of cash flows for the respective periods listed below is as follows (in thousands):

| | Previously Reported | Adjustments | Adjusted |
|---|---|---|---|
| Net cash provided by operating activities, three months ended March 31, 2013 | $ 3,855 | $ 45 | $ 3,900 |
| Net cash provided by financing activities, three months ended March 31, 2013 | 742 | (45) | 697 |
| Net cash provided by operating activities, six months ended June 30, 2013 | 11,041 | 318 | 11,359 |
| Net cash provided by financing activities, six months ended June 30, 2013 | 1,524 | (318) | 1,206 |
| Net cash provided by operating activities, nine months ended September 30, 2013 | 22,854 | 357 | 23,211 |
| Net cash provided by financing activities, nine months ended September 30, 2013 | 2,827 | (357) | 2,470 |
| Net cash provided by operating activities, year ended December 31, 2013 | 26,283 | 771 | 27,054 |
| Net cash provided by financing activities, year ended December 31, 2013 | 6,876 | (771) | 6,105 |
| Net cash provided by operating activities, three months ended March 31, 2014 | 9,189 | 5 | 9,194 |
| Net cash provided by financing activities, three months ended March 31, 2014 | 297 | (5) | 292 |

**8. BUSINESS SEGMENTS**

The Company primarily provides services to healthcare organizations and other members within the healthcare industry. The Company s services are primarily focused on the delivery of workforce development products and services (HealthStream Workforce Development Solutions), as well as survey and research services (HealthStream Research/Patient Experience Solutions). 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, 2013.

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 Unallocated component below includes corporate functions, such as accounting, human resources, legal, investor relations, administrative, and executive personnel, depreciation, a portion of amortization, and certain other expenses, which are not currently allocated in measuring segment performance. The following is the Company s business segment information as of and for the three and nine months ended September 30, 2014 and 2013 (in thousands).

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Revenues | | | | |
| Workforce Development | $ 36,288 | $ 26,574 | $ 101,632 | $ 74,841 |
| Research/Patient Experience | 8,237 | 7,085 | 23,719 | 20,383 |
| Total net revenue | $ 44,525 | $ 33,659 | $ 125,351 | $ 95,224 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Income from operations | | | | |
| Workforce Development | $ 9,811 | $ 7,355 | $ 26,555 | $ 21,685 |
| Research/Patient Experience | 285 | 755 | 610 | 1,964 |
| Unallocated | (5,355) | (4,231) | (15,016) | (12,492) |
| Total income from operations | $ 4,741 | $ 3,879 | $ 12,149 | $ 11,157 |

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**HEALTHSTREAM, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

## 8. BUSINESS SEGMENTS (continued)

| | September 30, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| Segment assets * | | | | |
| Workforce Development | $ | 82,795 | $ | 60,013 |
| Research/Patient Experience | | 34,478 | | 34,727 |
| Unallocated | | 126,060 | | 117,854 |
| Total assets | $ | 243,333 | $ | 212,594 |

* Segment assets include accounts and unbilled receivables, prepaid and other current assets, other assets, capitalized software development, certain property and equipment, and intangible assets. Cash and cash equivalents and marketable securities are not allocated to individual segments, and are included within Unallocated. A significant portion of property and equipment assets are included within Unallocated.

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**Item 2.** *Management s Discussion and Analysis of Financial Condition and Results of Operations*
**Special Cautionary Notice Regarding Forward-Looking Statements**

You should read the following discussion and analysis in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this report and our audited consolidated financial statements and the notes thereto for the year ended December 31, 2013, appearing in our Annual Report on Form 10-K that was filed with the Securities and Exchange Commission ( SEC ) on March 4, 2014, (the 2013 Form 10-K ). Statements contained in this Quarterly Report on Form 10-Q that are not historical fact are forward-looking statements that the Company intends to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Statements that are predictive in nature, that depend on or refer to future events or conditions, or that include words such as anticipates, believes, could, estimates, expects, intends, may, pl predicts, projects, should, will, would, and similar expressions are forward-looking statements.

