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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

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)

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

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

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

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

As of October 22, 2012, there were 26,224,619 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

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

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 23,703	\$ 76,904
Marketable securities – short-term	72,232	6,552
Accounts receivable, net of allowance for doubtful accounts of \$124 and \$149 at September 30, 2012 and December 31, 2011, respectively	15,766	16,014
Accounts receivable - unbilled	1,224	1,316
Deferred tax assets, current	1,013	5,080
Prepaid royalties, net of amortization	1,841	3,409
Other prepaid expenses and other current assets	2,163	1,804
Total current assets	117,942	111,079
Property and equipment:		
Equipment	17,480	16,362
Leasehold improvements	4,997	4,170
Furniture and fixtures	3,195	2,545
	25,672	23,077
Less accumulated depreciation and amortization	(18,275)	(16,990)
	7,397	6,087
Marketable securities – long-term	—	5,996
Capitalized software development, net of accumulated amortization of \$10,320 and \$8,344 at September 30, 2012 and December 31, 2011, respectively	9,061	7,940
Goodwill	24,110	21,147
Intangible assets, net of accumulated amortization of \$9,633 and \$8,930 at September 30, 2012 and December 31, 2011, respectively	2,723	1,957
Other assets	625	31
Total assets	<u>\$ 161,858</u>	<u>\$ 154,237</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 555	\$ 2,585
Accrued liabilities	5,911	5,492
Accrued compensation and related expenses	740	1,612
Deferred revenue	23,899	22,759
Total current liabilities	31,105	32,448
Deferred tax liabilities, noncurrent	918	323
Other long term liabilities	858	551
Commitments and contingencies	—	—
Shareholders' equity:		
Common stock, no par value, 75,000 shares authorized; 26,190 and 25,896 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	156,612	154,409
Accumulated deficit	(27,663)	(33,487)
Accumulated other comprehensive income (loss)	28	(7)
Total shareholders' equity	128,977	120,915
Total liabilities and shareholders' equity	<u>\$ 161,858</u>	<u>\$ 154,237</u>

See accompanying notes to the condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues, net	\$26,380	\$20,618	\$75,894	\$60,175
Operating costs and expenses:				
Cost of revenues (excluding depreciation and amortization)	10,804	7,915	30,546	22,623
Product development	2,278	1,946	6,328	5,644
Sales and marketing	4,423	3,810	14,637	11,674
Other general and administrative expenses	3,472	2,782	9,491	8,009
Depreciation and amortization	1,672	1,471	4,779	3,868
Total operating costs and expenses	22,649	17,924	65,781	51,818
Income from operations	3,731	2,694	10,113	8,357
Other income (expense), net	42	(8)	87	8
Income before income tax provision	3,773	2,686	10,200	8,365
Income tax provision	1,796	890	4,376	3,213
Net income	<u>\$ 1,977</u>	<u>\$ 1,796</u>	<u>\$ 5,824</u>	<u>\$ 5,152</u>
Earnings per share:				
Basic	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.22</u>	<u>\$ 0.23</u>
Diluted	<u>\$ 0.07</u>	<u>\$ 0.08</u>	<u>\$ 0.21</u>	<u>\$ 0.22</u>
Weighted average shares of common stock outstanding:				
Basic	<u>26,173</u>	<u>22,164</u>	<u>26,100</u>	<u>22,001</u>
Diluted	<u>27,591</u>	<u>23,496</u>	<u>27,476</u>	<u>23,272</u>

See accompanying notes to the condensed consolidated financial statements.

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

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
Net income	\$ 1,977	\$ 1,796	\$ 5,824	\$ 5,152
Other comprehensive income, net of taxes:				
Unrealized gain on marketable securities	25	1	35	5
Total other comprehensive income	25	1	35	5
Comprehensive income	<u>\$ 2,002</u>	<u>\$ 1,797</u>	<u>\$ 5,859</u>	<u>\$ 5,157</u>

See accompanying notes to the condensed consolidated financial statements.

HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)
NINE MONTHS ENDED SEPTEMBER 30, 2012
(In thousands)

	Common Stock		Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
	Shares	Amount			
Balance at December 31, 2011	25,896	\$ 154,409	\$ (33,487)	\$ (7)	\$ 120,915
Net income	—	—	5,824	—	5,824
Other comprehensive income	—	—	—	35	35
Issuance of common stock in acquisition	22	575	—	—	575
Stock based compensation expense	—	837	—	—	837
Exercise of stock options	272	791	—	—	791
Balance at September 30, 2012	<u>26,190</u>	<u>\$ 156,612</u>	<u>\$ (27,663)</u>	<u>\$ 28</u>	<u>\$ 128,977</u>

