ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.
Form 10-Q
November 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

OR

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

Commission file number 001-35547

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	36-4392754
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

222 Merchandise Mart, Suite 2024

Chicago, IL 60654

(Address of Principal Executive Offices, Zip Code)

(312) 506-1200

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 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. (Check one):

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

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

As of October 28, 2016, there were 185,090,723 shares of the registrant's $0.01 par value common stock outstanding.

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

FORM 10-Q

For the Fiscal Quarter Ended September 30, 2016

TABLE OF CONTENTS

		PAGE
PART I. FINANCIAL INFORMATION		3
Item 1.	Financial Statements (unaudited)	3
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	28
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	43
Item 4.	Controls and Procedures	43
PART II. OTHER INFORMATION		44
Item 1.	Legal Proceedings	44
Item 1A.	Risk Factors	44
Item 2.	Unregistered Sales of Equity Securities, Use of Proceeds and Issuer Purchases of Equity Securities	44
Item 6.	Exhibits	44
SIGNATURES		45

2

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except per share amounts)	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 77,251	$ 116,873
Accounts receivable, net of allowance of $35,264 and $31,266 as of September 30, 2016 and December 31, 2015, respectively	400,101	327,851
Prepaid expenses and other current assets	112,416	93,622
Total current assets	589,768	538,346
Long-term marketable securities	197,250	0
Fixed assets, net	144,804	125,617
Software development costs, net	140,025	85,775
Intangible assets, net	730,775	347,646
Goodwill	1,882,244	1,222,601
Deferred taxes, net	2,974	2,298
Other assets	122,297	359,665
Total assets	$ 3,810,137	$ 2,681,948
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 93,236	$ 60,004
Accrued expenses	85,336	62,021
Accrued compensation and benefits	52,773	62,398
Deferred revenue	370,821	315,925
Current maturities of long-term debt	12,051	12,178
Non-recourse current maturities of long-term debt - Netsmart	1,337	0
Current maturities of capital lease obligations	9,957	431
Total current liabilities	625,511	512,957
Long-term debt	663,089	612,405
Non-recourse long-term debt - Netsmart	533,589	0
Long-term capital lease obligations	13,096	617
Deferred revenue	18,155	20,273
Deferred taxes, net	155,860	22,164
Other liabilities	52,928	94,459
Total liabilities	2,062,228	1,262,875
Redeemable convertible non-controlling interest - Netsmart	377,494	0
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock: $0.01 par value, 1,000 shares authorized,	0	0

no shares issued and outstanding as of September 30, 2016 and December 31, 2015		
Common stock: $0.01 par value, 349,000 shares authorized as of September 30, 2016 and December 31, 2015; 267,868 and 185,090 shares issued and outstanding as of September 30, 2016, respectively; 266,545 and 189,308 shares issued and outstanding as of December 31, 2015, respectively	2,679	2,665
Treasury stock: at cost, 82,778 and 77,237 shares as of September 30, 2016 and December 31, 2015, respectively	(260,834)	(189,753)
Additional paid-in capital	1,790,179	1,789,449
Accumulated deficit	(190,229)	(190,235)
Accumulated other comprehensive loss	(12,111)	(4,242)
Total Allscripts Healthcare Solutions, Inc.'s stockholders' equity	1,329,684	1,407,884
Non-controlling interest	40,731	11,189
Total stockholders’ equity	1,370,415	1,419,073
Total liabilities and stockholders’ equity	$ 3,810,137	$ 2,681,948

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenue:				
Software delivery, support and maintenance	$252,692	$230,754	$731,721	$690,783
Client services	139,692	123,722	392,742	349,963
Total revenue	392,384	354,476	1,124,463	1,040,746
Cost of revenue:				
Software delivery, support and maintenance	86,537	70,775	240,860	223,188
Client services	116,415	109,006	335,957	327,790
Amortization of software development and acquisition-related assets	23,273	21,347	62,905	63,006
Total cost of revenue	226,225	201,128	639,722	613,984
Gross profit	166,159	153,348	484,741	426,762
Selling, general and administrative expenses	98,778	91,043	277,733	259,821
Research and development	45,142	47,702	140,070	138,796
Asset impairment charges	0	22	4,650	341
Amortization of intangible and acquisition-related assets	5,365	5,712	14,944	19,039
Income from operations	16,874	8,869	47,344	8,765
Interest expense	(19,367)	(9,254)	(42,757)	(23,993)
Other (expense) income, net	(6)	423	466	2,281
Equity in net loss of unconsolidated investments	0	(1,479)	(7,501)	(1,303)
Loss before income taxes	(2,499)	(1,441)	(2,448)	(14,250)
Income tax benefit (provision)	2,656	(3,692)	2,596	(4,183)
Net income (loss)	157	(5,133)	148	(18,433)
Less: Net income attributable to non-controlling interest	(151)	(111)	(142)	(120)
Less: Accretion of redemption preference on redeemable convertible non-controlling interest - Netsmart	(10,191)	0	(18,344)	0
Net loss attributable to Allscripts Healthcare Solutions, Inc. stockholders	$(10,185)	$(5,244)	$(18,338)	$(18,553)
Loss per share - basic attributable to Allscripts Healthcare Solutions, Inc. stockholders	$(0.06)	$(0.03)	$(0.10)	$(0.10)
Loss per share - diluted attributable to Allscripts Healthcare Solutions, Inc. stockholders	$(0.06)	$(0.03)	$(0.10)	$(0.10)