The Company cautions that forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements. Forward-looking statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

In evaluating any forward-looking statement, you should specifically consider the information regarding forward-looking statements and the information set forth under the caption Item 1A. Risk Factors in our 2013 Form 10-K and the information regarding forward-looking statements in our earnings releases, as well as other cautionary statements contained elsewhere in this report, including the matters discussed in Critical Accounting Policies and Estimates. We undertake no obligation beyond that required by law to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future. You should read this report and the documents that we reference in this report and have filed as exhibits to this report completely and with the understanding that our actual future results may be materially different from what we expect.

**Overview**

HealthStream provides workforce development and research/patient experience solutions for healthcare organizations all designed to assess and develop the people that deliver patient care which, in turn, supports the improvement of business and clinical outcomes. Our workforce development products are used by healthcare organizations to meet a broad range of their training, certification, competency assessment, performance appraisal, and development needs, while our research/patient experience products provide our customers information about patients experiences and how to improve them, workforce engagement, physician relations, and community perceptions of their services. HealthStream s customers include healthcare organizations, pharmaceutical and medical device companies, and other participants in the healthcare industry.

Key financial indicators for the third quarter of 2014 include:

- Revenues of $44.5 million in the third quarter of 2014, up 32% from $33.7 million in the third quarter of 2013

- Operating income of $4.7 million in the third quarter of 2014, up 22% from $3.9 million in the third quarter of 2013

Net income of $3.4 million in the third quarter of 2014, up 50% from $2.3 million in the third quarter of 2013, and earnings per share (EPS) of $0.12 per share (diluted) in the third quarter of 2014 compared to EPS of $0.08 per share (diluted) in the third quarter of 2013

Adjusted EBITDA[(1)] of $7.9 million in the third quarter of 2014, up 26% from $6.3 million in the third quarter of 2013

Annualized revenue per implemented subscriber[(2)] of $35.91 in the third quarter of 2014, up 16% from $30.95 in the third quarter of 2013

(1) Adjusted EBITDA is a non-GAAP financial measure. A reconciliation of adjusted EBITDA to net income is included in this report.

(2) Annualized revenue per implemented subscriber represents the quarter s revenue for internet-based subscription products, annualized, then divided by the quarter s average total implemented subscribers.

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**Business Combination**

On March 3, 2014, the Company acquired all of the stock of Health Care Compliance Strategies, Inc. (HCCS), a Jericho, New York based company that specializes in healthcare compliance solutions and services. The Company acquired HCCS to further advance its suite of workforce development solutions, including its offering of compliance solutions. The consideration paid for HCCS consisted of approximately $12.8 million in cash (taking into account a working capital adjustment) and 81,614 shares of our common stock. The Company may make additional payments of up to $750,000, contingent upon the achievement of certain performance milestones within one year post-closing. The Company incurred approximately $515,000 in transaction costs associated with the acquisition, of which $365,000 were incurred during the nine months ended September 30, 2014 and $150,000 were incurred during the year ended December 31, 2013. The transaction costs were recorded in other general and administrative expenses in the condensed consolidated statement of income. In allocating the purchase price, the Company has preliminarily recorded approximately $6.9 million of goodwill, $8.4 million of identifiable intangible assets, $2.4 million of tangible assets, and $2.1 million of liabilities. The goodwill balance is primarily attributed to assembled workforce, additional market opportunities of HCCS s compliance solutions, and expected synergies from integrating HCCS s products into our platform. The goodwill balance is deductible for U.S. income tax purposes. The allocation of purchase price is preliminary and may be subject to change within the measurement period of one year from the acquisition date. The primary area of the preliminary purchase price allocation that is not finalized includes goodwill associated with final working capital adjustments. The net tangible assets include deferred revenue, which was adjusted down from a book value at the acquisition date of $3.2 million to an estimated fair value of $1.7 million. The $1.5 million write-down of deferred revenue will result in lower revenues than would have otherwise been recognized for such services. The results of operations for HCCS have been included in the Company s condensed consolidated financial statements from the date of acquisition, and are also included in the HealthStream Workforce Development Solutions segment.

