ATHENAHEALTH INC
Form 10-Q
October 18, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013
or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission File Number 001-33689
athenahealth, Inc.
(Exact name of registrant as specified in its charter)

Delaware	04-3387530
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
311 Arsenal Street, Watertown, Massachusetts	02472
(Address of principal executive offices)	(Zip Code)

617-402-1000
(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 R No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R No ¨

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

Large accelerated filer R	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 Act). Yes ¨ No R

At October 16, 2013, the registrant had 37,167,863 shares of common stock, par value $0.01 per share, outstanding.

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PART I - FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements (unaudited).
athenahealth, Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, amounts in thousands, except per-share amounts)

	September 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$62,274	$154,988
Short-term investments	—	38,092
Accounts receivable - net	97,417	61,916
Current portion of restricted cash	—	1,357
Deferred tax assets - net	2,134	6,907
Prepaid expenses and other current assets	18,824	10,924
Total current assets	180,649	274,184
Property and equipment - net	203,638	54,035
Capitalized software costs - net	26,912	16,050
Purchased intangible assets - net	174,165	21,561
Goodwill	196,183	48,090
Deferred tax assets - net	—	11,759
Investments and other assets	6,670	2,773
Total assets	$788,217	$428,452
Liabilities and Stockholders' Equity		
Current liabilities:		
Line of credit	$50,000	$—
Current portion of long-term debt	15,000	—
Accounts payable	11,302	1,733
Accrued compensation	40,364	36,393
Accrued expenses	25,134	19,683
Current portion of deferred revenue	33,623	8,209
Current portion of deferred rent	100	799
Total current liabilities	175,523	66,817
Deferred rent, net of current portion	1,294	2,854
Long-term debt, net of current portion	177,500	—
Deferred revenue, net of current portion	52,631	45,515
Long-term deferred tax liability - net	17,729	—
Other long-term liabilities	5,181	1,618
Total liabilities	429,858	116,804
Commitments and contingencies (note 7)		
Stockholders' equity:		
Preferred stock, $0.01 par value: 5,000 shares authorized; no shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	—	—
Common stock, $0.01 par value: 125,000 shares authorized; 38,422 shares issued and 37,144 shares outstanding at September 30, 2013; 37,572 shares issued and 36,294 shares outstanding at December 31, 2012	385	376
Additional paid-in capital	360,869	303,547
Treasury stock, at cost, 1,278 shares	(1,200)	(1,200)
Accumulated other comprehensive loss	(150)	(81)

Retained (accumulated deficit) earnings	(1,545)	9,006
Total stockholders' equity	358,359	311,648
Total liabilities and stockholders' equity	$788,217	$428,452

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue:				
Business services	$141,326	$102,256	$400,708	$295,915
Implementation and other	10,201	3,630	22,716	10,052
Total revenue	151,527	105,886	423,424	305,967
Expense:				
Direct operating	63,245	41,866	175,820	121,678
Selling and marketing	37,584	25,603	111,541	76,720
Research and development	15,104	8,746	41,317	24,529
General and administrative	21,690	11,913	77,437	42,073
Depreciation and amortization	11,263	6,683	30,711	17,964
Total expense	148,886	94,811	436,826	282,964
Operating income (loss)	2,641	11,075	(13,402)	23,003
Other (expense) income:				
Interest expense	(1,421)	(88)	(2,586)	(264)
Other income	30	176	147	498
Total other (expense) income	(1,391)	88	(2,439)	234
Income (loss) before income tax (provision) benefit	1,250	11,163	(15,841)	23,237
Income tax (provision) benefit	(80)	(4,953)	5,290	(10,445)
Net income (loss)	$1,170	$6,210	$(10,551)	$12,792
Net income (loss) per share – Basic	$0.03	$0.17	$(0.29)	$0.36
Net income (loss) per share – Diluted	$0.03	$0.17	$(0.29)	$0.35
Weighted average shares used in computing net income (loss) per share:				
Basic	36,970	35,832	36,722	35,847
Diluted	38,343	37,212	36,722	37,038

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

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athenahealth, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, amounts in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss)	$1,170	$6,210	$(10,551)	$12,792
Other comprehensive income (loss):				
Unrealized gain on securities, net of tax of $0 and $10 for the three and nine months ended September 30, 2013 and 2012, respectively	—	9	20	47
Unrealized loss on change in fair value of interest rate swap, net of tax of $156 and $0 for the three and nine months ended September 30, 2013 and 2012, respectively	(234)	—	(234)	—
Foreign currency translation adjustment	292	79	147	58
Total other comprehensive income (loss)	58	88	(67)	105
Comprehensive income (loss)	$1,228	$6,298	$(10,618)	$12,897

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

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athenahealth, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, amounts in thousands)

	Nine Months Ended September 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$(10,551)	$12,792
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	43,674	20,341
Amortization of premium on investments	84	1,011
Provision for uncollectible accounts	771	188
Excess tax benefit from stock-based awards	—	(11,310)
Deferred income tax	(5,395)	(1,263)
Change in fair value of contingent considerations	76	(4,785)
Stock-based compensation expense	33,725	20,518
Other reconciling adjustments	232	(142)
Changes in operating assets and liabilities:		
Accounts receivable	(13,128)	(4,462)
Prepaid expenses and other current assets	(4,322)	4,774
Other long-term assets	600	206
Accounts payable	7,401	1,625
Accrued expenses	1,004	1,639
Accrued compensation	1,949	3,373
Deferred revenue	2,342	2,364
Deferred rent	(2,259)	(689)
Net cash provided by operating activities	56,203	46,180
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capitalized software development costs	(21,320)	(10,658)
Purchases of property and equipment	(21,405)	(19,126)
Proceeds from sales and maturities of investments	56,245	72,434
Purchases of investments	(2,000)	(62,689)
Payments on acquisitions, net of cash acquired	(410,161)	—
Decrease in restricted cash	1,357	4,151
Other investing activities	—	172
Net cash used in investing activities	(397,284)	(15,716)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock under stock plans and warrants	25,139	17,969
Taxes paid related to net share settlement of restricted stock units	(11,093)	(3,686)
Excess tax benefit from stock-based awards	—	11,310
Payment of contingent consideration accrued at acquisition date	(525)	(1,550)
Debt issuance costs	(1,699)	—
Net settlement of acquired company's board of directors equity shares	(5,806)	—
Proceeds from long-term debt	200,000	—
Proceeds from line of credit	155,000	—
Payments on line of credit	(105,000)	—
Payments on long-term debt	(7,500)	—
Net cash provided by financing activities	248,516	24,043
Effects of exchange rate changes on cash and cash equivalents	(149)	26

Net (decrease) increase in cash and cash equivalents	(92,714)	54,533
Cash and cash equivalents at beginning of period	154,988	57,781
Cash and cash equivalents at end of period	$62,274	$112,314
Non-cash transactions		
Property, equipment and purchased software recorded in accounts payable and accrued expenses	$1,196	$2,908
Tax benefit recorded in prepaid expenses and other current assets	$—	$11,247
Fair value of equity awards assumed	$13,028	$—
Additional disclosures		
Cash received for interest	$451	$1,360
Cash paid for interest	$1,990	$—
Cash paid for taxes	$1,273	$3,869

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

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by athenahealth, Inc. ("athenahealth" or "we") in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial reporting and as required by Regulation S-X, Rule 10-01. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of our management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of items of a normal and recurring nature) necessary to present fairly the financial position as of September 30, 2013, and the results of operations and cash flows for the nine month period ended September 30, 2013 and 2012. The results of operations for the nine month period ended September 30, 2013 are not necessarily indicative of the results to be expected for the full year. When preparing financial statements in conformity with GAAP, we must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

We consider events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date of issuance of these financial statements. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012, included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission ("SEC") on February 11, 2013.

Segment Reporting – We disclose information about our operating segments based on the way that management organizes the segments within athenahealth for making operating decisions and assessing financial performance. Operating segments are identified as components of an enterprise about which separate discrete financial information is evaluated by the chief operating decision-maker ("CODM"), or decision-making group, in making decisions regarding resource allocation and assessing performance. We are in the process of analyzing the information that will be prepared and presented to the CODM due to the acquisitions of Epocrates, Inc. ("Epocrates") and the Arsenal on the Charles during the nine months ended September 30, 2013 (see Note 2 Acquisitions). We anticipate that we will have at least two operating segments – athenahealth and Epocrates. Historically, we have operated in one segment.

Interim Tax Estimate – Due to the fact that we are projecting a nominal pre-tax income (loss) for the year and have significant permanent differences, we cannot reasonably predict our estimated effective tax rate for the year; therefore, we have used a discrete tax approach in calculating the year-to-date provision for the period ended September 30, 2013.

Related Party Transaction – During the three months ended September 30, 2013, we made an investment in a vendor. The total expense for the three month period ended September 30, 2013, was $0.4 million and the total amount payable at September 30, 2013 was $0.1 million.

2. ACQUISITIONS

Watertown, MA Corporate Headquarters – the Arsenal on the Charles

On May 10, 2013, athenahealth, through its wholly-owned subsidiary Athena Arsenal, LLC, completed the acquisition of the real estate commonly known as the Arsenal on the Charles, located in Watertown, Massachusetts. The Arsenal on the Charles is an expansive 29-acre, multi-building, commercial property where we were leasing space for our headquarters and related operating activities prior to the transaction. The purpose of this acquisition is to allow for future expansion of the corporate headquarters to accommodate anticipated headcount growth. The purchase price was $168.5 million, subject to working capital adjustments. The fair value of the consideration paid was $167.3 million, all of which was paid in cash.

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

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

Prepaid expenses and other current assets	$685
Property, equipment and buildings	144,071
Purchased intangible assets	25,545
Accrued expenses	(271)
Deferred revenue	(789)
Other long-term liabilities	(1,916)
Total identifiable net assets	$167,325

The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions and are based on the information that was available as of the date of the acquisition. We believe that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as the value of the purchased tangible and intangible assets and certain working capital adjustments to the purchase price may be subject to change as additional information is received about facts and circumstances that existed at the date of acquisition. Thus, the provisional measurements of fair value set forth above are subject to change. We expect to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The following table sets forth the fair value of the preliminary components of the identifiable intangible assets acquired by asset class:

Above market leases	$3,298
In-place leases	22,247
Total intangible assets subject to amortization	$25,545

The value of any in-place lease is estimated to be equal to the property owners' avoidance of costs necessary to release the property for a lease term equal to the remaining primary in-place lease term and the value of investment grade tenancy. The cost avoidance to the property owners of vacancy/leasing costs necessary to lease the property for a lease term equal to the remaining in-place lease term is derived first by determining the in-place lease term on the subject lease. Then, based on our review of the market, the cost to be borne by a property owner to replicate a market lease to the remaining in-place term was estimated. These costs consist of: (i) rent lost during downtime (e.g., assumed periods of vacancy), (ii) estimated expenses that would be incurred by the property owner during periods of vacancy, (iii) rent concessions (e.g., free rent), (iv) leasing commissions, and (v) tenant improvement allowances. We determine these values using our own estimates along with third-party appraisals. We amortize the capitalized value of in-place lease intangible assets to expense over the remaining initial term of each lease. We amortize the capitalized value of above market leases to expense over the initial and expected renewal terms of the leases. No amortization period for intangible assets will exceed the remaining depreciable life of the building.

The amounts of third-party tenant revenue (included in the line item "Implementation and other") and net loss from the Arsenal on the Charles included in our condensed consolidated statements of income from the acquisition date of May 10, 2013, through the period ended September 30, 2013, are $6.1 million and $0.2 million, respectively. Direct operating expense from the acquisition date of May 10, 2013, through the period ended September 30, 2013, includes $5.9 million of costs associated with third-party tenant revenue for the Arsenal on the Charles.

We incurred transaction costs in connection with the acquisition of $2.4 million during the nine months ended September 30, 2013, respectively, and $3.1 million in total. These costs are included in general and administrative expenses.

Epocrates, Inc.

On March 12, 2013, we acquired Epocrates, a leading provider of essential clinical content, practice tools, and health industry engagement via mobile devices at the point of care. We acquired Epocrates for the assembled workforce, expected synergies, and accelerated awareness of athenahealth's services across the physician market and to deliver high-value information to the clinical community. The acquisition date fair value of the consideration transferred for Epocrates, less cash and short-term investments acquired was approximately $237.6 million, which consisted of the following:

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

Cash payments	$294,632
Fair value of vested stock options and restricted stock units assumed	13,028
Fair value of total consideration	307,660
Less cash acquired	(51,796)
Less short-term investments acquired	(18,250)
Total	$237,614

The value of the share consideration for Epocrates' common stock was based on the average closing sales prices per share of athenahealth common stock for the ten trading days ending on the second trading day prior to the closing of the acquisition. The fair value of the stock options and restricted stock units assumed by us was determined using the Black-Scholes option pricing model. The share conversion ratio of 0.1239 was applied to convert Epocrates stock options and restricted stock units to athenahealth stock options and restricted stock units.

We assumed stock options and restricted stock units with a fair value of $22.6 million. Of the total consideration, $13.0 million was allocated to the purchase consideration and $9.6 million was allocated to future services and will be expensed over the remaining service periods on a straight-line basis over the remaining service period. In the nine months ended September 30, 2013, stock-based compensation expense recognized for stock options and restricted stock units assumed was $7.6 million.

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of the date of acquisition:

Accounts receivable	$23,144
Other current and long-term assets	3,833
Property, equipment and capitalized software costs	4,168
Purchased intangible assets	139,900
Current liabilities	(11,054)
Deferred tax liabilities, net	(39,811)
Deferred revenue	(29,400)
Other long-term liabilities	(1,259)
Total identifiable net assets	$89,521
Goodwill	148,093
	$237,614

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed were based on management's estimates and assumptions based on the information that was available as of the date of the acquisition. We believe that the information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but certain items such as accounts receivable, purchased intangible assets, current and non-current income taxes payable, deferred taxes, deferred revenue and uncertain tax benefits may be subject to change as additional information is received about facts and circumstances that existed at the date of acquisition and certain tax returns are finalized. Thus, the provisional measurements of fair value set forth above are subject to change. We expect to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

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

The following table sets forth the preliminary components of the identifiable intangible assets acquired by asset class and their preliminary estimated useful lives as of the date of acquisition:

	Fair Value	Useful Life
Physician network	$104,500	14 years
Drug information content	10,000	5 years
Trade name	11,500	10 years
Customer backlog	2,900	1.5 years
Epocrates non-compete agreement	4,500	1.5 years
Developed technology	6,500	3 years
Total intangible assets subject to amortization	$139,900	

We anticipate that we will allocate the acquired physician network among our operating segments once determined. The Epocrates segment will represent the fair values of the underlying relationships and agreements with Epocrates customers. The physician network related to the athenahealth segment will represent the fair values of the savings associated with future marketing spend for the athenahealth segment services to the acquired physician network. Drug information content represents the fair value of the cost to replace the drug information and interaction content used by the physician's network. The trade name represents the fair value of the brand and name recognition associated with the marketing of Epocrates' service offerings. Customer backlog represents the estimated fair value of existing contractual backlog orders as of the acquisition date. Epocrates non-compete agreement represents the estimated fair value of the contract between athenahealth and a former member of Epocrates management. Developed technology represents the estimated fair value of Epocrates' mobile device platform. All of the purchased intangible assets related to the Epocrates transaction have finite lives. For those purchased intangible assets where an income approach was used, we considered the projected undiscounted cash flows as the best indication of the pattern of economic benefit expected from each asset.

The goodwill balance is primarily attributed to the assembled workforce and expanded market opportunities when integrating Epocrates' mobile device platform with the athenahealth service offerings. We anticipate goodwill will be allocated among our reporting units and operating segments once determined. The goodwill balance is not deductible for U.S. income tax purposes.

The amounts of revenue and net loss of Epocrates included in our condensed consolidated statements of income from the acquisition date of March 12, 2013, through the period ended September 30, 2013, are $33.5 million and $17.6 million, respectively. The net loss includes $7.6 million in stock-based compensation expense primarily related to the acceleration of certain individuals' stock awards upon termination.

We incurred transaction costs in connection with the acquisition of $0.0 million and $2.7 million during the three and nine months ended September 30, 2013, respectively, and $3.2 million in total. These costs are included in general and administrative expenses.

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

As part of the integration of Epocrates, we communicated to certain employees severance and retention bonuses which total $4.2 million to be paid through the end of 2013. The following table summarizes these amounts on the condensed consolidated statements of income for the nine months ended September 30, 2013:

Summary of roll forward of integration costs

Beginning balance, January 1, 2013	$—
Addition to provision	2,209
Cash payments	(195)
Ending balance, March 31, 2013	$2,014
Addition to provision	979
Change in estimate	(129)
Cash payments	(1,122)
Ending balance, June 30, 2013	$1,742
Addition to provision	526
Change in estimate	(72)
Cash payments	(692)
Ending balance, September 30, 2013	$1,504

Pro Forma Presentation

The following pro forma financial information summarizes the combined results of operations for athenahealth as though the acquisitions of Epocrates and the Arsenal on the Charles occurred on January 1, 2012. The unaudited pro forma financial information is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenue	$151,527	$132,833	$443,196	$390,673
Net income (loss)	$1,170	$982	$(14,953)	$(9,101)
Net income (loss) per share – Basic	$0.03	$0.03	$(0.41)	$(0.25)
Net income (loss) per share – Diluted	$0.03	$0.03	$(0.41)	$(0.24)

The pro forma financial information for all periods presented has been calculated after adjusting the results of Epocrates and the Arsenal on the Charles to reflect the business combination accounting effects resulting from these acquisitions including the amortization expenses from acquired intangible assets, the deprecation expenses from acquired tangible assets, the stock-based compensation expense for unvested stock options and restricted stock units assumed and the related tax effects as though the acquisition occurred as of January 1, 2012. The pro forma financial information is for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of our 2012 fiscal year.

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

3. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding and potentially dilutive securities outstanding during the period under the treasury stock method. Potentially dilutive securities include stock options, restricted stock units, and shares to be purchased under the employee stock purchase plan. Under the treasury stock method, dilutive securities are assumed to be exercised at the beginning of the period and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Securities are excluded from the computations of diluted net income per share if their effect would be anti-dilutive to earnings per share.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss)	$1,170	$6,210	$(10,551)	$12,792
Weighted average shares used in computing basic net income (loss) per share	36,970	35,832	36,722	35,847
Net income (loss) per share – Basic	$0.03	$0.17	$(0.29)	$0.36
Net income (loss)	$1,170	$6,210	$(10,551)	$12,792
Weighted average shares used in computing basic net income (loss) per share	36,970	35,832	36,722	35,847
Effect of dilutive securities	1,373	1,380	—	1,191
Weighted average shares used in computing diluted net income (loss) per share	38,343	37,212	36,722	37,038
Net income (loss) per share – Diluted	$0.03	$0.17	$(0.29)	$0.35

The computation of diluted net income per share does not include 0.3 million of stock options and restricted stock units for the three months ended September 30, 2013, because their inclusion would have an anti-dilutive effect on net income per share. The computation of diluted net income per share does not include 0.4 million and 0.4 million of stock options and restricted stock units for the three and nine months ended September 30, 2012, respectively, because their inclusion would have an anti-dilutive effect on net income per share. For the nine months ended September 30, 2013, there were 3.5 million stock options and restricted stock units excluded from the calculation of the diluted net income (loss) per share, since to include them would be anti-dilutive.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

As of September 30, 2013, and December 31, 2012, the carrying amounts of cash and cash equivalents, restricted cash, receivables, accounts payable and accrued expenses approximated their estimated fair values because of the short-term nature of these financial instruments. Included in cash and cash equivalents as of September 30, 2013 and December 31, 2012, are money market fund investments of less than $0.1 million and $59.4 million, respectively, which are reported at fair value. As of September 30, 2013, we had $192.5 million outstanding on its term loan facility and $50 million outstanding on its revolving credit facility (see Note 6. Debt) which approximate their fair values due to their variable rate nature at current market rates. As of December 31, 2012, we had no outstanding debt.

