
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

**Quarterly Report pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2016

Commission File No.: 000-27701

HealthStream, Inc.

(Exact name of registrant as specified in its charter)

Tennessee
(State or other jurisdiction of
incorporation or organization)

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

209 10th Avenue South, Suite 450
Nashville, Tennessee
(Address of principal executive offices)

37203
(Zip Code)

(615) 301-3100
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

| | | | |
|-------------------------|--|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |

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 27, 2016, there were 31,739,034 shares of the registrant's common stock outstanding.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

| | June 30, 2016 (Unaudited) | December 31, 2015 |
|--|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 66,803 | \$ 82,010 |
| Marketable securities | 72,006 | 66,976 |
| Accounts receivable, net of allowance for doubtful accounts of \$510 and \$303 at June 30, 2016 and December 31, 2015, respectively | 42,014 | 36,348 |
| Accounts receivable - unbilled | 2,119 | 1,998 |
| Prepaid royalties, net of amortization | 13,242 | 14,036 |
| Other prepaid expenses and other current assets | 8,312 | 8,169 |
| Total current assets | 204,496 | 209,537 |
| Property and equipment, net | 11,138 | 12,471 |
| Capitalized software development, net of accumulated amortization of \$27,806 and \$24,130 at June 30, 2016 and December 31, 2015, respectively | 14,716 | 13,955 |
| Goodwill | 88,628 | 83,073 |
| Intangible assets, net of accumulated amortization of \$11,885 and \$8,685 at June 30, 2016 and December 31, 2015, respectively | 54,266 | 55,966 |
| Non-marketable equity investments | 3,564 | 3,640 |
| Other assets | 375 | 927 |
| Total assets | <u>\$ 377,183</u> | <u>\$ 379,569</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,742 | \$ 4,616 |
| Accrued royalties | 8,134 | 9,053 |
| Accrued liabilities | 10,960 | 7,003 |
| Accrued compensation and related expenses | 1,935 | 3,308 |
| Deferred revenue | 58,971 | 65,098 |
| Total current liabilities | 81,742 | 89,078 |
| Deferred tax liabilities | 6,295 | 4,763 |
| Deferred revenue, noncurrent | 4,002 | 4,350 |
| Other long term liabilities | 1,069 | 1,058 |
| Commitments and contingencies | — | — |
| Shareholders' equity: | | |
| Common stock, no par value, 75,000 shares authorized; 31,739 and 31,647 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively | 279,595 | 278,799 |
| Retained earnings | 4,494 | 1,591 |
| Accumulated other comprehensive loss | (14) | (70) |
| Total shareholders' equity | 284,075 | 280,320 |
| Total liabilities and shareholders' equity | <u>\$ 377,183</u> | <u>\$ 379,569</u> |

See accompanying notes to the unaudited condensed consolidated financial statements.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In thousands, except per share data)

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|--|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| | <u>June 30,</u> <u>2016</u> | <u>June 30,</u> <u>2015</u> | <u>June 30,</u> <u>2016</u> | <u>June 30,</u> <u>2015</u> |
| Revenues, net | \$54,793 | \$52,145 | \$108,871 | \$99,301 |
| Operating costs and expenses: | | | | |
| Cost of revenues (excluding depreciation and amortization) | 22,622 | 22,432 | 45,522 | 42,625 |
| Product development | 7,244 | 5,815 | 14,263 | 10,460 |
| Sales and marketing | 9,001 | 10,328 | 17,558 | 17,675 |
| Other general and administrative expenses | 8,529 | 6,750 | 16,505 | 13,678 |
| Depreciation and amortization | 5,081 | 4,256 | 10,221 | 7,509 |
| Total operating costs and expenses | 52,477 | 49,581 | 104,069 | 91,947 |
| Operating income | 2,316 | 2,564 | 4,802 | 7,354 |
| Other income (expense), net | 109 | (44) | 127 | (35) |
| Income before income tax provision | 2,425 | 2,520 | 4,929 | 7,319 |
| Income tax provision | 1,022 | 1,047 | 2,026 | 3,124 |
| Net income | <u>\$ 1,403</u> | <u>\$ 1,473</u> | <u>\$ 2,903</u> | <u>\$ 4,195</u> |
| Earnings per share: | | | | |
| Basic | <u>\$ 0.04</u> | <u>\$ 0.05</u> | <u>\$ 0.09</u> | <u>\$ 0.15</u> |
| Diluted | <u>\$ 0.04</u> | <u>\$ 0.05</u> | <u>\$ 0.09</u> | <u>\$ 0.15</u> |
| Weighted average shares of common stock outstanding: | | | | |
| Basic | <u>31,736</u> | <u>29,234</u> | <u>31,701</u> | <u>28,469</u> |
| Diluted | <u>32,071</u> | <u>29,617</u> | <u>32,021</u> | <u>28,843</u> |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | <u>Three Months Ended</u> | | <u>Six Months Ended</u> | |
|---|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| | <u>June 30,</u> <u>2016</u> | <u>June 30,</u> <u>2015</u> | <u>June 30,</u> <u>2016</u> | <u>June 30,</u> <u>2015</u> |
| Net income | \$ 1,403 | \$ 1,473 | \$ 2,903 | \$ 4,195 |
| Other comprehensive income, net of taxes: | | | | |
| Unrealized gain (loss) on marketable securities | — | (62) | 56 | (41) |
| Total other comprehensive income (loss) | — | (62) | 56 | (41) |
| Comprehensive income | <u>\$ 1,403</u> | <u>\$ 1,411</u> | <u>\$ 2,959</u> | <u>\$ 4,154</u> |

See accompanying notes to the unaudited condensed consolidated financial statements.

HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2016
(In thousands)

| | Common Stock | | Retained | Accumulated | Total |
|--|---------------------|------------------|-----------------|----------------------|----------------------|
| | Shares | Amount | Earnings | Other | Shareholders' |
| | | | | Comprehensive | Equity |
| | | | | Loss | |
| Balance at December 31, 2015 | 31,647 | \$278,799 | \$ 1,591 | \$ (70) | \$ 280,320 |
| Net income | — | — | 2,903 | — | 2,903 |
| Comprehensive loss | — | — | — | 56 | 56 |
| Stock based compensation | — | 1,004 | — | — | 1,004 |
| Common stock issued under stock plans, net of shares withheld for employee taxes | 92 | (208) | — | — | (208) |
| Balance at June 30, 2016 | <u>31,739</u> | <u>\$279,595</u> | <u>\$ 4,494</u> | <u>\$ (14)</u> | <u>\$ 284,075</u> |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | Six Months Ended June 30, | |
|---|----------------------------------|------------------|
| | 2016 | 2015 |
| OPERATING ACTIVITIES: | | |
| Net income | \$ 2,903 | \$ 4,195 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,221 | 7,509 |
| Deferred income taxes | 932 | 823 |
| Stock based compensation expense | 1,004 | 2,347 |
| Provision for doubtful accounts | 240 | 119 |
| Loss on non-marketable equity investments | 76 | — |
| Other | 607 | 386 |
| Changes in operating assets and liabilities: | | |
| Accounts and unbilled receivables | (5,722) | 3,055 |
| Prepaid royalties | 794 | (2,578) |
| Other prepaid expenses and other current assets | (1,123) | (424) |
| Other assets | 552 | 820 |
| Accounts payable | (1,755) | (1,703) |
| Accrued royalties | (919) | (1,776) |
| Accrued liabilities and accrued compensation and related expenses and other long-term liabilities | (1,051) | 645 |
| Deferred revenue | (6,474) | 5,713 |
| Net cash provided by operating activities | <u>285</u> | <u>19,131</u> |
| INVESTING ACTIVITIES: | | |
| Business combinations, net of cash acquired | (3,141) | (88,075) |
| Proceeds from maturities of marketable securities | 65,639 | 29,915 |
| Purchases of marketable securities | (71,220) | (76,768) |
| Payments to acquire equity method investments | — | (1,000) |
| Proceeds from sale of long-lived assets | 975 | — |
| Payments associated with capitalized software development | (4,303) | (3,566) |
| Purchases of property and equipment | (3,234) | (4,054) |
| Net cash used in investing activities | <u>(15,284)</u> | <u>(143,548)</u> |
| FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock | — | 98,014 |
| Proceeds from exercise of stock options | 94 | 277 |
| Proceeds from borrowings under revolving line of credit facility | — | 28,000 |
| Repayments under revolving line of credit facility | — | (28,000) |
| Payment of earn-outs related to business combinations | — | (628) |
| Taxes paid related to net settlement of equity awards | (302) | (748) |
| Net cash (used in) provided by financing activities | <u>(208)</u> | <u>96,915</u> |
| Net decrease in cash and cash equivalents | (15,207) | (27,502) |
| Cash and cash equivalents at beginning of period | 82,010 | 81,995 |
| Cash and cash equivalents at end of period | <u>\$ 66,803</u> | <u>\$ 54,493</u> |

See accompanying notes to the unaudited condensed consolidated financial statements.

