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

FORM 10-Q

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

For the quarterly period ended September 30, 2014

Commission File No.: 000-27701

HealthStream, Inc.
(Exact name of registrant as specified in its charter)

Tennessee **(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	☐	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 27, 2014, there were 27,634,449 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, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,927	$ 59,537
Marketable securities	51,495	48,659
Accounts receivable, net of allowance for doubtful accounts of $269 and $211 at September 30, 2014 and December 31, 2013, respectively	28,177	25,314
Accounts receivable - unbilled	1,938	1,392
Prepaid royalties, net of amortization	12,832	8,857
Other prepaid expenses and other current assets	3,566	3,365
Total current assets	162,935	147,124
Property and equipment:		
Equipment	23,850	21,631
Leasehold improvements	5,856	5,521
Furniture and fixtures	4,341	3,854
	34,047	31,006
Less accumulated depreciation and amortization	(25,040)	(21,968)
	9,007	9,038
Capitalized software development, net of accumulated amortization of $16,884 and $13,910 at September 30, 2014 and December 31, 2013, respectively	12,303	11,077
Goodwill	42,654	35,746
Intangible assets, net of accumulated amortization of $13,179 and $11,389 at September 30, 2014 and December 31, 2013, respectively	15,450	8,870
Other assets	984	739
Total assets	$ 243,333	$ 212,594
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 799	$ 2,311
Accrued royalties	6,622	8,435
Accrued liabilities	11,762	5,503
Accrued compensation and related expenses	1,727	1,614
Deferred tax liabilities, current	224	181
Deferred revenue	53,303	38,168
Total current liabilities	74,437	56,212
Deferred tax liabilities, noncurrent	5,437	6,173
Deferred revenue, noncurrent	1,507	—
Other long term liabilities	710	776
Commitments and contingencies	—	—
Shareholders' equity:		
Common stock, no par value, 75,000 shares authorized; 27,634 and 27,327 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	170,940	166,888
Accumulated deficit	(9,677)	(17,424)
Accumulated other comprehensive loss	(21)	(31)
Total shareholders' equity	161,242	149,433
Total liabilities and shareholders' equity	$ 243,333	$ 212,594

See accompanying notes to the condensed consolidated financial statements.

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

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

See accompanying notes to the condensed consolidated financial statements.

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

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

See accompanying notes to the condensed consolidated financial statements.

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HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (UNAUDITED)
NINE MONTHS ENDED SEPTEMBER 30, 2014
(In thousands)

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

See accompanying notes to the condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2014	2013
OPERATING ACTIVITIES:		
Net income	$ 7,747	$ 6,658
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,938	5,812
Stock based compensation expense	1,222	1,088
Deferred income taxes	4,519	4,560
Excess tax benefits from equity awards	129	72
Provision for doubtful accounts	170	95
Loss on non-marketable equity investments	34	30
Other	1,082	1,163
Changes in operating assets and liabilities:		
Accounts and unbilled receivables	(1,891)	(7,312)
Prepaid royalties	(3,975)	(4,509)
Other prepaid expenses and other current assets	(260)	(908)
Other assets	79	26
Accounts payable	(1,511)	792
Accrued royalties	(1,814)	3,037
Accrued liabilities and accrued compensation and related expenses and other long-term liabilities	288	703
Deferred revenue	14,918	11,904
Net cash provided by operating activities	28,675	23,211
INVESTING ACTIVITIES:		
Business combinations, net of cash acquired	(12,298)	(7,362)
Proceeds from maturities of investments in marketable securities	40,418	63,722
Proceeds from sales of investments in marketable securities	—	5,062
Purchases of investments in marketable securities	(44,324)	(67,634)
Investments in non-marketable equity investments	(325)	(300)
Payments associated with capitalized software development	(4,025)	(3,017)
Purchases of property and equipment	(3,044)	(2,414)
Net cash used in investing activities	(23,598)	(11,943)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	872	3,057
Taxes paid related to net settlement of equity awards	(160)	(158)
Excess tax benefits from equity awards	(129)	(72)
Payment of earn-outs related to acquisitions	(270)	(357)
Net cash provided by financing activities	313	2,470
Net increase in cash and cash equivalents	5,390	13,738
Cash and cash equivalents at beginning of period	59,537	41,365
Cash and cash equivalents at end of period	$ 64,927	$ 55,103
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Issuance of common stock in connection with acquisition	$ 2,247	$ 534

See accompanying notes to the condensed consolidated financial statements.

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, condensed consolidated financial statements do not include all of the information and footnotes required by US GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated in consolidation. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The balance sheet at December 31, 2013 is consistent with the audited financial statements at that date but does not include all of the information and footnotes required by US GAAP for a complete set of financial statements. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2013 (included in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 4, 2014).