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

The following table presents information about our financial assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2013, and December 31, 2012, and indicates the fair value hierarchy of the valuation techniques we utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities and fair values determined by Level 2 inputs utilize quoted prices (unadjusted) in active markets for similar assets or liabilities. The fair values determined by Level 3 inputs are unobservable values which are supported by little or no market activity.

	Fair Value Measurements At September 30, 2013, Using			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market funds	$37	$—	$—	$37
Total assets	$37	$—	$—	$37
Interest rate swap liability	$—	$(390)	$—	$(390)
Total liabilities	$—	$(390)	$—	$(390)

	Fair Value Measurements as of December 31, 2012, Using			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents:				
Money market funds	$89,480	$—	$—	$89,480
Available-for-sale investments:				
Commercial paper	—	11,748	—	11,748
Corporate bonds	—	20,334	—	20,334
Certificate of deposit	—	6,010	—	6,010
Total assets	$89,480	$38,092	$—	$127,572
Accrued contingent consideration	$—	$—	$(448)	$(448)
Total liabilities	$—	$—	$(448)	$(448)

Money market funds, certificates of deposit, corporate bonds and commercial paper are valued using a market approach based upon the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in inactive markets or similar securities. It is our policy to recognize transfers between levels of the fair value hierarchy, if any, at the end of the reporting period; however, there have been no such transfers during any periods presented. The estimated fair value of our interest rate swap agreement with certain financial institutions at September 30, 2013, was $0.4 million, based on inputs other than quoted prices that are observable for the interest rate swap (Level 2). There was no interest rate swap agreement at December 31, 2012.
Contingent consideration is recorded at fair value as an element of consideration paid with subsequent adjustments recognized in the consolidated statement of income. At the acquisition date and through the end of the measurement period, the fair value of the accrued contingent consideration was determined using a probability-weighted income approach based on upside, downside and base case scenarios. This approach is based on significant inputs that are not observable in the market, which are referred to as Level 3 inputs. The contingent consideration related to our acquisition of Proxsys in 2011 ranged from zero to $5.0 million and was payable in quarterly installments based upon the cross-selling of our athenaCollector services into Proxsys' new and acquired customer and physician sender base, from the acquisition date to the second year anniversary of the acquisition in the third quarter of 2013. As of December 31, 2012, we had a probability adjusted level of 60% for the base case and 20% for the upside and downside scenarios. We estimated the fair value of the contingent consideration at December 31, 2012, to be $0.4 million, primarily related to how much had been earned and the amount of time left to earn the additional consideration. We accrued an additional general and administrative expense of $0.1 million during the three and nine

months ended September 30, 2013, for the final payment based on the final cross-selling results. We paid $0.5 million related to the second contingent consideration during September 2013. As of September 30, 2013, there are no contingent consideration arrangements owed or outstanding.

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

The reconciliations for the fair values of financial instruments determined by Level 3 inputs for the periods presented are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Balance, beginning of period	$448	$6,259	$448	$8,176
Payments	(524)	(1,843)	(524)	(2,650)
Change in fair value (included in general and administrative expenses)	76	(3,675)	76	(4,785)
Balance, end of period	$—	$741	$—	$741

5. PROPERTY AND EQUIPMENT
The fair values of the property and equipment acquired as part of the purchase of the Arsenal on the Charles are allocated to buildings, land, and land improvements in the amounts of $121.3 million, $21.0 million, and $1.8 million, respectively.
Property and equipment consist of the following as of:

	September 30, 2013	December 31, 2012
Equipment	$74,358	$56,078
Furniture and fixtures	7,709	5,297
Leasehold improvements	2,756	15,518
Airplane	3,156	3,156
Building	136,181	14,644
Building improvements	18,281	3,500
Land	23,059	2,035
Land improvements	2,735	915
Total property and equipment, at cost	268,235	101,143
Accumulated depreciation and amortization	(68,156)	(49,902)
Construction in progress	3,559	2,794
Property and equipment, net	$203,638	$54,035

Depreciation expense on property and equipment was $6.6 million and $4.5 million for the three months ended September 30, 2013, and 2012, respectively. Depreciation expense on property and equipment was $18.3 million and $12.2 million for the nine months ended September 30, 2013, and 2012, respectively.
6. DEBT
2011 Line of Credit – On October 20, 2011, we entered into a $100.0 million revolving credit agreement (“Revolving Credit Agreement”) with a term of five years. The Revolving Credit Agreement contains certain covenants, including consolidated leverage and minimum fixed charge coverage ratios. The interest rates applicable to revolving loans under the Revolving Credit Agreement are at either (i) the British Bankers Association London Interbank Offered Rate (“LIBOR”) plus an interest margin based on our consolidated leverage ratio, or (ii) the base rate (which is the highest of (a) the bank’s prime rate, (b) the Federal Funds rate plus 0.50%, and (c) one month LIBOR plus 1.00%) plus an interest margin based on our consolidated leverage ratio.
2013 Commitment Letter – On January 7, 2013, we entered into a commitment letter, pursuant to which Bank of America, N.A. committed to increase its commitment to provide revolving loans under the Revolving Credit Agreement by an amount up to $55 million as a source of funding for the Epocrates transaction (see Note 2 Acquisitions). We were required to pay financing fees of $0.3 million for this commitment.

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

On March 11, 2013, we borrowed $155.0 million under the Revolving Credit Agreement as a source of funding for the Epocrates transaction. We repaid $50.0 million of the $155.0 million as of March 31, 2013. All amounts outstanding under the Revolving Credit Agreement were repaid on May 10, 2013, as discussed below.

2013 Credit Agreement – On May 10, 2013, we entered into a $325 million senior credit facility consisting of a $200 million unsecured term loan facility and a $125 million unsecured revolving credit facility (the “Senior Credit Facility”). We may increase the Senior Credit Facility up to an additional $100 million, subject to certain conditions including obtaining lender commitments. The terms and conditions of the Senior Credit Facility are customary to facilities of this nature. The Senior Credit Facility expires on May 10, 2018, although we may prepay the Senior Credit Facility in whole or in part at any time without premium or penalty, and the unutilized portion of the commitments may be irrevocably reduced or terminated by us in whole or in part without penalty or premium. The Senior Credit Facility contains customary default provisions and certain financial and nonfinancial covenants including limitations on our consolidated leverage ratio and capital expenditures.

On May 10, 2013, we borrowed $200 million under the unsecured term loan facility and $50 million under the unsecured revolving credit facility of the Senior Credit Facility to refinance existing indebtedness described above, to finance the Arsenal on the Charles acquisition as described in Note 2. Acquisitions, and for working capital and other general corporate purposes. The unsecured term loan facility was payable quarterly starting June 30, 2013, in the amount of $3.75 million each quarter. As of September 30, 2013, we had $192.5 million outstanding on the unsecured term loan facility and $50.0 million outstanding on the unsecured revolving credit facility. As of September 30, 2013, we had $75 million available on the unsecured revolving credit facility.

Any loan under the Senior Credit Facility will bear interest at the same rates as in the Revolving Credit Agreement. The interest rate for the Senior Credit Facility as of September 30, 2013 was 1.93%.

We were required to pay financing fees of $1.3 million for the Senior Credit Facility, which are being amortized as interest expense in the condensed consolidated statements of income over the five-year term of the agreement.

Future principle payments of the unsecured term loan facility at September 30, 2013 are as follows:

	Amount
Remaining 2013	$3,750
2014	15,000
2015	15,000
2016	15,000
2017	15,000
Thereafter	128,750
Total	192,500
Less current portion	15,000
Long-term portion	$177,500

During the quarter ended September 30, 2013, we entered into an interest rate swap agreement designed to fix the variable interest rate payable on $120 million of our outstanding borrowings under the Senior Credit Facility at 0.8396% exclusive of the credit spread under the Senior Credit Facility.

The interest rate swap agreement was designed to manage exposure to interest rates on our variable rate indebtedness. We recognize all derivatives on our balance sheet at fair value. We have designated our interest rate swap agreement as a cash flow hedge. Changes in the fair value of the interest rate swap are recognized in other comprehensive income (loss) (“OCI”) until the hedged items are recognized in earnings. Hedge ineffectiveness, if any, associated with the interest rate swap will be reported by us in interest expense. There was no ineffectiveness associated with the interest rate swap during the quarter ended September 30, 2013, nor was any amount excluded from ineffectiveness testing.

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

The fair value of the interest rate swap recognized in other long-term liabilities and in OCI is as follows (in thousands):

				Fair Value	
Effective Date	Notional Amount	Fixed Rate	Maturity	September 30, 2013	December 31, 2012
August 31, 2013	120,000	0.8396 %	August 31, 2016	$(390)	$—

7. COMMITMENTS AND CONTINGENCIES

On January 11, 2013, a complaint captioned Bushansky v. Epocrates, Inc., et al., Case No. 519078, was filed in San Mateo County Superior Court (the “Court”) on behalf of a putative class of Epocrates’ shareholders against Epocrates and each member of the Epocrates board of directors. This complaint challenged the proposed merger between Epocrates and one of our wholly owned subsidiaries. On January 25, 2013, a similar complaint was filed in the Court captioned DeJoice v. Epocrates, et al., Case No. 519461. This second complaint made similar allegations against Epocrates and each member of the Epocrates board of directors and included a claim against us for aiding and abetting a breach of fiduciary duty. On January 31, 2013, the Bushansky complaint was amended to include additional allegations. Plaintiffs allege, among other things, that the Epocrates directors breached their fiduciary duties by allegedly agreeing to sell Epocrates at an unfair and inadequate price, failing to take steps to maximize the sale price of Epocrates, and making material omissions to the preliminary proxy statement dated January 25, 2013. The complaints sought to enjoin the merger, other equitable relief, and monetary damages. On March 5, 2013, Epocrates and the plaintiffs signed a memorandum of understanding in which the parties agreed to enter into a stipulation of settlement whereby the plaintiffs and all class members would release all claims related to the merger in exchange for Epocrates filing a supplement to its definitive proxy statement regarding the merger with the SEC, which would include additional disclosures regarding the merger agreement, and an agreement to negotiate in good faith regarding the amount of attorneys’ fees and expenses for which plaintiffs may seek approval from the Court. On October 4, 2013, the Court granted final settlement approval including a grant of fees and expenses in the amount of $335,000 to plaintiffs’ counsel. The settlement has no material impact on the Company’s condensed consolidated financial statements.

In addition, we are engaged from time to time in certain legal disputes arising in the ordinary course of business, including employment discrimination claims and challenges to our intellectual property. We believe that we have adequate legal defenses and that the likelihood of a loss contingency relating to the ultimate dispositions of any of these disputes is remote. When the likelihood of a loss contingency becomes at least reasonably possible with respect to any of these disputes, or, as applicable in the future, if there is at least a reasonable possibility that a loss exceeding amounts already recognized may have been incurred, we will revise our disclosures in accordance with the relevant authoritative guidance.

Additionally, we will accrue liability for loss contingencies when we believe that it is both probable that a liability has been incurred and that we can reasonably estimate the amount of the loss. We will review these accruals and adjust them to reflect ongoing negotiations, settlements, rulings, advice of legal counsel, and other relevant information. To the extent new information is obtained, and our views on the probable outcomes of claims, suits, assessments, investigations, or legal proceedings change, changes in our accrued liabilities would be recorded in the period in which such determination is made.

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

This Quarterly Report on Form 10-Q contains forward-looking statements. All statements other than statements of historical fact contained in this Quarterly Report on Form 10-Q are forward-looking statements, including those regarding the combination or integration of newly acquired services; the integration of Epocrates; the purchase of the Arsenal on the Charles campus; expected tax credits from states; expanded sales and marketing efforts; changes in expenses related to operations, selling, marketing, research and development, general and administrative matters, and depreciation and amortization; liquidity issues; additional fundraising; and the expected performance period and estimated term of our client relationships, as well as more general statements regarding our expectations for future financial and operational performance, product and service offerings, regulatory environment, and market trends. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” or “continue”; the negative of these terms; or other comparable terminology. Forward-looking statements in this Item 2 include, without limitation, statements reflecting management's expectations for future financial performance and operating expenditures, expected growth, profitability and business outlook, increased sales and marketing expenses, increased cross-selling efforts among our service offerings, expected client implementations, expected certification and regulatory approvals and the benefits of our current service offerings and research and development for new service offerings and the benefits of current and expected strategic and sales and marketing relationships.

Forward-looking statements are only current predictions and are subject to known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from those anticipated by such statements. These factors include, among other things, those set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, under the heading Part I, Item 1A “Risk Factors” and any set forth below under Part II, Item 1A, “Risk Factors.”

Although we believe that the expectations reflected in the forward-looking statements contained in this Quarterly Report on Form 10-Q are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Except as required by law, we are under no duty to update or revise any of such forward-looking statements, whether as a result of new information, future events, or otherwise, after the date of this Quarterly Report on Form 10-Q.

Overview

athenahealth provides business services that help medical caregivers achieve and sustain financial health by collecting more money and exercising more control over their administrative and clinical tasks. These services are designed to reduce the administrative burden of complex billing rules, quality measurement and reporting, clinical documentation and data exchange, patient communication and referrals, and many of the related tasks that distract medical caregivers and staff from delivering care. Our services are delivered and consumed through a single instance of our cloud-based platform, athenaNet. We differentiate our services by regularly deploying updates and improvements through athenaNet to clients without any action on the part of the client. athenaNet enables us to quickly implement our solution at a low up-front cost and to seamlessly work in tandem with our clients in real time.

The services provided through our single-instance cloud are currently packaged as five integrated components: athenaCollector for revenue cycle management, athenaClinicals for electronic health record management, athenaCommunicator for patient communication management, and athenaCoordinator for referral cycle management. The use of our single-instance platform allows all clients to benefit from the collective knowledge of all of our other clients through our patented billing Rules Engine and our clinical Quality Management Engine. Our clients use these rules engines to monitor and benchmark their performance with peer practices across the network. Complementing athenaCollector is our cloud-based analytics service, athenaClarity, which delivers actionable insight in both fee-for-service and risk-based payment environments.

Each service we provide is supported by a model comprised of three distinct components: Software, Knowledge, and Work. The cloud-based software is provided at no extra charge to users but is the primary conduit through which we exchange information between clients, payers, and our staff of experts. Knowledge is infused into each of our services via our Rules Engine as we work with clients, payers, and other partners to codify rules associated with reimbursement, clinical quality measures, and other factors related to our clients' performance. The third component to each of our services is the Work that we perform on behalf of our clients. Wherever possible, we replace manual processes with automation, but where automation is not possible, we provide that manual labor rather than returning it to clients to be completed. This unique service model of Software, Knowledge, and Work has allowed us to align our success with our clients' performance, creating a continual cycle of improvement and efficiency. We charge clients a percentage of collections in most cases, so our financial results are a direct reflection of our ability to drive revenue to medical practices.

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For the nine months ended September 30, 2013, we generated revenue of $423.4 million from the sale of our services compared to $306.0 million for the nine months ended September 30, 2012. Given the scope of our market opportunity, we have increased our spending each year on growth, innovation, and infrastructure.

Our revenue is predominately derived from business services that we provide on an ongoing basis. This revenue is generally determined as a percentage of payments collected by us on behalf of our clients, so the key drivers of our revenue include growth in the number of physicians and other medical providers working within our client accounts, the collections of these physicians, and the number of services purchased. To provide these services, we incur expenses in several categories, including direct operating, selling and marketing, research and development, general and administrative, and depreciation and amortization. In general, our direct operating expense increases as our volume of work increases, whereas our selling and marketing expense increases in proportion to our intended growth rate of adding new accounts to our network of physician clients. Our other expense categories are less directly related to growth of revenues and relate more to our planning for the future, our overall business management activities, and our infrastructure. We manage our cash and our use of credit facilities to ensure adequate liquidity, in adherence to related financial covenants.

Recent Developments

Watertown, MA Corporate Headquarters – the Arsenal on the Charles

On May 10, 2013, we acquired the real estate commonly known as the Arsenal on the Charles, located in Watertown, Massachusetts. The Arsenal on the Charles is an expansive 29-acre, multi-building, commercial property where we were leasing our headquarters prior to the transaction. The purpose of this acquisition is to allow for future expansion of the corporate headquarters to accommodate anticipated headcount growth. The purchase price was $168.5 million, subject to working capital adjustments. The fair value of the consideration paid was $167.3 million, all of which was paid in cash. The acquisition of our Watertown, Massachusetts, corporate headquarters increased our total assets on the condensed consolidated balance sheet by approximately $170 million, primarily due to increases in property and equipment of $144.1 million and intangible assets of $25.5 million. Total liabilities increased by approximately $160 million due to increases in borrowings. See Note 2. Acquisitions in the notes to the condensed consolidated financial statements for detailed information related to the business combination accounting.

Massachusetts Incentive Tax Credits

During the three months ended June 30, 2013, the Commonwealth of Massachusetts awarded us approximately $9.5 million of Massachusetts investment tax credits over 10 years, subject to fulfillment of capital investment and jobs commitments by us. The agreement was signed during the three months ended September 30, 2013.

Epocrates, Inc.

On March 12, 2013, we acquired Epocrates, a leading provider of essential clinical content, practice tools, and health industry engagement via mobile devices at the point of care. The Epocrates member network consists of more than one million health care professionals, including approximately 50% of U.S. physicians, who routinely use its solutions and services. Epocrates' portfolio includes top-ranked medical applications, such as the industry's #1 medical application among U.S. physicians, which provides convenient, point-of-care access to information such as dosing, drug interactions, pricing, and insurance coverage for thousands of brand, generic, and over-the-counter drugs. The features available through its unique physician platform are often referenced multiple times per day and help health care professionals make more informed prescribing decisions, improve workflow, and enhance patient safety.

Epocrates offers its products on major U.S. mobile platforms, including Apple, Android, and BlackBerry. Epocrates generates revenue by providing clients in the health care industry (e.g., pharmaceutical companies, managed care companies, and market research firms) with interactive services to engage with its network of members and through the sale of subscriptions to its premium drug and clinical reference tools to health care professionals. Its client base is located almost entirely within the U.S. We acquired Epocrates for the assembled workforce, expected synergies, and accelerated awareness of athenahealth's services across the physician market and to deliver high-value information to the clinical community.