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(In thousands)	2016	2015	2016	2015
Net income (loss)	$157	$(5,133)	$148	$(18,433)
Other comprehensive income (loss):				
Foreign currency translation adjustments	150	(1,482)	(49)	(1,873)
Change in unrealized loss on marketable securities	9,750	0	(8,365)	(228)
Change in fair value of derivatives qualifying as cash flow hedges	686	(225)	900	5
Other comprehensive income (loss) before income tax expense	10,586	(1,707)	(7,514)	(2,096)
Income tax (expense) benefit related to items in other comprehensive income (loss)	(270)	88	(355)	86
Total other comprehensive income (loss)	10,316	(1,619)	(7,869)	(2,010)
Comprehensive income (loss)	10,473	(6,752)	(7,721)	(20,443)
Less: Comprehensive income attributable to non-controlling interest	(151)	(111)	(142)	(120)
Comprehensive income (loss) attributable to Allscripts Healthcare Solutions, Inc. stockholders	$10,322	$(6,863)	$(7,863)	$(20,563)

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	Nine Months Ended September 30, 2016	2015
Cash flows from operating activities:		
Net income (loss)	$ 148	$ (18,433)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	120,473	124,486
Stock-based compensation expense	29,717	27,225
Excess tax benefits from stock-based compensation	(972)	(346)
Deferred taxes	(4,198)	2,323
Asset impairment charges	4,650	341
Other losses, net	9,558	2,288
Changes in operating assets and liabilities (net of businesses acquired):		
Accounts receivable, net	(12,723)	7,060
Prepaid expenses and other assets	3,381	11,730
Accounts payable	26,341	(2,050)
Accrued expenses	(8,843)	(17,789)
Accrued compensation and benefits	(12,933)	(4,672)
Deferred revenue	30,587	(2,760)
Other liabilities	(28)	(1,090)
Net cash provided by operating activities	185,158	128,313
Cash flows from investing activities:		
Capital expenditures	(25,046)	(14,211)
Capitalized software	(69,994)	(32,696)
Purchases of equity securities, other investments and related intangible assets	(20,685)	(212,654)
Sales and maturities of marketable securities and other investments	0	3,763
Cash paid for business acquisitions, net of cash acquired	(935,280)	(9,372)
Proceeds received from sale of fixed assets	37	15
Net cash used in investing activities	(1,050,968)	(265,155)
Cash flows from financing activities:		
Proceeds from sale or issuance of common stock	84	102,091
Proceeds from issuance of redeemable convertible preferred stock - Netsmart	333,606	0
Excess tax benefits from stock-based compensation	972	346
Taxes paid related to net share settlement of equity awards	(7,379)	(5,714)
Payments of capital lease obligations	(3,858)	(311)
Credit facility payments	(80,507)	(189,912)
Credit facility borrowings, net of issuance costs	654,135	269,719

Repurchase of common stock	(71,082)	0
Net cash provided by financing activities	825,971	176,219
Effect of exchange rate changes on cash and cash equivalents	217	(1,152)
Net (decrease) increase in cash and cash equivalents	(39,622)	38,225
Cash and cash equivalents, beginning of period	116,873	53,173
Cash and cash equivalents, end of period	$77,251	$91,398
Supplemental non-cash information:		
Exchange of Netsmart, Inc. common stock for redeemable convertible preferred stock in Netsmart by Netsmart, Inc. management	$25,543	$0

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Allscripts Healthcare Solutions, Inc. (“Allscripts”) and its wholly-owned subsidiaries and controlled affiliates. All significant intercompany balances and transactions have been eliminated. Each of the terms “we,” “us,” “our” or the “Company” as used herein refers collectively to Allscripts Healthcare Solutions, Inc. and its wholly-owned and controlled affiliates, unless otherwise stated.

Unaudited Interim Financial Information

The unaudited interim consolidated financial statements as of and for the three and nine months ended September 30, 2016 have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial reporting. These interim consolidated financial statements are unaudited and, in the opinion of our management, include all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly the consolidated financial statements for the periods presented in accordance with generally accepted accounting principles in the United States of America (“GAAP”). The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year ending December 31, 2016.

Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted in accordance with the SEC's rules and regulations for interim reporting, although the Company believes that the disclosures made are adequate to make that information not misleading. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2015 (our “Form 10-K”).

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

Significant Accounting Policies

There have been no changes to our significant accounting policies from those disclosed in our Form 10-K.