See accompanying notes to the condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2012	2011
OPERATING ACTIVITIES:		
Net income	\$ 5,824	\$ 5,152
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,779	3,868
Stock based compensation expense	837	597
Deferred income taxes	4,200	2,902
Provision for doubtful accounts	70	45
Changes in operating assets and liabilities, net of acquisition:		
Accounts and unbilled receivables	451	(1,920)
Prepaid royalties	1,568	1,233
Other prepaid expenses and other current assets	(372)	(286)
Other assets	466	243
Accounts payable	(2,031)	(1,073)
Accrued liabilities and accrued compensation and related expenses and other long-term liabilities	(958)	(21)
Deferred revenue	768	3,748
Net cash provided by operating activities	<u>15,602</u>	<u>14,488</u>
INVESTING ACTIVITIES:		
Acquisition, net of cash acquired	(2,904)	—
Proceeds from maturities of investments in marketable securities	35,125	8,130
Proceeds from sales of investments in marketable securities	—	2,221
Purchases of investments in marketable securities	(95,283)	(4,728)
Changes in other investments	(250)	—
Payments associated with capitalized software development	(3,097)	(5,199)
Purchases of property and equipment	(3,185)	(3,560)
Net cash used in investing activities	<u>(69,594)</u>	<u>(3,136)</u>
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	791	1,020
Payments on capital lease obligations	—	(4)
Net cash provided by financing activities	<u>791</u>	<u>1,016</u>
Net (decrease) increase in cash and cash equivalents	(53,201)	12,368
Cash and cash equivalents at beginning of period	76,904	17,868
Cash and cash equivalents at end of period	<u>\$ 23,703</u>	<u>\$ 30,236</u>

See accompanying notes to the 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 nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

The balance sheet at December 31, 2011 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, 2011 (included in the Company’s Annual Report on Form 10-K, filed with the Securities and Exchange Commission on February 28, 2012).

2. INCOME TAXES

Income taxes are accounted for using the asset and liability method, whereby deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and tax bases of assets and liabilities measured at tax rates that will be in effect for the year in which the differences are expected to affect taxable income.

During the nine months ended September 30, 2012 and 2011, the Company recorded a provision for income taxes of \$4.4 million and \$3.2 million, respectively. The Company’s effective tax rate for the nine months ended September 30, 2012 and 2011 was 42.9% and 38.4%, 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. The increase in the Company’s effective tax rate during 2012 was due to several factors, including changes in estimated state apportionment factors, stock based compensation, and other permanent tax differences.

3. STOCK BASED COMPENSATION

The Company maintains two stock incentive plans. The Company accounts for its stock based compensation plans using the fair-value based method for costs related to share-based payments, including stock options and restricted share units. During the nine months ended September 30, 2012, the Company issued 73,150 restricted share units with a weighted average grant date fair value of \$23.13 per share, measured based on the closing fair market value of the Company’s stock on the date of grant. During the nine months ended September 30, 2011, the Company granted 362,750 stock options with a weighted average grant date fair value of \$4.67. The fair value of stock options granted during the nine months ended September 30, 2011 was estimated using the Black Scholes option pricing model, with the assumptions as follows:

	Nine Months Ended September 30, 2011
Risk-free interest rate	1.05 – 2.39%
Expected dividend yield	0.0%
Expected life	5 – 7 years
Expected forfeiture rate	0 – 5%
Volatility	50%

Total stock based compensation expense recorded for the three and nine months ended September 30, 2012 and 2011, which is recorded in the condensed consolidated statements of income, is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Cost of revenues (excluding depreciation and amortization)	\$ 11	\$ 9	\$ 32	\$ 29
Product development	33	34	104	110
Sales and marketing	39	35	116	117
Other general and administrative	213	145	585	341
Total stock based compensation expense	\$ 296	\$ 223	\$ 837	\$ 597

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

4. 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 common and common equivalent shares outstanding during the period. Common equivalent shares, composed of incremental common shares issuable upon the exercise of stock options and restricted share units subject to vesting are included in diluted earnings per share only to the extent these shares are dilutive. Common equivalent shares are dilutive when the average market price during the period exceeds the exercise price of the underlying shares. The total number of common equivalent shares excluded from the calculations of diluted earnings per share, due to their anti-dilutive effect, was approximately 0.1 million for both the three and nine months ended September 30, 2012, respectively, and approximately 0.1 million and 0.3 million for the three and nine months ended September 30, 2011, respectively.

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2012 and 2011 (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income	\$ 1,977	\$ 1,796	\$ 5,824	\$ 5,152
Denominator:				
Weighted-average shares outstanding	26,173	22,164	26,100	22,001
Effect of dilutive shares	1,418	1,332	1,376	1,271
Weighted-average diluted shares	27,591	23,496	27,476	23,272
Basic earnings per share	\$ 0.08	\$ 0.08	\$ 0.22	\$ 0.23
Diluted earnings per share	\$ 0.07	\$ 0.08	\$ 0.21	\$ 0.22

5. MARKETABLE SECURITIES

At September 30, 2012 and December 31, 2011, the fair value of marketable securities, which were all classified as available for sale, included the following (in thousands):

	September 30, 2012			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Level 1:				
Mutual funds	\$ 5,033	\$ 44	\$ —	\$ 5,077
Level 2:				
Certificates of deposit	2,251	—	—	2,251
Municipal debt securities	2,500	—	—	2,500
Corporate debt securities	26,911	3	(21)	26,893
U.S. government securities	35,509	3	(1)	35,511
Subtotal	67,171	6	(22)	67,155
Total	\$ 72,204	\$ 50	\$ (22)	\$ 72,232
	December 31, 2011			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Level 1:				
Mutual funds	\$ 2,504	\$ —	\$ —	\$ 2,504
Level 2:				
Corporate debt securities	2,038	—	(1)	2,037
U.S. government securities	8,013	—	(6)	8,007
Subtotal	10,051	—	(7)	10,044
Total	\$ 12,555	\$ —	\$ (7)	\$ 12,548

The carrying amounts reported in the condensed consolidated balance sheet approximate the fair value based on quoted market prices or alternative pricing sources and models utilizing market observable inputs. As of September 30, 2012, the Company does not consider any of its marketable securities to be other than temporarily impaired.

