ALLSCRIPTS HEALTHCARE SOLUTIONS INC
Form 10-Q
August 09, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006

OR

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

Commission file number 000-32085

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 Number)**

222 Merchandise Mart, Suite 2024

Chicago, IL 60654

(Address of principal executive offices)

(800) 654-0889

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

¨ Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer

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

As of July 31, 2006, there were 52,385,811 shares of the registrant s $0.01 par value common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	June 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$32,978	$60,905
Marketable securities	14,212	54,408
Accounts receivable, net of allowances of $4,104 and $2,337 at June 30, 2006 and December 31, 2005, respectively	44,610	29,244
Other receivables	150	502
Deferred taxes, net	5,467	
Inventories	5,124	2,174
Prepaid expenses and other current assets	6,800	5,811
Total current assets	109,341	153,044
Long-term marketable securities	18,626	30,750
Property and equipment, net	12,821	2,753
Software development costs, net	8,176	6,409
Deferred taxes, net	28,305	
Intangible assets, net	83,641	9,151
Goodwill	182,801	13,760
Other assets	5,356	5,097
Total assets	$449,067	$220,964
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$10,434	$8,630
Accrued expenses	20,218	11,489
Accrued compensation	2,616	2,302
Current portion of long-term debt	248	
Deferred revenue	32,967	17,306
Total current liabilities	66,483	39,727
Long-term debt	85,573	82,500
Other liabilities	313	318
Total liabilities	152,369	122,545
Preferred stock:		

Undesignated, $0.01 par value, 1,000 shares authorized, no shares issued and outstanding at June 30, 2006 and December 31, 2005		
Common stock:		
$0.01 par value, 150,000 shares authorized; 52,385 shares issued and outstanding at June 30, 2006; 42,302 shares issued and 40,873 shares outstanding as of December 31, 2005, respectively	524	423
Less treasury stock:		
$0.01 par value, 0 and 1,399 shares at June 30, 2006 and December 31, 2005, respectively		(11,250)
Additional paid-in-capital	838,074	655,980
Accumulated deficit	(541,547)	(545,700)
Unearned compensation		(374)
Accumulated other comprehensive loss	(353)	(660)
Total stockholders equity	296,698	98,419
Total liabilities and stockholders equity	$449,067	$220,964

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

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ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per-share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(Unaudited)			
Revenue:				
Software and related services	$46,745	$16,145	$75,059	$30,455
Prepackaged medications	10,508	11,489	22,018	21,324
Information services	2,761	1,900	5,141	3,950
Total revenue	60,014	29,534	102,218	55,729
Cost of revenue:				
Software and related services	18,504	5,231	29,985	10,485
Prepackaged medications	8,716	9,697	18,042	17,420
Information services	1,522	725	2,794	1,776
Total cost of revenue	28,742	15,653	50,821	29,681
Gross profit	31,272	13,881	51,397	26,048
Selling, general and administrative expenses	22,706	11,458	39,107	21,815
Stock-based compensation expense	416		823	
Amortization of intangible assets	3,281	436	4,651	872
Income from operations	4,869	1,987	6,816	3,361
Interest expense	(940)	(881)	(1,835)	(1,758)
Interest income	639	957	1,838	1,834
Other expense, net	(8)	(30)	(126)	(70)
Income before income taxes	4,560	2,033	6,693	3,367
Provision for income taxes	1,733		2,543	
Net income	$2,827	$2,033	$4,150	$3,367
Net income per share basic	$0.05	$0.05	$0.09	$0.09
Net income per share diluted	$0.05	$0.05	$0.08	$0.08
Weighted-average shares of common stock outstanding used in computing basic net income per share	52,202	39,824	48,573	39,451
Weighted-average shares of common stock outstanding used in computing diluted net income per share	55,282	43,144	51,665	42,585

