

ATHENAHEALTH INC
Form 10-Q
July 20, 2012
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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 June 30, 2012

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)

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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)

(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 (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

As of July 16, 2012, there were 35,998,819 shares of the registrant's \$0.01 par value common stock outstanding.

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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)**

| | June 30, 2012 | December 31, 2011 |
|--|-------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 92,330 | \$ 57,781 |
| Short-term investments | 63,029 | 62,084 |
| Current portion of restricted cash | 3,344 | |
| Accounts receivable - net | 50,885 | 49,038 |
| Deferred tax assets | 5,971 | 5,245 |
| Prepaid expenses and other current assets | 13,975 | 8,988 |
| Total current assets | 229,534 | 183,136 |
| Property and equipment - net | 52,503 | 52,275 |
| Restricted cash, net of current portion | 856 | 5,007 |
| Software development costs - net | 9,372 | 6,974 |
| Purchased intangibles - net | 18,546 | 20,052 |
| Goodwill | 47,307 | 47,307 |
| Deferred tax assets | 12,229 | 12,532 |
| Investments and other assets | 4,323 | 21,503 |
| Total assets | \$ 374,670 | \$ 348,786 |
| Liabilities & Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,755 | \$ 6,318 |
| Accrued compensation | 27,493 | 28,176 |
| Accrued expenses | 17,200 | 17,774 |
| Current portion of deferred revenue | 6,301 | 6,345 |
| Current portion of deferred rent | 996 | 960 |
| Total current liabilities | 54,745 | 59,573 |
| Deferred rent, net of current portion | 2,458 | 2,932 |
| Deferred revenue, net of current portion | 45,433 | 44,281 |
| Other long-term liabilities | 3,109 | 5,529 |
| Total liabilities | 105,745 | 112,315 |
| Commitments and contingencies (note 5) | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.01 par value: 5,000 shares authorized; no shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively | | |
| Common stock, \$0.01 par value: 125,000 shares authorized; 37,240 shares issued, and 35,962 shares outstanding at June 30, 2012; 36,678 shares issued and 35,400 shares outstanding at December 31, 2011 | 372 | 367 |
| Additional paid-in capital | 272,981 | 247,131 |
| Treasury stock, at cost, 1,278 shares | (1,200) | (1,200) |

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| | | |
|--|------------|------------|
| Accumulated other comprehensive loss | (84) | (101) |
| Accumulated deficit | (3,144) | (9,726) |
| Total stockholders' equity | 268,925 | 236,471 |
| Total liabilities and stockholders' equity | \$ 374,670 | \$ 348,786 |

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------------|------------------------------|-----------------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenue: | | | | |
| Business services | \$ 100,110 | \$ 75,349 | \$ 193,659 | \$ 142,835 |
| Implementation and other | 3,405 | 2,536 | 6,422 | 4,980 |
| Total revenue | 103,515 | 77,885 | 200,081 | 147,815 |
| Expense: | | | | |
| Direct operating | 41,014 | 29,020 | 79,812 | 56,290 |
| Selling and marketing | 27,389 | 18,815 | 51,117 | 35,756 |
| Research and development | 8,615 | 5,166 | 15,783 | 10,245 |
| General and administrative | 13,961 | 11,718 | 30,160 | 23,437 |
| Depreciation and amortization | 5,795 | 3,737 | 11,281 | 7,135 |
| Total expense | 96,774 | 68,456 | 188,153 | 132,863 |
| Operating income | 6,741 | 9,429 | 11,928 | 14,952 |
| Other income (expense) | 12 | (77) | 146 | (44) |
| Income before income taxes | 6,753 | 9,352 | 12,074 | 14,908 |
| Income tax provision | (2,599) | (4,166) | (5,492) | (6,471) |
| Net income | \$ 4,154 | \$ 5,186 | \$ 6,582 | \$ 8,437 |
| Net income per share - Basic | \$ 0.12 | \$ 0.15 | \$ 0.18 | \$ 0.24 |
| Net income per share - Diluted | \$ 0.11 | \$ 0.14 | \$ 0.18 | \$ 0.24 |
| Weighted average shares used in computing net income per share: | | | | |
| Basic | 35,685 | 34,917 | 35,713 | 34,798 |
| Diluted | 36,906 | 35,773 | 36,951 | 35,715 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income | \$ 4,154 | \$ 5,186 | \$ 6,582 | \$ 8,437 |
| Other comprehensive income | | | | |
| Unrealized (loss) gain on securities, net of tax | (34) | 25 | 38 | 15 |
| Foreign currency translation adjustment | (12) | (17) | (21) | 15 |