Accounting Pronouncements Not yet Adopted

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers: Topic 606 (“ASU 2014-09”), to supersede nearly all existing revenue

recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five-step process to achieve this principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The new standard permits the use of either the retrospective or cumulative effect transition methods. As issued, ASU 2014-09 is effective for us for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. On August 12, 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 by one year to annual reporting periods beginning after December 15, 2017, while also permitting companies to voluntarily adopt the new revenue standard as of the original effective date. In addition, during the first half of 2016 the FASB issued ASU 2016-08, ASU 2016-10, 2016-11 and 2016-12, all of which clarify certain implementation guidance within ASU 2014-09. We have initiated an assessment of our systems, data and processes related to the implementation of this accounting standard. This assessment is expected to be completed by the end of fiscal 2016. Additionally, we are currently evaluating the potential impact that the implementation of this standard will have on our consolidated financial statements, as well as the selection of the method of adoption. We currently do not expect to implement this standard prior to its mandatory effective date.

In March 2016, the FASB issued Accounting Standards Update No. 2016-07, Investments – Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting (“ASU 2016-07”). The guidance in ASU 2016-07 eliminates the requirement that, when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor’s previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. The amendments in this Update require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. ASU 2016-07 is effective for interim and annual periods beginning after December 15, 2016, and should be applied prospectively. Earlier application is permitted. We are currently evaluating the impact of this new accounting guidance.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Share-Based Payment Accounting (“ASU 2016-09”). The guidance in ASU 2016-09, among other things, (i) will require all income tax effects of share-based awards to be recognized in the statement of operations when the awards vest or are settled, (ii) will allow an employer to repurchase more of an employee’s shares for tax withholding purposes than it can today without triggering liability accounting and (iii) will allow a policy election to account for forfeitures as they occur. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Based on our analysis, we do not expect this new guidance to materially impact our previously reported consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). The guidance in ASU 2016-13 replaces the incurred loss impairment methodology under current GAAP. The new impairment model requires immediate recognition of estimated credit losses expected to occur for most financial assets and certain other instruments. For available-for-sale debt securities with unrealized losses, the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Early adoption for fiscal years beginning after December 15, 2018 is permitted. We are currently in the process of evaluating this new guidance, which we expect to have an impact on our consolidated financial statements and results of operations.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). The guidance in ASU 2016-15 eliminates the diversity in practice related to the classification of certain cash receipts and payments in the statement of cash flows, by adding or clarifying guidance on eight specific cash flow issues. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted. We are currently evaluating the impact of this accounting guidance, but do not expect it to have any material impact on our consolidated financial statements.

We do not believe that any other recently issued, but not yet effective accounting standards, if adopted, would have a material impact on our consolidated financial statements.

2. Business Combinations

Formation of Joint Business Entity and Acquisition of Netsmart, Inc.

On March 20, 2016, we entered into a Contribution and Investment Agreement (the “Contribution Agreement”) with GI Netsmart Holdings LLC, a Delaware limited liability company (“GI Partners”) to form a joint business entity, Nathan Holding LLC, a Delaware limited liability company (“Nathan”). The formation of Nathan was completed on April 19, 2016. As a result, pursuant to, and subject to the terms and conditions of, the Contribution Agreement, Nathan issued to Allscripts Class A Common Units in exchange for Allscripts contributing its Homecare™ business and cash to Nathan and issued to GI Partners Class A Preferred Units in exchange for cash.

The Nathan operating agreement provides that the Class A Preferred Units entitle the owners at any time and from time to time following the later of (A) the earlier of (I) the fifth anniversary of the effective date and (II) a change in control of Allscripts, and (B) the earlier of (I) the payment in full of the obligations under the credit facilities and the termination of any commitments thereunder or (II) with respect to any proposed redemption, such earlier date for such redemption consented to in writing by the required lenders under each of the credit facilities under which obligations remain unpaid or under which commitments continue, to redeem all or any portion of their Class A Preferred Units for cash at a price per Unit equal to the Class A Preferred liquidation preference for each such Class A Preferred Unit as of the date of such redemption. The liquidation preference is equal to the greater of (i) a return of the original issue price plus a preferred return (accruing on a daily basis at the rate of 11% per annum and compounding annually on the last day of each calendar year) or (ii) the as-converted value of Class A Common Units in Nathan. The consolidated statements of operations for the three and nine months periods ended September 30, 2016 give effect to the accretion of the 11% redemption preference as part of the calculation of net income (loss) attributable to Allscripts stockholders.

Also on April 19, 2016, Nathan acquired Netsmart, Inc., a Delaware corporation, pursuant to the Agreement and Plan of Merger, dated as of March 20, 2016 (the “Merger Agreement”), by and among Nathan Intermediate LLC, a Delaware limited liability company and a wholly-owned subsidiary of Nathan (“Intermediate”), Nathan Merger Co., a Delaware corporation and a wholly-owned subsidiary of Intermediate (“Merger Sub”), Netsmart, Inc. and Genstar Capital Partners V, L.P., as the equityholders’ representative. Pursuant to the Merger Agreement, on April 19, 2016, Merger Sub was merged with and into Netsmart, Inc., with Netsmart, Inc. surviving as a wholly-owned subsidiary of Intermediate (the “Merger”). As a result of these transactions (the “Netsmart Transaction” or “Netsmart Acquisition”), the establishment of Nathan combined the Allscripts Homecare™ business with Netsmart, Inc. Throughout the rest of this Form 10-Q, Nathan is referred to as “Netsmart”.