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

6. BUSINESS COMBINATION

On June 29, 2012, the Company acquired all of the stock of Decision Critical, Inc. (DCI), an Austin, Texas based company that specializes in learning and competency management products for acute-care hospitals. The Company acquired DCI to further advance its suite of talent management solutions. The consideration paid for DCI consisted of approximately \$3.4 million in cash and 22,124 shares of our common stock. Also, the Company may make additional payments of up to \$300,000, contingent upon achievement of certain financial targets and business outcomes. The Company incurred approximately \$165,000 in transaction costs associated with the DCI acquisition. In allocating the purchase price, the Company recorded approximately \$2.9 million of goodwill, \$1.5 million of identifiable intangible assets, \$346,000 of net tangible assets and \$595,000 of deferred tax liabilities. The net tangible assets include deferred revenue, which in accordance with US GAAP, was adjusted down from a book value \$573,000 to an estimated fair value of \$373,000. The deferred revenue recorded represents the estimated fair value of the contractual obligation assumed as of the acquisition date. The \$200,000 write-down of deferred revenue will result in lower revenues than would have otherwise been recognized for such services. The allocation of purchase price is preliminary and may be subject to change within the measurement period of one year from the acquisition date. The primary areas of the preliminary purchase price allocation that are not finalized include the composition and valuation of intangible assets, goodwill and deferred revenue. The results of operations for DCI have been included in the Company's condensed consolidated financial statements from the date of acquisition.

7. BUSINESS SEGMENTS

The Company primarily provides services to healthcare organizations and other members within the healthcare industry. The Company's services are primarily focused on the delivery of education and training products and services (HealthStream Learning), as well as survey and research services (HealthStream Research). The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

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 following is the Company's business segment information as of and for the three and nine months ended September 30, 2012 and 2011 (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues				
Learning	\$20,341	\$14,805	\$57,444	\$42,248
Research	6,039	5,813	18,450	17,927
Total net revenue	<u>\$26,380</u>	<u>\$20,618</u>	<u>\$75,894</u>	<u>\$60,175</u>
Income from operations				
Learning	\$ 6,424	\$ 4,649	\$17,289	\$13,124
Research	430	504	1,625	1,977
Unallocated	<u>(3,123)</u>	<u>(2,459)</u>	<u>(8,801)</u>	<u>(6,744)</u>
Total income from operations	<u>\$ 3,731</u>	<u>\$ 2,694</u>	<u>\$10,113</u>	<u>\$ 8,357</u>
			September 30, 2012	December 31, 2011
Segment assets *				
Learning		\$ 32,274		\$ 27,322
Research		25,162		26,088
Unallocated		<u>104,422</u>		<u>100,827</u>
Total assets		<u>\$ 161,858</u>		<u>\$ 154,237</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.

8. COLLABORATIVE ARRANGEMENT

The Company participates in a collaborative arrangement, SimVentures™, with Laerdal Medical A/S (Laerdal Medical). The Company receives 50 percent of the profits or losses generated from this collaborative arrangement. For the nine months ended September 30, 2012, the Company has recorded approximately \$1.2 million of revenues and \$1.3 million of expenses related to the collaborative arrangement. For the nine months ended September 30, 2011, the Company recorded \$0.5 million of revenues and \$0.9 million of expenses related to the collaborative arrangement. The Company has also recorded approximately \$1.0 million of capitalized software development for SimVentures during 2012.

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

9. CONTENT RIGHTS AND DEFERRED SERVICE CREDITS

During 2012, the Company entered into a renewal agreement with a customer in which the Company was provided continued rights to distribute and resell courseware owned by the customer. In exchange for the receipt of an exclusive license to distribute and resell this courseware, the Company has provided, and will continue to provide, the customer with service credits that can be exchanged for future purchases of the Company's products and services. The value assigned to the content rights and the deferred service credits was \$500,000, which represents the estimated fair value of the assets relinquished. The content rights are classified within other prepaid expenses and other assets, and the deferred service credits are classified within accrued liabilities and other long-term liabilities on our condensed consolidated balance sheets.

These exchangeable service credits will be issued annually through December 31, 2016, and will expire twenty-four months after issuance. Any unused credits will be forfeited upon expiration. During 2012, the Company has issued exchangeable service credits of \$100,000 in accordance with this agreement, and is obligated to issue remaining service credits of \$100,000 annually through 2016. The content rights are being amortized on a straight-line basis through December 31, 2016. Revenues for products or services provided in exchange for these service credits will be recognized in accordance with the Company's revenue recognition policies.

10. SUBSEQUENT EVENT

On October 19, 2012, the Company acquired all of the stock of Sy.Med Development, Inc., (Sy.Med) a Brentwood, Tennessee based company that specializes in credentialing related software products for healthcare providers. The Company acquired Sy.Med to further advance its suite of talent management solutions. The consideration paid for Sy.Med consisted of approximately \$7.1 million in cash and 34,060 shares of our common stock, as well as a working capital adjustment payment of approximately \$180,000. The Company may make additional payments of up to \$1.5 million, contingent upon achievement of certain financial targets and business outcomes over the next two years. The Company does not expect the acquisition of Sy.Med to have a material impact on its consolidated financial statements.