2. RECENT ACCOUNTING PRONOUNCEMENTS

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

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

3. INCOME TAXES

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

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

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

4. STOCK BASED COMPENSATION

The Company maintains two stock incentive plans. The Company accounts for its stock based compensation plans using the fair-value based method for costs related to share-based payments, including stock options and restricted share units (RSUs). During the nine months ended September 30, 2014, the Company issued 70,080 RSUs with a weighted average grant date fair value of $28.71 per share, measured based on the closing fair market value of the Company's stock on the date of grant. During the nine months ended September 30, 2013, the Company issued 80,250 RSUs with a weighted average grant date fair value of $22.02 per share, measured based on the closing fair market value of the Company's stock on the date of grant.

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

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

5. EARNINGS PER SHARE

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

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

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

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

6. MARKETABLE SECURITIES

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

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

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

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

7. BUSINESS COMBINATION

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

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

7. BUSINESS COMBINATION (continued)

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

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

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

8. BUSINESS SEGMENTS

The Company primarily provides services to healthcare organizations and other members within the healthcare industry. The Company's services are primarily focused on the delivery of workforce development products and services (HealthStream Workforce Development Solutions), as well as survey and research services (HealthStream Research/Patient Experience Solutions). The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

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

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

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

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

8. BUSINESS SEGMENTS (continued)

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

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

Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

Special Cautionary Notice Regarding Forward-Looking Statements

You should read the following discussion and analysis in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this report and our audited consolidated financial statements and the notes thereto for the year ended December 31, 2013, appearing in our Annual Report on Form 10-K that was filed with the Securities and Exchange Commission ("SEC") on March 4, 2014, (the "2013 Form 10-K"). Statements contained in this Quarterly Report on Form 10-Q that are not historical fact are forward-looking statements that the Company intends to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Statements that are predictive in nature, that depend on or refer to future events or conditions, or that include words such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "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 2013 Form 10-K and the information regarding forward-looking statements in our earnings releases, as well as other cautionary statements contained elsewhere in this report, including the matters discussed in "Critical Accounting Policies and Estimates." We undertake no obligation beyond that required by law to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future. You should read this report and the documents that we reference in this report and have filed as exhibits to this report completely and with the understanding that our actual future results may be materially different from what we expect.

Overview

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

Key financial indicators for the third quarter of 2014 include:

- Revenues of $44.5 million in the third quarter of 2014, up 32% from $33.7 million in the third quarter of 2013
- Operating income of $4.7 million in the third quarter of 2014, up 22% from $3.9 million in the third quarter of 2013
- Net income of $3.4 million in the third quarter of 2014, up 50% from $2.3 million in the third quarter of 2013, and earnings per share (EPS) of $0.12 per share (diluted) in the third quarter of 2014 compared to EPS of $0.08 per share (diluted) in the third quarter of 2013
- Adjusted EBITDA(1) of $7.9 million in the third quarter of 2014, up 26% from $6.3 million in the third quarter of 2013
- Annualized revenue per implemented subscriber(2) of $35.91 in the third quarter of 2014, up 16% from $30.95 in the third quarter of 2013

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

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

Business Combination

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

Critical Accounting Policies and Estimates

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

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

- Revenue recognition
- Accounting for income taxes
- Software development costs
- Goodwill, intangibles, and other long-lived assets
- Allowance for doubtful accounts
- Stock based compensation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Income Tax Provision. The Company recorded a provision for income taxes of approximately $4.5 million for the nine months ended September 30, 2014 compared to $4.6 million for the nine months ended September 30, 2013. The Company's effective tax rate was 36.8% for the first nine months of 2014 compared to 41.0% for the first nine months of 2013. The decrease in the effective tax rate resulted primarily from the recognition of approximately $670,000 in tax benefits during the third quarter of 2014 associated with research and development tax credits.