The acquisition of Epocrates increased our total assets on the condensed consolidated balance sheet by approximately $180 million, primarily due to increases in goodwill of $148 million, purchased intangible assets of $140 million and accounts receivable of $23 million, which were offset by a decrease in cash of $145 million. Total liabilities and stockholders' equity increased $180 million, primarily due to increases in borrowings of $105 million, net long-term deferred tax liabilities of $40 million, deferred revenue of $30 million, and a $13 million increase in additional paid-in capital related to the equity portion of the fair value of consideration paid. See Note 2. Acquisitions in the notes to the condensed consolidated financial statements for detailed information related to the business combination accounting.

Critical Accounting Policies

Our discussion and analysis of our results of operations and liquidity and capital resources are based on our condensed consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP"). In connection with the preparation of our condensed consolidated financial statements in conformity with GAAP, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors we believe to be relevant at the time we prepare our condensed consolidated financial statements. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that our condensed consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

Our condensed consolidated financial statements use estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but are not limited to: (1) revenue recognition; including our estimated expected customer life; (2) asset impairments; (3) estimated useful lives of assets; (4) fair value of stock options; (5) allocation of direct and indirect expenses; (6) fair value of contingent consideration and acquired intangible assets in a business combination; and (7) litigation reserves. Future events and their effects cannot be predicted with certainty, and accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our condensed consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. Actual results could differ from the estimates we have used.

Critical accounting policies are those policies that affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements. We believe our critical accounting policies include our policies regarding revenue recognition and business combinations related to purchased intangible assets and contingent consideration. For a more detailed discussion of our critical accounting policies, please refer to our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Securities and Exchange Commission on February 11, 2013.

Financial Operations Overview

Revenue. We derive our revenue from two sources: from business services associated with our revenue cycle management, electronic health record management, patient communication management, referral cycle management, analytics offerings, and from Epocrates; and from implementation and other services. Implementation and other revenue consists primarily of professional services fees related to assisting clients with the initial implementation of our services, for ongoing training and related support services, and for third-party tenant revenue. Business services accounted for 93% of our total revenues for the three months ended September 30, 2013 and 97% for the three months ended September 30, 2012. Business services accounted for 95% of our total revenues for the nine months ended September 30, 2013 and 97% for the nine months ended September 30, 2012. Business services revenue are typically 2% to 8% of a practice's total collections depending upon the services purchased, the size, complexity, and other characteristics of the practice, plus a per-statement charge for billing statements that are generated for patients. Accordingly, business services revenue is largely driven by the number of physician practices and other service providers we serve, the number of physicians and other medical providers working in those physician practices, the volume of activity and related collections of those physicians, the mix of our services used by those physician practices and other medical providers, and our contracted rates. There is moderate seasonality in the activity level of physician practices. Typically, discretionary use of physician services declines in the late summer and during the holiday season, which leads to a decline in collections by our physician clients about 30 to 50 days later. Additionally, the volume of activity and related collections vary from year to year based in large part on the severity, length and timing of the onset of the flu season. While we believe that the severity, length and timing of the onset of the cold and flu season will continue to impact collections by our physician clients, there can be no assurance that our future sales of these services will necessarily follow historical patterns. Implementation and other revenue are largely driven by the increase in the volume of our new business. As a result, we expect implementation and other revenue to increase in absolute terms for the foreseeable future but to remain relatively consistent as a percentage of total revenue. None of our clients accounted for more than 10% of our total revenues for the three and nine months ended September 30, 2013 and 2012.

Direct Operating Expense. Direct operating expense consists primarily of salaries, benefits, claim processing costs, other direct expenses, and stock-based compensation related to personnel who provide services to clients, including staff who implement new clients. We expense implementation costs as incurred. We include in direct operating expense all service costs associated with athenaCollector, athenaClinicals, athenaCommunicator, athenaCoordinator, athenaClarity, and Epocrates. We expect to increase our overall level of automation as we become a larger operation, with higher volumes of work in particular functions, geographies, and medical specialties. Although we expect that direct operating expense will increase in absolute terms for the foreseeable future, the direct operating expense is expected to decline as a percentage of revenue as we increase automation. Direct operating expense does not include allocated amounts for rent, occupancy and other indirect costs (including building maintenance and utilities), depreciation, and amortization, except for a portion of amortization related to purchased intangible assets. Direct operating expense includes costs associated with third party tenant revenue for the Arsenal on the Charles.

Selling and Marketing Expense. Selling and marketing expense consists primarily of marketing programs (including trade shows, brand messaging, and on-line initiatives) and personnel-related expense for sales and marketing employees (including salaries, benefits, commissions, stock-based compensation, non-billable travel, lodging, and other out-of-pocket employee-related expenses). Although we recognize substantially all of our revenue when services have been delivered, we recognize a large portion of our sales commission expense at the time of contract signature and at the time our services commence. Accordingly, we incur a portion of our sales and marketing expense prior to the recognition of the corresponding revenue. We have increased our sales and marketing expenses from year to year and we expect to continue to increase our investment in sales and marketing by hiring additional direct sales personnel and support personnel to add new clients and increase sales to our existing clients and to expand awareness through paid search and other similar initiatives. We also plan to expand our marketing activities, such as attending trade shows, expanding user groups, and creating new printed materials. As a result, we expect that, in the near-term, sales and marketing expense will increase in line with revenue growth. Sales and marketing expense does not include allocated amounts for rent, occupancy and other indirect costs (including building maintenance and utilities), depreciation, and amortization, except for a portion of amortization related to purchased intangible assets.

Research and Development Expense. Research and development expense consists primarily of personnel-related expenses for research and development employees (including salaries, benefits, stock-based compensation, non-billable travel, lodging, and other out-of-pocket employee-related expenses) and consulting fees for third-party developers. We expect that, in the near-term, research and development expenditures will increase in absolute terms and will likely remain consistent as a percent of revenue as we develop and enhance new and existing services; however, the amount of expenditures that should be capitalized as software development costs versus expensed as research and development could vary based on the specific projects we undertake.

General and Administrative Expense. General and administrative expense consists primarily of personnel-related expense for administrative employees (including salaries, benefits, stock-based compensation, non-billable travel, lodging, and other out-of-pocket employee-related expense), occupancy and other indirect costs (including building maintenance and utilities), and insurance premiums; and, outside professional fees for accountants, lawyers, external costs associated with acquisitions, change in the fair value of contingent consideration, and consultants. We expect that general and administrative expense will increase in absolute terms as we invest in infrastructure to support our growth. Though expenses are expected to continue to rise in absolute terms, we expect general and administrative expense to decline as a percentage of total revenue over time.

Depreciation and Amortization Expense. Depreciation and amortization expense consists primarily of depreciation of fixed assets and amortization of capitalized software development and acquisition costs, which we amortize over a two to three-year period from the time of the release of the related software code. As we grow, we will continue to make capital investments in the infrastructure of the business and we will continue to develop software that we capitalize. In the near term, we expect depreciation and amortization expense to increase as a percentage of total revenue.

Interest Expense. Interest expense consists primarily of interest costs related to our term and revolving loans under our credit facility and the amortization of deferred financing fees.

Income Tax (Provision) Benefit. Income tax (provision) benefit consists of federal and state income taxes in the United States and India. The difference between our effective tax rate and our statutory rate is mainly related to transaction costs associated with stock acquisitions, any changes in the fair value of contingent consideration related to non-tax deductible goodwill, the treatment of Incentive Stock Options (“ISOs”), and the impact of certain tax deduction limits related to certain of our highly compensated officers. Transaction costs related to stock acquisitions are primarily non-tax deductible. The changes in the fair value of contingent consideration related to non-tax deductible goodwill and the treatment of disqualifying dispositions related to ISOs are also treated as discrete items which means they are recorded in the quarter in which they occur and could cause significant differences between the quarterly and annual effective tax rate. Also, we substantially ceased issuing ISOs in 2009, but we expect continued volatility related to these options since we cannot anticipate when disqualifying dispositions related to these options will occur. We expect that our income tax provision for the 2013 fiscal year will be substantially lower than in prior years based on expected lower pretax income (loss).

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Results of Operations

Revenue. Total revenue for the three and nine months ended September 30, 2013 is primarily due to an increase in business services revenue.

Comparison of the Three and Nine Months Ended September 30, 2013 and 2012

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Amount	Percent	2013	2012	Amount	Percent
	(in thousands)							
Business services	$141,326	$102,256	$39,070	38 %	$400,708	$295,915	$104,793	35 %
Implementation and other	10,201	3,630	6,571	181 %	22,716	10,052	12,664	126 %
Total	$151,527	$105,886	$45,641	43 %	$423,424	$305,967	$117,457	38 %

Business Services Revenue. The increase in business services revenue is primarily driven by the growth in the number of physicians and providers using our services, and includes revenue from Epocrates. The three and nine months ended September 30, 2013 includes $13.4 million and $33.5 million of total revenue, respectively, attributable to Epocrates business services revenue. The increases in the number of physicians and providers using our revenue cycle management service, athenaCollector; electronic health record management service, athenaClinicals; and patient communication management service, athenaCommunicator; are as follows:

		As of September 30,			
		2013	2012	Change	
		Number	Number	Number	Percent
athenaCollector	Physicians	33,764	27,013	6,751	25 %
	Providers	47,195	38,145	9,050	24 %
athenaClinicals	Physicians	11,401	7,340	4,061	55 %
	Providers	15,483	10,062	5,421	54 %
athenaCommunicator	Physicians	17,330	8,739	8,591	98 %
	Providers	23,024	12,149	10,875	90 %

Also contributing to the increase in business services revenue was the growth in related collections on behalf of these physicians and providers. The amount of collections processed are as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Amount	Percent	2013	2012	Amount	Percent
	(in millions)							
Collections processed	$2,975	$2,303	$672	29 %	$8,378	$6,643	$1,735	26 %

Implementation and Other Revenue. The increase in revenue from implementation and other revenue was driven by new client implementations, increased professional services for our larger client base, an increased volume of our new business, and third-party tenant revenue of $6.1 million associated with the Arsenal on the Charles property from the date of acquisition in May through September 30, 2013.

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Amount	Percent	2013	2012	Amount	Percent
	(in thousands)							
Direct operating	$63,245	$41,866	$21,379	51 %	$175,820	$121,678	$54,142	44 %

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Direct Operating Expense. The increase in direct operating expense is primarily due to an increase in the number of claims that we process on behalf of our clients and the related expense of providing services, including transactions expense and employee-related costs. The total claims submitted on behalf of clients are as follows:

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Amount	Percent	2013	2012	Amount	Percent
	(in thousands)							
Total claims submitted	22.9	17.7	5.2	29 %	65.3	53.0	12.3	23 %

Also contributing to this increase was the direct operating employee-related costs, including stock-based compensation, which increased $6.7 million and $22.7 million for the three and nine months ended September 30, 2013, respectively, primarily due to a 37% increase in headcount from September 30, 2012. We increased headcount to meet the current and anticipated demand for our services as our customer base continues to expand and includes larger medical groups. Additionally, headcount at September 30, 2013, includes approximately 55 employees from our acquisition of Epocrates in March 2013.

Amortization related to purchased intangible assets allocated to direct operating expenses increased $2.9 million and $5.6 million for the three and nine months ended September 30, 2013, respectively, from the same period in the prior year due to our acquisitions of Epocrates during the three months ended March 31, 2013, and the Arsenal on the Charles during the three months ended June 30, 2013. Direct operating expense from the acquisition date of May 10, 2013, through the period ended September 30, 2013, includes $5.9 million of costs associated with third-party tenant revenue for the Arsenal on the Charles. No amounts of costs associated with third-party tenant revenue were included in direct operating expenses during the three and nine months ended September 31, 2012.

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Amount	Percent	2013	2012	Amount	Percent
	(in thousands)							
Selling and marketing	$37,584	$25,603	$11,981	47 %	$111,541	$76,720	$34,821	45 %
Research and development	15,104	8,746	6,358	73 %	41,317	24,529	16,788	68 %
General and administrative	21,690	11,913	9,777	82 %	77,437	42,073	35,364	84 %
Depreciation and amortization	11,263	6,683	4,580	69 %	30,711	17,964	12,747	71 %
Total	$85,641	$52,945	$32,696	62 %	$261,006	$161,286	$99,720	62 %

Selling and Marketing Expense. The increase in selling and marketing expense was primarily due to compensation costs, including stock-based compensation expense, internal sales commissions and external partner channel commissions of $8.0 million and $21.4 million for the three and nine months ended September 30, 2013, respectively. The cost of compensation is primarily driven by headcount. Our sales and marketing headcount increased by 25% from September 30, 2012, as we hired additional sales personnel to focus on adding new customers and increasing penetration within our existing markets. Additionally, headcount at September 30, 2013, includes 59 employees from our acquisition of Epocrates in March 2013. The increase was also due to $1.5 million and $8.6 million increases in online and offline marketing, consulting, employee-related travel, infrastructure, and other marketing-related costs for the three and nine months ended September 30, 2013, respectively. Amortization related to purchased intangible assets allocated to selling and marketing expense increased $2.4 million and $4.8 million for the three and nine months ended September 30, 2013, respectively, from the same periods in the prior year primarily due to our acquisition of Epocrates during the three months ended March 31, 2013.

Research and Development Expense. Research and development expense increased due to higher employee-related costs, including stock-based compensation expense of $5.1 million and $14.3 million for the three and nine months ended September 30, 2013, respectively. These increases are primarily due to a 52% increase in headcount from September 30, 2012. Additionally, headcount at September 30, 2013 includes 91 employees from our acquisition of

Epocrates in March 2013. The additional research and development personnel were necessary in order to upgrade and extend our service offerings and develop new technologies.

General and Administrative Expense. General and administrative expense increased primarily due to higher employee-related costs, including stock-based compensation expense; infrastructure costs and transaction costs. Employee-related compensation increased $3.8 million and $16.7 million for the three and nine months ended September 30, 2013, respectively, largely due to a 31% increase in headcount from September 30, 2012. General and administrative headcount at September 30, 2013 includes 28 employees from our acquisition of Epocrates in March 2013. We increased our general and administrative personnel to support our growth. Included in the employee-related compensation for the three and nine months ended September 30, 2013 are increases in stock-based compensation expenses of $0.8 million and $7.5 million, respectively. The

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stock-based compensation increase for the nine months ended September 30, 2013 is primarily related to acceleration of vesting for certain Epocrates employees upon termination. Additionally, the general and administrative consulting expenses increased $1.3 million and $2.1 million for the three and nine months ended September 30, 2013, respectively. Comparatively, in the three and nine months ended September 30, 2012, there was a net fair value adjustment of a $3.7 million credit related to our contingent considerations compared to a less than $0.1 million charge in the three and nine months ended September 30, 2013.

The increase we experienced in headcount drove the increased investment in our infrastructure of $0.7 million and $5.7 million for the three and nine months ended September 30, 2013, respectively. Additionally, transaction costs associated with the Epocrates and Arsenal on the Charles acquisitions increased general and administrative expenses by $5.1 million for the nine months ended September 30, 2013. These costs are partially offset by a $2.5 million net gain in the nine months ended September 30, 2013 due to the early termination of our lease and the realization of the remaining balance in deferred rent upon acquisition of the Arsenal on the Charles property where our corporate headquarters are located in Watertown, Massachusetts.

Depreciation and Amortization Expense. Depreciation and amortization expense increases for the three and nine months ended September 30, 2013 are primarily due to higher depreciation from fixed asset expenditures in 2013, the acquisitions of Epocrates and the Arsenal on the Charles, and higher amortization related to an increase in our software development costs.

Interest Expense. Interest expense increased for the three and nine months ended September 30, 2013, primarily due to the increase in the amount of debt outstanding compared to the same periods in the prior year.

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2013	2012	Amount	Percent	2013	2012	Amount	Percent
	(in thousands)							
Income tax (provision) benefit	($80)	($4,953)	$4,873	(98)%	$5,290	($10,445)	$15,735	(151)%
Effective tax rate	6.4 %	44.4 %			33.4 %	44.9 %		

Income Tax Provision. The volatility in the effective tax rate for the three and nine months ended September 30, 2013 is due to the fact that we are expecting a nominal amount of pre-tax net income (loss) for the year ended December 31, 2013, and therefore have used a discrete tax approach. In addition, there were larger permanent items for the nine months ended September 30, 2013, primarily related to non-deductible transaction costs associated with Epocrates transaction, as it was a stock acquisition. Comparatively, the effective tax rate for the nine months ended September 30, 2012 was impacted by changes related to the Anodyne contingent consideration.

Liquidity and Capital Resources

Sources of Liquidity

As of September 30, 2013, our principal sources of liquidity consisted of cash and cash equivalents of $62.3 million. As of September 30, 2013, we have outstanding indebtedness of $242.5 million. On October 20, 2011, we entered into a credit agreement which provides for a five-year $100 million revolving credit facility (“Revolving Credit Agreement”). The Revolving Credit Agreement contains certain covenants, including consolidated leverage and minimum fixed charge coverage ratios. The interest rates applicable to revolving loans under the Revolving Credit Agreement are at either (i) the British Bankers Association London Interbank Offered Rate (“LIBOR”) plus an interest margin based on our consolidated leverage ratio, or (ii) the base rate (which is the highest of (a) the bank’s prime rate, (b) the Federal Funds rate plus 0.50%, and (c) one month LIBOR plus 1.00%) plus an interest margin based on our consolidated leverage ratio. We will pay a commitment fee during the term of the Revolving Credit Agreement which varies between 0.20% and 0.30% depending on our consolidated leverage ratio. There was no balance outstanding on the revolving credit facility as of December 31, 2012. The Revolving Credit Agreement was increased by $55 million on January 7, 2013. On March 11, 2013, we borrowed $155 million from the revolving credit facility to fund the Epocrates acquisition. The entire amount borrowed under this facility was repaid as of May 10, 2013.

On May 10, 2013, we entered into a five-year $325 million senior credit facility consisting of a $200 million unsecured term loan facility and a $125 million unsecured revolving credit facility (“Senior Credit Facility”). The Senior

Credit Facility replaces the Revolving Credit Agreement. The Senior Credit Facility contains terms and conditions that are customary to facilities of this nature, and may be used to refinance existing indebtedness, to finance the acquisition of the real estate known as the Arsenal on the Charles, and for working capital and other general corporate purposes. We may increase the Senior Credit Facility up to an additional $100 million subject to certain terms, including obtaining lender commitments. As of September 30, 2013, we had $192.5 million outstanding on the unsecured term loan facility and $50.0 million outstanding on the unsecured revolving credit facility. As of September 30, 2013, we had $75 million available on the unsecured revolving credit facility. As of September 30, 2013, we were in compliance with our covenants under the Senior Credit Facility.

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We believe our current and future sources of liquidity will be sufficient to sustain operations, to finance strategic initiatives, to make payments on our contractual obligations, and to purchase property and equipment in the foreseeable future. Our analysis is supported by the growth in our new customer base and a high rate of renewal with our existing customers and the corresponding increase in billings and collections. There can be no assurance that we will continue to generate cash flows at or above current levels or that we will be able to maintain our ability to borrow under these credit facilities or obtain additional financing.

Commitments

We enter into various purchase commitments with vendors in the normal course of business. We believe that our existing sources of liquidity will be adequate to fund these purchases during the 2013 fiscal year. In the normal course of business, we make representations and warranties that guarantee the performance of services under service arrangements with clients. Historically, there have been no material losses related to such guarantees.

