

ATHENAHEALTH INC
Form 10-Q
April 29, 2011

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

(Mark One)

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

For the quarterly period ended March 31, 2011

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

04-3387530

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

311 Arsenal Street, Watertown, Massachusetts

02472

(Address of principal executive offices)

(Zip Code)

617-402-1000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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 Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of April 26, 2011, the registrant had 34,871,353 shares of common stock, par value \$0.01 per share, outstanding.

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

| | March 31, 2011 | December 31, 2010 |
|---|----------------------|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 45,582 | \$ 35,944 |
| Short-term investments | 57,152 | 80,231 |
| Accounts receivable net | 42,714 | 36,870 |
| Deferred tax assets | 4,347 | 3,856 |
| Prepaid expenses and other current assets | 8,327 | 6,749 |
| Total current assets | 158,122 | 163,650 |
| Property and equipment net | 31,423 | 31,899 |
| Restricted cash | 5,804 | 8,691 |
| Software development costs net | 4,225 | 3,642 |
| Purchased intangibles net | 12,191 | 12,651 |
| Goodwill | 22,450 | 22,450 |
| Deferred tax assets | 10,332 | 10,959 |
| Investments and other assets | 24,510 | 7,228 |
| Total assets | \$ 269,057 | \$ 261,170 |

Liabilities & Stockholders Equity

| | | |
|---|----------|----------|
| Current liabilities: | | |
| Current portion of long-term debt and capital lease obligations | \$ 2,666 | \$ 2,909 |
| Accounts payable | 2,648 | 559 |
| Accrued compensation | 12,585 | 19,178 |
| Accrued expenses | 10,404 | 10,981 |
| Current portion of deferred revenue | 5,364 | 4,978 |
| Interest rate derivative liability | 425 | 490 |
| Current portion of deferred rent | 1,522 | 1,497 |
| Total current liabilities | 35,614 | 40,592 |
| Deferred rent, net of current portion | 5,583 | 5,960 |
| Deferred revenue, net of current portion | 38,006 | 35,661 |
| Other long-term liabilities | 1,821 | 1,897 |
| Debt and capital lease obligations, net of current portion | 5,757 | 6,307 |
| Total liabilities | 86,781 | 90,417 |

Commitments and contingencies (note 9)

Stockholders' equity:

Preferred stock, \$0.01 par value: 5,000 shares authorized; no shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively

Common stock; \$0.01 par value: 125,000 shares authorized; 36,106 shares issued, and 34,828 shares outstanding at March 31, 2011; 35,808 shares issued and 34,530 shares outstanding at December 31, 2010

| | | |
|--|------------|------------|
| | 361 | 358 |
| Additional paid-in capital | 208,586 | 200,339 |
| Treasury stock, at cost, 1,278 shares | (1,200) | (1,200) |
| Accumulated other comprehensive income | 50 | 28 |
| Accumulated deficit | (25,521) | (28,772) |
| | | |
| Total stockholders' equity | 182,276 | 170,753 |
| | | |
| Total liabilities and stockholders' equity | \$ 269,057 | \$ 261,170 |

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

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

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2011 | 2010 |
| Revenue: | | |
| Business services | \$ 67,486 | \$ 52,565 |
| Implementation and other | 2,444 | 1,912 |
| Total revenue | 69,930 | 54,477 |
| Expense: | | |
| Direct operating | 27,270 | 23,519 |
| Selling and marketing | 16,941 | 12,060 |
| Research and development | 5,079 | 4,074 |
| General and administrative | 11,719 | 11,677 |
| Depreciation and amortization | 3,398 | 2,420 |
| Total expense | 64,407 | 53,750 |
| Operating income | 5,523 | 727 |
| Other income (expense): | | |
| Interest income | 107 | 78 |
| Interest expense | (177) | (217) |
| Gain (loss) on interest rate derivative contract | 65 | (60) |
| Other income | 38 | 30 |
| Total other income (expense) | 33 | (169) |
| Income before income taxes | 5,556 | 558 |
| Income tax provision | (2,305) | (281) |
| Net income | \$ 3,251 | \$ 277 |
| Net income per share Basic | \$ 0.09 | \$ 0.01 |
| Net income per share Diluted | \$ 0.09 | \$ 0.01 |
| Weighted average shares used in computing net income per share Basic | 34,678 | 34,014 |