At the effective time of the Merger, Netsmart, Inc.’s common stock shares issued and outstanding immediately prior to the effective time were converted into the right to receive a pro rata share of $950 million, reduced by net debt and subject to working capital and other adjustments (the “Purchase Price”). Each vested outstanding option to acquire shares of Netsmart, Inc.’s common stock became entitled to receive a pro rata share of the Purchase Price, less applicable exercise prices of the options. Certain holders of shares of Netsmart, Inc.’s common stock, who were members of Netsmart, Inc.’s management, exchanged a portion of such shares for equity interests in Nathan, in lieu of receiving their pro rata share of the Purchase Price, and certain holders of options to purchase Netsmart, Inc.’s common stock, who were also members of Netsmart, Inc.’s management, invested a portion of such holder’s proceeds from the Merger in equity interests in Nathan (collectively, the “Rollover”). After the completion of the Merger and the Rollover, Allscripts owned 49.1%, GI Partners owned 47.2% and Netsmart’s management owned 3.7% of the outstanding equity interests in Netsmart, in each case on an as-converted basis. As part of the Netsmart Transaction, we deposited $15 million in an escrow account to be used by Netsmart to facilitate the integration of our Homecare™ business within Netsmart over the next 5 years, at which time the restriction on any unused funds will lapse.

Pursuant to the consolidation guidance in FASB Accounting Standards Codification (“ASC”) Topic 810, Consolidation, we performed a qualitative and quantitative assessment to determine whether Netsmart was a variable interest entity (“VIE”). Our assessment involved consideration of all facts and circumstances relevant to the Netsmart’s structure, including its capital structure, contractual rights to earnings (losses), subordination of our interests relative to those of other investors, contingent payments, as well as other contractual arrangements that have potential to be economically significant. Based on this analysis, we determined that Netsmart was not a VIE and that we, through our 49.1% interest in Netsmart and other contractual rights, including budgetary approval, have the power to direct the activities of Netsmart that most significantly impact its economic performance. As a result, we concluded that we will account for our investment in Netsmart on a consolidated basis and the financial results of Netsmart will be consolidated with Allscripts starting on April 19, 2016.

The acquisition of Netsmart, Inc. by Nathan was completed for an aggregate Purchase Price of $937 million. The Purchase Price was funded by the sources of funds as described in the table below. The Netsmart term loans are non-recourse to Allscripts and its wholly-owned subsidiaries. A portion of the debt proceeds were used to extinguish Netsmart, Inc.'s existing debt of $325 million, including accrued interest and fees of $2 million. The sources of funds used in connection with the Netsmart Acquisition are as follows:

	(In thousands)	
Cash contribution for redeemable convertible non-controlling interest in Netsmart - GI Partners	$	333,606
Exchange of Netsmart, Inc.'s common stock for redeemable convertible non-controlling interest in Netsmart - Netsmart, Inc. management		25,543
Cash contribution from borrowings under revolver in exchange for common stock in Netsmart - Allscripts		43,782
Net borrowings under new term loans - Netsmart		534,135
Total funds used for the acquisition	$	937,066

Under the acquisition method of accounting, the fair value of consideration transferred for Netsmart, Inc. was allocated to the tangible and intangible assets acquired and the liabilities assumed based on their estimated fair values as of the acquisition date with the remaining unallocated amount recorded as goodwill. Our estimates and assumptions are subject to change as we obtain additional information for our estimates during the measurement period (up to one year from the acquisition date). During the three months ended September 30, 2016, we recorded several measurement period adjustments, the largest of which included $12.0 million increase in intangible assets, $4.4 million increase in deferred taxes, net, $2.0 million decrease in accrued expenses, and $9.6 million decrease in the residual allocation to goodwill. During the three months ended September 30, 2016, we also recorded the resulting adjustment to accumulated amortization associated with the change in the fair value of intangible assets. The amount of amortization expense adjustment related to the second quarter of 2016 was not material.

The preliminary allocation of the fair value of the consideration transferred, including measurement period adjustments through September 30, 2016, is shown in the table below. The primary areas of the preliminary allocation of the fair value of consideration transferred that are not yet finalized relate to the finalization of certain tax-related balances and valuation estimates.

	(In thousands)
Cash and cash equivalents	$ 5,982
Accounts receivable, net	54,042
Prepaid expenses and other current assets	9,335

Fixed assets	26,829
Intangible assets	409,500
Goodwill	615,634
Other assets	6,889
Accounts payable	(14,151)
Accrued expenses	(9,595)
Deferred revenue	(18,843)
Capital lease obligations	(17,833)
Deferred taxes, net	(127,050)
Other liabilities	(3,673)
Net assets acquired	$ 937,066

Allscripts' contribution of its Homecare™ business to Nathan was deemed to be a transaction between entities under common control and the net assets of the Homecare™ business were contributed at carryover basis.