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 six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.

The balance sheet at December 31, 2015 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, 2015 included in the Company’s Annual Report on Form 10-K (the “Form 10-K”), filed with the Securities and Exchange Commission on February 26, 2016.

Recently Adopted Accounting Standards

The Company has adopted Accounting Standards Update (“ASU”) 2015-16, *Business Combinations (Topic 805)*. Under the provisions of the revised guidance, acquirers in a business combination must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The Company recorded a measurement period adjustment during the period ended March 31, 2016. See Note 7 Business Combinations for further discussion.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (“FASB”) issued 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, 2017, and early adoption is permitted for the first interim period within annual reporting periods beginning after December 15, 2016. The Company is currently reviewing this standard to determine the method of adoption and to assess the impact on its future consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which requires lessees to recognize assets and liabilities for most leases. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee is not expected to significantly change under such guidance; however, the Company is currently reviewing this standard to determine the method of adoption and to assess the impact on its future consolidated financial statements. The standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2018, and early adoption is permitted.

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718)*, which serves to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2016, and early adoption is permitted in any interim or annual period. The Company is currently reviewing this standard to determine the method of adoption and to assess the impact on its future consolidated financial statements.

In March 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Sub Topic 825-10)*, which addresses certain aspects of the recognition, measurement, presentation, and disclosure of financial instruments. The guidance will, among other things, require equity method investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2017, and early adoption is permitted for only limited aspects of such guidance. The Company is currently reviewing this standard to determine the method of adoption and to assess the impact on its future consolidated financial statements.

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 six months ended June 30, 2016 and 2015, the Company recorded a provision for income taxes of approximately \$2.0 million and \$3.1 million, respectively. The Company's effective tax rate for the six months ended June 30, 2016 and 2015 was 41.1% and 42.7%, 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.

4. STOCK BASED COMPENSATION

The Company has stock awards outstanding under two stock incentive plans, the Company's 2010 Stock Incentive Plan and the Company's 2000 Stock Incentive Plan, as amended. In addition, the Company's shareholders approved the Company's 2016 Omnibus Incentive Plan at the annual meeting of shareholders held on May 26, 2016; however, no awards were granted under such plan during the three months ended June 30, 2016. 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 six months ended June 30, 2016, the Company issued 103,210 RSUs, subject to service-based vesting, with a weighted average grant date fair value of \$20.20 per share, measured based on the closing fair market value of the Company's stock on the date of grant. During the six months ended June 30, 2015, the Company issued 76,855 RSUs with a weighted average grant date fair value of \$25.64 per share, and the Company issued 49,310 stock awards with a weighted average grant date fair value of \$30.42 per share. Both measurements were 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 six months ended June 30, 2016 and 2015, which is recorded in the condensed consolidated statements of income, is as follows (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------------|------------------------------|----------------|
| | 2016 | 2015 | 2016 | 2015 |
| Cost of revenues (excluding depreciation and amortization) | \$ 35 | \$ 738 | \$ 76 | \$ 761 |
| Product development | 70 | 413 | 127 | 458 |
| Sales and marketing | 65 | 372 | 127 | 426 |
| Other general and administrative | 335 | 415 | 674 | 702 |
| Total stock based compensation expense | <u>\$ 505</u> | <u>\$ 1,938</u> | <u>\$1,004</u> | <u>\$2,347</u> |

Stock Awards

During June 2015, the Company's Chief Executive Officer ("CEO"), Robert A. Frist, Jr., entered into an agreement with the Company pursuant to which he contributed 54,241 of his personally owned shares of HealthStream, Inc. common stock to the Company, without any consideration paid to him. In connection with this contribution, the Company approved the grant of 49,310 shares of HealthStream, Inc. common stock to over 600 employees who were not otherwise eligible to receive equity awards and had at least one year of service with the Company. The Company recognized approximately \$1.5 million of stock based compensation expense for these stock awards during the three months ended June 30, 2015 based on the closing fair market value of the Company's stock on the date of the Company's approval of these grants. In connection with these equity awards, effective in the second quarter of 2015, the Company withheld shares with value equivalent to the employees' minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. The total shares withheld were 17,279, and were based on the value of the stock awards on the date of the Company's approval of these grants, as determined by the Company's closing stock price on that date. Total payments related to the employees' tax obligations to taxing authorities for these stock awards were approximately \$526,000, and are reflected as a financing activity within the condensed consolidated statements of cash flows for the six months ended June 30, 2015. These share withholdings had the effect of share repurchases by the Company as they reduced and retired the number of shares otherwise issuable as a result of the stock awards and did not represent an expense to the Company.

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 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 21,250 and -0- for the three months ended June 30, 2016 and 2015, respectively, and approximately 53,000 and 7,000 for the six months ended June 30, 2016 and 2015, respectively.

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2016 and 2015 (in thousands, except per share data):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|--------------------------------|----------|------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Numerator: | | | | |
| Net income | \$ 1,403 | \$ 1,473 | \$ 2,903 | \$ 4,195 |
| Denominator: | | | | |
| Weighted-average shares outstanding | 31,736 | 29,234 | 31,701 | 28,469 |
| Effect of dilutive shares | 335 | 383 | 320 | 374 |
| Weighted-average diluted shares | 32,071 | 29,617 | 32,021 | 28,843 |
| Basic earnings per share | \$ 0.04 | \$ 0.05 | \$ 0.09 | \$ 0.15 |
| Diluted earnings per share | \$ 0.04 | \$ 0.05 | \$ 0.09 | \$ 0.15 |

6. MARKETABLE SECURITIES

At June 30, 2016 and December 31, 2015, the fair value of marketable securities, which were all classified as available for sale, included the following (in thousands):

| | June 30, 2016 | | | |
|---|-------------------|---------------------|----------------------|------------------|
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Level 2: | | | | |
| Certificates of deposit | \$ 1,000 | \$ — | \$ — | \$ 1,000 |
| Corporate debt securities | 51,397 | 5 | (29) | 51,373 |
| Government-sponsored enterprise debt securities | 19,623 | 10 | — | 19,633 |
| Total | \$ 72,019 | \$ 15 | \$ (29) | \$ 72,006 |
| | | | | |
| | December 31, 2015 | | | |
| | Adjusted Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| Level 2: | | | | |
| Certificates of deposit | \$ 1,000 | \$ — | \$ — | \$ 1,000 |
| Corporate debt securities | 66,046 | — | (70) | 65,976 |
| Total | \$ 67,046 | \$ — | \$ (70) | \$ 66,976 |

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 June 30, 2016, the Company does not consider any of its marketable securities to be other than temporarily impaired. During the six months ended June 30, 2016 and 2015, the Company did not reclassify any 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.