Diluted

35,657

35,201

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, in thousands)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2011 | 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 3,251 | \$ 277 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,858 | 2,880 |
| Amortization of premiums on investments | 381 | 381 |
| Provision for uncollectible accounts | 259 | 213 |
| Excess tax benefit from stock-based awards | (2,175) | |
| Deferred income tax | 136 | 152 |
| Increase in fair value of contingent consideration | 114 | 304 |
| Stock-based compensation expense | 4,005 | 2,784 |
| (Gain) loss on interest rate derivative contract | (65) | 60 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (6,103) | (1,122) |
| Prepaid expenses and other current assets | 542 | (1,808) |
| Other long-term assets | 79 | (153) |
| Accounts payable | 2,124 | (392) |
| Accrued expenses | (4,802) | (4,121) |
| Deferred revenue | 2,731 | 1,964 |
| Deferred rent | (352) | (300) |
| Net cash provided by operating activities | 3,983 | 1,119 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capitalized software development costs | (1,469) | (703) |
| Purchases of property and equipment | (2,067) | (6,836) |
| Proceeds from sales or disposals of property and equipment | | 362 |
| Proceeds from sales and maturities of investments | 54,054 | 20,750 |
| Purchases of short-term and long-term investments | (48,766) | (27,691) |
| Decrease in restricted cash | 2,887 | 332 |
| Net cash provided by (used in) investing activities | 4,639 | (13,786) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock under stock plans | 2,125 | 3,269 |
| Excess tax benefit from stock-based awards | 2,175 | |
| Payment of contingent consideration accrued at acquisition date | (2,558) | |
| Payments on long-term debt and capital lease obligations | (793) | (887) |
| Net cash provided by financing activities | 949 | 2,382 |
| Effects of exchange rate changes on cash and cash equivalents | 67 | 13 |

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| | | |
|---|-----------|-----------|
| Net increase (decrease) in cash and cash equivalents | 9,638 | (10,272) |
| Cash and cash equivalents at beginning of period | 35,944 | 30,526 |
| Cash and cash equivalents at end of period | \$ 45,582 | \$ 20,254 |
| Supplemental disclosures of non-cash items Property and equipment recorded in accounts payable and accrued expenses | \$ 179 | \$ 229 |
| Supplemental disclosures Cash paid for interest | \$ 177 | \$ 117 |
| Supplemental disclosures Cash paid for taxes | \$ 241 | \$ 983 |
| Property and equipment acquired under capital leases | \$ | \$ 362 |

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

Table of Contents**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 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 March 31, 2011, and the results of operations for the three month period ended March 31, 2011 and 2010 and cash flows for the three month period ended March 31, 2011 and 2010. The results of operations for the three month period ended March 31, 2011 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, liabilities, revenue, expenses, and related disclosures at the date of the financial statements. 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, 2010, included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission (SEC) on February 18, 2011.

2. RECENT ACCOUNTING PRONOUNCEMENTS

From time to time, new accounting pronouncements are issued by FASB and are adopted by us as of the specified effective date. Unless otherwise discussed, we believe that the impact of other recently issued accounting pronouncements will not have a material impact on consolidated financial position, results of operations, and cash flows, or do not apply to our operations.

3. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net 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, warrants, shares to be purchased under the employee stock purchase plan, and restricted stock units. Under the treasury stock method, dilutive securities are assumed to be exercised at the beginning of the periods 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 antidilutive to earnings per share.