As noted above, the formation of Netsmart resulted in the merger of our Homecare™ business with Netsmart, Inc.'s behavioral health technology business. As a result, Netsmart became one of the largest healthcare IT companies serving the health and human services sector, which includes behavioral health, public health and child and family services. Among the factors that contributed to a purchase price resulting in the recognition of goodwill were the expected growth and synergies that we believe will result from the integration of our Homecare solutions with Netsmart, Inc.'s product offerings. The goodwill is not deductible for tax purposes.

The acquired intangible assets are being amortized over their useful lives, using a method that approximates the pattern of economic benefits to be gained by the intangible asset and consist of the following amounts for each class of acquired intangible asset:

(Dollar amounts in thousands) Description	Useful Life in Years	Fair Value
Technology	10-12 yrs	$144,000
Corporate Trademark	indefinite	27,000
Product Trademarks	10 yrs	8,500
Customer Relationships	12-20 yrs	230,000
		$409,500

Acquisition costs related to the Netsmart acquisition are included in selling, general and administrative expenses in the accompanying consolidated statement of operations totaled $4.1 million for the nine months ended September 30, 2016. There were no acquisition-related costs recorded during the three months ended September 30, 2016.

The revenue and net loss of Netsmart since April 19, 2016 are included in our consolidated statement of operations for the three and nine months ended September 30, 2016 and the supplemental pro forma revenue and net loss of the combined entity, presented as if the acquisition of Netsmart, Inc. had occurred on January 1, 2015, are as follows:

(In thousands, except per share amounts)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Actual from Netsmart since acquisition date of April 19, 2016:				
Revenue [(1)]	$52,621	$0	$96,855	$0
Net loss [(1)]	$(11,126)	$0	$(18,239)	$0
Supplemental pro forma data for combined entity:				
Revenue	$399,811	$400,819	$1,198,048	$1,157,087
Net loss attributable to Allscripts Healthcare Solutions, Inc. stockholders	$(5,147)	$(21,223)	$(34,862)	$(88,933)
Loss per share, basic and diluted	$(0.03)	$(0.11)	$(0.19)	$(0.48)

(1) Amounts are not adjusted for the effects of transactions between us and Netsmart.

The supplemental pro forma results were calculated after applying our accounting policies and adjusting the results of Netsmart to reflect (i) the additional depreciation and amortization that would have been charged resulting from the fair value adjustments to property, plant and equipment and intangible assets, (ii) the additional interest expense associated with Netsmart's borrowings under the new term loans, and (iii) the additional amortization of the estimated adjustment to decrease the assumed deferred revenue obligations to fair value that would have been charged assuming the acquisition occurred on January 1, 2015, together with the consequential tax effects. Supplemental pro forma results for the nine months ended September 30, 2016 were also adjusted to exclude acquisition-related and transaction costs incurred during this period. Supplemental pro forma results for the nine months ended September 30, 2015 were adjusted to include these items. The supplemental pro forma results for the nine months ended September 30, 2016 exclude expenses incurred by Netsmart immediately prior to the Netsmart Transaction related to the accelerated pay-out of outstanding equity awards and the payment of seller costs. The effects of transactions between us and Netsmart during the periods presented have been eliminated in the supplemental pro forma data.

3. Fair Value Measurements and Investments

We carry a portion of our financial assets and liabilities at fair value that are measured at a reporting date using an exit price (i.e., the price that would be received to sell an asset or paid to transfer a liability) and disclosed according to the quality of valuation inputs under the following hierarchy:

Level 1: Inputs are unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2: Inputs, other than quoted prices included in Level 1, are observable for the asset or liability, either directly or indirectly. Our Level 2 derivative financial instruments include foreign currency forward contracts valued based upon observable values of spot and forward foreign currency exchange rates. Refer to Note 10, “Derivative Financial Instruments,” for further information regarding these derivative financial instruments.

Level 3: Unobservable inputs that are significant to the fair value of the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Our Level 3 financial instruments include derivative financial instruments comprising the 1.25% Call Option asset and the 1.25% embedded cash conversion option liability that are not actively traded. These derivative instruments were designed with the intent that changes in their fair values would substantially offset, with limited net impact to our earnings. Therefore, we believe the sensitivity of changes in the unobservable inputs to the option pricing model for

these instruments is substantially mitigated. Refer to Note 10, “Derivative Financial Instruments,” for further information regarding these derivative financial instruments.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of the respective balance sheet dates:

	Balance Sheet	September 30, 2016				December 31, 2015			
(In thousands)	Classifications	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
1.25% Call Option	Other assets	$0	$0	$40,804	$40,804	$0	$ 0	$80,208	$80,208
NantHealth Common Stock	Long-term marketable securities	197,250	0	0	197,250	0	0	0	0
1.25% Embedded cash conversion option	Other liabilities	0	0	(41,601)	(41,601)	0	0	(81,210)	(81,210)
Foreign exchange derivative assets	Prepaid expenses and other current assets	0	1,324	0	1,324	0	424	0	424
Foreign exchange derivative liabilities	Accrued expenses	0	0	0	0	0	0	0	0
Total Investments		$197,250	$1,324	$(797)	$197,777	$0	$ 424	$(1,002)	$(578)