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

7. BUSINESS COMBINATIONS***HealthLine Systems***

On March 16, 2015, the Company acquired all of the membership interests of HealthLine Systems, LLC ("HLS"), a San Diego, California based company that specializes in credentialing, privileging, call center, and quality management solutions for the healthcare industry. The acquisition of HLS enables the Company to provide a comprehensive solution set for healthcare provider credentialing, privileging, enrollment, referral, onboarding, and analytics in support of HealthStream's approach to talent management for healthcare organizations. The consideration paid for HLS consisted of approximately \$90.3 million in cash (taking into account an estimated closing working capital adjustment and amounts due to the seller as of June 30, 2016). The Company incurred approximately \$1.3 million in transaction costs associated with the acquisition, of which \$965,000 were incurred during the three months ended March 31, 2015 and \$329,000 were incurred during the year ended December 31, 2014. The transaction costs were recorded in other general and administrative expenses in the condensed consolidated statement of income for such periods. The results of operations for HLS have been included in the Company's condensed consolidated financial statements from the date of acquisition, and are also included in the HealthStream Provider Solutions segment.

A summary of the purchase price is as follows (in thousands):

| | |
|---------------------------------|------------------|
| Cash paid at closing | \$ 81,379 |
| Consideration due to the seller | 2,180 |
| Cash held in escrow | <u>6,750</u> |
| Total consideration paid | <u>\$ 90,309</u> |

The following table summarizes the fair value of the assets acquired and liabilities assumed as of the date of acquisition (in thousands):

| | |
|--|-----------------|
| Cash | \$ 54 |
| Accounts receivable, net | 3,052 |
| Prepaid assets | 546 |
| Property and equipment | 200 |
| Deferred tax assets | 2,523 |
| Goodwill | 43,798 |
| Intangible assets | 47,200 |
| Accounts payable and accrued liabilities | (1,085) |
| Deferred revenue | <u>(5,979)</u> |
| Net assets acquired | <u>\$90,309</u> |

The excess of purchase price over the fair values of net tangible and intangible assets has been recorded as goodwill. The fair values of tangible and identifiable intangible assets, deferred tax assets, deferred revenue, and other liabilities are based on management's estimates and assumptions. Included in the assets and liabilities assumed is an estimated indemnification asset of \$300,000 and a contingent liability of \$700,000, both of which are associated with tax liabilities. The contingent liability is measured based on management's estimate of a range of probable outcomes. The goodwill balance is primarily attributed to the assembled workforce, additional market opportunities from offering HLS's products, and expected synergies from integrating HLS with other products or other combined functional areas within the Company. During the three months ended March 31, 2016, the Company received notice of an indemnification claim from the former owners of HLS pursuant to the terms of the membership purchase agreement. The terms of such agreement require the Company to indemnify such owners for incremental taxes incurred as the result of the structure of the acquisition, which had favorable tax aspects to the Company. Although the amount of such claim has not been agreed to by the Company, the Company recorded a measurement period adjustment in relation to the claim that increased goodwill by approximately \$2.2 million during the three months ended March 31, 2016. This additional goodwill will be deductible for U.S. income tax purposes when any amounts underlying the indemnification claim are paid. Accordingly, this measurement period adjustment has no effect on current or prior period earnings. The goodwill balance excluding such measurement period adjustment is also deductible for U.S. income tax purposes. The Company surpassed the one year measurement period as of the period ended March 31, 2016; therefore, in accordance with requisite accounting guidance, at such time that the amount of the indemnification claim is agreed to by the Company, the difference, if any, of the agreed to indemnification amount in comparison to the \$2.2 million measurement period adjustment noted above will be reflected in net income, thus impacting the Company's results of operations in the period of settlement. The net tangible assets include deferred revenue, which was adjusted down from a book value at the acquisition date of \$15.0 million to an estimated fair value of \$6.0 million. The \$9.0 million write-down of deferred revenue will result in lower revenues than would have otherwise been recognized for such services.

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

7. BUSINESS COMBINATIONS (continued)

The following table sets forth the components of identifiable intangible assets and their estimated useful lives as of the acquisition date (in thousands):

| | <u>Fair value</u> | <u>Useful life</u> |
|---|-------------------|--------------------|
| Customer relationships | \$ 42,600 | 13 years |
| Developed technology | 3,700 | 5 years |
| Trade names | 900 | 6 years |
| Total intangible assets subject to amortization | <u>\$ 47,200</u> | |

The amounts of revenue and operating income (loss) of HLS included in the Company's condensed consolidated statement of income from the date of acquisition of March 16, 2015 to the period ending June 30, 2015 are as follows (in thousands):

| | |
|----------------|------------------|
| Total revenues | <u>\$ 2,606</u> |
| Operating loss | <u>\$(1,170)</u> |

The following unaudited pro forma financial information summarizes the combined results of operations of the Company and HLS as though the companies were combined as of January 1, 2014 (in thousands, except per share data):

| | Three Months Ended | | Six Months Ended | |
|----------------------------|--------------------|-----------------|------------------|------------------|
| | June 30, | | June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Total revenues | <u>\$55,231</u> | <u>\$54,604</u> | <u>\$110,265</u> | <u>\$106,213</u> |
| Net income | <u>\$ 1,656</u> | <u>\$ 2,909</u> | <u>\$ 3,730</u> | <u>\$ 6,840</u> |
| Basic earnings per share | <u>\$ 0.05</u> | <u>\$ 0.10</u> | <u>\$ 0.12</u> | <u>\$ 0.24</u> |
| Diluted earnings per share | <u>\$ 0.05</u> | <u>\$ 0.10</u> | <u>\$ 0.12</u> | <u>\$ 0.24</u> |

These unaudited pro forma combined results of operations include certain adjustments arising from the acquisition such as adjustment for amortization of intangible assets, depreciation of property and equipment, fair value adjustments of acquired deferred revenue balances, and interest expense associated with borrowings under a revolving credit facility by the Company to partially fund the acquisition. The unaudited pro forma combined results of operations is for informational purposes only and is not indicative of what the Company's results of operations would have been had the transaction occurred at the beginning of the period presented or to project the Company's results of operations in any future period.

The unaudited pro forma financial information for the three and six months ended June 30, 2016 and 2015 combines the historical results of the Company and HLS for the three and six months ended June 30, 2016 and 2015, and the pro forma adjustments listed above.

Other Business Combination

On June 30, 2016, the Company completed the acquisition of Performance Management Services, Inc. ("PMSI"), a Company based in Tustin, California focused on competency-based performance development for nurses, for \$4.0 million in cash and up to an additional \$500,000 of contingent consideration. The acquisition, including associated transaction costs, is not considered material to the Company's financial statements. The Company accounted for the acquisition as a business combination and has allocated purchase consideration based on preliminary estimates of fair value. The Company expects to finalize estimates of fair value as soon as practicable, but not later than one year from the date of acquisition. The results of operations for PMSI are included in the Company's condensed consolidated financial statements from the date of acquisition and are included in the HealthStream Workforce Solutions segment.

Goodwill

The changes in the carrying amount of goodwill for the six months ended June 30, 2016 are as follows (in thousands):

| | <u>Workforce</u> | <u>Patient Experience</u> | <u>Provider</u> | <u>Total</u> |
|--|------------------|-------------------------------|-----------------|-----------------|
| Balance at January 1, 2016 | \$ 12,336 | \$ 24,154 | \$46,583 | \$83,073 |
| Other business combinations | 3,375 | — | — | 3,375 |
| Acquisition of HealthLine Systems, LLC | — | — | 2,180 | 2,180 |
| Balance at June 30, 2016 | <u>\$ 15,711</u> | <u>\$ 24,154</u> | <u>\$48,763</u> | <u>\$88,628</u> |

During the three months ended March 31, 2016, the Company recorded approximately \$2.2 million of additional goodwill in relation to the March 2015 acquisition of HealthLine Systems, LLC. Such amount relates to the measurement period adjustment previously discussed under the above caption “HealthLine Systems.”