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, 2011, appearing in our Annual Report on Form 10-K that was filed with the Securities and Exchange Commission ("SEC") on February 28, 2012, (the "2011 Form 10-K"). Statements contained in this Quarterly Report on Form 10-Q that are not historical fact are forward-looking statements that the Company intends to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Statements that are predictive in nature, that depend on or refer to future events or conditions, or that include words such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "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" in our 2011 Form 10-K and the information regarding forward-looking statements in our earnings releases, as well as other cautionary statements contained elsewhere in this report, including the matters discussed in "Critical Accounting Policies and Estimates." We undertake no obligation beyond that required by law to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future. You should read this report and the documents that we reference in this report and have filed as exhibits to this report completely and with the understanding that our actual future results may be materially different from what we expect.

Overview

HealthStream provides Internet-based learning and research 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 learning products are used by healthcare organizations to meet a broad range of their training, certification, and development needs, while our research products provide our customers information about patients' experiences, workforce engagement, physician relations, and community perceptions of their services. HealthStream's customers include healthcare organizations, pharmaceutical and medical device companies, and other participants in the healthcare industry.

Key financial indicators for the third quarter of 2012 include:

- Revenues of \$26.4 million in the third quarter of 2012, up 28% from revenues of \$20.6 million in the third quarter of 2011
- Operating income of \$3.7 million in the third quarter of 2012, up 39% from operating income of \$2.7 million in the third quarter of 2011
- Net income of \$2.0 million in the third quarter of 2012, up 10% from net income of \$1.8 million in the third quarter of 2011, and earnings per share (EPS) of \$0.07 per share in the third quarter of 2012, compared to EPS of \$0.08 per share in the third quarter of 2011
- Adjusted EBITDA⁽¹⁾ of \$5.7 million in the third quarter of 2012, up 30% from \$4.4 million in the third quarter of 2011

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

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.

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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
- Accrual for service credits
- 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 2011 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 2011 Form 10-K.

Business Combination

On June 29, 2012, the Company acquired all of the stock of Decision Critical, Inc. (DCI), an Austin, Texas based company that specializes in learning and competency management products for acute-care hospitals. The Company acquired DCI to further advance its suite of talent management solutions. The consideration paid for DCI consisted of approximately \$3.4 million in cash and 22,124 shares of our common stock. Also, the Company may make additional payments of up to \$300,000, contingent upon achievement of certain financial targets and business outcomes. In allocating the purchase price, the Company recorded approximately \$2.9 million of goodwill, \$1.5 million of identifiable intangible assets, \$346,000 of net tangible assets and \$595,000 of deferred tax liabilities. The net tangible assets include deferred revenue, which in accordance with US GAAP, was adjusted down from a book value \$573,000 to an estimated fair value of \$373,000. The deferred revenue recorded represents the estimated fair value of the contractual obligation assumed as of the acquisition date. The \$200,000 write-down of deferred revenue will result in lower revenues than would have otherwise been recognized for such services (See Reconciliation of Non-GAAP Financial Measures in Management's Discussion and Analysis of Financial Condition and Results of Operations for a summary of the deferred revenue write-down impact on the 2012 financial results). The allocation of purchase price is preliminary and may be subject to change within the measurement period of one year from the acquisition date. The primary areas of the preliminary purchase price allocation that are not finalized include the composition and valuation of intangible assets, goodwill and deferred revenue. The results of operations for DCI have been included in the Company's condensed consolidated financial statements from the date of acquisition.

Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011

Revenues, net. Revenues increased approximately \$5.8 million, or 27.9%, to \$26.4 million for the three months ended September 30, 2012 from \$20.6 million for the three months ended September 30, 2011. Revenues for 2012 consisted of \$20.4 million, or 77% of total revenue, for HealthStream Learning and \$6.0 million, or 23% of total revenue, for HealthStream Research. In 2011, revenues consisted of \$14.8 million, or 72% of total revenue, for HealthStream Learning and \$5.8 million, or 28% of total revenue, for HealthStream Research.

Revenues for HealthStream Learning increased \$5.5 million, or 37.4%, over the third quarter of 2011. Revenues from our Internet-based subscription learning products increased by \$4.9 million, or 34.9%, over the prior year third quarter due to a higher number of subscribers and more courseware consumption by subscribers. Our HLC subscriber base increased to 2,869,000 fully-implemented subscribers and 2,975,000 contracted subscribers at September 30, 2012 compared to 2,536,000 fully-implemented subscribers and 2,653,000 contracted subscribers at September 30, 2011. "Contracted subscribers" include both those already implemented (2,869,000 and 2,536,000 at September 30, 2012 and 2011, respectively) and those in the process of implementation (106,000 and 117,000 at September 30, 2012 and 2011, respectively). Revenues from SimVentures, our collaborative arrangement with Laerdal Medical, increased by \$98,000 and approximated \$419,000 during the third quarter of 2012 compared to \$321,000 during the third quarter of 2011. Revenues from project-based services increased by \$503,000 compared to the prior year third quarter.

Revenues for HealthStream Research increased \$227,000, or 3.9%, over the third quarter of 2011. Revenues from Patient Insights™ surveys, our survey research product that generates recurring revenues, increased by \$371,000, or 8.2%, over the prior year third quarter. Revenues from other surveys, which are conducted on annual or bi-annual cycles, declined by \$144,000, or 11.4%, compared to the prior year third quarter due to fewer survey engagements.