**Critical Accounting Policies and Estimates**

The Company s condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (US GAAP). These accounting principles require us to make certain estimates, judgments and assumptions during the preparation of our financial statements. We believe the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected.

The accounting policies and estimates that we believe are the most critical in fully understanding and evaluating our reported financial results include the following:

- Revenue recognition
- Accounting for income taxes
- Software development costs

Goodwill, intangibles, and other long-lived assets

Allowance for doubtful accounts

Stock based compensation

In many cases, the accounting treatment of a particular transaction is specifically dictated by US GAAP and does not require management s judgment in its application. There are also areas where management s judgment in selecting among available alternatives would not produce a materially different result. See Notes to Consolidated Financial Statements in our 2013 Form 10-K, which contains additional information regarding our accounting policies and other disclosures required by US GAAP. There have been no changes in our critical accounting policies and estimates from those reported in our 2013 Form 10-K.

**Three Months Ended September 30, 2014 Compared to Three Months Ended September 30, 2013**

*Revenues, net.* Revenues increased approximately $10.9 million, or 32.3%, to $44.5 million for the three months ended September 30, 2014 from $33.6 million for the three months ended September 30, 2013. Revenues for the 2014 period consisted of $36.3 million, or 82% of total revenue, for HealthStream Workforce Development Solutions and $8.2 million, or 18% of total revenue, for HealthStream Research/Patient Experience Solutions. In the 2013 period, revenues consisted of $26.6 million, or 79% of total revenue, for HealthStream Workforce Development Solutions and $7.1 million, or 21% of total revenue, for HealthStream Research/Patient Experience Solutions.

Revenues for HealthStream Workforce Development Solutions increased approximately $9.7 million, or 36.6%, over the third quarter of 2013. Revenues from our subscription-based workforce development products increased approximately $9.3 million, or 38.2%, over the prior year third quarter due to a higher number of subscribers and more courseware consumption by subscribers. Annualized revenue per implemented subscriber increased by 16.0% to $35.91 per subscriber for the third quarter of 2014 compared to $30.95 per subscriber for the third quarter of 2013. Our implemented subscriber base increased by 19.7% over the prior year third quarter to 3.83 million implemented subscribers at September 30, 2014 compared to 3.20 million implemented subscribers at September 30, 2013. Additionally, we had a 21.1% increase in total subscribers over the prior year third quarter, with 4.13 million total subscribers at September 30, 2014 compared to 3.41 million total subscribers at September 30, 2013. Total subscribers include those already implemented and those in the process of implementation. Revenues in the third quarter of 2014 were positively influenced by courseware subscriptions associated with, among other products, ICD-10 training. Revenues from ICD-10 training were approximately $7.4 million for the third quarter of 2014, compared to $3.9 million for the third quarter of 2013. Revenues from the HCCS acquisition, consummated on March 3, 2014, were approximately $1.9 million during the third quarter of 2014.

Revenues for HealthStream Research/Patient Experience Solutions increased approximately $1.2 million, or 16.3%, over the third quarter of 2013. Revenues from Patient Insights surveys, our survey research product that generates recurring revenues, increased by $378,000, or 6.7%, over the prior year third quarter. Revenues from other surveys, which are conducted on annual or bi-annual cycles, increased by $156,000 compared to the prior year third quarter. Revenues from the Baptist Leadership Group (BLG) acquisition, consummated on September 9, 2013, were approximately $870,000 during the third quarter of 2014 compared to $252,000 during the third quarter of 2013.