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

8. BUSINESS SEGMENTS

The Company provides services to healthcare organizations and other members within the healthcare industry. The Company's services are focused on the delivery of workforce development products and services (HealthStream Workforce Solutions), survey and research services (HealthStream Patient Experience Solutions), and provider credentialing, privileging, call center and enrollment products and services (HealthStream Provider Solutions).

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 six months ended June 30, 2016 and 2015 (in thousands).

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|--------------------------------|-----------------|------------------------------|-----------------|
| | 2016 | 2015 | 2016 | 2015 |
| Revenues, net: | | | | |
| Workforce | \$40,157 | \$39,803 | \$ 81,473 | \$77,396 |
| Patient Experience | 8,968 | 8,766 | 16,932 | 16,753 |
| Provider | 5,668 | 3,576 | 10,466 | 5,152 |
| Total revenues, net | <u>\$54,793</u> | <u>\$52,145</u> | <u>\$108,871</u> | <u>\$99,301</u> |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------|--------------------------------|-----------------|------------------------------|-----------------|
| | 2016 | 2015 | 2016 | 2015 |
| Operating income: | | | | |
| Workforce | \$ 9,242 | \$ 8,654 | \$ 19,647 | \$ 19,404 |
| Patient Experience | (134) | 605 | (791) | 930 |
| Provider | 445 | (923) | 279 | (787) |
| Unallocated | (7,237) | (5,772) | (14,333) | (12,193) |
| Total operating income | <u>\$ 2,316</u> | <u>\$ 2,564</u> | <u>\$ 4,802</u> | <u>\$ 7,354</u> |

| | June 30, 2016 | December 31, 2015 |
|-------------------------|-------------------|-------------------|
| Segment assets * | | |
| Workforce | \$ 85,937 | \$ 82,375 |
| Patient Experience | 37,245 | 34,902 |
| Provider | 101,251 | 100,948 |
| Unallocated | 152,750 | 161,344 |
| Total assets | <u>\$ 377,183</u> | <u>\$ 379,569</u> |

* 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.

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

9. DEBT

Revolving Credit Facility

The Company maintains a Loan Agreement (the “Revolving Credit Facility”) with SunTrust Bank (“SunTrust”) in the aggregate principal amount of \$50.0 million, which matures on November 24, 2017. Under the Revolving Credit Facility, the Company may borrow up to \$50.0 million, which includes a \$5.0 million swing line subfacility and a \$5.0 million letter of credit subfacility, as well as an accordion feature that allows the Company to increase the Revolving Credit Facility by a total of up to \$25.0 million, subject to securing additional commitments from existing lenders or new lending institutions. The obligations under the Revolving Credit Facility are guaranteed by each of the Company’s subsidiaries. At the Company’s election, the borrowings under the Revolving Credit Facility bear interest at either (1) a rate per annum equal to the highest of SunTrust’s prime rate or 0.5% in excess of the Federal Funds Rate or 1.0% in excess of one-month LIBOR (the “Base Rate”), plus an applicable margin, or (2) the one, two, three, or six-month per annum LIBOR for deposits in the applicable currency (the “Eurocurrency Rate”), as selected by the Company, plus an applicable margin. The applicable margin for Eurocurrency Rate loans depends on the Company’s funded debt leverage ratio and varies from 1.50% to 2.00%. The applicable margin for Base Rate loans depends on the Company’s funded debt leverage ratio and varies from 0.50% to 1.50%. Commitment fees and letter of credit fees are also payable under the Revolving Credit Facility. Principal is payable in full at maturity on November 24, 2017, and there are no scheduled principal payments prior to maturity. The Company is required to pay a commitment fee ranging between 20 and 30 basis points per annum of the average daily unused portion of the Revolving Credit Facility, depending on the Company’s funded debt leverage ratio.

The purpose of the Revolving Credit Facility is for general working capital needs, permitted acquisitions (as defined in the Loan Agreement), and for stock repurchase and/or redemption transactions that the Company may authorize.

The Revolving Credit Facility contains certain covenants that, among other things, restrict additional indebtedness, liens and encumbrances, changes to the character of the Company’s business, acquisitions, asset dispositions, mergers and consolidations, sale or discount of receivables, creation or acquisitions of additional subsidiaries, and other matters customarily restricted in such agreements.

In addition, the Revolving Credit Facility requires the Company to meet certain financial tests, including, without limitation:

- a funded debt leverage ratio (consolidated debt/consolidated EBITDA) of not greater than 3.0 to 1.0; and
- an interest coverage ratio (consolidated EBITDA/consolidated interest expense) of not less than 3.0 to 1.0.

As of June 30, 2016, the Company was in material compliance with all covenants. There were no balances outstanding on the Revolving Credit Facility as of or during the six months ended June 30, 2016. During the three months ended June 30, 2015, the Company repaid approximately \$28.0 million of balances previously outstanding under the Revolving Credit Facility from proceeds received in the Company’s public offering of 3,869,750 shares which closed on May 28, 2015.

10. RELATED PARTY TRANSACTIONS

During the three months ended June 30, 2015, the Company’s CEO, Robert A. Frist, Jr., entered into an agreement with the Company pursuant to which he contributed 54,241 of his personally owned shares of HealthStream, Inc. common stock to the Company, without any consideration paid to him. In connection with this contribution, the Company approved the grant of 49,310 shares of common stock to over 600 employees, with a fair market value of approximately \$1.5 million. Mr. Frist contributed 4,931 of the contributed shares noted above to take into account the estimated Company costs, such as administrative expenses and employer payroll taxes associated with the grants. (See Note 4 Stock Based Compensation).

11. SUBSEQUENT EVENTS

On July 25, 2016, the Company purchased 68% of the outstanding stock of Nursing Registry Consultant Corporation (“Nurse Competency”) for approximately \$1.0 million in cash and up to an additional \$75,000 in contingent consideration. The contingent consideration is subject to the achievement of certain performance milestones during the 24-month period following the closing. The Company held a 32% minority equity interest in Nurse Competency as of the period ended June 30, 2016 and accounted for such interest as an equity method investment. Nurse Competency is a wholly-owned subsidiary of the Company following such acquisition and its results of operations will be reflected in the HealthStream Workforce Solutions segment beginning on the noted date of acquisition. Nurse Competency provides SaaS-based clinical assessment and testing products to the healthcare industry.

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, 2015, appearing in our Annual Report on Form 10-K that was filed with the Securities and Exchange Commission ("SEC") on February 26, 2016 (the "2015 Form 10-K"). Statements contained in this Quarterly Report on Form 10-Q that are not historical facts 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," "plans," "potential," "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" and other disclosures in our 2015 Form 10-K and the information regarding forward-looking statements and other disclosures in our earnings releases, and other filings with the Securities and Exchange Commission from time to time, as well as other cautionary statements contained elsewhere in this Quarterly 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 our current expectations.

Overview

HealthStream provides workforce, patient experience, and provider 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 products are used by healthcare organizations to meet a broad range of their training, certification, competency assessment, performance appraisal, and development needs. Our 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. Our provider products are used by healthcare organizations for their provider credentialing, privileging, call center, and enrollment needs. HealthStream's customers include healthcare organizations, pharmaceutical and medical device companies, and other participants in the healthcare industry.

Key financial indicators for the second quarter of 2016 include:

- Revenues of \$54.8 million in the second quarter of 2016, up 5% from \$52.1 million in the second quarter of 2015
- Operating income of \$2.3 million in the second quarter of 2016, down 10% from \$2.6 million in the second quarter of 2015
- Net income of \$1.4 million in the second quarter of 2016, down 5% from \$1.5 million in the second quarter of 2015, and earnings per share ("EPS") of \$0.04 per share (diluted) in the second quarter of 2016, compared to \$0.05 per share (diluted) in the second quarter of 2015
- Adjusted EBITDA⁽¹⁾ of \$7.9 million in the second quarter of 2016, down 10% from \$8.8 million in the second quarter of 2015

⁽¹⁾ Adjusted EBITDA is a non-GAAP financial measure. A reconciliation of adjusted EBITDA to net income, and disclosure regarding why we believe Adjusted EBITDA provides useful information to investors is included later in this Quarterly Report.