Cost of Revenues (excluding depreciation and amortization). Cost of revenues increased approximately \$2.9 million, or 36.5%, to \$10.8 million for the three months ended September 30, 2012 from \$7.9 million for the three months ended September 30, 2011. Cost of revenues as a percentage of revenues was 41.0% of revenues for the three months ended September 30, 2012 compared to 38.4% of revenues for the three months ended September 30, 2011. Cost of revenues for HealthStream Learning increased approximately \$2.7 million to \$7.5 million and approximated 37.0% and 32.5% of revenues for HealthStream Learning for the three months ended September 30, 2012 and 2011, respectively. The increase is primarily associated with increased royalties paid by us resulting from growth in courseware subscription revenues, increased personnel costs, and increased costs associated with project-based services. Cost of revenues for HealthStream Research increased approximately \$164,000 to \$3.3 million and approximated 54.2% and 53.5% of revenues for HealthStream Research for the three months ended September 30, 2012 and 2011, respectively. The increase in amount is primarily the result of additional costs associated with the growth in patient survey volume over the prior year third quarter.

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Product Development. Product development expenses increased approximately \$331,000, or 17.0%, to \$2.3 million for the three months ended September 30, 2012 from \$2.0 million for the three months ended September 30, 2011. Product development expenses as a percentage of revenues were 8.6% and 9.4% of revenues for the three months ended September 30, 2012 and 2011, respectively.

Product development expenses for HealthStream Learning increased approximately \$355,000 and approximated 9.2% and 10.3% of revenues for HealthStream Learning for the three months ended September 30, 2012 and 2011, respectively. The decrease as a percentage of revenue is the result of the growth in revenues over the prior year third quarter, while the increase in amount is due to additional personnel expenses associated with the maintenance of our platform, as well as working on new product development initiatives. Product development expenses for HealthStream Research decreased approximately \$24,000 and approximated 6.7% and 7.3% of revenues for HealthStream Research for the three months ended September 30, 2012 and 2011, respectively.

Sales and Marketing. Sales and marketing expenses, including personnel costs, increased approximately \$613,000, or 16.1%, to \$4.4 million for the three months ended September 30, 2012 from \$3.8 million for the three months ended September 30, 2011. Sales and marketing expenses were 16.8% and 18.5% of revenues for the three months ended September 30, 2012 and 2011, respectively.

Sales and marketing expenses for HealthStream Learning increased \$387,000 and approximated 15.0% and 18.0% of revenues for HealthStream Learning for the three months ended September 30, 2012 and 2011, respectively. This increase in amount was associated with additional personnel and related expenses and increased commissions associated with higher sales performance compared to the prior year. Sales and marketing expenses for HealthStream Research increased approximately \$229,000, and approximated 21.3% and 18.2% of revenues for HealthStream Research for the three months ended September 30, 2012 and 2011, respectively. The expense increase was primarily due to additional personnel and related expenses and increased commissions associated with higher sales performance compared to the prior year.

Other General and Administrative Expenses. Other general and administrative expenses increased approximately \$690,000, or 24.8%, to \$3.5 million for the three months ended September 30, 2012 from \$2.8 million for the three months ended September 30, 2011. Other general and administrative expenses as a percentage of revenues were 13.2% and 13.5% of revenues for the three months ended September 30, 2012 and 2011, respectively.

Other general and administrative expenses for HealthStream Learning increased \$200,000 over the prior year third quarter primarily due to employee recruiting costs and other support costs, while other general and administrative expenses for HealthStream Research decreased \$67,000 compared to the prior year third quarter primarily due to lower personnel costs. The unallocated corporate portion of other general and administrative expenses increased \$557,000 over the prior year third quarter, primarily associated with additional personnel, professional fees, stock based compensation expense, rent, franchise taxes, and other general expenses.

Depreciation and Amortization. Depreciation and amortization increased approximately \$201,000, or 13.7%, to \$1.7 million for the three months ended September 30, 2012 from \$1.5 million for the three months ended September 30, 2011. The increase primarily resulted from amortization of capitalized software development assets and DCI intangible assets within HealthStream Learning and higher depreciation expense associated with leasehold improvements to our Nashville, Tennessee office space.

Other Income (Expense), Net. Other income, net was approximately \$42,000 for the three months ended September 30, 2012 compared to a net expense of \$8,000 for the three months ended September 30, 2011. The improvement is associated with income from investments in marketable securities.

Income Tax Provision. The Company recorded a provision for income taxes of \$1.8 million for the three months ended September 30, 2012 compared to \$890,000 for the three months ended September 30, 2011. The Company's effective tax rate was 47.6% for the third quarter of 2012 compared to 33.1% for the third quarter of 2011. The increase in the effective tax rate compared to the prior year third quarter was due to several factors, including changes in estimated state apportionment factors, stock based compensation, and other permanent tax differences.

Net Income. Net income increased approximately \$181,000, or 10.1%, to \$2.0 million for the three months ended September 30, 2012 from \$1.8 million for the three months ended September 30, 2011. Earnings per diluted share were \$0.07 per share for the three months ended September 30, 2012, compared to \$0.08 per diluted share for the three months ended September 30, 2011. A key factor impacting the comparison of EPS (diluted) for the third quarter of 2012 to EPS (diluted) for the third quarter of 2011 was the effect of additional shares of the Company's common stock outstanding that were issued during the Company's fourth quarter 2011 stock offering. The impact of the stock offering increased the outstanding share count by approximately 3.6 million shares for the three months ended September 30, 2012 compared to the three months ended September 30, 2011.