*Cost of Revenues (excluding depreciation and amortization).* Cost of revenues increased approximately $5.0 million, or 35.6%, to $19.1 million for the three months ended September 30, 2014 from $14.1 million for the three months ended September 30, 2013. Cost of revenues as a percentage of revenues was 42.9% of revenues for the three months ended September 30, 2014 compared to 41.9% of revenues for the three months ended September 30, 2013. Cost of revenues for HealthStream Workforce Development Solutions increased approximately $3.6 million to $13.8 million and approximated 38.1% and 38.5% of revenues for HealthStream Workforce Development Solutions for the three months ended September 30, 2014 and 2013, respectively. The increase in amount is primarily associated with increased royalties paid by us resulting from growth in courseware subscription revenues and increased personnel costs. Cost of revenues for HealthStream Research/Patient Experience Solutions increased approximately $1.4 million to $5.3 million and approximated 64.0% and 54.4% of revenues for HealthStream Research/Patient Experience Solutions for the three months ended September 30, 2014 and 2013, respectively. The increase in both amount and as a percentage of revenues is primarily the result of increased personnel costs from the BLG acquisition as well as additional costs associated with the growth in patient survey volume over the prior year third quarter.

*Product Development.* Product development expenses increased approximately $1.0 million, or 31.2%, to $4.2 million for the three months ended September 30, 2014 from $3.2 million for the three months ended September 30, 2013. Product development expenses as a percentage of revenues were 9.5% of revenues for both the three months ended September 30, 2014 and 2013.

Product development expenses for HealthStream Workforce Development Solutions increased approximately $1.1 million and approximated 10.7% and 10.5% of revenues for HealthStream Workforce Development Solutions for the three months ended September 30, 2014 and 2013, respectively. The increase in both amount and as a percentage of revenues is due to additional personnel expenses associated with new product development initiatives for our subscription-based products. Product development expenses for HealthStream Research/Patient Experience Solutions decreased approximately $103,000 and approximated 3.8% and 5.9% of revenues for HealthStream Research/Patient Experience Solutions for the three months ended September 30, 2014 and 2013, respectively. The decrease in both amount and as a percentage of revenues is due to lower personnel expenses.

*Sales and Marketing.* Sales and marketing expenses, including personnel costs, increased approximately $1.7 million, or 28.8%, to $7.6 million for the three months ended September 30, 2014 from $5.9 million for the three months ended September 30, 2013. Sales and marketing expenses were 17.0% and 17.5% of revenues for the three months ended September 30, 2014 and 2013, respectively.

Sales and marketing expenses for HealthStream Workforce Development Solutions increased approximately $1.5 million and approximated 16.3% and 16.5% of revenues for HealthStream Workforce Development Solutions for the three months ended September 30, 2014 and 2013, respectively. The increase in amount is primarily due to additional personnel and related expenses, increased commissions associated with higher sales performance over the prior year third quarter, and increased marketing spending. Sales and marketing expenses for HealthStream Research/Patient Experience Solutions increased approximately $106,000, and approximated 18.6% and 20.1% of revenues for HealthStream Research/Patient Experience Solutions for the three months ended September 30, 2014 and 2013, respectively. The increase in amount was primarily a result of additional personnel associated with the BLG acquisition.

*Other General and Administrative Expenses.* Other general and administrative expenses increased approximately $1.5 million, or 33.1%, to $6.1 million for the three months ended September 30, 2014 from $4.6 million for the three months ended September 30, 2013. Other general and administrative expenses as a percentage of revenues were 13.6% and 13.5% of revenues for the three months ended September 30, 2014 and 2013, respectively.

Other general and administrative expenses for HealthStream Workforce Development Solutions increased approximately $540,000 over the prior year third quarter primarily due to the HCCS acquisition, while other general and administrative expenses for HealthStream Research/Patient Experience Solutions increased approximately $144,000 compared to the prior year third quarter primarily due to the BLG acquisition. The unallocated corporate portion of other general and administrative expenses increased approximately $824,000 over the prior year third quarter, primarily associated with additional personnel, professional fees, business taxes, rent, and other general expenses.