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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 2015 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 2015 Form 10-K. In addition, see Note 7 Business Combinations in this Quarterly Report on Form 10-Q for information regarding the goodwill measurement period adjustment recorded by the Company during the three months ended March 31, 2016 in connection with an outstanding tax indemnification claim under the HLS purchase agreement and the potential impact to the Company's results of operations at such time that the claim is agreed upon in accordance with the purchase agreement.

Three Months Ended June 30, 2016 Compared to Three Months Ended June 30, 2015

Revenues, net. Revenues increased approximately \$2.7 million, or 5%, to \$54.8 million for the three months ended June 30, 2016 from \$52.1 million for the three months ended June 30, 2015. A comparison of revenues by business segment is as follows (in thousands):

| | Three Months Ended June 30, | | Percentage Change |
|--------------------------------------|-----------------------------|-----------------|-------------------|
| | 2016 | 2015 | |
| Revenues by Business Segment: | | | |
| Workforce | \$40,157 | \$39,803 | 1% |
| Patient Experience | 8,968 | 8,766 | 2% |
| Provider | 5,668 | 3,576 | 59% |
| Total revenues, net | <u>\$54,793</u> | <u>\$52,145</u> | 5% |
| % of Revenues | | | |
| Workforce | 73% | 76% | |
| Patient Experience | 17% | 17% | |
| Provider | 10% | 7% | |

Revenues for HealthStream Workforce Solutions increased approximately \$354,000, or 1%, over the second quarter of 2015. Revenues from our subscription-based workforce products increased approximately \$530,000, or 1%, over the prior year second quarter. Revenues for the second quarter of 2016 were negatively impacted by a decline in ICD-10 readiness revenues. Revenues from ICD-10 readiness products declined by \$4.6 million to \$2.2 million in the second quarter of 2016 compared to \$6.8 million in the prior year second quarter. The requirement mandated by CMS for healthcare organizations to transition to the ICD-10 coding system was effective in October 2015, and generated significant demand for our ICD-10 readiness training courseware from 2012 through 2015. However, as a result of the effectiveness of such mandate in October 2015, sales of that product have ceased and there will not be renewals of the specific ICD-10 readiness product. Accordingly, revenues and operating income contributions from this product will continue to significantly decline during 2016. In addition, revenues for the second quarter of 2016 were positively impacted by growth in our courseware subscriptions and our enterprise applications. Our Workforce Solutions annualized revenue per implemented subscriber metric was \$35.70 per subscriber for the second quarter of 2016 compared to \$35.35 per subscriber for the second quarter of 2015. Our implemented subscriber base decreased by less than one percent compared to the prior year second quarter to 4.34 million implemented subscribers at June 30, 2016 compared to 4.37 million implemented subscribers at June 30, 2015. Additionally, total subscribers increased by less than one percent over the prior year second quarter, with 4.51 million total subscribers at June 30, 2016 compared to 4.49 million total subscribers at June 30, 2015.

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Revenues for HealthStream Patient Experience Solutions increased approximately \$201,000, or 2%, over the second quarter of 2015. Revenues from Patient Insights™ surveys, our survey research product that generates recurring revenues, increased by \$105,000, or 2%, over the prior year second quarter. Revenues from other products, including surveys conducted on annual or bi-annual cycles and consulting/coaching services, collectively increased by \$96,000, or 14%, over the prior year second quarter.

Revenues for HealthStream Provider Solutions increased approximately \$2.1 million, or 59%, over the second quarter of 2015. Revenues from the HLS acquisition, which was consummated on March 16, 2015, accounted for the majority of the increase in revenues during the second quarter of 2016.

Cost of Revenues (excluding depreciation and amortization). Cost of revenues increased approximately \$190,000, or 1%, to \$22.6 million for the three months ended June 30, 2016 from \$22.4 million for the three months ended June 30, 2015. Cost of revenues as a percentage of revenues was approximately 41% of revenues for the three months ended June 30, 2016 compared to approximately 43% of revenues for the three months ended June 30, 2015. Cost of revenues for HealthStream Workforce Solutions increased approximately \$70,000 to \$15.6 million and approximated 39% of revenues for HealthStream Workforce Solutions for both the three months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily associated with increased royalties paid by us resulting from growth in courseware subscription revenues, and increased hosting and personnel costs. These expense increases were partially offset by lower stock based compensation. Cost of revenues for HealthStream Patient Experience Solutions decreased approximately \$157,000 to \$5.7 million and approximated 64% and 67% of revenues for HealthStream Patient Experience Solutions for the three months ended June 30, 2016 and 2015, respectively. The decrease in both amount and as a percentage of revenues is primarily the result of lower stock based compensation, but was partially offset by increased personnel costs associated with growth in survey volumes. Cost of revenues for HealthStream Provider Solutions increased approximately \$276,000, or 27%, to \$1.3 million and approximated 23% and 29% of HealthStream Provider Solutions revenues for the three months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily the result of increased personnel expenses.

Product Development. Product development expenses increased approximately \$1.4 million, or 25%, to \$7.2 million for the three months ended June 30, 2016 from \$5.8 million for the three months ended June 30, 2015. Product development expenses as a percentage of revenues were approximately 13% and 11% of revenues for the three months ended June 30, 2016 and 2015, respectively.

Product development expenses for HealthStream Workforce Solutions increased approximately \$277,000 and approximated 13% and 12% of revenues for HealthStream Workforce Solutions for the three months ended June 30, 2016 and 2015, respectively. The increase in both amount and as a percentage of revenues resulted from additional personnel expenses associated with new product development initiatives for our subscription-based products, but was partially offset by lower stock based compensation. Product development expenses for HealthStream Patient Experience Solutions increased approximately \$920,000 and approximated 15% and 4% of revenues for HealthStream Patient Experience Solutions for the three months ended June 30, 2016 and 2015. The increase in both amount and as a percentage of revenues resulted from additional personnel expenses associated with new product development initiatives. Product development expenses for HealthStream Provider Solutions increased approximately \$233,000 and approximated 14% and 15% of revenues for HealthStream Provider Solutions for the three months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily the result of increased personnel costs associated with new product development initiatives.

Sales and Marketing. Sales and marketing expenses, including personnel costs, decreased approximately \$1.3 million, or 13%, to \$9.0 million for the three months ended June 30, 2016 from \$10.3 million for the three months ended June 30, 2015. Sales and marketing expenses were approximately 16% and 20% of revenues for the three months ended June 30, 2016 and 2015, respectively.

Sales and marketing expenses for HealthStream Workforce Solutions decreased approximately \$1.4 million and approximated 17% and 20% of revenues for HealthStream Workforce Solutions for the three months ended June 30, 2016 and 2015, respectively. The decrease in both amount and as a percentage of revenues is primarily due to lower expenses associated with our annual customer Summit and sales commissions. Our annual customer Summit was held during the second quarter of 2015, but will be held during the fourth quarter of 2016. Sales and marketing expenses for HealthStream Patient Experience Solutions decreased approximately \$79,000, and approximated 12% and 13% of revenues for HealthStream Patient Experience Solutions for the three months ended June 30, 2016 and 2015, respectively. The decrease in both amount and as a percentage of revenues is due to lower personnel costs and stock based compensation. Sales and marketing expenses for HealthStream Provider Solutions increased by approximately \$10,000, and approximated 18% and 29% of revenues for HealthStream Provider Solutions for the three months ended June 30, 2016 and 2015, respectively.