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| | | | | |
|----------------------------------|----------|----------|----------|----------|
| Total other comprehensive income | (46) | 8 | 17 | 30 |
| Comprehensive income | \$ 4,108 | \$ 5,194 | \$ 6,599 | \$ 8,467 |

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

Table of Contents**athenahealth, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited, in thousands)**

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2012 | 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 6,582 | \$ 8,437 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 12,861 | 8,055 |
| Amortization of premium on investments | 681 | 868 |
| Provision for uncollectible accounts | 287 | 593 |
| Excess tax benefit from stock-based awards | (5,680) | (6,432) |
| Deferred income tax | (426) | (819) |
| (Decrease) Increase in fair value of contingent consideration | (1,110) | 224 |
| Stock-based compensation expense | 12,984 | 7,916 |
| Other reconciling adjustments | (120) | 73 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (2,134) | (7,650) |
| Prepaid expenses and other current assets | 605 | 5,985 |
| Other long-term assets | 117 | 166 |
| Accounts payable | 1,222 | 781 |
| Accrued expenses | 1,742 | 388 |
| Accrued compensation | (683) | |
| Deferred revenue | 1,108 | 4,887 |
| Deferred rent | (438) | (3,303) |
| Net cash provided by operating activities | 27,598 | 20,169 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capitalized software development costs | (5,915) | (3,068) |
| Purchases of property and equipment | (15,657) | (6,841) |
| Proceeds from sales and maturities of investments | 46,374 | 86,834 |
| Purchases of short-term and long-term investments | (30,883) | (80,175) |
| Payment of acquisition | | (6,988) |
| Decrease in restricted cash | 807 | 2,887 |
| Other investing activities | 172 | |
| Net cash (used in) investing activities | (5,102) | (7,351) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock under stock plans and warrants | 10,905 | 4,558 |
| Taxes paid related to net share settlement of restricted stock awards | (3,686) | |
| Excess tax benefit from stock-based awards | 5,680 | 6,432 |
| Payment of contingent consideration accrued at acquisition date | (807) | (2,558) |
| Payment to terminate interest rate derivative contract | | (563) |
| Payments on long-term debt and capital lease obligations | | (9,216) |
| Net cash (used in) provided by financing activities | 12,092 | (1,347) |
| Effects of exchange rate changes on cash and cash equivalents | (39) | (45) |

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| | | |
|--|-----------|-----------|
| Net increase in cash and cash equivalents | 34,549 | 11,426 |
| Cash and cash equivalents at beginning of period | 57,781 | 35,944 |
| | | |
| Cash and cash equivalents at end of period | \$ 92,330 | \$ 47,370 |
| | | |
| Non-cash transactions | | |
| Property and equipment recorded in accounts payable and accrued expenses | \$ 450 | \$ 222 |
| | | |
| Tax benefit recorded in prepaid expenses and other current assets | \$ 5,651 | \$ 6,344 |
| | | |
| Additional disclosures | | |
| Cash paid for interest | \$ 51 | \$ 225 |
| | | |
| Cash paid for taxes | \$ 3,824 | \$ 804 |

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

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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, 2012, and the results of operations for the three and six month periods ended June 30, 2012 and 2011 and cash flows for the six month period ended June 30, 2012. The results of operations for the three and six month periods ended June 30, 2012 is 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 and 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, 2011, included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission (SEC) on February 16, 2012.

Comprehensive Income: In June 2011, the Financial Accounting Standards Board (the FASB) issued Standards Update 2011-5, Comprehensive Income (Topic 220) as amended, requiring amendments to disclosure for presentation of comprehensive income. This guidance, effective retrospectively for the interim and annual periods beginning on or after December 31, 2011, requires presentation of total comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In December 2011, the FASB issued an amendment to this guidance which indefinitely defers the requirement to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. This guidance is effective for annual periods beginning after December 15, 2011. The Company adopted the amended guidance requiring presentation of comprehensive financial statements for the three months ended March 31, 2012. Simultaneously, the Company made the decision to change the title of their income statement from Condensed Consolidated Statement of Operations to Condensed Consolidated Statement of Income to be consistent with the new presentation. The implementation of this guidance did not have a material impact on the Company s consolidated results of operations or financial position.

Comprehensive income is defined as net income or loss and other changes in stockholders equity from transactions and other events from sources other than stockholders. Comprehensive income is reflected in the consolidated statements of comprehensive income.

2. 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, 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 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.