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Adjusted EBITDA (which we define as net income before interest, income taxes, stock-based compensation, and depreciation and amortization) increased by 30.0% to approximately \$5.7 million for the three months ended September 30, 2012 compared to \$4.4 million for the three months ended September 30, 2011. This improvement is consistent with the factors mentioned above. See Reconciliation of Non-GAAP Financial Measures in Management's Discussion and Analysis of Financial Condition and Results of Operations for our reconciliation of this calculation to measures under US GAAP.

Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011

Revenues, net. Revenues increased approximately \$15.7 million, or 26.1%, to \$75.9 million for the nine months ended September 30, 2012 from \$60.2 million for the nine months ended September 30, 2011. Revenues for 2012 consisted of \$57.4 million, or 76% of total revenue, for HealthStream Learning and \$18.5 million, or 24% of total revenue, for HealthStream Research. In 2011, revenues consisted of \$42.3 million, or 70% of total revenue, for HealthStream Learning and \$17.9 million, or 30% of total revenue, for HealthStream Research.

Revenues for the first nine months of 2012 for HealthStream Learning increased \$15.2 million, or 36.0%, over the first nine months of 2011. Revenues from our Internet-based subscription learning products increased by \$12.7 million, or 31.6% over the prior year period due to a higher number of subscribers and more courseware consumption by subscribers. Revenues from project-based services increased by \$1.8 million compared to the prior year period due to more engagements than the prior year. Revenues from SimVentures, our collaborative arrangement with Laerdal Medical, increased approximately \$716,000 over the prior year period.

Revenues for HealthStream Research increased \$524,000, or 2.9%, over 2011. Revenues from Patient Insights™ surveys, our survey research product that generates recurring revenues, increased by \$1.2 million, or 9.2%, over the prior year. Revenues from other surveys, which are conducted on annual or bi-annual cycles, declined by \$692,000, or 14.7%, compared to the prior year due to fewer survey engagements.

Cost of Revenues (excluding depreciation and amortization). Cost of revenues increased approximately \$7.9 million, or 35.0%, to \$30.5 million for the nine months ended September 30, 2012 from \$22.6 million for the nine months ended September 30, 2011. Cost of revenues as a percentage of revenues was 40.2% of revenues for the nine months ended September 30, 2012 compared to 37.6% of revenues for the nine months ended September 30, 2011. Cost of revenues for HealthStream Learning increased approximately \$7.4 million to \$20.1 million and approximated 36.4% and 32.0% of revenues for HealthStream Learning for the nine months ended September 30, 2012 and 2011, respectively. The increase is primarily associated with increased royalties paid by us resulting from growth in courseware subscription revenues, increased personnel expenses, and increased costs associated with project-based services. Cost of revenues for HealthStream Research increased approximately \$519,000 to \$9.6 million and approximated 52.3% and 50.9% of revenues for HealthStream Research for the nine months ended September 30, 2012 and 2011, respectively. The increase in amount is primarily the result of additional costs associated with the growth in patient survey volume over the prior year.

Product Development. Product development expenses increased approximately \$684,000, or 12.1%, to \$6.3 million for the nine months ended September 30, 2012 from \$5.6 million for the nine months ended September 30, 2011. Product development expenses as a percentage of revenues were 8.3% and 9.4% of revenues for the nine months ended September 30, 2012 and 2011, respectively.

Product development expenses for HealthStream Learning increased approximately \$629,000 and approximated 8.9% and 10.6% of revenues for HealthStream Learning for the nine months ended September 30, 2012 and 2011, respectively. The decrease as a percentage of revenue is the result of the growth in revenues over the prior year period, while the increase in amount is due to additional personnel expenses associated with the maintenance of our platform, as well as working on new product development initiatives. Product development expenses for HealthStream Research increased approximately \$55,000 and approximated 6.6% and 6.5% of revenues for HealthStream Research for the nine months ended September 30, 2012 and 2011, respectively.

Sales and Marketing. Sales and marketing expenses, including personnel costs, increased approximately \$2.9 million, or 25.4%, to \$14.6 million for the nine months ended September 30, 2012 from \$11.7 million for the nine months ended September 30, 2011. Sales and marketing expenses were 19.3% and 19.4% of revenues for the nine months ended September 30, 2012 and 2011, respectively.

Sales and marketing expenses for HealthStream Learning increased approximately \$2.4 million and approximated 17.9% and 18.6% of revenues for HealthStream Learning for the nine months ended September 30, 2012 and 2011, respectively. This expense increase is primarily due to additional personnel and related expenses, increased travel expenses, increased marketing spending, increased expenses for our annual customer Summit, and increased commissions associated with higher sales performance compared to the prior year period. Sales and marketing expenses for HealthStream Research increased approximately \$553,000, and approximated 22.0% and 19.5% of revenues for HealthStream Research for the nine months ended September 30, 2012 and 2011, respectively. The expense increase was primarily due to additional personnel and related expenses and increased commissions.

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Other General and Administrative Expenses. Other general and administrative expenses increased approximately \$1.5 million, or 18.5%, to \$9.5 million for the nine months ended September 30, 2012 from \$8.0 million for the nine months ended September 30, 2011. Other general and administrative expenses as a percentage of revenues were 12.5% and 13.3% of revenues for the nine months ended September 30, 2012 and 2011, respectively.