The following table reconciles the weighted average shares outstanding for basic and diluted net income per share for the periods indicated.

| | Three Months Ended March 31, 2011 | Three Months Ended March 31, 2010 |
|--|--|---|
| Net income | \$ 3,251 | \$ 277 |
| Weighted average shares used in computing basic net income per share | 34,678 | 34,014 |

| | | |
|--|----------|---------|
| Net income per share basic | \$ 0.09 | \$ 0.01 |
| Net income | \$ 3,251 | \$ 277 |
| Weighted average shares used in computing basic net income per share | 34,678 | 34,014 |
| Effect of dilutive securities | 979 | 1,187 |
| Weighted average shares used in computing diluted net income per share | 35,657 | 35,201 |
| Net income per share diluted | \$ 0.09 | \$ 0.01 |

The computation of diluted net income per share does not include 909 and 963 stock options for the three months ended March 31, 2011, and March 31, 2010, respectively, because their inclusion would have an antidilutive effect on net income per share.

Table of Contents**athenahealth, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited amounts in thousands, except per-share amounts)****4. COMPREHENSIVE INCOME**

Comprehensive income was as follows for the periods indicated:

| | Three Months Ended March 31, 2011 | Three Months Ended March 31, 2010 |
|---|--|---|
| Net income | \$ 3,251 | \$ 277 |
| Unrealized holding loss on available-for-sale investments | (10) | (55) |
| Foreign currency translation adjustment | 32 | 17 |
| | | |
| Total comprehensive income | \$ 3,273 | \$ 239 |

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

As of March 31, 2011 and December 31, 2010, 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. All highly liquid debt instruments purchased with a maturity of three months or less at the date of acquisition are included in cash and cash equivalents. Included in cash and cash equivalents as of March 31, 2011 and December 31, 2010, are money market fund investments of \$26,215 and \$10,799, respectively, which are reported at fair value.

The carrying amounts of the Company's debt obligations approximate fair value based upon our best estimate of interest rates that would be available to the Company for similar debt obligations. The estimated fair value of our long-term debt was determined using quoted market prices and other inputs that were derived from available market information and may not be representative of actual values that could have been or will be realized in the future.

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 March 31, 2011 and December 31, 2010, 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 inactive markets for identical assets or liabilities obtained from readily available pricing sources for similar instruments. The fair values determined by Level 3 inputs are unobservable values which are supported by little or no market activity. Investments include \$22,985 of long-term U.S. government backed securities that have been classified in investments and other assets on the condensed consolidated balance sheet at March 31, 2011. Investments include \$3,500 of long-term U.S. government backed securities and \$2,081 of long-term corporate bonds that have been classified in investments and other assets on the condensed consolidated balance sheet at December 31, 2010.

| | Fair Value Measurements as of March 31, 2011, Using | | | |
|---------------------------------|--|----------------|----------------|--------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Cash and cash equivalents: | | | | |
| Money market | \$ 26,215 | \$ | \$ | \$ 26,215 |
| Available-for-sale investments: | | | | |

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| | | | | |
|-----------------------------------|-----------|-----------|------------|------------|
| Commercial Paper | | 8,247 | | 8,247 |
| Corporate bonds | | 45,904 | | 45,904 |
| U.S. government backed securities | | 25,986 | | 25,986 |
| Total assets | \$ 26,215 | \$ 80,137 | \$ | \$ 106,352 |
| Accrued contingent consideration | \$ | \$ | \$ (2,211) | \$ (2,211) |
| Interest rate derivative contract | | (425) | | (425) |
| Total liabilities | \$ | \$ (425) | \$ (2,211) | \$ (2,636) |

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| | Fair Value Measurements as of December 31, 2010, | | | Total |
|-----------------------------------|--|------------------|-------------------|-------------------|
| | Level 1 | Level 2 | Level 3 | |
| Cash and cash equivalents: | | | | |
| Money market | \$ 10,799 | \$ | \$ | \$ 10,799 |
| Corporate bonds | | 577 | | 577 |
| Available-for-sale investments: | | | | |
| Commercial Paper | | 29,642 | | 29,642 |
| Corporate bonds | | 40,676 | | 40,676 |
| U.S. government backed securities | | 15,494 | | 15,494 |
| Total assets | \$ 10,799 | \$ 86,389 | \$ | \$ 97,188 |
| Accrued contingent consideration | \$ | \$ | \$ (4,655) | \$ (4,655) |
| Interest rate derivative contract | | (490) | | (490) |
| Total liabilities | \$ | \$ (490) | \$ (4,655) | \$ (5,145) |

U.S. government backed securities, 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. The interest rate derivative is valued using an interest rate swap model and observable inputs at the reporting date.