Operating Cash Flow Activities

	Nine Months Ended September 30,		Change
(in thousands)	2013	2012	Amount
Net (loss) income	$(10,551)	$12,792	$(23,343)
Non-cash adjustments	73,167	24,558	48,609
Cash (used in) provided by changes in operating assets and liabilities	(6,413)	8,830	(15,243)
Net cash provided by operating activities	$56,203	$46,180	$10,023

The increase in the cash flow provided by operating activities is mainly attributable to an increase in net income after non-cash adjustments of $25.3 million are added back. The non-cash adjustments include an increase in stock-based compensation of $13.2 million and an increase in depreciation and amortization of $23.3 million. The increase in stock-based compensation is a result of an increase in the fair value of recently issued stock-based awards due to an increase in the stock price as well as the acceleration of vesting of stock awards related to the termination of certain employees related to the integration of Epocrates. The majority of the increase in depreciation and amortization is a result of the acquisitions of Epocrates and The Arsenal on the Charles.

The year-over-year increase in cash used in operating assets and liabilities is driven by the change in deferred rent which decreased $2.3 million due the removal of $3.2 million in deferred rent associated with our corporate headquarters in Watertown, Massachusetts as of the acquisition date offset by an increase in deferred rent associated with new leases. The removal of the deferred rent associated with our corporate headquarters was recognized as a gain on lease termination in general and administrative expenses. Excluding the impact of the acquisition of Epocrates, accounts receivable increased by $13.1 million from December 31, 2012 to September 30, 2013. The increase is attributed to the overall increase in revenue and the timing of current billings and subsequent payment of those billings as of September 30, 2013, as compared to the same period and timing as of December 31, 2012. Excluding the impact of the acquisition of Epocrates, the year-over-year increase in prepaid and other current assets of $4.3 million relates to a prior year tax benefit of $5.7 million impacting our income tax receivable position at September 30, 2013. Accounts payable increased by $5.8 million due to the timing of vendor payments.

Investing Cash Flow Activities

The cash used in investing activities increased $381.6 million to $397.3 million for the nine months ended September 30, 2013, as compared to the cash used in investing activities of $15.7 million for the nine months ended September 30, 2012. Cash flows used in investing activities consist primarily of cash paid for the acquisitions of Epocrates of $242.8 million, net of cash acquired, and our corporate headquarters of $167.3 million. The cash used in investing activities also includes increases in purchases of property and equipment and capitalized software development costs. We make investments in property and equipment and in software development on an ongoing basis. Our investment in equipment consists primarily of purchases of technology infrastructure to provide service stability and additional capacity to support our expanding client base. Our investment in software development consists of company-managed design, development, and testing of new application functionality.

The cash used in investing activities includes increases in purchases of property and equipment of $2.3 million and capitalized software development costs of $10.7 million. Capitalized software development costs increased $10.7 million for the period ended September 30, 2013 compared to the period ended September 30, 2012, primarily related to the new automation activities related to the new athenaCoordinator service offering as well as our athenaClinicals service offering.

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The net change in proceeds and purchases of our available for sale investments is based upon the changes in maturity of our investments in securities. We decreased the amount of available-for-sale investments in 2013, in anticipation of the acquisitions of Epocrates and the Arsenal on the Charles property. In addition, we made a $2.0 million investment in a vendor during the three months ended September 30, 2013.

Financing Cash Flow Activities

The cash provided by financing activities was $248.5 million for the nine months ended September 30, 2013 compared to cash provided by financing activities of $24.0 million for the nine months ended September 30, 2012. The change is primarily attributable to the $50 million in net proceeds from our line of credit and $200 million in proceeds from our term loan which we utilized in our acquisitions of Epocrates and our corporate headquarters, offset by payments on our term loan of $7.5 million and deferred financing fees of $1.7 million. Also contributing to the change was a $7.2 million increase in the cash received from the exercise of stock options during the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012. These increases were offset by an increase of $7.4 million related to the cash paid to settle tax obligations through the net settlement option that our employees can elect when restricted stock units vest in the nine month period ended September 30, 2013. We began issuing restricted stock units in 2010 and have since experienced an increase in the proportionate number of restricted stock units granted compared to stock options granted. We expect that the cash paid to settle tax obligations will increase in the near future as these issued restricted stock units begin to vest.

Contractual Obligations

We have contractual obligations under our operating leases for properties. The following table summarizes our long-term contractual obligations and commitments as of September 30, 2013:

	Payments Due by Period					
(in thousands)	Total	Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 years	Other
Long-term debt [1]	$192,500	$15,000	$30,000	$30,000	$117,500	$—
Operating lease obligations	43,915	5,697	8,094	8,360	21,764	—
Other	1,279	—	—	—	—	1,279
Total	$237,694	$20,697	$38,094	$38,360	$139,264	$1,279

[1] We have cash interest requirements due on the Senior Credit Facility payable at variable rates which are not included in the above table.

The commitments under our operating leases shown above consist primarily of lease payments for our offices in Atlanta, Georgia; Alpharetta, Georgia; Birmingham, Alabama; Austin, Texas; San Mateo, California; Ewing, New Jersey; Princeton, New Jersey; Durham, North Carolina; and Chennai, India.

"Other" consists of uncertain tax benefits. We have not utilized these uncertain tax benefits, nor do we have an expectation of when these uncertain tax benefits would be challenged. As of September 30, 2013, we cannot reasonably estimate when any future cash outlays would occur related to these uncertain tax positions.

Off-Balance Sheet Arrangements

As of September 30, 2013 and 2012 and December 31, 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as "structured finance" or "special purpose" entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Other than our operating leases for office space, we do not engage in off-balance sheet financing arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Foreign Currency Exchange Risk. Our results of operations and cash flows are subject to fluctuations due to changes in the Indian rupee. None of our consolidated revenues are generated outside the United States. None of our vendor relationships, including our contracts with our offshore service providers International Business Machines Corporation, Access Healthcare Services USA, LLC, and Vision Business Process Solutions, Inc., a subsidiary of Dell, Inc. (formerly Perot Systems Corporation), for work performed in India and the Philippines, is denominated in any currency other than the U.S. dollar. For the three and nine months ended September 30, 2013, less than 1% of our expenses occurred in our direct subsidiary in Chennai, India, and were incurred in Indian rupees. We therefore believe that the risk of a significant impact on our operating income from foreign currency fluctuations is not likely.

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Interest Rate Risk. We had $242.5 million of outstanding borrowings under our Senior Credit Facility at September 30, 2013. The Senior Credit Facility bears interest at the British Bankers Association London Interbank Offered Rate (“LIBOR”) plus an applicable margin. Accordingly, we are exposed to fluctuations in interest rates on borrowings under the Senior Credit Facility.

During the quarter ended September 30, 2013, we utilized a interest rate swap to manage exposure to interest rates on the variable rate of our indebtedness. Our interest rate swap is with a major financial institution and is not for speculative or trading purposes. We have designated our interest rate swap as a cash flow hedge and changes in the fair value of the interest rate swap are recognized in other comprehensive income. Hedge effectiveness, if any, associated with the interest rate swap will be reported by us in interest expense.

We recorded the interest rate swap at fair value, which amounted to a liability of $0.4 million at September 30, 2013. A one hundred basis point change in the interest rate on our borrowings outstanding as of September 30, 2013 would result in a change in interest expense of approximately $2.4 million annually.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934 is (1) recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. As of September 30, 2013, (the “Evaluation Date”), our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934). Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our Chief Executive Officer and Chief Financial Officer have concluded based upon the evaluation described above that, as of the Evaluation Date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control

We are in the process of evaluating and integrating Epocrates processes with ours. We anticipate that this will be completed during the fourth quarter of 2013.

Other than the change noted above, there have been no changes in our internal control over financial reporting for the quarter ended September 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

On July 18, 2011, we filed a complaint against ADP AdvancedMD, Inc. in the United States District Court for the District of Massachusetts. The complaint alleges that ADP AdvancedMD, Inc. has infringed two of our U.S. Patents: No. 7,617,116, which was issued on November 10, 2009, for "Practice Management and Billing Automation System" and No. 7,720,701, which was issued on May 18, 2010, for "Automated Configuration of Medical Practice Management Systems." On May 16, 2012, the Court entered the parties' joint stipulation of dismissal without prejudice of claims and counterclaims related to U.S. Patent No. 7,720,701. A Markman Hearing was held on September 14, 2012. The Court has not yet issued its Markman decision. We are seeking permanent injunctive relief, damages, pre- and post-judgment costs and interest, and attorneys' fees.

On July 28, 2011, a complaint was filed by PPS Data, LLC naming us in a patent infringement case (PPS Data, LLC v. athenahealth, Inc., Civil Action No. 3:11-cv-00746, United States District Court for the Middle District of Florida). The complaint alleges that we have infringed U.S. Patent No. 6,343,271 with a listed issue date of January 29, 2002, entitled "Electronic Creation, Submission, Adjudication, and Payment of Health Insurance Claims" (the "'271 Patent"). The complaint seeks an injunction enjoining infringement, damages, pre- and post-judgment costs and interest, and attorneys' fees. On September 8, 2011, we filed a motion to dismiss, or, in the alternative, a motion for summary judgment. On October 18, 2011, the plaintiff filed a motion for leave to amend its complaint to allege that we have infringed on U.S. Patent No. 6,341,265 with a listed issue date of January 22, 2002, entitled "Provider claim editing and settlement system," and U.S. Patent No. 7,194,416 with a listed issue date of March 20, 2007, entitled "Interactive creation and adjudication of health care insurance claims." The Court granted the plaintiff's motion for leave to amend its complaint on December 21, 2011, and on December 23, 2011, the plaintiff filed its amended complaint. On December 27, 2011, we filed a motion to dismiss, or, in the alternative, a motion for summary judgment of non-infringement with respect to the '271 Patent. On December 29, 2011, the United States Patent and Trademark Office granted our request for reexamination of the '271 Patent. On January 9, 2012, we filed a motion to stay the case pending completion of the patent reexamination, and on March 1, 2012, the Court granted our motion to stay the case. We believe that we have meritorious defenses to the amended complaint and will continue to contest the claims vigorously.

On January 11, 2013, a complaint captioned Bushansky v. Epocrates, Inc., et al., Case No. 519078, was filed in San Mateo County Superior Court (the "Court") on behalf of a putative class of Epocrates' shareholders against Epocrates and each member of the Epocrates board of directors. This complaint challenged the proposed merger between Epocrates and one of our wholly owned subsidiaries. On January 25, 2013, a similar complaint was filed in the Court captioned DeJoice v. Epocrates, et al., Case No. 519461. This second complaint made similar allegations against Epocrates and each member of the Epocrates board of directors and included a claim against us for aiding and abetting a breach of fiduciary duty. On January 31, 2013, the Bushansky complaint was amended to include additional allegations. Plaintiffs allege, among other things, that the Epocrates directors breached their fiduciary duties by allegedly agreeing to sell Epocrates at an unfair and inadequate price, failing to take steps to maximize the sale price of Epocrates, and making material omissions to the preliminary proxy statement dated January 25, 2013. The complaints sought to enjoin the merger, other equitable relief, and monetary damages. On March 5, 2013, Epocrates and the plaintiffs signed a memorandum of understanding in which the parties agreed to enter into a stipulation of settlement whereby the plaintiffs and all class members would release all claims related to the merger in exchange for Epocrates filing a supplement to its definitive proxy statement regarding the merger with the SEC, which would include additional disclosures regarding the merger agreement, and an agreement to negotiate in good faith regarding the amount of attorneys' fees and expenses for which plaintiffs may seek approval from the Court. On October 4, 2013, the court granted final settlement approval including a grant of fees and expenses in the amount of $335,000 to plaintiffs' counsel. The settlement has no material impact on the Company's condensed consolidated financial statements.

On March 1, 2013, a complaint was filed in the United States District Court for the Northern District of California captioned Police and Fire Retirement System of the City of Detroit v. Epocrates, Inc. et al., Case No. 5:13cv0945, on behalf of a putative class of Epocrates' stockholders against Epocrates and certain of its former officers and directors.

The complaint asserts claims under sections 11, 12, and 15 of the Securities Act of 1933 on behalf of all stockholders that purchased Epocrates stock in its Initial Public Offering and claims under sections 10(b) and 20 of the Securities Exchange Act of 1934 on behalf of all stockholders that purchased shares between the February 2, 2011, IPO and August 9, 2011. The complaint alleges that Epocrates made false or misleading statements with respect to the fact that Epocrates' pharmaceutical clients were awaiting guidance from the Food and Drug Administration on the use of advertising and social media, which caused the clients to delay spending on marketing and negatively impacted Epocrates' sales and revenue growth. The complaint seeks certification as a class action, compensatory damages in an unspecified amount, plaintiff's costs, attorneys' fees, and such other and further relief as the Court may deem just and proper. We believe that we have meritorious defenses to the complaint and will continue to contest the claims vigorously.

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In addition, from time to time we may be subject to other legal proceedings, claims, and litigation arising in the ordinary course of business. We do not, however, currently expect that the ultimate costs to resolve any pending matter will have a material effect on our consolidated financial position, results of operations, or cash flows.

Item 1A. Risk Factors.

Our operating results and financial condition have varied in the past and may in the future vary significantly depending on a number of factors. Except for the historical information in this report, the matters contained in this report include forward-looking statements that involve risks and uncertainties. The following factors, among others, could cause actual results to differ materially from those contained in forward-looking statements made in this report and presented elsewhere by management from time to time. Such factors, among others, may have a material adverse effect upon our business, results of operations, and financial condition.

In Part I-Item 1A ("Risk Factors") of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, which was filed with the Securities and Exchange Commission on February 11, 2013, we described risk factors related to the Company. The following risk factors update and replace those set forth in our Annual Report on Form 10-K for the year ended December 31, 2012. You should carefully review these risk factors and those described in other reports we file with the Securities and Exchange Commission in evaluating our business.

Those risk factors below denoted with a "*" are newly added or have been materially updated from our Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 11, 2013.

RISKS RELATED TO OUR BUSINESS - GENERAL

We operate in a highly competitive industry, and if we are not able to compete effectively, our business and operating results will be harmed.*

The provision by third parties of revenue cycle services to medical practices has historically been dominated by small service providers who offer highly individualized services and a high degree of specialized knowledge applicable in many cases to a limited medical specialty, a limited set of payers, or a limited geographical area. We anticipate that the software, statistical, and database tools that are available to such service providers will continue to become more sophisticated and effective and that demand for our services could be adversely affected.

Revenue cycle and clinical cycle software for medical practices has historically been dominated by large, well-financed, and technologically sophisticated entities that have focused on software solutions. Some of these entities are now offering "on-demand" services or a "software-as-a-service" model under which software is centrally administered, and these vendors may also provide administrative services. The size, financial strength, and breadth of offerings of the larger entities is increasing as a result of continued consolidation in both the information technology and health care industries. We expect large integrated technology companies to continue to become more active in our markets, both through acquisition and internal investment. As costs fall and technology improves, increased market saturation may change the competitive landscape in favor of competitors with greater scale than we possess. In addition, a few smaller companies have started providing single-instance, Internet-based software using a model similar to ours; the offerings of these smaller companies may reduce the perceived competitive advantage of our services and impact our market share. Further, while the market for patient communication and referral management services is growing and is not as yet dominated by a small group of vendors with significant resources, our patient and referral cycle services face competition from a wide variety of market participants. For example, certain health systems have developed their own patient portals or referral management systems. If we fail to distinguish our patient and referral cycle offerings from the other options available to health care providers, the demand for and market share of those offerings may decrease.

In regard to our Epocrates services, we compete with other companies for users of the types of drug and clinical reference tools that we offer and for budget dollars from our pharmaceutical, managed care, and market research clients. We compete within a broad industry of health care content providers for the attention of health care professionals who can choose to use mobile, online or print media to reference clinical information. Companies providing clinical content include Medscape, a division of WebMD, LLC, and UpToDate, Inc., a division of Wolters Kluwer Health. Competition from each of these sources of clinical reference content may lead to a loss of our existing network members and a reduction in the rate at which we attract new members for our clinical information. Our primary competition for the promotional spend available from our pharmaceutical clients in the area of interactive services is from companies, including WebMD, that help such companies market their products, programs, and services to health care professionals. Our market research business competes with numerous companies that recruit physicians to participate in surveys in a variety of formats, as well as the recruitment arms of market research companies that have assembled their own survey panels of health care professionals. To the extent competing channels are available to access health care professionals, including physicians, the value of our interactive services to our clients is reduced.

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Some of our current large competitors, such as Allscripts-Misys Healthcare Solutions, Inc.; Epic Systems Corporation; GE Healthcare; McKesson Corp.; Quality Systems, Inc.; Sage Software Healthcare, Inc.; and Siemens Medical Solutions USA, Inc., have greater name recognition, longer operating histories, and significantly greater resources than we do. As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards, or client requirements. In addition, current and potential competitors have established, and may in the future establish, cooperative relationships with vendors of complementary products, technologies, or services to increase the availability of their products to the marketplace. Current or future competitors may consolidate to improve the breadth of their products, directly competing with our integrated offerings. Accordingly, new competitors or alliances may emerge that have greater market share, larger client bases, more widely adopted proprietary technologies, broader offerings, greater marketing expertise, greater financial resources, and larger sales forces than we have, which could put us at a competitive disadvantage. Further, in light of these advantages, even if our services are more effective than the product or service offerings of our competitors, current or potential clients might accept competitive products and services in lieu of purchasing our services. Increased competition is likely to result in pricing pressures, which could negatively impact our sales, profitability, or market share. In addition to new niche vendors, who offer stand-alone products and services, we face competition from existing enterprise vendors, including those currently focused on software solutions, which have information systems in place with clients in our target markets. These existing enterprise vendors may now, or in the future, offer or promise products or services with less functionality than our services, but that offer ease of integration with existing systems and that leverage existing vendor relationships.

If we are unable to retain existing members of our Epocrates network and attract new members, especially physician members with desired characteristics for our interactive services who actively participate in those services, our revenue will decline, the anticipated benefits of our Epocrates acquisition may not be realized, and our business will suffer.*

Most of the members of our Epocrates network use only our free drug reference product and may stop using the products at any time without loss. Members who subscribe to our premium drug and clinical reference products usually do so for a term of one year and have no obligation to renew their subscriptions when such subscriptions expire. Under certain circumstances, our members may cancel their subscriptions prior to expiration. Factors that may affect the retention rate of our existing members and the rate at which we attract new members for our drug and clinical reference tools include:

Service Relevance. Unless we are able to provide current, relevant, and reliable health care content, drug and clinical reference tools, formulary hosting, and other services that meet and continue to meet the needs of health care professionals, including physicians, the value of those services to new and existing members will decrease. Our provision of such services depends on our ability to hire and retain qualified physician and pharmacist editors and authors, license accurate and relevant content from third parties, contract with health plans and insurers to host formulary information, monitor and respond to changes in member interest in specific topics, and develop new or enhanced services. If we cannot meet our staffing needs or develop or acquire needed content at a reasonable cost, if there are errors or omissions in such content, if our competitors obtain exclusive access to or develop content that health care professionals consider superior to ours, or if we cannot meet the needs of our members, the value of our content and services would diminish.