Other General and Administrative Expenses. Other general and administrative expenses increased approximately \$1.7 million, or 26%, to \$8.5 million for the three months ended June 30, 2016 from \$6.8 million for the three months ended June 30, 2015. Other general and administrative expenses as a percentage of revenues were approximately 16% and 13% of revenues for the three months ended June 30, 2016 and 2015, respectively.

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Other general and administrative expenses for HealthStream Workforce Solutions increased approximately \$455,000 over the prior year second quarter as the result of increased technology infrastructure investments. Other general and administrative expenses for HealthStream Patient Experience Solutions increased approximately \$197,000 over the prior year second quarter due to additional personnel and facility costs. Other general and administrative expenses for HealthStream Provider Solutions increased approximately \$215,000 over the prior year second quarter due to higher facility costs and stock based compensation. The unallocated corporate portion of other general and administrative expenses increased approximately \$912,000 over the prior year second quarter. During the second quarter of 2016, we incurred approximately \$300,000 of expenses associated with the ongoing evaluation of business development opportunities, including the acquisition of Performance Management Services, Inc. In addition, the second quarter of 2016 included approximately \$300,000 of expenses associated with the implementation of a new financial systems platform, which was substantially completed during the second quarter of 2016.

Depreciation and Amortization. Depreciation and amortization increased approximately \$825,000, or 19%, to \$5.1 million for the three months ended June 30, 2016 from \$4.3 million for the three months ended June 30, 2015. The increase primarily resulted from amortization of capitalized software development and depreciation expense associated with capital expenditures.

Other Income (Expense), Net. Other income (expense), net was income of approximately \$109,000 for the three months ended June 30, 2016 compared to expense of \$44,000 for the three months ended June 30, 2015. The increase is primarily associated with interest income from investments in marketable securities and lower interest expense.

Income Tax Provision. The Company recorded a provision for income taxes of approximately \$1.0 million for both the three months ended June 30, 2016 and 2015, respectively. The Company's effective tax rate was approximately 42% for both the three months ended June 30, 2016 and 2015, respectively.

Net Income. Net income decreased approximately \$70,000, or 5%, to \$1.4 million for the three months ended June 30, 2016 from \$1.5 million for the three months ended June 30, 2015. Earnings per diluted share were \$0.04 and \$0.05 per share for the three months ended June 30, 2016 and 2015, respectively.

Adjusted EBITDA (which we define as net income before interest, income taxes, stock based compensation, and depreciation and amortization) decreased approximately 10% to approximately \$7.9 million for the three months ended June 30, 2016 compared to \$8.8 million for the three months ended June 30, 2015. This decrease resulted from the factors mentioned above. See Reconciliation of Non-GAAP Financial Measures below for our reconciliation of this calculation to measures under US GAAP.

Six Months Ended June 30, 2016 Compared to Six Months Ended June 30, 2015

Revenues, net. Revenues increased approximately \$9.6 million, or 10%, to \$108.9 million for the six months ended June 30, 2016 from \$99.3 million for the six months ended June 30, 2015. A comparison of revenues by business segment is as follows (in thousands):

| | Six Months Ended June 30, | | |
|--------------------------------------|---------------------------|-----------------|-------------------|
| | 2016 | 2015 | Percentage Change |
| Revenues by Business Segment: | | | |
| Workforce | \$ 81,474 | \$77,396 | 5% |
| Patient Experience | 16,931 | 16,753 | 1% |
| Provider | 10,466 | 5,152 | 103% |
| Total revenues, net | <u>\$108,871</u> | <u>\$99,301</u> | 10% |
| % of Revenues | | | |
| Workforce | 75% | 78% | |
| Patient Experience | 16% | 17% | |
| Provider | 9% | 5% | |

Revenues for HealthStream Workforce Solutions, which are primarily subscription-based, increased approximately \$4.1 million, or 5%, over the first six months of 2015. Revenues in 2016 were positively influenced by growth in courseware subscriptions and our enterprise applications, but were partially offset by an expected decline in ICD-10 readiness revenues. Revenues from ICD-10 readiness products declined by \$7.8 million to \$6.1 million in the first six months of 2016 compared to \$13.9 million in the first six months of 2015.

Revenues for HealthStream Patient Experience Solutions increased approximately \$179,000, or 1%, over the first six months of 2015. Revenues from Patient Insights™ surveys, our survey research product that generates recurring revenues, increased by approximately \$357,000, or 2%, over the first six months of 2015. Revenues from other products, including surveys conducted on annual or bi-annual cycles and consulting/coaching services, collectively decreased by \$178,000 compared to the first six months of 2015 due to fewer engagements.

Revenues for HealthStream Provider Solutions increased approximately \$5.3 million, or 103%, over the first six months of 2015. The increase resulted primarily from the HLS acquisition, which was consummated on March 16, 2015.

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Cost of Revenues (excluding depreciation and amortization). Cost of revenues increased approximately \$2.9 million, or 7%, to \$45.5 million for the six months ended June 30, 2016 from \$42.6 million for the six months ended June 30, 2015. Cost of revenues as a percentage of revenues was approximately 42% of revenues for the six months ended June 30, 2016 compared to approximately 43% of revenues for the six months ended June 30, 2015. Cost of revenues for HealthStream Workforce Solutions increased approximately \$1.8 million to \$31.9 million and approximated 39% of revenues for HealthStream Workforce Solutions for both the six months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily associated with increased royalties paid by us resulting from growth in courseware subscription revenues. Cost of revenues for HealthStream Patient Experience Solutions increased approximately \$60,000 to \$11.2 million and approximated 66% and 67% of revenues for HealthStream Patient Experience Solutions for the six months ended June 30, 2016 and 2015, respectively. Cost of revenues for HealthStream Provider Solutions increased approximately \$1.1 million, or 79%, to \$2.5 million and approximated 23% and 27% of HealthStream Provider Solutions revenues for the six months ended June 30, 2016 and 2015, respectively. The increase in amount of revenue is primarily the result of the HLS acquisition.

Product Development. Product development expenses increased approximately \$3.8 million, or 36%, to \$14.3 million for the six months ended June 30, 2016 from \$10.5 million for the six months ended June 30, 2015. Product development expenses as a percentage of revenues were approximately 13% and 11% of revenues for the six months ended June 30, 2016 and 2015, respectively.

Product development expenses for HealthStream Workforce Solutions increased approximately \$986,000 and approximated 12% of revenues for HealthStream Workforce Solutions for both the six months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily due to additional personnel expenses associated with new product development initiatives for our subscription-based products. Product development expenses for HealthStream Patient Experience Solutions increased approximately \$1.9 million and approximated 15% and 4% of revenues for HealthStream Patient Experience Solutions for the six months ended June 30, 2016 and 2015, respectively. The increase in both amount and as a percentage of revenues is primarily due to additional personnel expenses associated with new product development initiatives. Product development expenses for HealthStream Provider Solutions increased approximately \$924,000 and approximated 16% and 15% of revenues for HealthStream Provider Solutions for the six months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily associated with the HLS acquisition.

Sales and Marketing. Sales and marketing expenses, including personnel costs, decreased approximately \$117,000, or 1%, to \$17.6 million for the six months ended June 30, 2016 from \$17.7 million for the six months ended June 30, 2015. Sales and marketing expenses were approximately 16% and 18% of revenues for the six months ended June 30, 2016 and 2015, respectively.