On September 8, 2016, we acquired a majority interest in a third party for $29 million, net of cash acquired. This acquisition broadens our solution portfolio. The financial results of this third party were consolidated with our financial results starting on the date of the transaction. The preliminary allocations of the estimated fair value of the net assets of the third party to goodwill, intangibles and non-controlling interest were $45.2 million, $21.4 million and $29.4 million, respectively. The goodwill is not deductible for tax purposes.

The following table summarizes our equity investments which are included in other assets in the accompanying consolidated balance sheet:

	Number of	Original	Carrying Value at	
(In thousands)	Investees	Investment	September 30, 2016	December 31, 2015
Equity method investments (1):				
Nant Health, LLC (2)	0	$ 0	$0	$203,117

Other	3	1,658	2,436	2,436
Total equity method investments	3	1,658	2,436	205,553
Cost method investments	5	29,991	26,041	17,876
Total equity investments	8	$ 31,649	$28,477	$223,429

(1) Allscripts share of the earnings of our equity method investees is reported based on a one quarter lag.
(2) As noted below, effective June 2, 2016, Nant Health LLC is no longer accounted for under the equity method.

Effective June 1, 2016, in preparation for an initial public offering ("IPO") of its equity securities, Nant Health converted from an LLC into a Delaware corporation under the name of NantHealth, Inc. ("NantHealth"). We received 14,285,714 shares of common stock in the new corporation in replacement of our Series G Units of the former Nant Health LLC, representing a 12.6% ownership interest in NantHealth immediately prior to the IPO. On June 2, 2016, NantHealth completed its IPO of 6,500,000 shares and its stock began trading on the NASDAQ under the ticker symbol "NH". The issuance of the IPO shares initially diluted our ownership interest to 11.8%. Also on June 2, 2016, we purchased an additional 714,286 shares at the IPO price of $14 per share for an additional investment in NantHealth of $10 million. This additional share purchase brought our total voting interest in NantHealth to 15,000,000 shares or 12.4% of the voting common stock.

Based on the guidance under FASB ASC Topic 323, Investments – Equity Method and Joint Ventures and given our ownership percentage of 12.4% and lack of significant influence over NantHealth's operations, we concluded that we should no longer account for our investment in NantHealth as an equity method investment subsequent to June 2, 2016. The carrying amount of our Nant Health, LLC investment immediately after the IPO was $205.6 million, which became the initial cost of our investment in NantHealth common stock. This amount includes the recognition of our equity in the net earnings of NantHealth and the amortization of cost basis adjustments through June 2, 2016.

In accordance with FASB ASC Topic 320, Investments – Debt and Equity Securities and Topic 820, Fair Value Measurement, we will account prospectively for our investment in NantHealth's common stock as an available for sale marketable security with unrealized gains and losses due to the changes in the fair value of the investment recorded as part of accumulated other comprehensive income ("AOCI") in stockholders' equity. If we determine that a decline in fair value below cost is other than temporary, we will recognize an impairment charge in current period earnings for the difference between cost and fair value. As of September 30, 2016, the fair value of our investment, based on the closing price as quoted on the NASDAQ, was $197.3 million, resulting in an unrealized loss of $8.4 million recognized in AOCI.

The decline in the carrying value of our equity method investments from December 31, 2015 to September 30, 2016 was primarily due to NantHealth no longer being accounted for under the equity method as discussed above.

The increase in the carrying value of our cost method investments from December 31, 2015 to September 30, 2016 was due to the acquisition of two additional non-marketable equity securities during the second quarter of 2016, as discussed below. This was offset by the recognition of an impairment charge of $2.1 million on one investment during the first quarter of 2016.

During first quarter of 2016, we acquired a $0.5 million non-marketable convertible note of a third party with which we have an existing license and distribution agreement. This investment is accounted as an available-for-sale security with changes in fair value recorded in accumulated other comprehensive loss. The fair value of the convertible note was $0.5 million as of September 30, 2016 and was included in other assets in the accompanying consolidated balance sheet as of September 30, 2016.

During second quarter of 2016, we acquired certain non-marketable equity securities of two third parties and entered into new commercial agreements with each of those third parties to license and distribute their products and services, for a total consideration of $10.2 million. Both of these equity investments acquired during the second quarter are accounted for under the cost method. The carrying value of these investments was $10.2 million as of September 30, 2016 and are included in other assets in the accompanying consolidated balance sheet. As of September 30, 2016, it is not practicable to estimate the fair value of our equity investments primarily because of their illiquidity and restricted marketability. The factors we considered in trying to determine fair value include, but are not limited to, available financial information, the issuer's ability to meet its current obligations and the issuer's subsequent or planned raises of capital.