Other general and administrative expenses for HealthStream Learning increased \$302,000 over the prior year period primarily due to employee recruiting costs, rent, and other support costs, while other general and administrative expenses for HealthStream Research decreased \$237,000 compared to the prior year period primarily due to lower personnel costs. The unallocated corporate portion of other general and administrative expenses increased \$1.4 million over the prior year period, primarily associated with additional personnel, professional fees, stock based compensation expense, rent, franchise taxes, and other general expenses, as well as one-time expenses associated with the acquisition of DCI.

Depreciation and Amortization. Depreciation and amortization increased approximately \$911,000, or 23.5%, to \$4.8 million for the nine months ended September 30, 2012 from \$3.9 million for the nine months ended September 30, 2011. The increase primarily resulted from amortization of capitalized software development assets and DCI intangible assets within HealthStream Learning and depreciation expense associated with leasehold improvements to our Nashville, Tennessee office space.

Other Income (Expense), Net. Other income, net was approximately \$87,000 for the nine months ended September 30, 2012 compared to \$8,000 for the nine months ended September 30, 2011. The improvement over the prior year period was associated with higher interest income from investments in marketable securities.

Income Tax Provision. The Company recorded a provision for income taxes of \$4.4 million for the nine months ended September 30, 2012 compared to \$3.2 million for the nine months ended September 30, 2011. The Company's effective tax rate was 42.9% for 2012 compared to 38.4% for 2011. The increase in the effective tax rate primarily resulted from changes in certain state apportionment factor estimates, which resulted in a higher proportion of income subject to taxation in those states and a reduction in our state operating loss carryforwards. We expect the full year 2012 effective tax rate to range between 41 and 44 percent, compared to the full year 2011 effective tax rate of 39%. Actual tax payments will be substantially less than our income tax provision until we utilize our federal and state net operating loss carry-forwards of approximately \$14.5 million and \$8.7 million, respectively, at December 31, 2011, to offset taxable income.

Net Income. Net income increased approximately \$672,000, or 13.0%, to \$5.8 million for the nine months ended September 30, 2012 from \$5.2 million for the nine months ended September 30, 2011. Earnings per diluted share were \$0.21 per share for the nine months ended September 30, 2012, compared to \$0.22 per diluted share for the nine months ended September 30, 2011. A key factor impacting the comparison of EPS (diluted) for the first nine months of 2012 to EPS (diluted) for the first nine months of 2011 was the effect of additional shares of the Company's common stock outstanding that were issued during the Company's fourth quarter 2011 stock offering. The impact of the stock offering increased the outstanding share count by approximately 3.6 million shares for the nine months ended September 30, 2012 compared to the nine months ended September 30, 2011.

Adjusted EBITDA increased by 22.6% to approximately \$15.7 million for the nine months ended September 30, 2012 compared to \$12.8 million for the nine months ended September 30, 2011. This improvement is consistent with the factors mentioned above. See Reconciliation of Non-GAAP Financial Measures in Management's Discussion and Analysis of Financial Condition and Results of Operations for our reconciliation of this calculation to measures under US GAAP.

Reconciliation of Non-GAAP Financial Measures

This report contains certain non-GAAP financial measures, including, non-GAAP net income, non-GAAP operating income, non-GAAP revenue and adjusted EBITDA, which are used by management in analyzing 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 because adjusted EBITDA reflects net income adjusted for non-cash and non-operating items. Adjusted EBITDA is also used by many investors and securities analysts to assess the Company's results from current operations. Adjusted EBITDA is a non-GAAP financial measure and should not be considered as a measure of financial performance under US GAAP. Because adjusted EBITDA is not a measurement determined in accordance with US GAAP, it is susceptible to varying calculations. Accordingly, adjusted EBITDA, as presented, may not be comparable to other similarly titled measures of other companies.

The Company understands that, although adjusted EBITDA is frequently used by investors and securities analysts in their evaluation of companies, this measure has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for an analysis of the Company's results as reported under US GAAP. For example, adjusted EBITDA does not reflect cash expenditures, or future requirements for capital expenditures or contractual commitments; it does not reflect non-cash components of employee

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compensation; it does not reflect changes in, or cash requirements for, our working capital needs; and due to the Company's utilization of federal and state net operating loss carryforwards in 2011 and 2012, actual cash income tax payments have been significantly less than the tax provision recorded in accordance with US GAAP, and income tax payments will continue to be less than the income tax provision until our existing federal and state net operating loss carryforwards have been fully utilized or have expired.

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

As discussed elsewhere in this report, the Company completed the acquisition of DCI during June 2012. In accordance with US GAAP reporting requirements for fair value, we recorded a deferred revenue write-down of approximately \$200,000. This write-down will result in lower revenues than would have otherwise been recognized for such services.