Brand Reputation. The reputation of our Epocrates brand is dependent in large part on the medical community's continued perception of us as independent from our health care industry clients, particularly pharmaceutical companies. If health care professionals believe that we are too closely associated with such clients as a result of the revenue we receive from their purchase or sponsorship of our interactive services, the credibility of our brand will diminish. Although we take precautions to remain independent from our health care industry clients, including separating the development of our application content from our commercial dealings with such clients and clearly labeling the source and responsibility of sponsored messages, programs, and activities, we cannot assure you that the medical community will view our content as sufficiently unbiased. If the reputation of our brand is damaged, it will be difficult, expensive and time-consuming to restore the quality of our brand with health care professionals and our business could suffer.

Competitive Landscape. If the developers of mobile operating systems and mobile devices with which our products and services are compatible fail to remain competitive in the marketplace and to be adopted into medical practice and practice workflow, members will be less inclined to use our services. The availability, price, performance, and functionality of competing products and services, including mobile, Web-based, and traditional products and services offered by competitors or through online resources and searches may affect our retention rate and the rate at which we attract new members for our drug and clinical reference tools. The availability of download sites such as the Apple App Store[SM] that offer numerous free or low-priced competing products at one location has also reduced the demand for our paid subscription products. We expect the use of such sites to expand, reducing the number of paying members for our drug and clinical reference tools as a percentage of total members.

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In addition to the loss of subscription revenue, our inability to attract or retain members, especially physician members with desired characteristics, such as specialty and prescribing habits, who update their mobile devices through our servers with sufficient frequency, may cause an even more significant decline in revenue from our interactive services. Our market research, payer, and pharmaceutical clients are attracted to our large, engaged member network for the delivery of their clinical messages, formularies, and other sponsored content, and, without sufficient active members who meet desired criteria, those clients may reduce their subscription for our interactive services, and our revenue may decline.

Even if the number of our members is not materially reduced, their participation in our services may decrease, which could impact our revenues. We have established limits on the number and the mix of sponsored and non-sponsored messages delivered to members in order to promote the quality of members' experience with our services. If an insufficient number of members update during a given service period, or the demand for promotional clinical messaging sponsorship exceeds the available supply, our health care clients could become dissatisfied with our service. As a result, we may be unable to grow our interactive services revenue beyond the bounds we have set, as changes to such limits could cause our members to be dissatisfied with our services and the response to our interactive services to decrease. Furthermore, if our members generally become less responsive to participating in our services, the value of these interactive services will likely decline. This could cause our revenue to remain flat or to decline.

Finally, if there is a reduction in the number of network members or their participation in our services, certain anticipated benefits of our acquisition of Epocrates, such as increased name recognition and reputation, cross-sell potential, and the market acceptance of joint services may not be fully realized, if at all.

The market for Internet-based medical business services may not develop substantially further or develop more slowly than we expect, harming the growth of our business.

While Internet-based medical business services are becoming more accepted, the market for these services remains narrowly based, and it is uncertain whether these services will achieve and sustain the high levels of demand and market acceptance we anticipate. Our success will depend to a substantial extent on the willingness of enterprises, large and small, to increase their use of on-demand business services in general, and for their revenue, clinical, and patient cycles in particular. Many enterprises have invested substantial personnel and financial resources to integrate established enterprise software into their businesses and therefore may be reluctant or unwilling to switch to an on-demand application service. Furthermore, some enterprises may be reluctant or unwilling to use on-demand application services, because they have concerns regarding the risks associated with the security and reliability, among other things, of the technology delivery model associated with these services. If enterprises do not perceive the benefits of our services, then the market for these services may not expand as much or develop as quickly as we expect, either of which would significantly adversely affect our business, financial condition, or operating results.

Changes in the health care industry could affect the demand for our services, cause our existing contracts to terminate, and negatively impact the process of negotiating future contracts.*

As the health care industry evolves, changes in our member, client, and vendor bases may reduce the demand for our services, result in the termination of existing contracts, and make it more difficult to negotiate new contracts on terms that are acceptable to us. For example, the current trend toward consolidation of health care providers within hospital systems may cause our existing practice client contracts to terminate as independent practices are merged into hospital systems. Such larger health care organizations may also have their own practice management services and health IT systems, reducing demand for our services. Similarly, client and vendor consolidation results in fewer, larger entities with increased bargaining power and the ability to demand terms that are unfavorable to us. If these trends continue, we cannot assure you that we will be able to continue to maintain or expand our client base, negotiate contracts with acceptable terms, or maintain our current pricing structure, and our revenues may decrease.

General reductions in expenditures by health care companies, or reductions in such expenditures within market segments that we serve, could have similar impacts with regard to our interactive services. Such reductions may result from, among other things, reduced governmental funding for health care; a decrease in the number of, or the market exclusivity available to, new drugs coming to market; government regulation or private initiatives that affect the manner in which health care providers interact with patients, pharmaceutical companies, payers, or other health care industry participants (e.g., limitations on advertising to physicians or required disclosure of payments made to them);

or adverse changes in business or economic conditions affecting health care payers or providers, the pharmaceutical industry, or other health care companies that subscribe for our interactive services (e.g., changes in the design of health plans). Any of these changes could reduce the purchase of our services by such interactive services clients, reducing our revenue and possibly requiring us to materially revise our offerings. In addition, our interactive services clients' expectations regarding pending or potential industry developments may also affect their budgeting processes and spending plans with respect to services of the types we provide.

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If we do not continue to innovate and provide services that are useful to clients and users, we may not remain competitive, and our revenues and operating results could suffer.*

Our success depends on our ability to keep pace with technological developments, satisfy increasingly sophisticated client and user requirements, and sustain market acceptance. Our competitors are constantly developing products and services that may become more efficient or appealing to our clients or users. As a result, we must continue to invest significant resources in research and development in order to enhance our existing services and introduce new high-quality services that clients and users will want, while offering these services at competitive prices. For example, our mobile clinical information services are not compatible with all mobile platforms. If a mobile platform that is incompatible with our services achieves widespread use and acceptance in the medical community, or if Internet resources or other non-mobile device resources become more attractive than what is offered for mobile platforms, we may be unable to retain or attract members to our products or services.

If we are unable to predict user preferences or industry changes, or if we are unable to modify our services on a timely or cost-effective basis, we may lose clients and users. Our operating results would also suffer if our innovations are not responsive to the needs of our clients and users, are not appropriately timed with market opportunity, or are not effectively brought to market. As technology continues to develop, our competitors may be able to offer results that are, or that are perceived to be, substantially similar to or better than those generated by our services. This may force us to compete on additional service attributes and to expend significant resources in order to remain competitive.

Failure to manage our rapid growth effectively could increase our expenses, decrease our revenue, and prevent us from implementing our business strategy.

We have been experiencing a period of rapid growth. To manage our anticipated future growth effectively, we must continue to maintain, and may need to enhance, our information technology infrastructure and financial and accounting systems and controls, as well as manage expanded operations in geographically distributed locations. We also must attract, train, and retain a significant number of qualified sales and marketing personnel, professional services personnel, software engineers, technical personnel, and management personnel. Failure to manage our rapid growth effectively could lead us to over-invest or under-invest in technology and operations; result in weaknesses in our infrastructure, systems, or controls; give rise to operational mistakes, losses, or loss of productivity; reduce client or user satisfaction; limit our ability to respond to competitive pressures; and result in loss of employees and reduced productivity of remaining employees. Our growth could require significant capital expenditures and may divert financial resources and management attention from other projects, such as the development of new or enhanced services or the acquisition of suitable businesses or technologies. If our management is unable to effectively manage our growth, our expenses may increase more than expected, our revenue could decline or may grow more slowly than expected, and we may be unable to implement our business strategy.

We may be unable to adequately protect, and we may incur significant costs in enforcing, our intellectual property and other proprietary rights.*

Our success depends in part on our ability to enforce our intellectual property and other proprietary rights. We rely upon a combination of copyright, patent, trademark, trade secret, and unfair competition laws, as well as license agreements and other contractual provisions, to protect these rights.

Our attempts to protect our intellectual property through copyright, patent, and trademark registration may be challenged by others or invalidated through administrative process or litigation. While we have ten issued U.S. patents and a number of U.S. and foreign patent applications pending as of September 30, 2013, the scope of issued patents may be insufficient to prevent competitors from providing products and services similar to ours, our patents may be successfully challenged, and we may not be able to obtain additional meaningful patent protection in the future.

Our agreements with clients and users and with certain vendors and strategic partners limit their use of, and retain our rights in, our intellectual property and proprietary information and grant us ownership of intellectual property created in the performance of those agreements to the extent that it relates to the provision of our services. In addition, we require certain of our employees and consultants to enter into confidentiality, non-competition, and assignment of inventions agreements and certain of our vendors and strategic partners to agree to contract provisions regarding confidentiality and non-competition. However, these agreements may be breached, and we may not have adequate remedies for any such breach. Further, no assurance can be given that these agreements will be effective in preventing the unauthorized access to, or use of, our proprietary information or the reverse engineering of our technology. In any event, these agreements do not prevent our competitors from independently developing technology or authoring clinical information that is substantially equivalent or superior to our technology or the information we distribute. Agreement terms that address non-competition are difficult to enforce in many jurisdictions and may not be enforceable in any particular case.

In addition, our platforms incorporate "open source" software components that are licensed to us under various public domain licenses. While we believe that we have complied with our obligations under the various applicable licenses for open source software that we use, open source license terms are often ambiguous, and there is little or no legal precedent governing the interpretation of many of the terms of certain of these licenses. Therefore, the potential impact of such terms on our business is somewhat unknown. For example, some open source licenses require that those using the associated code disclose modifications made to that code and that such modifications be licensed to third parties at no cost. We monitor our use of open source software in an effort to avoid uses in a manner that would require us to disclose or grant licenses under our proprietary source code. However, there can be no assurance that such efforts will be successful, and such use could inadvertently occur.

To the extent that our intellectual property and other proprietary rights are not adequately protected, third parties might gain access to our proprietary information, develop and market products or services similar to ours, or use trademarks similar to ours, each of which could materially harm our business. Existing U.S. federal and state intellectual property laws offer only limited protection. Moreover, the laws of other countries in which we now or may in the future conduct operations or contract for services may afford little or no effective protection of our intellectual property. If we resort to legal proceedings to enforce our intellectual property rights or to determine the validity and scope of the intellectual property or other proprietary rights of others, the proceedings could be burdensome and expensive, even if we were to prevail. Any litigation that may be necessary in the future could result in substantial costs and diversion of resources and could have a material adverse effect on our business, operating results, or financial condition.

We may be sued by third parties for alleged infringement of their proprietary rights.

The software and Internet industries are characterized by the existence of a large number of patents, trademarks, and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. Moreover, our business involves the systematic gathering and analysis of data about the requirements and behaviors of payers and other third parties, some or all of which may be claimed to be confidential or proprietary. We have received in the past, and may receive in the future, communications from third parties claiming that we have infringed on the intellectual property rights of others, either through the use of our own technologies or those of third parties. For example, in 2011 a complaint was filed by PPS Data, LLC naming us in a patent infringement case. For additional information regarding this litigation, see Part II, Item 1, "Legal Proceedings." Our technologies may not be able to withstand such third-party claims of rights against their use, and we could lose the right to use third-party technologies that are the subject of such claims. Any intellectual property claims, with or without merit, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, and require us to pay monetary damages or enter into royalty or licensing agreements. In addition, many of our contracts contain warranties with respect to intellectual property rights, and some require us to indemnify our clients and third-party service providers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim. Although many of our third-party service providers are obligated to indemnify us if their products infringe the rights of others, such indemnification may not be effective or adequate to protect us or the indemnifying party may be unable to uphold its contractual obligations.

Moreover, any settlement or adverse judgment resulting from such a claim could require us to pay substantial amounts of money or obtain a license to continue to use the technology or information that is the subject of the claim, or otherwise restrict or prohibit our use of the technology or information. There can be no assurance that we would be able to obtain a license on commercially reasonable terms, if at all, from third parties asserting an infringement claim; that we would be able to develop alternative technology on a timely basis, if at all; that we would be able to obtain a license to use a suitable alternative technology or information to permit us to continue offering, and our clients to continue using, our affected services; or that we would not need to change our product and design plans, which could require us to redesign affected products or services or delay new offerings. Accordingly, an adverse determination could prevent us from offering our services to others.

Current and future litigation against us could be costly and time-consuming to defend and could result in additional liabilities.*

We may from time to time be subject to legal proceedings and claims that arise in the ordinary course of business, such as claims brought by our clients in connection with commercial disputes and employment claims made by our current or former employees. Claims may also be asserted by or on behalf of a variety of other parties, including government agencies, patients of our physician clients, or stockholders. For example, we have purchased the property on which our corporate headquarters are located. This property is a former Superfund site, and our ownership of it, or any of our other properties, could expose us to liability under applicable environmental laws, as well as to liability as a landlord or as owner of property that may be used by members of the public. Any litigation involving us may result in substantial costs and may divert management’s attention and resources, which may seriously harm our business, overall financial condition, and operating results. Insurance may not cover existing or future claims, be sufficient to fully compensate us for one or more of such claims, or continue to be available on terms acceptable to us. A claim brought against us that is uninsured or underinsured could result in unanticipated costs, thereby

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reducing our operating results and leading analysts or potential investors to reduce their expectations of our performance resulting in a reduction in the trading price of our stock.

RISKS RELATED TO OUR BUSINESS - OPERATIONS

We depend upon two third-party service providers for important processing functions. If either of these third-party providers does not fulfill its contractual obligations or chooses to discontinue its services, our business and operations could be disrupted and our operating results would be harmed.

We have entered into service agreements with International Business Machines Corporation and Dell Marketing L.P. to provide data entry and other services from facilities located in India and the Philippines to support our client service operations. Among other things, these providers process critical claims data and clinical documents. If these services fail or are of poor quality, our business, reputation, and operating results could be harmed. Failure of either service provider to perform satisfactorily could result in client dissatisfaction, disrupt our operations, and adversely affect operating results. With respect to these service providers, we have significantly less control over the systems and processes involved than if we maintained and operated them ourselves, which increases our risk. In some cases, functions necessary to our business are performed on proprietary systems and software to which we have no access. If we need to find an alternative source for performing these functions, we may have to expend significant money, resources, and time to develop the alternative, and if this development is not accomplished in a timely manner and without significant disruption to our business, we may be unable to fulfill our responsibilities to clients or the expectations of clients, with the attendant potential for liability claims and a loss of business reputation, loss of ability to attract or maintain clients, and reduction of our revenue or operating margin.

Various risks could affect our worldwide operations, exposing us to significant costs.*

We conduct operations in the United States, India, and the Philippines, either directly or through our service providers. Such worldwide operations expose us to potential operational disruptions and costs as a result of a wide variety of events, including local inflation or economic downturn, currency exchange fluctuations, political turmoil, terrorism, labor issues, natural disasters, unfavorable intellectual property protection, and pandemics. Any such disruptions or costs could have a negative effect on our ability to provide our services or meet our contractual obligations, the cost of our services, practice client and user satisfaction, our ability to attract or maintain practice clients, and, ultimately, our profits.

In addition, although the substantial majority of the members of our Epocrates network are located in the United States, we currently have members in numerous other countries, and we could expand our international offerings in the future. Having members who are foreign residents could subject us to additional risks of conducting business, including failure to comply with local consumer protection laws or regulations, the impact of a country’s or region’s political or economic conditions on purchasing decisions, exposure to competitors who are more familiar with local markets, and restrictions on repatriation of earnings. Furthermore, we have limited experience in marketing, selling, and supporting our services abroad. For example, while Symbian is the most widely used mobile operating system in Europe, our clinical information and interactive services are not compatible with Symbian-based devices. If we invest substantial time and resources to expand our international operations and are unable to do so successfully and in a timely manner, our business and operating results will suffer.

Because competition for our target employees is intense, we may not be able to attract and retain the highly skilled employees we need to support our planned growth.*

To continue to execute on our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel is intense, especially for senior sales executives and engineers with high levels of experience in designing and developing software and Internet-related services. We may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. For example, Epocrates has experienced high turnover in recent years, and we cannot assure you that we will be able to fill all open positions on a timely basis, or at all, on acceptable terms or that the limited exposure to Epocrates’ business of those hired will not hinder our ability to manage and grow that business effectively, regardless of the extent of their past professional experience. In addition, our search for replacements for departed employees may cause uncertainty regarding the future of our business, impact employee hiring and retention, and adversely impact our revenue, operating results, and financial condition.

Many of the companies with which we compete for experienced personnel have greater resources than we have. In addition, in making employment decisions, particularly in the Internet and high-technology industries, job candidates often consider the value of the equity awards they are to receive in connection with their employment. Volatility in the price of our stock or failure to obtain stockholder approval for increases in the number of shares available for grant under our equity plans may, therefore, adversely affect our ability to attract or retain key employees. Furthermore, the requirements to expense equity awards may discourage us from granting the size or type of equity awards that job candidates require to join our company. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

If we acquire companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value, and adversely affect our operating results and the value of our common stock.

As part of our business strategy, we may acquire, enter into joint ventures with, or make investments in complementary companies, services, and technologies in the future. Acquisitions and investments involve numerous risks, including:

- difficulties in identifying and acquiring products, technologies, or businesses that will help our business;
- difficulties in integrating operations, technologies, services, and personnel;
- diversion of financial and managerial resources from existing operations;
- the risk of entering new markets in which we have little to no experience;
- risks related to the assumption of known and unknown liabilities;
- the risk of write-offs and the amortization of expenses related to purchased intangible assets; and
- delays in client purchases due to uncertainty and the inability to maintain relationships with clients of the acquired businesses.

As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, we may incur costs in excess of what we anticipate, and management resources and attention may be diverted from other necessary or valuable activities.

RISKS RELATED TO THE ACQUISITION OF EPOCRATES, INC.

We may fail to realize the anticipated benefits of the acquisition of Epocrates.

The success of the acquisition of Epocrates will depend on, among other things, our ability to combine the businesses of athenahealth and Epocrates in a manner that does not materially disrupt existing relationships and that allows us to achieve operational synergies and capitalize on the increased brand recognition and customer base of the combined company. If we are not able to achieve these objectives, the anticipated benefits of the acquisition may not be realized fully or at all or may take longer to realize than expected. In particular, the acquisition may not be accretive or accelerate sales in the near or long term.

The integration process may result in the loss of key employees; the disruption of athenahealth's or Epocrates' ongoing businesses; or inconsistencies in standards, controls, procedures, or policies that could adversely affect our ability to maintain relationships with third parties and employees or to achieve the anticipated benefits of the acquisition. Integration efforts between the two companies will also divert management's attention from our core business and other opportunities that could have been beneficial to our shareholders. An inability to realize the full extent of, or any of, the anticipated benefits of the acquisition, as well as any delays encountered in the integration process, could have an adverse effect on our business and results of operations, which may affect the value of the shares of our common stock after the completion of the acquisition.

Further, the actual integration may result in additional and unforeseen expenses. Operational improvements and actual cost synergies, if achieved at all, may be lower than we expect and may take longer to achieve than we anticipate. If we are not able to adequately address these challenges, athenahealth and Epocrates may be unable to realize the anticipated benefits of the integration of the two companies.