Long-Term Financial Liabilities

Our long-term financial liabilities include amounts outstanding under our senior secured credit facility and Netsmart's Credit Agreements (as defined in Note 8, Debt), with carrying values that approximate fair value since the interest rates approximate current market rates. In addition, the carrying amount of our 1.25% Cash Convertible Senior Notes (the "1.25% Notes") approximates fair value as of September 30, 2016, since the effective interest rate on the 1.25% Notes approximates current market rates. See Note 8, "Debt," for further information regarding our long-term financial liabilities.

4. Stockholders' Equity

Stock-based Compensation Expense

Stock-based compensation expense recognized during the three and nine months ended September 30, 2016 and 2015 is included in our consolidated statements of operations as shown in the below table. Stock-based compensation expense includes both non-cash expense related to grants of stock-based awards as well as cash expense related to the employee discount applied to purchases of our common stock under our employee stock purchase plan. In addition, the table below includes stock-based compensation expense related to Netsmart's time-based liability classified option

awards. No stock-based compensation costs were capitalized during the three and nine months ended September 30, 2016 and 2015.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2016	2015	2016	2015
Cost of revenue:				
Software delivery, support and maintenance	$979	$972	$3,209	$3,247
Client services	884	824	3,512	3,554
Total cost of revenue	1,863	1,796	6,721	6,801
Selling, general and administrative expenses	6,464	5,649	17,972	15,860
Research and development	1,446	1,747	6,141	6,067
Total stock-based compensation expense	$9,773	$9,192	$30,834	$28,728

Allscripts Stock-based Awards

We measure stock-based compensation expense at the grant date based on the fair value of the award. We recognize the expense for service-based share awards over the requisite service period on a straight-line basis, net of estimated forfeitures. We recognize the expense for performance-based and market-based share awards over the vesting period under the accelerated attribution method, net of estimated forfeitures. In addition, we recognize stock-based compensation cost for awards with performance conditions if and when we conclude that it is probable that the performance conditions will be achieved.

The fair value of service-based restricted stock units and restricted stock awards is measured at the underlying closing share price of our common stock on the date of grant. The fair value of market-based restricted stock units is measured using the Monte Carlo pricing model. No stock options were granted during the three and nine months ended September 30, 2016 and 2015.

We granted stock-based awards as follows:

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2016	
(In thousands, except per share amounts)	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Service-based restricted stock units	24	$ 13.16	2,019	$ 13.14
Performance-based restricted stock units with a service condition	0	$ 0.00	545	$ 12.39
Market-based restricted stock units with a service condition	0	$ 0.00	621	$ 13.68
	24	$ 13.16	3,185	$ 13.12

During the nine months ended September 30, 2016 and the year ended December 31, 2015, 1.3 million and 1.4 million shares of stock, respectively, were issued in connection with the exercise of options and the release of restrictions on stock awards.

Net Share-settlements

Beginning in 2011, upon vesting, restricted stock units and awards are generally net share-settled to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The majority of restricted stock units and awards that vested in 2016 and 2015 were net-share settled such that we withheld shares with value equivalent to the employees’ minimum statutory obligation for the applicable income and other employment taxes, and remitted the cash to the appropriate taxing authorities. Total payments for the employees' minimum statutory tax obligations to the taxing authorities are reflected as a financing activity within the accompanying consolidated statements of cash flows. The total shares withheld for the nine months ended September 30, 2016 and 2015 were 572 thousand and 433 thousand, respectively, and were based on the value of the restricted stock units and awards on their vesting date as determined by our closing stock price. These net-share settlements had the effect of share repurchases by us as they reduced the number of shares that would have otherwise been issued as a result of the vesting.

Stock Repurchases

In November 2015, our Board of Directors authorized a stock repurchase program under which we may repurchase up to $150 million of our common stock through December 31, 2018. Any share repurchase transactions may be made through open market transactions, block trades, privately negotiated transactions (including accelerated share repurchase transactions) or other means, subject to market conditions. Any repurchase activity will depend on many factors such as our working capital needs, cash requirements for investments, debt repayment obligations, economic and market conditions at the time, including the price of our common stock, and other factors that we consider relevant. Our stock repurchase program may be accelerated, suspended, delayed or discontinued at any time. During the three and nine months ended September 30, 2016, we repurchased 1.5 million and 5.5 million shares, respectively, of our common stock for $19.0 million and $71.0 million, respectively, pursuant to this stock repurchase program. As of September 30, 2016, the amount available for repurchase of common stock under this program was $79.0 million.

Issuance of Warrants

On June 30, 2016, we issued to a commercial partner, as part of an overall commercial relationship, unregistered warrants to purchase 900,000 shares of Company common stock, par value $0.01 per share at a price per share of $12.47, 1,000,000 shares of common stock at a price per share of $14.34, and 1,100,000 shares of common stock at a price per share of $15.59, in each case subject to customary anti-dilution adjustments. The warrants vest in four equal annual installments of 750 thousand shares beginning in June 2017 and expire in June 2026. Our issuance of the warrants was a private placement exempt from registration pursuant to Section 4(a)(2) under the Securities Act of 1933, as amended.