In order to provide more accurate trends and comparisons of the Company's revenues, operating income, and net income, management believes that adding back the deferred revenue write-down associated with fair value accounting for acquired businesses provides a better indication of the ongoing performance of the Company. The revenue for the acquired contracts is deferred and typically recognized over a one year period, so our US GAAP revenues for the one year period after the acquisition will not reflect the full amount of revenues that would have been reported if the acquired deferred revenue was not written down to fair value.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
GAAP net income	\$ 1,977	\$ 1,796	\$ 5,824	\$ 5,152
Interest income	(53)	(5)	(123)	(36)
Interest expense	13	13	38	35
Income tax provision	1,796	890	4,376	3,213
Stock based compensation expense	296	223	837	597
Depreciation and amortization	1,672	1,471	4,779	3,868
Adjusted EBITDA	\$ 5,702	\$ 4,388	\$ 15,731	\$ 12,829
GAAP revenues	\$26,380	\$20,618	\$75,894	\$60,175
Adjustment for deferred revenue write-down	92	—	92	—
Non-GAAP revenues	\$26,472	\$20,618	\$75,986	\$60,175
GAAP operating income	\$ 3,731	\$ 2,694	\$ 10,113	\$ 8,357
Adjustment for deferred revenue write-down	92	—	92	—
Non-GAAP operating income	\$ 3,823	\$ 2,694	\$ 10,205	\$ 8,357
GAAP net income	\$ 1,977	\$ 1,796	\$ 5,824	\$ 5,152
Adjustment for deferred revenue write-down, net of tax	53	—	53	—
Non-GAAP net income	\$ 2,030	\$ 1,796	\$ 5,877	\$ 5,152

Liquidity and Capital Resources

Net cash provided by operating activities was approximately \$15.6 million and \$14.5 million during the nine months ended September 30, 2012 and 2011, respectively. The Company's primary sources of cash were receipts generated from the sales of our products and services. Days sales outstanding ("DSO") which is calculated by dividing the accounts receivable balance, excluding unbilled and other receivables, by average daily revenues for the quarter, approximated 55 days for the third quarter of 2012 compared to 59 days for the third quarter of 2011. 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 \$69.6 million and \$3.1 million for the nine months ended September 30, 2012 and 2011, respectively. During 2012, the Company purchased \$95.3 million of marketable securities, utilized \$2.9 million (net of cash acquired) to acquire DCI, spent \$3.1 million for capitalized software development, purchased \$3.2 million of property and equipment, and made \$0.3 million in other investments. These uses of cash were partially offset by maturities of marketable securities of \$35.1 million. During 2011, the Company purchased \$4.7 million of marketable securities, spent \$5.2 million for capitalized software development, and purchased \$3.6 million of property and equipment. These uses of cash were partially offset by maturities and sales of marketable securities of \$10.4 million.

Cash provided by financing activities was approximately \$791,000 and \$1.0 million for the nine months ended September 30, 2012 and 2011, respectively. The primary source of cash from financing activities for 2012 and 2011 resulted from proceeds associated with the exercise of stock options.

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Revenues increased and operating income improved over the prior year period, and our balance sheet reflects positive working capital of \$86.8 million at September 30, 2012 compared to \$78.6 million at December 31, 2011. The increase in working capital was primarily due to the cash generated from operations. The Company's primary source of liquidity is \$95.9 million of cash and cash equivalents and marketable securities. The Company also has a \$20.0 million revolving credit facility loan agreement, all of which was available at September 30, 2012.

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 seven years, we have utilized our federal and state net operating loss carryforwards to offset taxable income. We anticipate our remaining net operating loss carryforwards will become fully utilized within the next 12 months. Our actual tax payments may increase significantly once the net operating loss carryforwards are fully utilized. As part of our growth strategy, we review possible acquisitions that complement our products and services. We anticipate that future acquisitions, if any, would be effected through a combination of stock and cash consideration. The issuance of our stock as consideration for an acquisition could have a dilutive effect on earnings per share and could adversely affect our stock price. Because we have no material debt or outstanding borrowings under our revolving credit facility, our balance sheet is unleveraged. Our revolving credit facility contains financial covenants and availability calculations designed to set a maximum leverage ratio of outstanding debt to equity. Therefore, if we were to borrow against our revolving credit facility, our debt capacity would be dependent on the covenant values at the time of borrowing. As of September 30, 2012, we believe we were in compliance with all covenants. The credit markets have been experiencing extreme volatility and disruption, and we cannot provide assurances 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. As of September 30, 2012, the Company had no outstanding debt. We may become subject to interest rate market risk associated with any future borrowings under our revolving credit facility. The interest rate under the revolving credit facility is based on 30 Day LIBOR plus a margin of either 175 or 200 basis points determined in accordance with a pricing grid. We are exposed to market risk with respect to our cash and investment balances, which approximated \$95.9 million at September 30, 2012. Assuming a hypothetical 10% decrease in interest rates, interest income from cash and investments would decrease on an annualized basis by approximately \$28,000.

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

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 Securities and Exchange Commission'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 and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There was no change in HealthStream's internal control over financial reporting that occurred during the period covered by this Quarterly Report that has materially affected, or that is reasonably likely to materially affect, HealthStream's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 6. Exhibits

(a) Exhibits

- 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

* - The XBRL-related information in Exhibit No. 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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.

HEALTHSTREAM, INC.

October 30, 2012

By: /s/ GERARD M. HAYDEN, JR.
Gerard M. Hayden, Jr.
Chief Financial Officer

HEALTHSTREAM, INC.

EXHIBIT INDEX

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* - The XBRL-related information in Exhibit No. 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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: October 30, 2012

/s/ ROBERT A. FRIST, JR.

Robert A. Frist, Jr.
Chief Executive Officer

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: October 30, 2012

/s/ GERARD M. HAYDEN, JR.

Gerard M. Hayden, Jr.
Chief Financial Officer

**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 September 30, 2012, 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
October 30, 2012

**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 September 30, 2012, 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
October 30, 2012