Sales and marketing expenses for HealthStream Workforce Solutions decreased approximately \$583,000 and approximated 16% and 18% of revenues for HealthStream Workforce Solutions for the six months ended June 30, 2016 and 2015, respectively. The decrease is primarily due to a reduction of expenses associated with our annual customer Summit, which was held during the second quarter of 2015, but will be held during the fourth quarter of 2016. Sales and marketing expenses for HealthStream Patient Experience Solutions decreased approximately \$374,000, and approximated 12% and 14% of revenues for HealthStream Patient Experience Solutions for the six months ended June 30, 2016 and 2015, respectively. The decrease in amount and as a percentage of revenues is primarily due to a decrease in personnel costs. Sales and marketing expenses for HealthStream Provider Solutions increased approximately \$565,000, and approximated 19% and 28% of revenues for HealthStream Provider Solutions for the six months ended June 30, 2016 and 2015, respectively. The increase in amount is primarily associated with the HLS acquisition.

Other General and Administrative Expenses. Other general and administrative expenses increased approximately \$2.8 million, or 21%, to \$16.5 million for the six months ended June 30, 2016 from \$13.7 million for the six months ended June 30, 2015. Other general and administrative expenses as a percentage of revenues were approximately 15% and 14% of revenues for the six months ended June 30, 2016 and 2015, respectively.

Other general and administrative expenses for HealthStream Workforce Solutions increased approximately \$788,000 over the first six months of 2015, primarily as the result of increased technology infrastructure investments. Other general and administrative expenses for HealthStream Patient Experience Solutions increased approximately \$262,000 over the first six months of 2016 primarily due to increased facilities costs and personnel costs. Other general and administrative expenses for HealthStream Provider Solutions increased approximately \$811,000 over the first six months of 2015 primarily associated with the HLS acquisition. The unallocated corporate portion of other general and administrative expenses increased approximately \$957,000 over the first six months of 2015, of which approximately \$600,000 of the increase was associated with the implementation of the new financial systems platform, which was substantially completed during the second quarter.

Depreciation and Amortization. Depreciation and amortization increased approximately \$2.7 million, or 36%, to \$10.2 million for the six months ended June 30, 2016 from \$7.5 million for the six months ended June 30, 2015. The increase primarily resulted from amortization of capitalized software development, amortization of intangible assets from acquisitions (including amortization of software acquired for resale), and depreciation expense associated with capital expenditures.

Other Income (Expense), Net. Other income (expense), net was income of approximately \$127,000 for the six months ended June 30, 2016 compared to net expense of \$35,000 for the six months ended June 30, 2015. The increase is primarily associated with interest income from investments in marketable securities and lower interest expense.

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Income Tax Provision. The Company recorded a provision for income taxes of approximately \$2.0 million for the six months ended June 30, 2016 compared to \$3.1 million for the six months ended June 30, 2015. The Company's effective tax rate was approximately 41% for the six months ended June 30, 2016 compared to approximately 43% for the six months ended June 30, 2015. The reduction in the effective tax rate is primarily associated with research and development tax credits.

Net Income. Net income decreased approximately \$1.3 million, or 31%, to \$2.9 million for the six months ended June 30, 2016 compared to \$4.2 million for the six months ended June 30, 2015. Earnings per diluted share were \$0.09 per share and \$0.15 per share for the six months ended June 30, 2016 and 2015, respectively.

Adjusted EBITDA (which we define as net income before interest, income taxes, stock based compensation, and depreciation and amortization) decreased approximately 7% to approximately \$15.9 million for the six months ended June 30, 2016 compared to \$17.2 million for the six months ended June 30, 2015. This decrease resulted from 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, and adjusted EBITDA, which are used by management in analyzing its 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 and provides useful information to investors because adjusted EBITDA reflects net income adjusted for certain non-cash and non-operating items. We believe that 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.

In recent years, including the March 2015 acquisition of HLS, the Company has acquired businesses whose net tangible assets include deferred revenue. In accordance with GAAP reporting requirements, following the completion of any such acquisition, the Company may record a write down of deferred revenue to fair value as defined in GAAP. If the Company is required to record a write-down of deferred revenue, it may result in lower recognized revenue, operating income and net income in subsequent periods.

In connection therewith, this report presents below non-GAAP operating income and non-GAAP net income, which in each such case reflects the corresponding GAAP figures adjusted to exclude the impact of the deferred revenue write-down associated with fair value accounting for acquired businesses as referenced above. Management believes that the presentation of these non-GAAP financial measures assists investors in understanding the Company's performance between periods by excluding the impact of this deferred revenue write-down and provides a useful measure of the ongoing performance of the Company. Both on a quarterly and year-to-date basis, the revenue for the acquired business is deferred and typically recognized over a one-to-two year period following the completion of any particular acquisition, so our GAAP operating income and net income for this one-to-two year period will not reflect the full amount that would have been reported if the acquired deferred revenue was not written down to fair value. A reconciliation of these non-GAAP financial measures to the corresponding GAAP measures is set forth below.

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------------|------------------------------|------------------|
| | 2016 | 2015 | 2016 | 2015 |
| GAAP net income | \$ 1,403 | \$ 1,473 | \$ 2,903 | \$ 4,195 |
| Interest income | (167) | (54) | (265) | (109) |
| Interest expense | 25 | 93 | 51 | 137 |
| Income tax provision | 1,022 | 1,047 | 2,026 | 3,124 |
| Stock based compensation expense | 505 | 1,938 | 1,004 | 2,347 |
| Depreciation and amortization | 5,081 | 4,256 | 10,221 | 7,509 |
| Adjusted EBITDA | <u>\$ 7,869</u> | <u>\$ 8,753</u> | <u>\$ 15,940</u> | <u>\$ 17,203</u> |
| GAAP operating income | \$ 2,316 | \$ 2,564 | \$ 4,802 | \$ 7,354 |
| Adjustment for deferred revenue write-down | 439 | 2,663 | 1,394 | 3,241 |
| Non-GAAP operating income | <u>\$ 2,755</u> | <u>\$ 5,227</u> | <u>\$ 6,196</u> | <u>\$ 10,595</u> |
| GAAP net income | \$ 1,403 | \$ 1,473 | \$ 2,903 | \$ 4,195 |
| Adjustment for deferred revenue write-down, net of tax | 254 | 1,555 | 822 | 1,857 |
| Non-GAAP net income | <u>\$ 1,657</u> | <u>\$ 3,028</u> | <u>\$ 3,725</u> | <u>\$ 6,052</u> |

Liquidity and Capital Resources

Net cash provided by operating activities was approximately \$285,000 and \$19.1 million during the six months ended June 30, 2016 and 2015, respectively. The decrease in cash flows from operating activities was significantly impacted by increases in accounts receivable, resulting from slower collections during the second quarter of 2016, as well as reductions in deferred revenue balances compared to the prior year period. Slower collections from customers was partially due to the implementation of a new financial systems platform during the second quarter of 2016. The number of days sales outstanding (“DSO”) was 62 days for the second quarter of 2016 compared to 60 days for the second quarter of 2015. The Company calculates DSO by dividing the average accounts receivable balance for the quarter by average daily revenues for the quarter. The Company’s primary sources of cash were receipts generated from the sales of our products and services. The primary uses of cash to fund operations included personnel expenses, sales commissions, royalty payments, payments for contract labor and other direct expenses associated with delivery of our products and services, and general corporate expenses.

Net cash used in investing activities was approximately \$15.3 million and \$143.5 million for the six months ended June 30, 2016 and 2015, respectively. During 2016, the Company utilized \$3.1 million (net of cash acquired) for acquisitions, purchased \$71.2 million of marketable securities, purchased \$3.2 million of property and equipment, and spent \$4.3 million for capitalized software development. These uses of cash were partially offset by maturities of marketable securities of \$65.6 million and the sale of long-lived assets of \$975,000. During 2015, the Company utilized \$88.1 million (net of cash acquired) for acquisitions, purchased \$76.8 million of marketable securities, purchased \$4.1 million of property and equipment, spent \$3.6 million for capitalized software development, and made \$1.0 million in non-marketable equity investments. These uses of cash were partially offset by maturities of marketable securities of \$29.9 million

Cash used in financing activities was approximately \$208,000 for the six months ended June 30, 2016 compared to cash provided by financing activities of approximately \$96.9 million for the six months ended June 30, 2015, respectively. The sole source of cash from financing activities for 2016 resulted from \$94,000 of proceeds from the exercise of employee stock options. The primary use of cash during 2016 related to payments of payroll taxes from stock based compensation arrangements of \$302,000. The primary sources of cash from financing activities for 2015 resulted from \$98.0 million in proceeds from the issuance of 3.9 million shares of our common stock in our underwritten public offering that was completed on May 28, 2015, and \$277,000 of proceeds from the exercise of employee stock options. The primary uses of cash during 2015 related to payments of payroll taxes from stock based compensation arrangements of \$748,000, and earn-outs for prior business combinations of \$628,000.