*Depreciation and Amortization.* Depreciation and amortization increased approximately $776,000, or 38.1%, to $2.8 million for the three months ended September 30, 2014 from $2.0 million for the three months ended September 30, 2013. The increase primarily resulted from amortization of capitalized software development, amortization of intangible assets, and depreciation expense associated with capital expenditures, including leasehold improvements to our Nashville, Tennessee office space.

*Other Income, Net.* Other income, net was approximately $49,000 for the three months ended September 30, 2014 compared to $46,000 for the three months ended September 30, 2013.

*Income Tax Provision.* The Company recorded a provision for income taxes of approximately $1.4 million for the three months ended September 30, 2014 compared to $1.6 million for the three months ended September 30, 2013. The Company s effective tax rate was 28.3% for the three months ended September 30, 2014 compared to 41.5% for the three months ended September 30, 2013. The decrease in the effective tax rate resulted primarily from the recognition of approximately $670,000 in tax benefits associated with research and development tax credits during the three months ended September 30, 2014.

*Net Income.* Net income increased approximately $1.1 million, or 49.7%, to $3.4 million for the three months ended September 30, 2014 from $2.3 million for the three months ended September 30, 2013. Earnings per diluted share was $0.12 per share for the three months ended September 30, 2014 compared to $0.08 per diluted share for the three months ended September 30, 2013.

Adjusted EBITDA (which we define as net income before interest, income taxes, stock based compensation, and depreciation and amortization) increased by 26.2% to approximately $7.9 million for the three months ended September 30, 2014 compared to $6.3 million for the three months ended September 30, 2013. This improvement is consistent with the factors mentioned above. See Reconciliation of Non-GAAP Financial Measures below for our reconciliation of this calculation to measures under US GAAP.

**Nine Months Ended September 30, 2014 Compared to Nine Months Ended September 30, 2013**

*Revenues, net.* Revenues increased approximately $30.1 million, or 31.6%, to $125.3 million for the nine months ended September 30, 2014 from $95.2 million for the nine months ended September 30, 2013. Revenues for the 2014 period consisted of $101.6 million, or 81% of total revenue, for HealthStream Workforce Development Solutions and $23.7 million, or 19% of total revenue, for HealthStream Research/Patient Experience Solutions. In the 2013 period, revenues consisted of $74.8 million, or 79% of total revenue, for HealthStream Workforce Development Solutions and $20.4 million, or 21% of total revenue, for HealthStream Research/Patient Experience Solutions.

Revenues for HealthStream Workforce Development Solutions increased approximately $26.8 million, or 35.8%, over the first nine months of 2013. Revenues from our subscription-based workforce development products increased approximately $26.7 million, or 39.1%, over the prior year period due to a higher number of subscribers and more courseware consumption by subscribers. Revenues in the 2014 period were positively influenced by courseware subscriptions associated with, among other products, ICD-10 training. Revenues from ICD-10 training were approximately $21.2 million during the first nine months of 2014, compared to $8.8 million during the first nine months of 2013. Revenues from the HCCS acquisition were approximately $3.1 million during the first nine months of 2014.

Revenues for HealthStream Research/Patient Experience Solutions increased approximately $3.3 million, or 16.4%, over the first nine months of 2013. Revenues from Patient Insights surveys, our survey research product that generates recurring revenues, increased approximately $1.4 million, or 8.3%, over the prior year period. Revenues from other surveys, which are conducted on annual or bi-annual cycles, were comparable to the prior year period. Revenues from the BLG acquisition were approximately $2.2 million during the first nine months of 2014 compared to $252,000 during the first nine months of 2013.