We expect to incur additional costs in connection with the acquisition of Epocrates and in integrating the companies into a single business.

Through September 30, 2013, athenahealth incurred transaction costs in connection with the Epocrates acquisition of approximately $3.2 million. We expect to incur additional costs integrating the companies' operations, product offerings, and personnel, which cannot be estimated accurately at this time. If the total costs of the integration exceed the anticipated benefits of the acquisition, our financial results could be adversely affected.

RISKS RELATED TO OUR BUSINESS - FINANCIALS

Our operating results have in the past fluctuated and may continue to fluctuate significantly, and if we fail to meet the expectations of analysts or investors, our stock price and the value of an investment in our common stock could decline substantially.

Our operating results are likely to fluctuate, and if we fail to meet or exceed the expectations of securities analysts or investors, the trading price of our common stock could decline. Moreover, our stock price may be based on expectations of our

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future performance that may be unrealistic or that may not be met. Some of the important factors that could cause our revenues and operating results to fluctuate from quarter to quarter include:

- the extent to which our services achieve or maintain market acceptance;
- our ability to introduce new services and enhancements to our existing services on a timely basis;
- new competitors and the introduction of enhanced products and services from new or existing competitors;
- the length of our contracting and implementation cycles and our fulfillment periods for our services to pharmaceutical companies;
- changes in Client Days in Accounts Receivable;
- the severity, length, and timing of seasonal and pandemic illnesses;
- seasonal declines in the use of physician services, generally in the late summer and during the holiday season, which lead to a decline in collections by our physician clients about 30 to 50 days later;
- the financial condition of our current and future clients;
- changes in client budgets and procurement policies;
- changes in pharmaceutical company demand as a result of delays or changes in product approvals and changes in regulations or marketing strategies;
- the amount and timing of our investment in research and development activities;
- the amount and timing of our investment in sales and marketing activities;
- technical difficulties or interruptions in our services;
- our ability to hire and retain qualified personnel and maintain an adequate rate of expansion of our sales force;
- changes in the regulatory environment related to health care;
- regulatory compliance costs;
- the timing, size, and integration success of potential future acquisitions; and
- unforeseen legal expenses, including litigation and settlement costs.

Many of these factors are not within our control, and the occurrence of one or more of them might cause our operating results to vary widely. As such, we believe that quarter-to-quarter comparisons of our revenues and operating results may not be meaningful and should not be relied upon as an indication of future performance.

A significant portion of our operating expense is relatively fixed in nature, and planned expenditures are based in part on expectations regarding future revenue and profitability. Accordingly, unexpected revenue shortfalls, lower-than-expected revenue increases as a result of planned expenditures, and longer-than-expected impact on profitability and margins as a result of planned revenue expenditures may decrease our gross margins and profitability and could cause significant changes in our operating results from quarter to quarter. In addition, our future quarterly operating results may fluctuate and may not meet the expectations of securities analysts or investors. If this occurs, the trading price of our common stock could fall substantially, either suddenly or over time.

If the revenue of our practice clients decreases, or if our clients cancel or elect not to renew their contracts, our revenue will decrease.*

Under most of our practice client contracts, we base our charges on a percentage of the revenue that the client realizes while using our services. Many factors may lead to decreases in client revenue, including:

- interruption of client access to our system for any reason;
- our failure to provide services in a timely or high-quality manner;
- failure of our clients to adopt or maintain effective business practices;
- actions by third-party payers of medical claims to reduce reimbursement;
- government regulations and government or other payer actions or inaction reducing or delaying reimbursement; and
- reduction of client revenue resulting from increased competition or other changes in the marketplace for physician services.

An economic downturn, such as the one we are currently experiencing, may give rise to several of these factors. For example, patients who have lost health insurance coverage due to unemployment or who face increased deductibles imposed by financially struggling employers or insurers could reduce the number of visits those patients make to our practice clients. Patients without health insurance or with reduced coverage may also default on their payment obligations at a higher rate than patients with coverage. Added financial stress on our clients could lead to their acquisition or bankruptcy, which could cause

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the termination of some of our service relationships. Further, despite the cost benefits that we believe our services provide, prospective clients may wish to delay contract decisions due to implementation costs or be reluctant to make any material changes in their established business methods in the current economic climate. With a reduction in tax revenue, state and federal government health care programs, including reimbursement programs such as Medicaid, may be reduced or eliminated, which could negatively impact the payments that our practice clients receive.

Also, although we currently estimate our expected customer life for practice clients to be twelve years, this is only an estimate, and there can be no assurance that such clients will elect to renew their contracts for this period of time. Our practice clients typically purchase one-year contracts that, in most cases, may be terminated on 90 days' notice without cause. The majority of our clinical information subscriptions have terms of one year, and our contracts with our market research, payer, and pharmaceutical clients for our interactive services typically range from one to three years. We cannot assure you that members of our Epocrates network and other Epocrates clients will continue to participate in our existing programs beyond the terms of their existing contracts or that they will enter into any additional contracts for new programs that we offer. If our practice clients' revenue decreases for any of the above or other reasons, or if our clients cancel or elect not to renew their contracts, our revenue will decrease.

If we are required to collect sales and use taxes on the services we sell in additional jurisdictions, we may be subject to liability for past sales and incur additional related costs and expenses, and our future sales may decrease.

We may lose sales or incur significant expenses should states be successful in imposing state sales and use taxes on our services. A successful assertion by one or more states that we should collect sales or other taxes on the sale of our services could result in substantial tax liabilities for past sales, decrease our ability to compete with software vendors subject to sales and use taxes, and otherwise harm our business. Each state has different rules and regulations governing sales and use taxes, and these rules and regulations are subject to varying interpretations that may change over time. We review these rules and regulations periodically and, when we believe that our services are subject to sales and use taxes in a particular state, we voluntarily approach state tax authorities in order to determine how to comply with their rules and regulations. We cannot assure you that we will not be subject to sales and use taxes or related penalties for past sales in states where we believe no compliance is necessary.

Vendors of services, like us, are typically held responsible by taxing authorities for the collection and payment of any applicable sales and similar taxes. If one or more taxing authorities determines that taxes should have, but have not, been paid with respect to our services, we may be liable for past taxes in addition to taxes going forward. Liability for past taxes may also include very substantial interest and penalty charges. Our client contracts provide that our clients must pay all applicable sales and similar taxes. Nevertheless, clients may be reluctant to pay back taxes and may refuse responsibility for interest or penalties associated with those taxes. If we are required to collect and pay back taxes and the associated interest and penalties, and if our clients fail or refuse to reimburse us for all or a portion of these amounts, we will have incurred unplanned expenses that may be substantial. Moreover, imposition of such taxes on our services going forward will effectively increase the cost of such services to our clients and may adversely affect our ability to retain existing clients or to gain new clients in the states in which such taxes are imposed.

We may also become subject to tax audits or similar procedures in states where we already pay sales and use taxes. The incurrence of additional accounting and legal costs and related expenses in connection with, and the assessment of, taxes, interest, and penalties as a result of audits, litigation, or otherwise could be materially adverse to our current and future results of operations and financial condition.

As a result of the variable sales and implementation cycles for our athenahealth services, and the uncertainty as to the timing of the fulfillment of our Epocrates services, we may be unable to recognize revenue to offset expenditures, which could result in fluctuations in our quarterly results of operations or otherwise harm our future operating results.*

The sales cycle for our athenahealth services can be variable, typically ranging from three to five months from initial contact to contract execution, although this period can be substantially longer. During the sales cycle, we expend time and resources, and we do not recognize any revenue to offset such expenditures. Our implementation cycle is also variable, typically ranging from three to five months from contract execution to completion of implementation, although some of our new-client set-up projects-especially those for larger practice clients-are complex and require a lengthy delay and significant implementation work. Each client's situation is different, and unanticipated difficulties and delays may arise as a result of failure by us or by the client to meet our respective implementation responsibilities. During the implementation cycle, we expend substantial time, effort, and financial resources implementing our services, but accounting principles do not allow us to recognize the resulting revenue until the service has been implemented, at which time we begin recognition of implementation revenue over an expected attribution period of the longer of the estimated expected customer life, currently twelve years, or the contract term.

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Even if implementation has begun, there can be no assurance that we will recognize revenue on a timely basis or at all from our efforts. Implementation for a given practice client may be canceled, as our contracts typically provide that they can be terminated for any reason or no reason on 90 days notice. Despite the fact that we typically require a deposit in advance of implementation, some clients have canceled before our services have been started. In addition, implementation may be delayed, or the target dates for completion may be extended into the future, for a variety of reasons, including the needs and requirements of the client, delays with payer processing, and the volume and complexity of the implementations awaiting our work. If implementation periods are extended, our provision of the revenue cycle, clinical cycle, or patient cycle services upon which we realize most of our revenues will be delayed, and our financial condition may be adversely affected. In addition, cancellation of any implementation after it has begun may involve loss to us of time, effort, and expenses invested in the canceled implementation process and lost opportunity for implementing paying clients in that same period of time.

In regard to our Epocrates services, the time between the date of the signing of the contract with a pharmaceutical client for a program, the actual fulfillment of the services under such contract and the revenue recognition associated with such revenues may be lengthy, especially for larger contracts with multiple deliverables, and may be subject to delays over which we have little or no control, including those that result from that client’s need for internal approvals. These factors may contribute to substantial fluctuations in our quarterly operating results, particularly in the near term and during any period in which our sales volume is relatively low. As a result, in future quarters our operating results could fall below the expectations of securities analysts or investors, in which event our stock price would likely decrease.

Because we recognize revenue from our drug and clinical reference tool subscriptions and certain of our interactive services over the term or at the end of the service period, a significant downturn in our business may not be reflected immediately in our operating results, which may make it more difficult to evaluate our prospects.*

We recognize revenue from our Epocrates subscription agreements monthly over the terms of these agreements, which are typically one year. In most cases, we recognize revenue from our interactive services over the terms of these agreements or upon delivery of each service element. As a result, a significant portion of the revenue we report in each quarter is generated from subscription and service agreements entered into during prior periods. Consequently, a decline in new or renewed subscriptions or service agreements in any one quarter may not materially affect our financial performance in that quarter but will negatively affect our revenue in future quarters. In addition, we may be unable to adjust our costs, many of which are fixed, in response to reduced revenue. Accordingly, the effect of significant declines in sales and market acceptance of our services may not be reflected in our short-term results of operations, which would make our reported results less indicative of our future prospects.

If we fail to meet our current credit agreement’s financial covenants, our business and financial condition could be adversely affected.*

We currently have a credit agreement which contains financial covenants, including maintaining a consolidated fixed charge coverage ratio, a consolidated leverage ratio, and a consolidated senior leverage ratio. As of September 30, 2013, we borrowed $250 million under the agreement and were in compliance with its financial covenants. There is no assurance that we will continue to be in compliance with all of the covenants under the agreement, and, if at any point we fail to comply with the financial covenants, the lenders can demand immediate repayment of our outstanding balance and deny future borrowings under the agreement. This could have a negative impact on our liquidity, thereby reducing the availability of cash flow for other purposes and adversely affecting our business.

RISKS RELATED TO OUR SERVICE OFFERINGS

Our proprietary software or our services may not operate properly, which could damage our reputation, give rise to claims against us, or divert application of our resources from other purposes, any of which could harm our business and operating results.*

Proprietary software development is time-consuming, expensive, and complex. Unforeseen difficulties can arise. We may encounter technical obstacles, and it is possible that we discover additional problems that prevent our applications from operating properly. If our systems do not function reliably or fail to achieve user or client expectations in terms of performance, clients could assert liability claims against us or attempt to cancel their contracts with us, and members could choose to terminate their use of our services. This could damage our reputation and impair our ability to attract or maintain clients and members.

Information services as complex as those we offer have in the past contained, and may in the future develop or contain, undetected defects or errors. We cannot assure you that material performance problems or defects in our services will not arise in the future. Errors may result from sources beyond our control, including the receipt, entry, or interpretation of patient information; interface of our services with legacy systems that we did not develop; or errors in data provided by third parties. It is challenging for us to test our software for all potential problems because it is difficult to simulate the wide variety of computing environments or treatment methodologies that our practice clients or members may deploy or rely upon. Therefore, despite testing, defects or errors may arise in our existing or new software or service processes following introduction to the market. For example, changes in payer requirements and practices are frequent and sometimes difficult to determine except through trial and error, so we are continuously discovering defects and errors in our software and service processes compared against these requirements and practices.

Because practice clients rely on our services to collect, manage, and report clinical, business, and administrative data-including information to assist care providers in tracking and treating ill patients-and members rely on our services to provide timely and accurate information regarding medical conditions and medicines, they may have a greater sensitivity to service errors and security vulnerabilities than clients of software products in general. Any operational delay in or failure of our technology or service processes may result in the disruption of patient care and could cause harm to patients and thereby give rise to a product liability claim or errors or omissions claim. Such claims could subject us to significant legal defense costs and adverse publicity, regardless of the merits or eventual outcome of those claims. While our subscription and services agreements typically contain limitations of liability and disclaimers that purport to limit our liability for damages related to defects in our software or content, such limitations and disclaimers may not be enforced by a court or other tribunal or otherwise effectively protect us from related claims. We maintain liability insurance coverage, including coverage for errors and omissions. However, it is possible that claims could exceed the amount of our applicable insurance coverage, if any, or that this coverage may not continue to be available on acceptable terms or in sufficient amounts.

In light of this, defects and errors and any failure by us to identify and address them could result in loss of revenue or market share; liability to clients, members, their patients, or others; failure to achieve market acceptance or expansion; diversion of development and management resources; delays in the introduction of new services; injury to our reputation; and increased service and maintenance costs. Defects or errors in our software and service processes might discourage existing or potential clients or members from purchasing services from us. Correction of defects or errors could prove to be impossible or impracticable. The costs incurred in correcting any defects or errors or in responding to resulting claims or liability may be substantial and could adversely affect our operating results.

If our security measures are breached or fail, and unauthorized access is obtained to a client's or member's data, our services may be perceived as not being secure, clients and members may curtail or stop using our services, and we may incur significant liabilities.

Our services involve the web-based storage and transmission of clients' and members' proprietary information and protected health information of patients. Because of the sensitivity of this information, security features of our software are very important. From time to time we may detect vulnerabilities in our systems, which, even if they do not result in a security breach, may reduce customer confidence and require substantial resources to address. If our security measures are breached or fail as a result of third-party action, employee error, malfeasance, insufficiency, defective design, or otherwise, someone may be able to obtain unauthorized access to client, member, or patient data. As a result, our reputation could be damaged, our business may suffer, and we could face damages for contract breach, penalties for violation of applicable laws or regulations, and significant costs for remediation and efforts to prevent future occurrences. We rely upon users of our systems for key activities to promote security of those systems and the data within them, such as administration of client-side access credentialing and control of client-side display of data. On occasion, users have failed to perform these activities. Failure of users to perform these activities may result in claims against us that this reliance was misplaced, which could expose us to significant expense and harm to our reputation. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose sales, clients, and members. In addition, our practice clients may authorize or enable third parties to access their data or the data of their patients on our systems. Because we do not control such access, we cannot ensure the complete propriety of that access or integrity or security of such data in our systems.

Failure by our clients to obtain proper permissions and waivers may result in claims against us or may limit or prevent our use of data, which could harm our business.

We require our clients to provide necessary notices and to obtain necessary permissions and waivers for use and disclosure of the information that we receive, and we require contractual assurances from them that they have done so and will do so. If they do not obtain necessary permissions and waivers, then our use and disclosure of information that we receive from them or on their behalf may be limited or prohibited by state or federal privacy laws or other laws. This could impair our functions, processes, and databases that reflect, contain, or are based upon such data and may prevent use of such data. In addition, this could interfere with or prevent creation or use of rules, and analyses or limit other data-driven activities that benefit us.

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Moreover, we may be subject to claims or liability for use or disclosure of information by reason of lack of valid notice, permission, or waiver. These claims or liabilities could subject us to unexpected costs and adversely affect our operating results.

Various events could interrupt users' access to our systems, exposing us to significant costs.

The ability to access our systems is critical to our practice clients' administration of care, cash flow, and business viability. Our operations and facilities are vulnerable to interruption or damage from a number of sources, many of which are beyond our control, including, without limitation: (i) power loss and telecommunications failures; (ii) earthquake, fire, flood, hurricane, and other natural disasters; (iii) terrorism and acts of war; (iv) software and hardware errors, failures, or crashes in our systems or those of others; and (v) computer viruses, hacking, and similar disruptive problems in our systems or those of others. We attempt to mitigate these risks through various means, including redundant infrastructure, disaster recovery plans, business continuity plans, separate test systems, and change control and system security measures, but our precautions will not protect against all potential problems. If users' access is interrupted because of problems in the operation of our facilities, we could be exposed to significant claims by practice clients or their patients, particularly if the access interruption is associated with problems in the timely delivery of funds due to those clients or medical information relevant to patient care. Our plans for disaster recovery and business continuity rely in part upon third-party providers of related services, and if those vendors fail us at a time that our systems are not operating correctly, we could incur a loss of revenue and liability for failure to fulfill our obligations. Although we carry business interruption insurance, it only covers some, but not all, of these potential events, and even for those events that are covered, it may not be sufficient to compensate us fully for losses or damages that may occur as a result of such events, including, for example, loss of market share and diminution of our brand, reputation, and member and client loyalty.

In addition, retention and availability of patient care and physician reimbursement data are subject to federal and state laws governing record retention, accuracy, and access. Some laws impose obligations on our practice clients and on us to produce information to third parties and to amend or expunge data at their direction. Our failure to meet these obligations may result in liability that could increase our costs and reduce our operating results.

We rely on Internet infrastructure, bandwidth providers, data center providers, other third parties, and our own systems for providing services to our users, and any failure or interruption in the services provided by these third parties or our own systems could expose us to litigation and negatively impact our relationships with users or clients, adversely affecting our brand and our business.*

In addition to the services we provide from our offices, we currently serve our practice clients from three third-party data-hosting facilities located in the greater Boston, Massachusetts, and Dallas-Fort Worth, Texas, areas. These facilities are operated by Colospace Inc. and two subsidiaries of Digital Realty Trust, Inc. In addition, in December 2009 we signed a contract with a major provider of disaster recovery services, SunGard Availability Services, LP, to store our disaster recovery plans and provide disaster recovery testing services. In the case of a significant event at any of these data centers, we could move operations from that data center to our other data centers within a reasonable timeframe. For Epocrates, in addition to our operations at our facility in San Mateo, California, we use a co-location service administered by AT&T, Inc. in Redwood City, California.

However, these facilities are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures, and similar events. They are also subject to break-ins, sabotage, intentional acts of vandalism, and similar misconduct. Despite precautions taken at these facilities, the occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice, or other unanticipated problems at two or more of the facilities could result in lengthy interruptions in our service. For example, the proximity of our San Mateo and Redwood City, California, operations, which are the sole facilities used to provide our Epocrates services, could result in both facilities being impacted by a regional event, such as an earthquake. Even with our disaster recovery arrangements, our services could be interrupted.