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

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

| | Three Months Ended June 30, 2012 | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2012 | Six Months Ended June 30, 2011 |
|--|-------------------------------------|-------------------------------------|-----------------------------------|-----------------------------------|
| Net income | \$ 4,154 | \$ 5,186 | \$ 6,582 | \$ 8,437 |
| Weighted average shares used in computing basic net income per share | 35,685 | 34,917 | 35,713 | 34,798 |
| Net income per share - basic | \$ 0.12 | \$ 0.15 | \$ 0.18 | \$ 0.24 |
| Net income | \$ 4,154 | \$ 5,186 | \$ 6,582 | \$ 8,437 |
| Weighted average shares used in computing basic net income per share | 35,685 | 34,917 | 35,713 | 34,798 |
| Effect of dilutive securities | 1,221 | 856 | 1,238 | 917 |
| Weighted average shares used in computing diluted net income per share | 36,906 | 35,773 | 36,951 | 35,715 |
| Net income per share - diluted | \$ 0.11 | \$ 0.14 | \$ 0.18 | \$ 0.24 |

The computation of diluted net income per share does not include 0.4 million and 0.4 million of options and restricted stock units for the three and six months ended June 30, 2012, respectively, because their inclusion would have an antidilutive effect on net income per share. The computation of diluted net income per share does not include 1.4 million and 1.2 million of options and restricted stock units for the three and six months ended June 30, 2011, because their inclusion would have an antidilutive effect on net income per share.

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

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, 2012 and December 31, 2011, 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 \$1.6 million of long-term corporate bonds in long-term investments that have been classified in investments and other assets on the condensed consolidated balance sheet at June 30, 2012. Investments include \$18.6 million of long-term U.S. government backed securities that have been classified in investments and other assets on the condensed consolidated balance sheet at December 31, 2011.

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(Unaudited amounts in thousands, except per-share amounts)

| | Fair Value Measurements At June 30, 2012, Using | | | Total |
|-----------------------------------|---|-----------|------------|------------|
| | Level 1 | Level 2 | Level 3 | |
| Cash and cash equivalents: | | | | |
| Money market | \$ 62,711 | \$ | \$ | \$ 62,711 |
| Available-for-sale investments: | | | | |
| Commercial paper | | 19,094 | | 19,094 |
| Corporate bonds | | 40,607 | | 40,607 |
| Certificate of Deposit | | 4,008 | | 4,008 |
| U.S. government backed securities | | 875 | | 875 |
| Total assets | \$ 62,711 | \$ 64,584 | \$ | \$ 127,295 |
| Accrued contingent consideration | \$ | \$ | \$ (6,259) | \$ (6,259) |
| Total liabilities | \$ | \$ | \$ (6,259) | \$ (6,259) |

| | Fair Value Measurements as of December 31, 2011, Using | | | Total |
|-----------------------------------|--|-----------|------------|------------|
| | Level 1 | Level 2 | Level 3 | |
| Cash and cash equivalents: | | | | |
| Money market | \$ 33,444 | \$ | \$ | \$ 33,444 |
| Commercial paper | | 7,250 | | 7,250 |
| Available-for-sale investments: | | | | |
| Commercial paper | | 6,499 | | 6,499 |
| Corporate bonds | | 40,833 | | 40,833 |
| U.S. government backed securities | | 33,370 | | 33,370 |
| Total assets | \$ 33,444 | \$ 87,952 | \$ | \$ 121,396 |
| Accrued contingent consideration | \$ | \$ | \$ (8,176) | \$ (8,176) |
| Total liabilities | \$ | \$ | \$ (8,176) | \$ (8,176) |

Money markets, certificates of deposit, 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. 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. As of June 30, 2012, and December 31, 2011, the Company has accrued a liability of \$6.3 million and \$8.2 million, respectively for the estimated fair value of contingent considerations estimated to be payable upon the acquired companies reaching specific performance metrics over a specified period of operations or time after acquisition. The elements that make up the contingent consideration are as follows:

Anodyne

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The first potential contingent consideration related to our acquisition of Anodyne Health Partners, Inc. (Anodyne) in 2009 ranges from zero to \$4.8 million 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 \$2.4 million relating to the first potential contingent consideration which was paid in March of 2011.