*Cost of Revenues (excluding depreciation and amortization).* Cost of revenues increased approximately $15.3 million, or 38.7%, to $54.8 million for the nine months ended September 30, 2014 from $39.5 million for the nine months ended September 30, 2013. Cost of revenues as a percentage of revenues was 43.7% of revenues for the nine months ended September 30, 2014 compared to 41.5% of revenues for the nine months ended September 30, 2013. Cost of revenues for HealthStream Workforce Development Solutions increased approximately $11.7 million to $39.7 million and approximated 39.1% and 37.5% of revenues for HealthStream Workforce Development Solutions for the nine months ended September 30, 2014 and 2013, respectively. The increase in both amount and as a percentage of revenues is primarily associated with increased royalties paid by us resulting from growth in courseware subscription revenues and increased personnel costs. Cost of revenues for HealthStream Research/Patient Experience Solutions increased approximately $3.6 million to $15.1 million and approximated 63.6% and 56.1% of revenues for HealthStream Research/Patient Experience Solutions for the nine months ended September 30, 2014 and 2013, respectively. The increase in both amount and as a percentage of revenues is primarily the result of increased personnel costs from the BLG acquisition as well as additional costs associated with the growth in patient survey volume over the prior year period.

*Product Development.* Product development expenses increased approximately $3.5 million, or 40.2%, to $12.1 million for the nine months ended September 30, 2014 from $8.6 million for the nine months ended September 30, 2013. Product development expenses as a percentage of revenues were 9.6% and 9.0% of revenues for the nine months ended September 30, 2014 and 2013, respectively.

Product development expenses for HealthStream Workforce Development Solutions increased approximately $3.5 million and approximated 10.8% and 10.0% of revenues for HealthStream Workforce Development Solutions for the nine months ended September 30, 2014 and 2013, respectively. The increase in both amount and as a percentage of revenues is due to additional personnel expenses associated with new product development initiatives for our subscription-based products. Product development expenses for HealthStream Research/Patient Experience Solutions decreased approximately $57,000 and approximated 4.4% and 5.4% of revenues for HealthStream Research/Patient Experience Solutions for the nine months ended September 30, 2014 and 2013, respectively.

*Sales and Marketing.* Sales and marketing expenses, including personnel costs, increased approximately $5.2 million, or 31.7%, to $21.8 million for the nine months ended September 30, 2014 from $16.5 million for the nine months ended September 30, 2013. Sales and marketing expenses were 17.4% of revenues for both the nine months ended September 30, 2014 and 2013.

Sales and marketing expenses for HealthStream Workforce Development Solutions increased approximately $4.7 million and approximated 16.6% and 16.3% of revenues for HealthStream Workforce Development Solutions for the nine months ended September 30, 2014 and 2013, respectively. The increase in both amount and as a percentage of revenues is primarily due to additional personnel and related expenses, increased commissions associated with higher sales performance over the prior year, and increased marketing spending. Sales and marketing expenses for HealthStream Research/Patient Experience Solutions increased approximately $467,000, and approximated 19.2% and 20.0% of revenues for HealthStream Research/Patient Experience Solutions for the nine months ended September 30, 2014 and 2013, respectively. The increase in amount was a result of additional personnel associated with the BLG acquisition and increased commissions.

*Other General and Administrative Expenses.* Other general and administrative expenses increased approximately $3.0 million, or 22.1%, to $16.6 million for the nine months ended September 30, 2014 from $13.6 million for the nine months ended September 30, 2013. Other general and administrative expenses as a percentage of revenues were 13.3% and 14.3% of revenues for the nine months ended September 30, 2014 and 2013, respectively.

Other general and administrative expenses for HealthStream Workforce Development Solutions increased approximately $834,000 over the prior year period primarily due to additional personnel and other support costs associated with the HCCS acquisition, while other general and administrative expenses for HealthStream Research/Patient Experience Solutions increased approximately $444,000 compared to the prior year period primarily due to the BLG acquisition. The unallocated corporate portion of other general and administrative expenses increased approximately $1.7 million over the prior year period, primarily associated with additional personnel, professional fees, rent, and other general expenses, as well as approximately $365,000 of one-time expenses associated with the acquisition of HCCS.