Netsmart Long-Term Incentive Plan

Netsmart has established the Nathan Holding LLC 2016 Unit Option Plan (the "Plan") in order to provide key employees, managers, advisors and consultants of Netsmart and its affiliates with an opportunity to acquire an equity interest in Netsmart. The Plan provides for the maximum issuance of 116,491 thousand options related to Netsmart's Class B Non-Voting Common Member Units ("Option Units"). The option unit grants may contain varying vesting conditions, including service, performance and market conditions established on a grant by grant basis as determined by the compensation committee of the board of directors and expire no more than 10 years after the date of grant. The Plan includes a call right which enables Netsmart to repurchase any outstanding units in the event of termination of employment. At September 30, 2016, there were 27,986 thousand Class B Non-Voting Common Units available for further issuance under the Plan. As discussed further below, for the period from April 19, 2016, the date of acquisition, through September 30, 2016, Netsmart issued 89,889 thousand Option Units to officers and employees at an exercise price of $1.00.

Time Based

During the period from April 19, 2016 through September 30, 2016, Netsmart granted 64,198 thousand Option Units to certain of its executives and employees. The Option Units were granted with an exercise price of $1.00 per Option Unit. During the same period, 989 thousand Time Based Option Units were forfeited. The Option Units vest ratably over a period of four years, with the first twenty-five percent vesting at the first anniversary of the issuance and the remaining vesting in equal monthly increments over the following thirty-six months. The Option Units are liability classified awards requiring the Option Units to be re measured at fair value at each reporting period.

Performance Based

During the period from April 19, 2016 through September 30, 2016, Netsmart granted 25,691 thousand Option Units to certain of its executives and employees to reward the recipients if certain financial objectives are met. The Option Units were granted with an exercise price of $1.00 per Option Unit, which was equal to the fair value of Netsmart's Common Units at the date of grant. During the same period, 395 thousand Performance Option Units were forfeited. In addition to a service condition, these Option Units only vest upon attaining certain performance and market conditions. There was no stock compensation expense recorded for these performance related Option Units, since achievement of the performance condition was not considered probable at September 30, 2016.

A summary of the activity under the Plan is as follows:

(Units in thousands)	Option Units	Weighted Average Exercise Price
Granted during the period	89,889	$ 1.00
Options called during the period	0	$ 0.00
Options exercised during the period	0	$ 0.00
Forfeited during the period	1,384	$ 1.00
Outstanding – September 30, 2016	88,505	$ 1.00
Exercisable – September 30, 2016	0	$ 0.00

Option Units outstanding at September 30, 2016 are as follows:

(Units in thousands)	Outstanding			Exercisable		
	Units	Average	Weighted	Shares	Average	Weighted

Exercise price		Black-Scholes Value	Average Remaining Life		Black-Scholes Value	Average Remaining Life
$ 1.00	88,505	$ 0.45	6.56	0	$ 0.00	0

As the current estimated fair value equals the exercise price of the Option Units as of September 30, 2016, there was no intrinsic value related to the outstanding Option Units.

The compensation expense was included in the following categories in Netsmart's statements of operations:

(in thousands)	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016
Cost of revenue	$ 64	$ 126
Research and development	43	79
Sales and marketing	81	174
General and administrative	1,536	2,771
Total	$ 1,724	$ 3,150

15

At September 30, 2016 the liability for outstanding awards was $3.2 million. As of September 30, 2016, the weighted average fair value of units using the Black Scholes Merton option pricing model was estimated at $0.45.

The fair value of Option Units granted during the period from April 19, 2016 through September 30, 2016 was estimated using the Black Scholes Merton option pricing model using the following weighted average assumptions:

Average expected term in years	6.56	
Risk free rate (weighted average)	1.4	%
Expected dividends	0.0	%
Average volatility	43.8	%

Netsmart determined the estimated share price of $1.00 at September 30, 2016. The September 30, 2016 value was determined based on the transaction value of a Netsmart Common Unit as of the transaction date.

The expected term of the awards was determined based upon an estimate of the expected term of “plain vanilla” options as prescribed by the simplified method. The risk free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Netsmart estimates expected volatility based primarily on historical monthly volatility of comparable companies that are publicly traded.

Netsmart has $25.4 million of share based compensation expense remaining to be recognized (based on the September 30, 2016 fair value) over future periods as follows: $1.8 million in 2016, $7.1 million in 2017, $7.1 million in 2018, $7.1 million in 2019, and $2.3 million in 2020.

5. Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted-average shares of common stock outstanding. For purposes of calculating diluted earnings (loss) per share, the denominator includes both the weighted average shares of common stock outstanding and dilutive common stock equivalents. Dilutive common stock equivalents consist of stock options, restricted stock unit awards and warrants calculated under the treasury stock method.

The calculations of earnings (loss) per share are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands, except per share amounts)	2016	2015	2016	2015
Basic Loss per Common Share:				