Our ability to deliver our Internet- and telecommunications-based services is dependent on the development and maintenance of the infrastructure of the Internet and other telecommunications services by third parties. This includes maintenance of a reliable network backbone with the necessary speed, data capacity, and security for providing reliable Internet access and services and reliable mobile device, telephone, facsimile, and pager systems. Our services are designed to operate without interruption in accordance with our service level commitments and to meet user expectations. However, we have experienced and expect that we will experience interruptions and delays in services and availability from time to time. We rely on internal systems as well as third-party vendors, including data center, bandwidth, and telecommunications equipment or service providers, to provide our services. We do not maintain redundant systems or facilities for some of these services. In the event of a catastrophic event with respect to one or more of these systems or facilities, we may experience an extended period of system unavailability, which could negatively impact our relationship with users or clients. To operate without interruption, both we and our service providers must guard against:

damage from fire, power loss, and other natural disasters;

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communications failures;
software and hardware errors, failures, and crashes;
security breaches, computer viruses, and similar disruptive problems; and
other potential interruptions.

Any disruption in the network access, telecommunications, or co-location services provided by these third-party providers or any failure of or by these third-party providers or our own systems to handle current or higher volume of use could significantly harm our business. We exercise limited control over these third-party vendors, which increases our vulnerability to problems with services they provide.

Any errors, failures, interruptions, or delays experienced in connection with these third-party technologies and information services or our own systems could negatively impact our relationships with users and clients, adversely affect our brand and business, and expose us to third-party liabilities. Although we maintain insurance for our business, the coverage under our policies may not be adequate to compensate us for all losses that may occur. In addition, we cannot provide assurance that we will continue to be able to obtain adequate insurance coverage at an acceptable cost.

The reliability and performance of the Internet may be harmed by increased usage or by denial-of-service attacks. The Internet has experienced a variety of outages and other delays as a result of damages to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage as well as the availability of the Internet to us for delivery of our Internet-based services.

We rely on third-party computer hardware and software that may be difficult to replace or that could cause errors or failures of our services, which could damage our reputation, harm our ability to attract and maintain members and clients, and decrease our revenue.

We rely on computer hardware purchased or leased and software licensed from third parties in order to offer our services, including database software from Oracle Corporation and storage devices from International Business Machines Corporation and EMC Corporation. These licenses are generally commercially available on varying terms; however, it is possible that this hardware and software may not continue to be available on commercially reasonable terms, or at all. Any loss of the right to use any of this hardware or software could result in delays in the provisioning of our services until equivalent technology is either developed by us, or, if available, is identified, obtained, and integrated, which could harm our business. Any errors or defects in third-party hardware or software could result in errors or a failure of our services, which could damage our reputation, harm our ability to attract and maintain members and clients, and decrease our revenue.

We are subject to the effect of payer and provider conduct that we cannot control and that could damage our reputation with clients and result in liability claims that increase our expenses.

We offer certain electronic claims submission services for which we rely on content from clients, payers, and others. While we have implemented certain features and safeguards designed to maximize the accuracy and completeness of claims content, these features and safeguards may not be sufficient to prevent inaccurate claims data from being submitted to payers. Should inaccurate claims data be submitted to payers, we may experience poor operational results and may be subject to liability claims, which could damage our reputation with clients and result in liability claims that increase our expenses.

If our services fail to provide accurate and timely information, or if our content or any other element of any of our services is associated with faulty clinical decisions or treatment, we could have liability to clients, members, clinicians, or patients, which could adversely affect our results of operations.*

Our software, content, and services are used to assist clinical decision-making and provide information about patient medical histories, treatment plans, medical conditions, and the use of particular medications. If our software, content, or services fail to provide accurate and timely information or are associated with faulty clinical decisions or treatment, then clients, members, clinicians, or their patients could assert claims against us that could result in substantial costs to us, harm our reputation in the industry, and cause demand for our services to decline.

Our athenaClinicals service is utilized in clinical decision-making, provides access to patient medical histories, and assists in creating patient treatment plans, including the issuance of prescription drugs. Therefore, if these data are incorrect or incomplete or if we make mistakes in the capture or input of these data, adverse consequences, including death, may occur and give rise to product liability and other claims against us by practice clients, clinicians, patients, or others. Although the data stored and displayed in athenaClinicals is generally provided by our practice clients or third parties, and we often have little control over their accuracy, a court or government agency may take the position that our storage and display of health

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information exposes us to personal injury liability or other liability for wrongful delivery or handling of health care services or erroneous health information.

Our Epocrates clinical reference tools and interactive services provide health care professionals with access to clinical information, including information regarding particular medical conditions and the use of particular medications. If our content, or content we obtain from third parties, contains inaccuracies, or we introduce inaccuracies in the process of implementing third-party content, it is possible that patients, physicians, consumers, the providers of the third-party content, or others may sue us if they are harmed as a result of such inaccuracies. We have editorial procedures in place to provide quality control of the information that we publish or provide. However, we cannot assure you that our editorial and other quality control procedures will be sufficient to ensure that there are no errors or omissions in particular content, and we have had content errors in the past.

The assertion of such claims and ensuing litigation, regardless of its outcome, could result in substantial cost to us, divert management’s attention from operations, damage our reputation, and decrease market acceptance of our services. We attempt to limit by contract our liability for damages; have our members assume responsibility for medical oversight and dosing decisions; and require that our practice clients assume responsibility for medical care and approve key system rules, protocols, and data. Despite these precautions, the allocations of responsibility and limitations of liability set forth in our contracts may not be enforceable, be binding upon patients, or otherwise protect us from liability for damages. Furthermore, while we maintain general liability and errors and omissions insurance coverage, this coverage may not continue to be available on acceptable terms or may not be available in sufficient amounts to cover one or more large claims against us. In addition, the insurer might disclaim coverage as to any future claim. One or more large claims could exceed our available insurance coverage.

If any of these risks occur, they could materially adversely affect our business, financial condition, or results of operations.

RISKS RELATED TO REGULATION

Government regulation of health care creates risks and challenges with respect to our compliance efforts and our business strategies.*

The health care industry is highly regulated and is subject to changing political, legislative, regulatory, and other influences. Existing and new laws and regulations affecting the health care industry could create unexpected liabilities for us, cause us to incur additional costs, and restrict our operations. Many health care laws are complex, and their application to specific services and relationships may not be clear. In particular, many existing health care laws and regulations, when enacted, did not anticipate the health care information and interactive services that we provide, and these laws and regulations may be applied to our services in ways that we do not anticipate, particularly as we develop and release new and more sophisticated products and services. Our failure to accurately anticipate the application of these laws and regulations, or our other failure to comply with them, could create liability for us, result in adverse publicity, and negatively affect our business. Some of the risks we face from health care regulation are described below:

False or Fraudulent Claim Laws. There are numerous federal and state laws that forbid submission of false information, or the failure to disclose information, in connection with submission and payment of physician claims for reimbursement. In some cases, these laws also forbid abuse in connection with such submission and payment. Any failure of our services to comply with these laws and regulations could result in substantial liability (including, but not limited to, criminal liability), adversely affect demand for our services, and force us to expend significant capital, research and development, and other resources to address the failure. Errors by us or our systems with respect to entry, formatting, preparation, or transmission of claim information may be determined or alleged to be in violation of these laws and regulations. Any determination by a court or regulatory agency that our services violate these laws could subject us to civil or criminal penalties, invalidate all or portions of some of our practice client contracts, require us to change or terminate some portions of our business, require us to refund portions of our services fees, cause us to be disqualified from serving practice clients doing business with government payers, and have an adverse effect on our business.

In most cases where we are permitted to do so, we calculate charges for our services based on a percentage of the collections that our practice clients receive as a result of our services. To the extent that violations or liability for violations of these laws and regulations require intent, it may be alleged that this percentage calculation provides us or our employees with incentive to commit or overlook fraud or abuse in connection with submission and payment of reimbursement claims. The U.S. Centers for Medicare and Medicaid Services has stated that it is concerned that percentage-based billing services may encourage billing companies to engage in or overlook fraudulent or abusive practices.

In addition, we may contract with third parties that offer software relating to the selection or verification of codes used to identify and classify the services for which reimbursement is sought. Submission of codes that do not accurately reflect the services provided or the location or method of their provision may constitute a violation of false or fraudulent claims laws. Our ability to comply with these laws depends on the coding decisions made by our practice clients and the accuracy of our vendors' software and services in suggesting possible codes to those clients and verifying that proper codes have been selected.

HIPAA and other Health Privacy Regulations. There are numerous federal and state laws related to patient privacy. In particular, the Health Insurance Portability and Accountability Act of 1996, or HIPAA, includes privacy standards that protect individual privacy by limiting the uses and disclosures of individually identifiable health information and implementing data security standards that require covered entities to implement administrative, physical, and technological safeguards to ensure the confidentiality, integrity, availability, and security of individually identifiable health information in electronic form. HIPAA also specifies formats that must be used in certain electronic transactions, such as claims, payment advice, and eligibility inquiries. Because we translate electronic transactions to and from HIPAA-prescribed electronic formats and other forms, we are considered a clearinghouse and, as such, a covered entity subject to HIPAA. In addition, our practice clients are also covered entities and are mandated by HIPAA to enter into written agreements with us-known as business associate agreements-that require us to safeguard individually identifiable health information. Business associate agreements typically include:

- a description of our permitted uses of individually identifiable health information;
- a covenant not to disclose that information except as permitted under the agreement and to make our subcontractors, if any, subject to the same restrictions;
- assurances that appropriate administrative, physical, and technical safeguards are in place to prevent misuse of that information;
- an obligation to report to our client any use or disclosure of that information other than as provided for in the agreement;
- a prohibition against our use or disclosure of that information if a similar use or disclosure by our client would violate the HIPAA standards;
- the ability of our clients to terminate the underlying support agreement if we breach a material term of the business associate agreement and are unable to cure the breach;
- the requirement to return or destroy all individually identifiable health information at the end of our support agreement; and
- access by the Department of Health and Human Services to our internal practices, books, and records to validate that we are safeguarding individually identifiable health information.

We may not be able to adequately address the business risks created by HIPAA implementation. Furthermore, we are unable to predict what changes to HIPAA or other laws or regulations might be made in the future or how those changes could affect our business or the costs of compliance. For example, the provisions of the HITECH Act and the regulations issued under it have provided clarification of certain aspects of both the Privacy and Security Rules, expansion of the disclosure requirements for a breach of the Security Rule, and strengthening of the civil and criminal penalties for failure to comply with HIPAA. In addition, ONCHIT is coordinating the ongoing development of standards to enable interoperable health information technology infrastructure nationwide based on the widespread adoption of electronic health records in the health care sector. We are unable to predict what, if any, impact the changes in such standards will have on our compliance costs or our services.

In addition, some payers and clearinghouses with which we conduct business interpret HIPAA transaction requirements differently than we do. Where clearinghouses or payers require conformity with their interpretations as a condition of effecting transactions, and their interpretations are no less stringent than ours, we seek to comply with their interpretations.

The HIPAA transaction standards include proper use of procedure and diagnosis codes. Since these codes are selected or approved by our practice clients, and since we do not verify their propriety, some of our capability to comply with the transaction standards is dependent on the proper conduct of those clients.

Among our services, we provide telephone reminder services to patients, Internet- and telephone-based access to medical test results, pager and email notification to practices of patient calls, and patient call answering services. We believe that reasonable efforts to prevent disclosure of individually identifiable health information have been and are being taken in connection with these services, including the use of multiple-password security. However, any failure of our practice clients to provide accurate contact information for their patients or physicians or any breach of our telecommunications systems could result in a disclosure of individually identifiable health information.

In addition to the HIPAA Privacy and Security Rules and the HITECH Act requirements, most states have enacted patient confidentiality laws that protect against the disclosure of confidential medical and other personally identifiable information, and many states have adopted or are considering further legislation in this area, including privacy safeguards, security standards, and data security breach notification requirements. Such state laws, if more stringent than HIPAA and HITECH Act requirements, are not preempted by the federal requirements, and we are required to comply with them.

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Failure by us to comply with any of the federal and state standards regarding patient privacy may subject us to penalties, including civil monetary penalties and, in some circumstances, criminal penalties. In addition, such failure may injure our reputation and adversely affect our ability to retain clients and attract new clients.

In addition to false claims and HIPAA requirements, we are subject to a variety of other regulatory schemes, including:

Anti-Kickback and Anti-Bribery Laws. There are federal and state laws that govern patient referrals, physician financial relationships, and inducements to health care providers and patients. For example, the federal health care programs' anti-kickback law prohibits any person or entity from offering, paying, soliciting, or receiving anything of value, directly or indirectly, for the referral of patients covered by Medicare, Medicaid, and other federal health care programs or the leasing, purchasing, ordering, or arranging for or recommending the lease, purchase, or order of any item, good, facility, or service covered by these programs. Many states also have similar anti-kickback laws that are not necessarily limited to items or services for which payment is made by a federal health care program. Moreover, both federal and state laws forbid bribery and similar behavior. Any determination by a state or federal regulatory agency that any of our activities or those of our clients, vendors, or channel partners violate any of these laws could subject us to civil or criminal penalties, require us to change or terminate some portions of our business, require us to refund a portion of our service fees, disqualify us from providing services to clients doing business with government programs, and have an adverse effect on our business. For example, one aspect of our athenaCoordinator service is the preparation and submission of electronic orders from providers to other participants in the health care system (e.g., hospitals, labs, and specialists). As the recipients of those orders will in certain instances pay us for the submission of accurate, complete, and readable orders instead of the handwritten and often incomplete orders traditionally submitted, our service could potentially be seen as providing referrals to the order recipients in exchange for payment. Although the Office of Inspector General issued an Advisory Opinion in November 2011 stating that our receipt of payments in such instances would not violate federal anti-kickback laws, we cannot predict whether changes in the law or our services might lead to a challenge of the legality of those services by government regulators. Even an unsuccessful challenge by regulatory authorities of our activities could result in adverse publicity and could require a costly response from us.

Legislation relating to payments to physicians. Recent legislation enacted or pending in several states and enacted at the federal level as part of the Patient Protection and Affordable Care Act and the Healthcare and Education Reconciliation Act of 2010 mandates public disclosure of, or otherwise regulates or limits the providing of, certain gifts and payments by pharmaceutical companies to physicians. These laws may be interpreted to cover honorarium payments made to physicians for participation in market research activities sponsored by pharmaceutical companies. Because we currently provide market research services involving participants from our member network, the increased adoption and enforcement of these laws and the application of any public disclosure requirements or other limitations may have a negative impact on the ability of pharmaceutical companies to sponsor these activities or the willingness of physicians to participate in the market research. To date, we have not experienced a significant reduction in our market research services business as a result of these laws in the few jurisdictions in which they have been enacted and become effective. However, we cannot predict how pharmaceutical companies or physicians will respond when such legislation becomes more widespread or becomes effective at the federal level. A significant decline in the sponsorship of our market research services by pharmaceutical companies or the agencies that represent such companies, or a significant decline in physicians' willingness to participate in such studies could negatively impact our operating results.

Anti-Referral Laws. There are federal and state laws that forbid payment for patient referrals, patient brokering, remuneration of patients, or billing based on referrals between individuals or entities that have various financial, ownership, or other business relationships with health care providers. In many cases, billing for care arising from such actions is illegal. These vary widely from state to state, and one of the federal laws-called the Stark Law-is very complex in its application. Any determination by a state or federal regulatory agency that any of our practice clients violate or have violated any of these laws may result in allegations that claims that we have processed or forwarded are improper. This could subject us to civil or criminal penalties, require us to change or terminate some portions of our business, require us to refund portions of our services fees, and have an adverse effect on our business. Even an

unsuccessful challenge by regulatory authorities of our activities could result in adverse publicity and could require a costly response from us.
Corporate Practice of Medicine Laws and Fee-Splitting Laws. Many states have laws forbidding physicians from practicing medicine in partnership with non-physicians, such as business corporations. In some states, including New York, these take the form of laws or regulations forbidding splitting of physician fees with non-physicians or others. In some cases, these laws have been interpreted to prevent business service providers from charging their physician clients on the basis of a percentage of collections or charges. We have varied our charge structure in some states to comply with these laws, which may make our services less desirable to potential clients. Any determination by a state

court or regulatory agency that our service contracts with our practice clients violate these laws could subject us to civil or criminal penalties, invalidate all or portions of some of those contracts, require us to change or terminate some portions of our business, require us to refund portions of our services fees, and have an adverse effect on our business. Even an unsuccessful challenge by regulatory authorities of our activities could result in adverse publicity and could require a costly response from us.

Anti-Assignment Laws. There are federal and state laws that prohibit or limit assignment of claims for reimbursement from government-funded programs. In some cases, these laws have been interpreted in regulations or policy statements to limit the manner in which business service companies may handle checks or other payments for such claims and to limit or prevent such companies from charging their physician clients on the basis of a percentage of collections or charges. Any determination by a state court or regulatory agency that our service contracts with our practice clients violate these laws could subject us to civil or criminal penalties, invalidate all or portions of some of those contracts, require us to change or terminate some portions of our business, require us to refund portions of our service fees, and have an adverse effect on our business. Even an unsuccessful challenge by regulatory authorities of our activities could result in adverse publicity and could require a costly response from us.

Prescribing Laws. The use of our software by physicians to perform a variety of functions relating to prescriptions, including electronic prescribing, electronic routing of prescriptions to pharmacies, and dispensing of medication, is governed by state and federal law, including fraud and abuse laws, drug control regulations, and state department of health regulations. States have differing prescription format requirements, and, due in part to recent industry initiatives, federal law and the laws of all 50 states now provide a regulatory framework for the electronic transmission of prescription orders. Regulatory authorities such as the U.S. Department of Health and Human Services' Centers for Medicare and Medicaid Services may impose functionality standards with regard to electronic prescribing and EHR technologies. Any determination that we or our practice clients have violated prescribing laws may expose us to liability, loss of reputation, and loss of business. These laws and requirements may also increase the cost and time necessary to market new services and could affect us in other respects not presently foreseeable.

Electronic Health Records Laws. A number of federal and state laws govern the use and content of electronic health record systems, including fraud and abuse laws that may affect how such technology is provided. As a company that provides EHR functionality, our systems and services must be designed in a manner that facilitates our practice clients' compliance with these laws. Because this is a topic of increasing state and federal regulation, we expect additional and continuing modification of the current legal and regulatory environment. We cannot predict the content or effect of possible future regulation on our business activities. The software component of our athenaClinicals service was certified as a 2011/2012 compliant Complete EHR by CCHIT, an ONC-ATCB, in accordance with the applicable certification criteria adopted by the Secretary of the U.S. Department of Health and Human Services (HHS). The 2011/2012 criteria support the Stage 1 meaningful use measures required to qualify eligible providers and hospitals for funding under the HITECH Act. However, such certification does not represent an endorsement of our athenaClinicals service by HHS or guarantee the receipt of incentive payments. While we believe that our system is well designed in terms of function and interoperability, we cannot be certain that it will meet future requirements.

Claims Transmission Laws. Our services include the manual and electronic transmission of medical practice claims for reimbursement from payers. Federal and various state laws provide for civil and criminal penalties for any person who submits, or causes to be submitted, a claim to any payer (including, without limitation, Medicare, Medicaid, and any private health plans and managed care plans) that is false or that overbills or bills for items that have not been provided to the patient. Although we do not determine what is billed to a payer, to the extent that such laws apply to a service that merely transmits claims on behalf of others, we could be subject to the same civil and criminal penalties as our practice clients.