*Depreciation and Amortization.* Depreciation and amortization increased approximately $2.1 million, or 36.6%, to $7.9 million for the nine months ended September 30, 2014 from $5.8 million for the nine months ended September 30, 2013. The increase primarily resulted from amortization of capitalized software development, amortization of intangible assets, and depreciation expense associated with capital expenditures, including leasehold improvements to our Nashville, Tennessee office space.

*Other Income, Net.* Other income, net was approximately $117,000 for the nine months ended September 30, 2014 compared to $121,000 for the nine months ended September 30, 2013.

*Income Tax Provision.* The Company recorded a provision for income taxes of approximately $4.5 million for the nine months ended September 30, 2014 compared to $4.6 million for the nine months ended September 30, 2013. The

Company s effective tax rate was 36.8% for the first nine months of 2014 compared to 41.0% for the first nine months of 2013. The decrease in the effective tax rate resulted primarily from the recognition of approximately $670,000 in tax benefits during the third quarter of 2014 associated with research and development tax credits.

*Net Income.* Net income increased approximately $1.1 million, or 16.4%, to $7.7 million for the nine months ended September 30, 2014 from $6.6 million for the nine months ended September 30, 2013. Earnings per diluted share was $0.28 per diluted share for the nine months ended September 30, 2014 compared to $0.24 per diluted share for the nine months ended September 30, 2013.

Adjusted EBITDA (which we define as net income before interest, income taxes, stock based compensation, and depreciation and amortization) increased by 18.0% to approximately $21.3 million for the nine months ended September 30, 2014 compared to $18.0 million for the nine months ended September 30, 2013. This improvement is consistent with the factors mentioned above. See Reconciliation of Non-GAAP Financial Measures below for our reconciliation of this calculation to measures under US GAAP.

**Reconciliation of Non-GAAP Financial Measures**

This report contains certain non-GAAP financial measures, including, non-GAAP net income, non-GAAP operating income, non-GAAP revenue and adjusted EBITDA, which are used by management in analyzing our financial results and ongoing operational performance. These non-GAAP financial measures should not be considered as a substitute for, or superior to, measures of financial performance which are prepared in accordance with US GAAP and may be different from non-GAAP financial measures used by other companies.

In order to better assess the Company s financial results, management believes that adjusted EBITDA is an appropriate measure for evaluating the operating performance of the Company because adjusted EBITDA reflects net income adjusted for non-cash and non-operating items. Adjusted EBITDA is also used by many investors and securities analysts to assess the Company s results from current operations. Adjusted EBITDA is a non-GAAP financial measure and should not be considered as a measure of financial performance under US GAAP. Because adjusted EBITDA is not a measurement determined in accordance with US GAAP, it is susceptible to varying calculations. Accordingly, adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies.

The Company understands that, although adjusted EBITDA is frequently used by investors and securities analysts in their evaluation of companies, this measure has limitations as an analytical tool and you should not consider it in isolation or as a substitute for an analysis of the Company s results as reported under US GAAP. For example, adjusted EBITDA does not reflect cash expenditures, or future requirements for capital expenditures or contractual commitments; it does not reflect non-cash components of employee compensation; it does not reflect changes in, or cash requirements for, our working capital needs; and due to the Company s utilization of federal and state net operating loss carryforwards and other available deductions in 2013 and 2014, actual cash income tax payments have been significantly less than the tax provision recorded in accordance with US GAAP, and income tax payments will continue to be less than the income tax provision until our existing federal and state net operating loss carryforwards have been fully utilized or have expired.

Management compensates for the inherent limitations associated with using adjusted EBITDA through disclosure of such limitations, presentation of our financial statements in accordance with US GAAP, and reconciliation of adjusted EBITDA to net income, the most directly comparable US GAAP measure.

The Company com