Our balance sheet reflects positive working capital of \$122.8 million at June 30, 2016 compared to \$120.4 million at December 31, 2015. The Company’s primary source of liquidity is \$138.8 million of cash and cash equivalents and marketable securities. The Company also has a \$50.0 million revolving credit facility, all of which was available for additional borrowing at June 30, 2016.

We believe that our existing cash and cash equivalents, marketable securities, cash generated from operations, and available borrowings under our revolving credit facility will be sufficient to meet anticipated cash needs for working capital, new product development and capital expenditures for at least the next 12 months. Over the past ten years, we have utilized our federal and state net operating loss carryforwards to offset taxable income, therefore reducing our tax liabilities. The federal net operating loss carryforwards have been fully utilized as of December 31, 2015; therefore, actual income tax payments are expected to increase significantly in the future and will more closely approximate the provision for income taxes.

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The Company's growth strategy includes acquiring businesses that provide complementary products and services. It is anticipated that future acquisitions, if any, would be effected through cash consideration, stock consideration or a combination of both. The issuance of our stock as consideration for an acquisition or to raise additional capital could have a dilutive effect on earnings per share and could adversely affect our stock price. Our revolving credit facility contains financial covenants and availability calculations designed to set a maximum leverage ratio of outstanding debt to adjusted EBITDA and an interest coverage ratio of adjusted EBITDA to interest expense. Therefore, the maximum borrowings against our revolving credit facility would be dependent on the covenant values at the time of borrowing. As of June 30, 2016, we were in material compliance with all covenants. There can be no assurance that amounts available for borrowing under our revolving credit facility will be sufficient to consummate any possible acquisitions, and we cannot assure you that if we need additional financing that it will be available on terms favorable to us, or at all. Failure to generate sufficient cash flow from operations or raise additional capital when required in sufficient amounts and on terms acceptable to us could harm our business, financial condition and results of operations.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

The Company is exposed to market risk from changes in interest rates. We do not have any foreign currency exchange rate risk or commodity price risk. There were no balances outstanding on the Revolving Credit Facility as of or during the six months ended June 30, 2016. We are subject to interest rate market risk associated with any borrowings under our revolving credit facility. The interest rate under the revolving credit facility varies depending on the interest rate option selected by the Company plus a margin determined in accordance with a pricing grid. We are also exposed to market risk with respect to our cash and investment balances, which approximated \$138.8 million at June 30, 2016. Assuming a hypothetical 10% decrease in interest rates for invested balances, interest income from cash and investments would decrease on an annualized basis by approximately \$91,000.

The Company's investment policy and strategy is focused on investing in highly rated securities, with the objective of minimizing the potential risk of principal loss. The Company's policy limits the amount of credit exposure to any single issuer and sets limits on the average portfolio maturity.

The above market risk discussion and the estimated amounts presented are forward-looking statements of market risk assuming the occurrence of certain adverse market conditions. Actual results in the future may differ materially from those projected as a result of actual developments in the market.

Item 4. *Controls and Procedures*

Changes in Internal Control Over Financial Reporting

The Company began using a new enterprise accounting system in the second quarter of 2016. The implementation of the new accounting system required the Company to modify various internal controls and processes. There have been no other changes in the Company's internal control over financial reporting that occurred during the period covered by this Quarterly Report that have materially affected, or are likely to materially effect, the Company's internal control over financial reporting.

Evaluation of Controls and Procedures

HealthStream's chief executive officer and principal financial officer have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this Quarterly Report. Based on that evaluation, the chief executive officer and principal financial officer have concluded that HealthStream's disclosure controls and procedures were effective to ensure that the information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and the information required to be disclosed in the reports the Company files or submits under the Exchange Act was accumulated and communicated to the Company's management, including its chief executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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PART II - OTHER INFORMATION

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds.*

On February 16, 2016, the Company announced a share repurchase program authorized by the Company's Board of Directors under which the Company may purchase up to \$25,000,000 of its common stock. The share repurchase program will terminate on the earlier of December 31, 2016 or when the maximum dollar amount has been expended. The table below sets forth activity under the stock repurchase plan for the three months ended June 30, 2016.

| <u>Period</u> | <u>(a)</u> <u>Total number of</u> <u>shares (or units)</u> <u>purchased (1)</u> | <u>(b)</u> <u>Average price</u> <u>paid per share</u> <u>(or unit)</u> | <u>(c)</u> <u>Total number of</u> <u>shares (or units)</u> <u>purchased as part of</u> <u>publicly announced</u> <u>plans or programs</u> | <u>(d)</u> <u>Maximum number (or</u> <u>approximate dollar</u> <u>value) of shares (or</u> <u>units) that may yet be</u> <u>purchased under the</u> <u>plans or programs</u> |
|-------------------------------|--|---|--|--|
| Month #1 (April 1 – April 30) | — | — | — | 25,000,000 |
| Month #2 (May 1 – May 31) | — | — | — | 25,000,000 |
| Month #3 (June 1 – June 30) | — | — | — | 25,000,000 |
| Total | — | \$ — | — | \$ 25,000,000 |

Item 6. *Exhibits*

- (a) Exhibits
- 10.1(1) ^ – HealthStream, Inc. 2016 Omnibus Incentive Plan
 - 31.1 – Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
 - 31.2 – Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
 - 32.1 – Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - 32.2 – Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
 - 101.1 INS – XBRL Instance Document
 - 101.1 SCH – XBRL Taxonomy Extension Schema
 - 101.1 CAL – XBRL Taxonomy Extension Calculation Linkbase
 - 101.1 DEF – XBRL Taxonomy Extension Definition Linkbase
 - 101.1 LAB – XBRL Taxonomy Extension Label Linkbase
 - 101.1 PRE – XBRL Taxonomy Extension Presentation Linkbase

(1) Incorporated by reference from exhibit 10.1 filed on our Current Report on Form 8-K dated May 31, 2016.

^ Management contract or compensatory plan or arrangement.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

August 1, 2016

HEALTHSTREAM, INC.

By: /s/ Gerard M. Hayden, Jr.

Gerard M. Hayden, Jr.
Chief Financial Officer

HEALTHSTREAM, INC.

EXHIBIT INDEX

| | |
|-----------------------|--|
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⁽¹⁾ Incorporated by reference from exhibit 10.1 filed on our Current Report on Form 8-K dated May 31, 2016.

^ Management contract or compensatory plan or arrangement.

Exhibit 31.1

I, Robert A. Frist, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of HealthStream, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2016

/s/ Robert A. Frist, Jr.
Robert A. Frist, Jr.
Chief Executive Officer

Exhibit 31.2

I, Gerard M. Hayden, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of HealthStream, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2016

/s/ Gerard M. Hayden, Jr.
Gerard M. Hayden, Jr.
Chief Financial Officer

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of HealthStream, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Robert A. Frist, Jr., Chief Executive Officer of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert A. Frist, Jr.

Robert A. Frist, Jr.
Chief Executive Officer

August 1, 2016

Exhibit 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of HealthStream, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Gerard M. Hayden, Jr., Chief Financial Officer of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gerard M. Hayden, Jr.

Gerard M. Hayden, Jr.
Chief Financial Officer

August 1, 2016