Prompt Pay Laws. Laws in many states govern prompt payment obligations for health care services. These laws generally define claims payment processes and set specific timeframes for submission, payment, and appeal steps. They frequently also define and require clean claims. Failure to meet these requirements and timeframes may result in rejection or delay of claims. Failure of our services to comply may adversely affect our business results and give rise to liability claims by practice clients.

Medical professional regulation. The practice of most health care professions requires licensing under applicable state law. In addition, the laws in some states prohibit business entities from practicing medicine. We do not believe that we engage in the practice of medicine and have attempted to structure our services, strategic relationships, and other operations to avoid violating these state licensing and professional practice laws. We employ and contract with physicians who provide only medical information to our users, some of whom may be consumers, and we do not intend to provide medical care or advice. Any determination that we are a health care provider and acted improperly as a health care provider may result in liability to us.

Regulation of drug and medical device advertising and promotion. We provide services involving promotion of prescription and over-the-counter drugs and medical devices. Any increase in regulation of these areas by the U.S. Food and Drug Administration, or FDA; the Federal Trade Commission, or FTC; or other governmental bodies at the federal, state, or local level, could make it more difficult for us to contract for certain of our interactive services. Physician groups and others have criticized the FDA's current policies and have called for restrictions on advertising of prescription drugs and for increased FDA enforcement. In response, the FDA has conducted hearings and sought public comment regarding its regulation of information concerning drugs on the Internet and the relationships between pharmaceutical companies and those disseminating information on drugs. We cannot predict what actions the FDA or industry participants may take in response to these criticisms. It is also possible that new laws would be enacted that impose restrictions on such marketing and advertising. Our interactive services revenues could be materially reduced by additional restrictions on the marketing or advertising of prescription drugs and medical devices, whether imposed by law or regulation or by policies adopted by industry members. If the FDA, the FTC, or another governmental body finds that any information available on our website or distributed by us violates FDA, FTC, or other laws or regulations, they may take regulatory or judicial action against us or the advertiser or sponsor of that information. State attorneys general may also take similar action based on their state's consumer protection statutes or other new or existing laws.

Medical Device Laws. The FDA has promulgated a draft policy for the regulation of computer software products as medical devices under the 1976 Medical Device Amendments to the Federal Food, Drug and Cosmetic Act. In addition, in February 2011 the FDA issued a final rule regarding regulation of Medical Device Data Systems (MDDSs), which are systems that are intended to transfer, store, convert, or display medical device data. While EHRs are expressly exempted from the final rule, it is possible that future changes in our services could involve the transfer, storage, conversion, or display of medical device data. In addition, a report, due by early 2014 from the FDA, ONCHIT, and the Federal Communications Commission, is expected to propose a regulatory framework for health information technology for the purpose of promoting innovation, protecting patient safety, and avoiding regulatory duplication. To the extent that our software is considered a medical device under the policy or an MDDS under the final rule, or is the subject of additional regulation promulgated as a result of the report, we, as a provider of application functionality, could be required, depending on the functionality, to:

register and list our products with the FDA;

notify the FDA and demonstrate substantial equivalence to other products on the market before marketing our functionality; or

obtain FDA approval by demonstrating safety and effectiveness before marketing our functionality.

The FDA can impose extensive requirements governing pre- and post-market conditions, such as service investigation and others relating to approval, labeling, and manufacturing. In addition, the FDA can impose extensive requirements governing development controls and quality assurance processes.

Potential health care reform and new regulatory requirements placed on our software, services, and content could impose increased costs on us, delay or prevent our introduction of new services types, and impair the function or value of our existing service types.

Our services may be significantly impacted by health care reform initiatives and will be subject to increasing regulatory requirements, either of which could affect our business in a multitude of ways. If substantive health care reform or applicable regulatory requirements are adopted, we may have to change or adapt our services and software to comply. Reform or changing regulatory requirements may also render our services obsolete or may block us from accomplishing our work or from developing new services. This may in turn impose additional costs upon us to adapt to the new operating environment or to further develop services or software. For example, the conversion to the ICD-10 standard for coding medical diagnoses will likely cause significant disruption to our industry and consume a large amount of resources on our part. Such reforms may also make introduction of new service types more costly or more time-consuming than we currently anticipate. Such changes may even prevent introduction by us of new services or make the continuation of our existing services unprofitable or impossible.

Potential additional regulation of the disclosure of health information outside the United States may adversely affect our operations and may increase our costs.

Federal or state governmental authorities may impose additional data security standards or additional privacy or other restrictions on the collection, use, transmission, and other disclosures of health information. Legislation has been proposed at various times at both the federal and the state level that would limit, forbid, or regulate the use or transmission of medical information outside of the United States. Such legislation, if adopted, may render our use of our off-shore partners, such as our data-entry and customer service providers, International Business Machines Corporation and Vision Business Process Solutions Inc., for work related to such data impracticable or substantially more expensive. Alternative processing of such information within the United States may involve substantial delay in implementation and increased cost.

Due to the particular nature of certain services we provide or the manner in which we provide them, we may be subject to government regulation unrelated to health care.*

While our services are primarily subject to government regulations pertaining to health care, certain aspects of those services may require us to comply with regulatory schemes from other areas. Examples of such regulatory schema include:

Anti-spam Laws. We may be required to comply with current or future anti-spam legislation by limiting or modifying some of our interactive services, such as our clinical messaging, which may result in a reduction in our revenue. One such law, the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, or CAN-SPAM, became effective in the United States on January 1, 2004. CAN-SPAM imposes complex and often burdensome requirements in connection with the sending of commercial e-mail. CAN-SPAM or similar laws may impose burdens on our member communication practices and on certain of our services, which in turn could harm our ability to attract new payer and pharmaceutical clients and increase revenues.

Antitrust Laws. Our national cloud-based network allows us access to cost and pricing data for a large number of providers in most regional markets, as well as to the contracted rates for third-party payers. To the extent that our services enable providers to compare their cost and pricing data with those of their competitors, those providers could collude to increase the pricing for their services, to reduce the compensation they pay their employees, or to collectively negotiate agreements with third parties. Similarly, if payers are able to compare their contracted rates of payment to providers, those payers may seek to reduce the amounts they might otherwise pay. Such actions may be deemed to be anti-competitive and a violation of federal antitrust laws. To the extent that we are deemed to have enabled such activities, we could be subject to fines and penalties imposed by the U.S. Department of Justice or the Federal Trade Commission and be required to curtail or terminate the services that permitted such collusion.

Debt Collection Laws. As a billing service that offers patient communication and registration services, our employees or those of our service providers may from time to time come into contact with patients who owe our practice clients outstanding amounts. Communications with patients that relate to amounts owed may be deemed to subject us or our service providers to federal or state debt collection laws and regulations. Such laws and regulations, if deemed to apply to us, could require registration with government agencies and compliance with significant administrative obligations (e.g., to maintain an in-state office with local employees), which could result in increased expenses and subject us to fines and penalties for violation. Following the disclosure in 2012 of the methods used by debt collector Accretive Health to obtain payment of amounts owed by patients to one of its hospital clients, heightened focus on debt collection practices may lead to additional regulation and greater scrutiny of existing debt collection practices.

Privacy Regulation. The FTC and many state attorneys general are applying federal and state consumer protection laws to require that the online collection, use, and dissemination of data, and the presentation of website or other electronic content, comply with certain standards for notice, choice, security, and access. Courts may also adopt these developing standards. A number of states, including California, have enacted laws or are considering the enactment of laws governing the release of credit card or other personal information received from consumers.

In addition, several foreign governments have regulations dealing with the collection and use of personal information obtained from their citizens. For example, the European Union, or EU, adopted the Data Protection Directive, or DPD, imposing strict regulations and establishing a series of requirements regarding the collection and use of personally identifiable information online. The DPD provides for specific regulations requiring all non-EU countries doing business with EU member states to provide adequate data privacy protection when receiving personal data from any of the EU member states. Similarly, Canada's Personal Information and Protection of Electronic Documents Act provides Canadian residents with privacy protections in regard to transactions with businesses and organizations in the private sector and sets out ground rules for how private sector organizations may collect, use, and disclose personal information in the course of commercial activities. Foreign governments may attempt to apply such laws extraterritorially or through treaties or other arrangements with U.S. governmental entities, and our practice management services for practices along the Canadian border and our market research services could each involve the personal information of foreign residents. Furthermore, in the conduct of our market research activities outside of the United States, we rely upon a third party to identify and recruit respondents for the market research and to comply with the applicable privacy laws in each jurisdiction in which it operates. We cannot assure you that this third party will successfully comply with such laws or that we would not be responsible for any failure of this third party to comply.

While we have privacy policies posted with our services that we believe comply with applicable laws requiring notice to our users and practice clients about our information collection, use, and disclosure practices, we cannot assure you that the privacy policies and other statements regarding our practices will be found sufficient to protect us from liability or adverse publicity relating to the privacy and security of personal information. Whether and how existing local and international privacy and consumer protection laws in various jurisdictions apply to the Internet and other online technologies is still uncertain and may take years to resolve. Privacy laws and regulations, if drafted or interpreted broadly, could be deemed to apply to the technology we use and could restrict our information collection methods or decrease the amount and utility of the information that we would be permitted to collect. The costs of compliance with, and the other burdens imposed by, these and other laws or regulatory actions may prevent us from selling our products or services, or increase the costs of doing so, and may affect our ability to invest in or jointly develop products. In addition, a determination by a court or government agency that any of our practices, or those of our agents, do not meet these standards could result in liability, result in adverse publicity, and adversely affect our business.

Errors or illegal activity on the part of our clients may result in claims against us.

We require our clients to provide us with accurate and appropriate data and directives for our actions. We also rely upon our clients as users of our system to perform key activities in order to produce proper claims for reimbursement. Failure of our clients to provide these data and directives or to perform these activities may result in claims against us alleging that our reliance was misplaced or unreasonable or that we have facilitated or otherwise participated in submission of false claims.

If participants in our channel marketing and sales lead programs do not maintain appropriate relationships with current and potential clients, our sales accomplished with their help or data may be unwound and our payments to them may be deemed improper.

We maintain a series of relationships with third parties that we term “channel relationships.” These relationships take different forms under different contractual language. Some relationships help us identify sales leads. Other relationships permit third parties to act as value-added resellers or as independent sales representatives for our services. In some cases, for example in the case of some membership organizations, these relationships involve endorsement of our services as well as other marketing activities. In each of these cases, we require contractually that the third party disclose information to and limit their relationships with potential purchasers of our services for regulatory compliance reasons. If these third parties do not comply with these regulatory requirements or if our requirements are deemed insufficient, sales accomplished with the data or help that they have provided, as well as the channel relationships themselves, may not be enforceable, may be unwound, and may be deemed to violate relevant laws or regulations. Third parties that, despite our requirements, exercise undue influence over decisions by current and prospective clients, occupy positions with obligations of fidelity or fiduciary obligations to current and prospective clients, or who offer bribes or kickbacks to current and prospective clients or their employees may be committing illegal acts that could render any resulting contract between us and the client unenforceable or in violation of relevant laws or regulations. Any misconduct by these third parties with respect to current or prospective clients, any failure to follow contractual requirements, or any insufficiency of those contractual requirements may result in allegations that we have encouraged or participated in illegal behavior and that payments to such third parties under our channel contracts are improper. This misconduct could subject us to civil or criminal claims and liabilities, require us to change or terminate some portions of our business, require us to refund portions of our services fees, and adversely affect our revenue and operating margin. Even an unsuccessful challenge of our activities could result in adverse publicity, require costly response from us, impair our ability to attract and maintain clients, and lead analysts or investors to reduce their expectations of our performance, resulting in reduction in the market price of our stock.

Our services present the potential for embezzlement, identity theft, or other similar illegal behavior by our employees or subcontractors with respect to third parties.

Among other things, our services involve handling mail from payers and from patients for many of our clients, and this mail frequently includes original checks and credit card information and occasionally includes currency. Even in those cases in which we do not handle original documents or mail, our services also involve the use and disclosure of personal and business information that could be used to impersonate third parties or otherwise gain access to their data or funds. If any of our employees or subcontractors takes, converts, or misuses such funds, documents, or data, we could be liable for damages, and our business reputation could be damaged or destroyed. In addition, we could be perceived to have facilitated or participated in illegal misappropriation of funds, documents, or data and therefore be subject to civil or criminal liability.

Subsidy of services similar to ours may reduce client demand if we do not participate in such programs.

In the past few years, entities such as the Massachusetts Healthcare Consortium have offered to subsidize adoption by physicians of EHR technology. In addition, federal regulations have been changed to permit such subsidy from additional sources, subject to certain limitations, and the current administration passed the HITECH Act, which provides federal support for EHR initiatives. While we have qualified for and participated in many of such subsidy programs, we cannot guarantee that we will be able to do so in the future. To the extent that we do not participate in such programs, demand for our services may be reduced, which may decrease our revenues.

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RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK

The price of our common stock may continue to be volatile.

The trading price of our common stock has been and is likely to remain highly volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control or unrelated to our operating performance. In addition to the factors discussed in this "Risk Factors" section and elsewhere in this Annual Report on Form 10-K, these factors include:

- the operating performance of similar companies;
- the overall performance of the equity markets;
- announcements by us or our competitors of acquisitions, business plans, or commercial relationships;
- threatened or actual litigation;
- changes in laws or regulations relating to the provision of health care or the sale of health insurance;
- any major change in our board of directors or management;
- publication of research reports or news stories about us, our competitors, or our industry or positive or negative recommendations or withdrawal of research coverage by securities analysts;
- large volumes of sales of our shares of common stock by existing stockholders; and
- general political and economic conditions.

In addition, the stock market in general, and the market for Internet-related companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company's securities. This litigation, if instituted against us, could result in very substantial costs; divert our management's attention and resources; and harm our business, operating results, and financial condition.

If a substantial number of shares become available for sale and are sold in a short period of time, the market price of our common stock could decline.

If our existing stockholders sell a large number of shares of our common stock or the public market perceives that these sales may occur, the market price of our common stock could decline. As of September 30, 2013, we had approximately 37.1 million shares of common stock outstanding. Moreover, certain holders of shares of our common stock have rights, subject to some conditions, to require us to file registration statements covering the shares they currently hold, or to include these shares in registration statements that we may file for ourselves or other stockholders.

We have also registered all common stock that we may issue under our 1997 Stock Plan, 2000 Stock Plan, 2007 Stock Option and Incentive Plan, and 2007 Employee Stock Purchase Plan, and we have assumed the 1999 Stock Option Plan, 2008 Equity Incentive Plan, and 2010 Equity Incentive Plan of Epocrates, under which all issuable common stock has been registered. As of September 30, 2013, we had outstanding options to purchase approximately 2.4 million shares of common stock (approximately 1.5 million of which were exercisable at September 30, 2013) that, if exercised, would result in those shares becoming available for sale in the public market. As of September 30, 2013, we had outstanding restricted stock units totaling approximately 1.2 million that, if vested, would result in those shares becoming available for sale in the public market. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our common stock.

Actual or potential sales of our stock by our employees, including members of our senior management team, pursuant to pre-arranged stock trading plans could cause our stock price to fall or prevent it from increasing for numerous reasons, and actual or potential sales by such persons could be viewed negatively by other investors.

In accordance with the guidelines specified under Rule 10b5-1 of the Securities and Exchange Act of 1934 and our policies regarding stock transactions, a number of our directors and employees, including members of our senior management team, have adopted and will continue to adopt pre-arranged stock trading plans to sell shares of our common stock that they hold or will hold as the result of exercise or vesting of equity grants. Generally, stock sales under such plans by members of our senior management team and directors require public filings. Actual or potential sales of our stock by such persons could cause our stock price to fall or prevent it from increasing for numerous reasons. For example, actual or potential sales by such persons could be viewed negatively by other investors.

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Provisions in our certificate of incorporation and by-laws or Delaware law might discourage, delay, or prevent a change of control of our company or changes in our management and, therefore, depress the trading price of our common stock.

Provisions of our certificate of incorporation and by-laws and Delaware law may discourage, delay, or prevent a merger, acquisition, or other change in control that stockholders may consider favorable, including transactions in which they might otherwise receive a premium for their shares of our common stock. These provisions may also prevent or frustrate attempts by our stockholders to replace or remove our management. These provisions include:

- limitations on the removal of directors;
- advance notice requirements for stockholder proposals and nominations;
- the inability of stockholders to act by written consent or to call special meetings; and
- the ability of our board of directors to make, alter, or repeal our by-laws.

The affirmative vote of the holders of at least 75% of our shares of capital stock entitled to vote is necessary to amend or repeal the above provisions of our certificate of incorporation. As our board of directors has the ability to designate the terms of and issue new series of preferred stock without stockholder approval, the effective number of votes required to make such changes could increase. Also, absent approval of our board of directors, our by-laws may only be amended or repealed by the affirmative vote of the holders of at least 75% of our shares of capital stock entitled to vote.

In addition, Section 203 of the Delaware General Corporation Law prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder (generally an entity that, together with its affiliates, owns, or within the last three years has owned, 15% or more of our voting stock) for a period of three years after the date of the transaction in which the entity became an interested stockholder, unless the business combination is approved in a prescribed manner.

The existence of the foregoing provisions and anti-takeover measures could limit the price that investors might be willing to pay in the future for shares of our common stock. They could also deter potential acquirers of our company, thereby reducing the likelihood that stockholders could receive a premium for their common stock in an acquisition.

We do not currently intend to pay dividends on our common stock, and, consequently, stockholders' ability to achieve a return on their investment will depend on appreciation in the price of our common stock.

We have never declared or paid any cash dividends on our common stock and do not currently intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Therefore, investors are not likely to receive any dividends on their common stock for the foreseeable future, and the success of an investment in shares of our common stock will depend upon any future appreciation in its value. There is no guarantee that shares of our common stock will appreciate in value or even maintain the price at which our stockholders have purchased their shares.

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

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

(a) Exhibits.

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Exhibit No.	Exhibit Index
†10.1	2007 Stock Option and Incentive Plan of the Registrant, as amended, and form of agreements thereunder
31.1	Rule 13a-14(a) or 15d-14 Certification of Chief Executive Officer
31.2	Rule 13a-14(a) or 15d-14 Certification of Chief Financial Officer
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Exchange Act rules 13a-14(b) or 15d-14(b) and 18 U.S.C. Section 1350
101**	The following financial statements from the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, as filed with the SEC on October 18, 2013, formatted in XBRL, as follows: (i) the Condensed Consolidated Balance Sheets (ii) the Condensed Consolidated Statements of Income (iii) the Condensed Consolidated Statements of Comprehensive Income (iv) the Condensed Consolidated Statements of Cash Flows (v) the Notes to the Condensed Consolidated Financial Statements, tagged in summary and detail

† Indicates a management contract or any compensatory plan, contract, or arrangement.
* Furnished herewith.
** As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Section 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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SIGNATURES

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.

ATHENAHEALTH, INC.

By:	/s/ Jonathan Bush Jonathan Bush Chief Executive Officer, President, and Chairman
By:	/s/ Timothy M. Adams Timothy M. Adams Chief Financial Officer, Senior Vice President, and Treasurer

Date: October 18, 2013