There were no transfers into and out of Levels 1, 2 and 3 of the fair value hierarchy during the three months ended March 31, 2011 and 2010, respectively. 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 the three months March 31, 2011, or the year ended December 31, 2010, respectively.

Contingent consideration is recorded at fair value as an element of purchase price with subsequent adjustments recognized in the consolidated statement of operations. 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. As of March 31, 2011 and December 31, 2010, the Company has accrued a liability of \$2,211 and \$4,655, respectively, for the estimated fair value of contingent considerations estimated to be payable upon the acquired company reaching specific performance metrics over the initial three years of operation after acquisition. There are two separate elements that make up the contingent consideration.

The first potential contingent consideration ranges from zero to \$4,800 and is payable in one installment based upon operational performance for the year ended December 31, 2010. Based on the actual operational performance for the year ended December 31, 2010, the Company had accrued \$2,400 relating to the first potential contingent consideration which was paid in March of 2011.

The second potential contingent consideration ranges from zero to \$2,900 and is payable in quarterly installments based upon the cross selling of the Company's services into the acquired company's customer base for the years ended December 31, 2010 and 2011, and the six-month period ending June 30, 2012. Any amounts not earned in the first potential contingent consideration can be earned under the second potential contingent consideration in excess of the initial \$2,900 bringing the total potential contingent consideration to \$5,300. At March 31, 2011, key assumptions relating to the second potential contingent consideration include a discount rate of 20% and a probability adjusted

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level of 50% for the base case scenario and 25% for the upside and downside scenarios. At December 31, 2010, key assumptions relating to the second potential contingent consideration include a discount rate of 21% and a probability adjusted level of 50% for the base case scenario and 25% for the upside and downside scenarios. The change in these assumptions were caused by the expected results from 2011 and 2012 operations and resulted in an increase of \$114 in the fair value of the total contingent consideration during the three months ended March 31, 2011. The Company paid \$158 during the three months ended March 31, 2011, under the terms of the second potential contingent consideration. No amounts were paid under either contingent consideration in the three months ended March 31, 2010.

| | |
|--|----------|
| Accrued contingent consideration balance as of January 1, 2010 | \$ 5,100 |
| Increase in fair value of contingent consideration | 304 |
| Accrued contingent consideration balance as of March 31, 2010 | \$ 5,404 |
| | |
| Accrued contingent consideration balance as of January 1, 2011 | \$ 4,655 |
| Payments of contingent consideration | (2,558) |
| Increase in fair value of contingent consideration | 114 |
| Accrued contingent consideration balance as of March 31, 2011 | \$ 2,211 |

Table of Contents**athenahealth, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited amounts in thousands, except per-share amounts)****6. INVESTMENTS**

The summary of available-for-sale securities as of March 31, 2011, is as follows:

| | Amortized Cost | | Gross Unrealized Gains (Loss) | | Fair Value |
|-----------------------------------|---------------------------|----|--|----|-----------------------|
| Commercial paper | \$ 8,238 | \$ | 9 | \$ | 8,247 |
| Corporate bonds | 45,915 | | (11) | | 45,904 |
| U.S. government backed securities | 26,006 | | (20) | | 25,986 |
| | | | | | |
| Total | \$ 80,159 | \$ | (22) | \$ | 80,137 |

Investments include \$22,985 of long-term U.S. government backed securities that have been classified in investments and other assets on the condensed consolidated balance sheet at March 31, 2011.

The summary of available-for-sale securities as of December 31, 2010, is as follows:

| | Amortized Cost | | Gross Unrealized Gains (Loss) | | Fair Value |
|-----------------------------------|---------------------------|----|--|----|-----------------------|
| Commercial paper | \$ 29,635 | \$ | 7 | \$ | 29,642 |
| Corporate bonds | 40,694 | | (18) | | 40,676 |
| U.S. government backed securities | 15,500 | | (6) | | 15,494 |