The second potential contingent consideration related to our acquisition of Anodyne in 2009 ranges from zero to \$2.9 million and is payable in quarterly installments based upon the cross selling of the Company's services for the years ended December 31, 2010 and 2011, and the six-month period ended 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 \$2.9 million bringing the total potential contingent consideration to \$5.3 million. On December 31, 2011, the Company estimated the fair value of the second contingent consideration at \$1.4 million based on key assumptions including a probability adjusted level of 50% for the base case scenario and 25% for the upside and downside scenarios. The significant judgment related to the estimated earn-out payments by scenario was primarily based on the Company's

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

i) past experience of our cross selling, ii) past experience of the timeline for converting pipeline opportunities into customers and iii) the remaining time period of this contingent consideration. At December 31, 2011, a large cross sell customer opportunity was included in the upside scenario which had a 25% probability. On March 31, 2012, the Company estimated the fair value of the second contingent consideration at \$3.4 million based on key assumptions including a 20% for the base case scenario, 70% for the upside scenario and 10% for the downside scenario. At March 31, 2012, this large cross sell opportunity was in final contract negotiations with the Company and therefore a higher probability was assigned to the upside scenario. The time period through which the contingent consideration could be earned elapsed on June 30, 2012 and the the Company will pay \$1.8 million based on the final cross selling results. The change in fair value of \$0.9 million and \$1.3 million for the three month and six month period ended June 30, 2012, respectively is a decrease and an increase in the general and administrative line item in the Condensed Consolidated Statement of Income, respectively. The Company has paid \$2.0 million over the term of the second contingent consideration to date.

Proxsys

The first potential contingent consideration related to our acquisition of Proxsys LLC (Proxsys) in 2011 ranges from zero to \$3.0 million and is payable in one installment in the first quarter of 2013 based upon revenue and new sales performance for the fiscal year ending December 31, 2012. In order to qualify for the earnout payment, the acquired subsidiary must achieve a minimum revenue threshold which was derived from both recurring revenue and revenue generated from new customers brought onto the service after the acquisition. Once that minimum revenue threshold is met, the amount of the payment is then determined by new sales of the Company s athenaCoordinator service offering since date of acquisition. At acquisition date and on December 31, 2011, the Company estimated the fair value of the first potential contingent consideration at \$2.4 million, the key assumptions relating to this potential contingent consideration included the athenaCoordinator revenue budget for the 2012 fiscal year, which included recurring revenue and estimates related new revenue generated from new customers based upon the existing sales pipeline and historical implementation timeline and a probability adjusted level of 60% for the base case and 25% and 15% for the upside and downside scenarios, respectively. The athenaCoordinator revenue budget for the 2012 fiscal year exceeded the minimum revenue threshold. The downside scenarios included a worse case scenario where the acquired subsidiary did not achieve the minimum revenue target. Certain contracts that were in an advanced negotiation stage at December 31, 2011 and estimated to close in the first quarter of 2012, did not close during the three months ended March 31, 2012; therefore as of March 31, 2012, the Company determined that it is more likely than not that the minimum revenue threshold for athenaCoordinator will not be achieved by a margin of 5-10%. On March 31, 2012, the Company determined that based on the reforecasted amounts and the pass fail structure of this contingent payment, the probability percentages have been adjusted to 90% for the worse case scenario and 10% for the upside scenario. On March 31, 2012 the Company estimated the fair value of the first potential contingent consideration at \$0.3 million. On June 30, 2012, based on the continued delay in finalizing certain contracts, the Company determined that the upside scenario is no longer achievable and has given no value to the first contingent consideration. The change in fair value of \$0.3 million and \$2.4 million is a decrease in the general and administrative expense line item in the Condensed Consolidated Statement of Income for the three and six months ended June 30, 2012.

The second potential contingent consideration related to our 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 services into the new and acquired company s customer base from acquisition to the second year anniversary of the acquisition in the third quarter of 2013. On June 30, 2012 and December 31, 2011, the key assumptions relating to this potential contingent consideration included a probability adjusted level of 65% for the base case and 25% and 10% for the upside and downside scenarios, respectively. The Company estimated the fair value the contingent consideration at June 30, 2012 at \$4.4 million.

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, 2012 | Three Months Ended June 30, 2011 | Six Months Ended June 30, 2012 | Six Months Ended June 30, 2011 |
|--|--|--------------------------------------|--------------------------------------|
|--|--|--------------------------------------|--------------------------------------|

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| | | | | |
|---|----------|----------|----------|----------|
| Balance beginning of period | \$ 8,143 | \$ 2,211 | \$ 8,176 | \$ 4,655 |
| Payments | (703) | | (807) | (2,558) |
| Change in fair value (included in G&A expenses) | (1,181) | 110 | (1,110) | 224 |
| Balance end of period | \$ 6,259 | \$ 2,321 | \$ 6,259 | \$ 2,321 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited amounts in thousands, except per-share amounts)

4. INVESTMENTS

The summary of available-for-sale securities at June 30, 2012, is as follows: