HEALTHSTREAM INC
Form 10-Q
May 12, 2009

Table of Contents

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 March 31, 2009
Commission File No.: 000-27701
HealthStream, Inc.
(Exact name of registrant as specified in its charter)

Tennessee	**62-1443555**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
209 10th Avenue South, Suite 450 Nashville, Tennessee	**37203**
(Address of principal executive offices)	(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 þ No o

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 o No o

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 o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

As of May 11, 2009, 21,383,055 shares of the registrant s common stock were outstanding.

Index to Form 10-Q
HEALTHSTREAM, INC.

PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,771,295	$ 4,106,612
Restricted cash	17,128	17,128
Interest receivable	984	4,090
Accounts receivable, net of allowance for doubtful accounts of $155,651 and $106,542 at March 31, 2009 and December 31, 2008, respectively	10,445,100	8,303,212
Accounts receivable unbilled	1,734,119	1,669,356
Prepaid royalties, net of amortization	1,338,392	995,493
Prepaid development fees, net of amortization	558,847	375,866
Deferred tax assets, current	356,987	356,987
Other prepaid expenses and other current assets	665,882	1,034,026
Total current assets	19,888,734	16,862,770
Property and equipment:		
Equipment	13,179,818	12,651,227
Leasehold improvements	2,001,232	1,990,532
Furniture and fixtures	1,579,592	1,579,592
	16,760,642	16,221,351
Less accumulated depreciation and amortization	(13,311,596)	(12,746,487)
	3,449,046	3,474,864
Capitalized software feature enhancements, net of accumulated amortization of $2,857,198 and $2,500,017 at March 31, 2009 and December 31, 2008, respectively	4,307,768	4,392,780
Goodwill	21,146,864	21,146,864
Intangible assets, net of accumulated amortization of $9,886,040 and $9,649,321 at March 31, 2009 and December 31, 2008, respectively	4,501,102	4,737,821
Deferred tax assets, noncurrent	2,008,342	2,008,342
Other assets	512,315	173,441
Total assets	$ 55,814,171	$ 52,796,882
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 970,202	$ 1,386,771
Accrued liabilities	2,868,124	2,556,102
Accrued compensation and related expenses	645,176	477,277

Commercial support liabilities	243,526	347,234
Deferred revenue	12,426,637	10,202,309
Current portion of long term debt	728,511	724,095
Current portion of capital lease obligations	13,340	20,592
Total current liabilities	17,895,516	15,714,380
Long term debt, less current portion	123,150	306,942
Capital lease obligations, less current portion	9,579	12,778
Commitments and contingencies		
Shareholders equity:		
Common stock, no par value, 75,000,000 shares authorized; 21,382,055 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	95,466,504	95,320,889
Accumulated deficit	(57,680,578)	(58,558,107)
Total shareholders equity	37,785,926	36,762,782
Total liabilities and shareholders equity	$ 55,814,171	$ 52,796,882

See accompanying notes to the condensed consolidated financial statements.

1

Table of Contents

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

	Three Months Ended March 31,	
	2009	**2008**
Revenues, net	$ 13,619,208	$ 11,421,700
Operating costs and expenses:		
Cost of revenues (excluding depreciation and amortization)	5,267,831	4,527,773
Product development	1,534,421	1,284,432
Sales and marketing	2,713,594	2,552,275
Other general and administrative expenses	1,901,278	1,767,276
Depreciation and amortization	1,266,300	1,246,047
Total operating costs and expenses	12,683,424	11,377,803
Income from operations	935,784	43,897
Other income (expense):		
Interest and other income	8,956	46,129
Interest and other expense	(9,841)	(24,342)
Total other income (expense)	(885)	21,787
Income before income taxes	934,899	65,684
Income tax provision	57,370	
Net income	$ 877,529	$ 65,684
Net income per share:		
Basic	$ 0.04	$ 0.00
Diluted	$ 0.04	$ 0.00
Weighted average shares of common stock outstanding:		
Basic	21,382,055	22,086,945
Diluted	21,567,204	22,727,096

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

HEALTHSTREAM, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2009

	Common Stock		Accumulated	Total Shareholders
	Shares	Amount	Deficit	Equity
Balance at December 31, 2008	21,382,055	$ 95,320,889	$ (58,558,107)	$ 36,762,782
Net income			877,529	877,529
Stock based compensation		145,615		145,615
Balance at March 31, 2009	21,382,055	$ 95,466,504	$ (57,680,578)	$ 37,785,926

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31,	
	2009	2008
OPERATING ACTIVITIES:		
Net income	$ 877,529	$ 65,684
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	566,764	521,497
Amortization	699,536	724,550
Stock based compensation expense	145,615	152,934
Provision for doubtful accounts	50,000	
Realized loss on disposal of property and equipment		7,472
Changes in operating assets and liabilities:		
Accounts and unbilled receivables	(2,256,651)	1,388,300
Restricted cash		(37,004)
Interest receivable	3,106	2,527
Prepaid royalties	(342,899)	(104,162)
Prepaid development fees	(66,950)	(14,464)
Other prepaid expenses and other current assets	368,144	(49,759)
Other assets	49,042	49,375
Accounts payable	(416,569)	(1,345,960)
Accrued liabilities and accrued compensation and related expenses	(129,663)	(779,826)
Commercial support liabilities	(103,708)	48,886
Deferred revenue	2,224,328	1,096,695
Net cash provided by operating activities	1,667,624	1,726,745
INVESTING ACTIVITIES:		
Acquisition, net of cash acquired		(9,194)
Payments associated with capitalized software feature enhancements	(272,168)	(159,597)
Purchases of property and equipment, net	(540,946)	(216,702)
Net cash used in investing activities	(813,114)	(385,493)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options		34,081
Payments on promissory note	(179,376)	(175,066)
Payments on capital lease obligations	(10,451)	(46,248)
Net cash used in financing activities	(189,827)	(187,233)
Net increase in cash and cash equivalents	664,683	1,154,019
Cash and cash equivalents at beginning of period	4,106,612	3,599,346

Cash and cash equivalents at end of period	$ 4,771,295	$ 4,753,365

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 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 generally accepted accounting principles 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 months ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

The balance sheet at December 31, 2008 is consistent with the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States 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, 2008 (included in the Company s Annual Report on Form 10-K, filed with the Securities and Exchange Commission).

2. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(R), Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, contractual contingencies, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) changes the accounting for acquisition-related restructuring cost accruals and the recognition of changes in the acquirer s income tax valuation allowance, and no longer permits the capitalization of certain acquisition costs. In addition, SFAS No. 141(R) establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective prospectively, except for certain retrospective adjustments for deferred tax balances. The Company s consolidated financial statements will be impacted by SFAS 141(R) in relation to business combination activities subsequent to January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The Company adopted SFAS No. 160 on January 1, 2009. The adoption of this new standard did not have a material effect on the Company s financial position, results of operations, or cash flows.

In April 2008, FASB Staff Position (FSP) No. FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP No. FAS 142-3), was issued. FSP No. FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The Company adopted FSP No. FAS 142-3 on January 1, 2009. The adoption of this new standard did not have a material effect on the Company s financial position, results of operations, or cash flows.

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. INCOME TAXES

Income taxes are accounted for under the provisions of SFAS No. 109, Accounting for Income Taxes (SFAS No. 109). Under SFAS No. 109, 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. Under the provisions of SFAS No. 109, management evaluates all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance is needed. Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law. SFAS No. 109 identifies four possible sources of taxable income that may be available under the tax law to realize a tax benefit for deductible temporary differences and carryforwards: 1) future reversals of existing taxable temporary differences, 2) future taxable income exclusive of reversing temporary differences and carryforwards, 3) taxable income in prior carryback year(s) if carryback is permitted under the tax law, and 4) tax-planning strategies that would, if necessary, be implemented to realize deductible temporary differences or carryforwards prior to their expiration. Management s estimate of future taxable income is performed during the fourth quarter in connection with the Company s annual budget process. Management reviews the realizability of its deferred tax assets each reporting period to identify whether any significant changes in circumstances or assumptions have occurred that could materially affect the realizability of deferred tax assets. As of March 31, 2009, the Company had established a valuation allowance of $11.7 million for the portion of its net deferred tax assets that are not more likely than not expected to be realized.

The Company s effective tax rate for the three months ended March 31, 2009 and 2008 is substantially less than the statutory rate because a significant portion of our taxable income has been offset through utilization of our net operating loss (NOL) carryforwards. Taxable income for the three months ended March 31, 2009 has been applied towards our NOL carryforwards and resulted in a reduction of the valuation allowance of approximately $422,000. The Company s effective tax rate could change in the future based on our projections of taxable income, changes in federal or state tax rates, or changes in state apportionment factors, as well as changes in the valuation allowance applied to the Company s deferred tax assets.

4. STOCK BASED COMPENSATION

The Company currently maintains a stock incentive plan. The Company terminated the Employee Stock Purchase Plan on February 9, 2009. We account for our stock based compensation plan under the provisions of SFAS No. 123(R), Share-Based Payments, which requires companies to recognize compensation expense, using a fair-value based method, for costs related to share-based payments, including stock options. We use the Black Scholes option pricing model for calculating the fair value of awards issued under our stock based compensation plan. During the three months ended March 31, 2009, we granted 209,000 stock options with a weighted average grant date fair value of $1.04. We did not grant stock options during the three months ended March 31, 2008. The fair value of stock based awards granted during the three months ended March 31, 2009 was estimated using the Black Scholes option pricing model, with the assumptions as follows:

Risk-free interest rate	1.73%
Expected dividend yield	0.0%
Expected life (in years)	5
Expected forfeiture rate	20%
Volatility	60%

Total stock based compensation expense recorded for the three months ended March 31, 2009 and 2008, which is recorded in our condensed consolidated statements of income, is as follows:

	Three months ended March 31,

	2009	2008
Cost of revenues (excluding depreciation and amortization)	$ 5,191	$ 10,800
Product development	35,086	33,248
Sales and marketing	38,640	50,214
Other general and administrative	66,698	58,672
Total stock based compensation expense	$ 145,615	$ 152,934

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. NET INCOME PER SHARE

Basic net income 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 net income 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 warrants, escrowed or restricted shares, and shares subject to vesting are included in diluted net income 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 net income per share, due to their anti-dilutive effect, was approximately 2.1 million at March 31, 2009 and 1.6 million at March 31, 2008.

The following table sets forth the computation of basic and diluted net income per share for three months ended March 31, 2009 and 2008:

	Three months ended March 31, 2009	Three months ended March 31, 2008
Numerator:		
Net income	$ 877,529	$ 65,684
Denominator:		
Weighted average shares outstanding:		
Basic	21,382,055	22,086,945
Employee stock options and escrowed shares	185,149	640,151
Diluted	21,567,204	22,727,096
Net income per share:		
Basic	$ 0.04	$ 0.00
Diluted	$ 0.04	$ 0.00

6. BUSINESS SEGMENTS

We provide our services to healthcare organizations, pharmaceutical and medical device companies, and other members within the healthcare industry. Our 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 our Annual Report on Form 10-K for the year ended December 31, 2008.

We measure segment performance based on operating income (loss) before income taxes and prior to the allocation of certain corporate overhead expenses, interest income, interest expense, and depreciation. The following is our business segment information as of and for the three months ended March 31, 2009 and 2008.

	Three months ended March 31, 2009	March 31, 2008
Revenues		

Learning	$ 8,993,611	$ 7,496,706
Research	4,625,597	3,924,994
Total net revenue	$ 13,619,208	$ 11,421,700
Income (loss) from operations		
Learning	$ 2,047,165	$ 1,659,632
Research	573,157	28,863
Unallocated	(1,684,538)	(1,644,598)
Total income from operations	$ 935,784	$ 43,897

7

Table of Contents

HEALTHSTREAM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. BUSINESS SEGMENTS (continued)

	March 31, 2009	December 31, 2008
Segment assets		
Learning *	$ 18,583,251	$ 16,027,451
Research *	26,958,707	27,018,000
Unallocated	10,272,213	9,751,431
Total assets	$ 55,814,171	$ 52,796,882

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

7. CONTENT RIGHTS AND DEFERRED SERVICE CREDITS

During the three months ended March 31, 2009, we entered into a renewal agreement with a customer in which we were provided continued rights to distribute and resell courseware owned by them. In exchange for the receipt of an exclusive license to distribute and resell this courseware, we provided the customer with service credits that can be exchanged for future purchases of our products and services. We accounted for this transaction in accordance with Accounting Principles Board Opinion No. 29 Accounting for Nonmonetary Transactions as amended by SFAS No. 153, Exchanges of Nonmonetary Assets. The value assigned to the content rights and the deferred service credits was $665,000, which represented the estimated fair value of the assets relinquished. The content rights are classified within prepaid development fees and other assets, and the deferred service credits are classified within accrued liabilities on our condensed consolidated balance sheet as of March 31, 2009.

These exchangeable service credits will be issued annually through December 31, 2011, and will expire twenty-four months after issuance. Any unused credits will be forfeited upon expiration. During the three months ended March 31, 2009, we issued exchangeable service credits of $465,000 in accordance with this agreement, and are obligated to issue remaining service credits of $100,000 per year in both 2010 and 2011. The content rights are being amortized on a straight-line basis through December 31, 2012. Revenues for products or services provided in exchange for these service credits will be recognized in accordance with our revenue recognition policies.

Table of Contents

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, 2008, appearing in our Annual Report on Form 10-K that was filed with the Securities and Exchange Commission (SEC) on March 27, 2009 (the 2008 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, pl 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 the 2008 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 s services are focused on the professionals who work within healthcare organizations, and include the delivery of education and training products and services (HealthStream Learning), as well as survey and research services (HealthStream Research). HealthStream Learning products and services are used by healthcare organizations to meet a broad range of their training and assessment needs, while HealthStream Research products and services provide our customers valuable insight into measuring quality and satisfaction of patients, physicians, employees, and members of the community. Across both our HealthStream Learning and HealthStream Research segments, our customers include approximately 2,400 healthcare organization facilities (predominately acute-care facilities) throughout the United States.

The Company s flagship learning product is the HealthStream Learning Center® (HLC), our proprietary, Internet-based learning platform. We deliver educational and training courseware to our customers through the HLC platform. HealthStream Learning products and services are focused on education and training initiatives designed to reach hospital-based healthcare professionals, as well as physicians and medical device and pharmaceutical industry sales representatives.

HealthStream Research products and services include quality and satisfaction surveys, data analyses of survey results, and other research-based measurement tools focused on patients, physicians, employees, and members of the community. HealthStream Research services are designed to provide customers thorough analyses that provide insightful recommendations for change; benchmarking capabilities using our comprehensive databases, and consulting services to identify solutions based on their survey results. As a certified vendor designated by the Centers for Medicare & Medicaid Services, we offer our customers CAHPS® (Consumer Assessment of Health Plan Survey) hospital survey services.

Key financial and operational indicators for the first quarter of 2009 include:

- Revenues of $13.6 million in the first quarter of 2009, up 19% over the first quarter of 2008
- Net income of $878,000 in the first quarter of 2009, up from $66,000 in the first quarter of 2008

Earnings per share (EPS) of $0.04, up from $0.00 for the same period last year

Critical Accounting Policies and Estimates

Our 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

Table of Contents

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

Product development costs and related capitalization

Goodwill, intangibles, and other long-lived assets

Allowance for doubtful accounts

Accrual for service credits

Stock based compensation

Nonmonetary exchange of content rights and deferred service credits

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 in which management s judgment in selecting among available alternatives would not produce a materially different result. See Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission, 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 Annual Report on Form 10-K for the year ended December 31, 2008.

Revenues and Expense Components

The following descriptions of the components of revenues and expenses apply to the comparison of results of operations.

Revenues. Revenues for our HealthStream Learning business segment consist of the provision of services through our Internet-based HLC, authoring tools, a variety of courseware subscriptions (add-on courseware), implementation and consulting services, maintenance of third party content, online sales training courses (RepDirect), online training and content development, HospitalDirect®, and a variety of other educational activities for physicians, nurses and other professionals within healthcare organizations. Revenues for our HealthStream Research business segment consist of quality and satisfaction surveys, data analyses of survey results, and other research-based measurement tools focused on physicians, patients, employees, and other members of the community.

Cost of Revenues (excluding depreciation and amortization). Cost of revenues (excluding depreciation and amortization) consists primarily of salaries and employee benefits, stock based compensation, employee travel and lodging, royalties paid by us to content providers based on a percentage of revenues, materials, outsourced phone survey support, contract labor, hosting costs, as