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

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

Reconciliation of Non-GAAP Financial Measures

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

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

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

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

The Company completed the acquisitions of Decision Critical, Inc. (DCI) in June 2012, Sy.Med Development, Inc. (Sy.Med) in October 2012, BLG in September 2013, and HCCS in March 2014. In accordance with US GAAP reporting requirements for fair value, we recorded a deferred revenue write-down of $192,000 for DCI, $916,000 for Sy.Med, $254,000 for BLG, and approximately $1.5 million for HCCS. These write-downs 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,	
	2014	2013	2014	2013
GAAP net income	$ 3,436	$ 2,296	$ 7,747	$ 6,658
Interest income	(73)	(69)	(190)	(189)
Interest expense	13	13	38	38
Income tax provision	1,354	1,629	4,519	4,620
Stock based compensation expense	388	378	1,222	1,088
Depreciation and amortization	2,815	2,039	7,938	5,812
Adjusted EBITDA	$ 7,933	$ 6,286	$ 21,274	$18,027
GAAP revenues	$44,525	$33,659	$125,351	$95,224
Adjustment for deferred revenue write-down	150	167	1,222	667
Non-GAAP revenues	$44,675	$33,826	$126,573	$95,891
GAAP operating income	$ 4,741	$ 3,879	$ 12,149	$11,157
Adjustment for deferred revenue write-down	150	167	1,222	667
Non-GAAP operating income	$ 4,891	$ 4,046	$ 13,371	$11,824
GAAP net income	$ 3,436	$ 2,296	$ 7,747	$ 6,658
Adjustment for deferred revenue write-down, net of tax	108	98	772	394
Non-GAAP net income	$ 3,544	$ 2,394	$ 8,519	$ 7,052

Liquidity and Capital Resources

Net cash provided by operating activities increased approximately 23.5% and approximated $28.7 million and $23.2 million during the nine months ended September 30, 2014 and 2013, respectively. This improvement primarily resulted from increased cash receipts from the sales of our products and services. The number of days sales outstanding (DSO) was 60 days for the third quarter of 2014 compared to 61 days for the third quarter of 2013. The Company calculates DSO by dividing the average accounts receivable balance for the quarter, excluding unbilled and other receivables, by average daily revenues for the quarter. The Company's primary source of cash was 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 $23.6 million and $11.9 million for the nine months ended September 30, 2014 and 2013, respectively. During the nine months ended September 30, 2014, the Company purchased $44.3 million of marketable securities, utilized $12.3 million (net of cash acquired) for acquisitions, spent $4.0 million for capitalized software development, purchased $3.0 million of property and equipment, and made $325,000 in non-marketable equity investments. These uses of cash were partially offset by maturities of marketable securities of $40.4 million. During the nine months ended September 30, 2013, the Company purchased $67.6 million of marketable securities, spent $3.0 million for capitalized software development, purchased $2.4 million of property and equipment, made $300,000 in non-marketable equity investments, and utilized $7.4 million for acquisitions. These uses of cash were partially offset by sales and maturities of marketable securities of $68.8 million.

Cash provided by financing activities was approximately $313,000 and $2.5 million for the nine months ended September 30, 2014 and 2013, respectively. The primary source of cash from financing activities for 2014 and 2013 resulted from proceeds from the exercise of employee stock options. The primary uses of cash for the nine months ended September 30, 2014 and 2013 resulted from earn-out payments associated with the acquisitions of DCI and Sy.Med, and the payment of payroll taxes associated with the issuance of shares from the vesting of RSUs.

Our balance sheet reflects positive working capital of $88.5 million at September 30, 2014 compared to $90.9 million at December 31, 2013. The decrease in working capital was primarily due to the use of cash for the HCCS acquisition, but was partially offset by cash generated from operations. The Company's primary source of liquidity is $116.4 million of cash and cash equivalents and marketable securities. As of September 30, 2014, the Company maintained full availability under a $20.0 million revolving credit facility. The revolving credit facility expires on November 19, 2014, and the Company intends to renew the facility on terms equal to or better than the previous agreement.

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 nine years, we have utilized our federal and state net operating loss carryforwards to offset taxable income, therefore reducing our tax liabilities. We anticipate our remaining net operating loss carryforwards will become fully utilized within the next 12 months. Our actual tax payments are expected to increase significantly once the net operating loss carryforwards are fully utilized. As part of our growth strategy, we have recently completed several acquisitions and we continue to 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 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 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, 2014, we were in compliance with all covenants. The credit and capital markets have been experiencing extreme volatility and disruption. 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.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company's off-balance sheet arrangements primarily consist of operating leases, contractual obligations, and our revolving credit facility. During the nine months ended September 30, 2014, the Company entered into an office lease agreement for a new patient interview center in Nashville, Tennessee, and in connection with the acquisition of HCCS, we have an office lease in Jericho, New York. There have been no other material changes in the Company's contractual obligations or commercial commitments during the nine months ended September 30, 2014 from those disclosed in our 2013 Form 10-K.

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, 2014, 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 $116.4 million at September 30, 2014. Assuming a hypothetical 10% decrease in interest rates, interest income from cash and investments would decrease on an annualized basis by approximately $54,000.

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 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 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

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, 2014

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

HEALTHSTREAM, INC.

EXHIBIT INDEX

31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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101.1 INS	XBRL Instance Document
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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: October 30, 2014

/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: October 30, 2014

/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 September 30, 2014, 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, 2014

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 September 30, 2014, 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, 2014