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

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ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended June 30, 2006 (Unaudited)	Six Months Ended June 30, 2005 (Unaudited)
Cash flows from operating activities:		
Net income	$4,150	$3,367
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,537	3,125
Stock-based compensation expense	823	
Write-off of capitalized software	290	
Realized loss on investments	126	23
Provision for doubtful accounts	1,471	430
Changes in operating assets and liabilities:		
Accounts receivable	(4,334)	(2,358)
Other receivables	352	(44)
Inventories	(586)	443
Prepaid expenses and other assets	106	76
Deferred taxes	1,660	
Accounts payable	(658)	(1,288)
Accrued expenses	1,517	3,052
Accrued compensation	315	(751)
Deferred revenue	(1,179)	(163)
Other liabilities	160	170
Net cash provided by operating activities	11,750	6,082
Cash flows from investing activities:		
Capital expenditures	(2,598)	(833)
Capitalized software and website development costs	(3,502)	(1,363)
Investment in promissory note receivable	(500)	(900)
Purchase of marketable securities	(3,508)	(6,525)
Maturities of marketable securities	55,942	19,543
Payment for A4 Health Systems, Inc. and related transaction costs (net of $21,742 cash acquired)	(209,718)	
Payments for other acquisitions		(1,763)
Net cash provided by (used in) investing activities	(163,884)	8,159
Cash flows from financing activities:		
Payments of capital lease obligations	(14)	(15)
Net proceeds received in issuance of common stock	140,674	
Repurchase of common stock from a related party	(21,078)	
Proceeds from exercise of common stock options	4,625	5,581
Net cash provided by financing activities	124,207	5,566
Net increase (decrease) in cash and cash equivalents	(27,927)	19,807
Cash and cash equivalents, beginning of period	60,905	16,972
Cash and cash equivalents, end of period	$32,978	$36,779

Non-cash investing and financing information:		
Common stock issued in connection with the acquisition of A4 Health Systems, Inc.	$68,775	$
Assumption of secured promissory note in connection with the A4 acquisition	$3,400	$

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

ALLSCRIPTS HEALTHCARE SOLUTIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited, dollar and share amounts in thousands, except per share amounts)

1. Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). The interim consolidated financial statements include the consolidated accounts of Allscripts Healthcare Solutions, Inc and its wholly-owned subsidiaries (Allscripts or the Company) with all significant intercompany transactions eliminated. In management s opinion, all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods presented have been made. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to SEC rules and regulations. These financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2005, in Allscripts Annual Report on Form 10-K, filed with the SEC on March 15, 2006. Operating results for the three-months and six-months ended June 30, 2006 are not necessarily indicative of the results for the full year. Certain of the 2005 amounts in the accompanying financial statements have been reclassified to conform to the presentation in this report.

2. Acquisitions

On March 2, 2006, Allscripts completed its acquisition of A4 Health Systems, Inc. (A4), whereby Allscripts acquired all of the outstanding equity interests of A4 for aggregate consideration of $215,000 in cash and 3,500 shares of Allscripts common stock. An additional payment of approximately $12,730, was made by Allscripts to A4 shareholders in respect of A4 s level of working capital at closing. The A4 acquisition enables Allscripts to reach new markets such as small and mid-sized physician practice groups that seek either an electronic health record (EHR) or a combined EHR and practice management system, and hospitals that seek emergency department information systems and care management solutions.

The A4 acquisition has been accounted for as a business combination under Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations. The assets acquired and liabilities assumed have been recorded at the date of acquisition at their respective fair values.

The results of operations of A4 have been included in the accompanying unaudited consolidated statements of operations from the date of the A4 acquisition. The total purchase price for the acquisition is as follows:

Cash consideration to A4 shareholders (cash payment of $215,000 and additional working capital payment of $12,730)	$227,730
Fair value of Allscripts shares issued to A4 shareholders (3,500 Allscripts common shares at $19.65 per share, the last sale price of Allscripts common stock on March 2, 2006)	68,775
Acquisition-related transaction costs	4,685
Total purchase price	$301,190

The above purchase price has been allocated to the tangible and intangible assets acquired and liabilities assumed based on management s estimates of their current fair values. The Company obtained a third party valuation of certain intangible assets. Acquisition-related transaction costs include investment banking fees, loan commitment fees, legal and accounting fees and other external costs directly related to the A4 acquisition.

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The purchase price has been allocated as follows:

Current assets, including $21,742 of cash acquired in the acquisition	$37,518
Property and equipment, net	8,791
Intangible assets	79,110
Non-current other assets	25
Goodwill	228,025
Current liabilities, excluding current portion of long term debt	(26,127)
Current and long-term debt	(3,400)
Deferred tax liabilities, net	(22,752)
Net assets acquired	$301,190

In connection with the acquisition of A4, management determined under the provisions of SFAS No. 109, Accounting for Income Taxes (SFAS 109), that it is more likely than not that Allscripts will generate adequate taxable income for the foreseeable future to realize the majority of its deferred tax assets. Accordingly, management reversed $58,984 of its valuation allowance against goodwill in purchase accounting for the A4 acquisition.

Of the $79,110 intangible assets acquired, $40,000 was assigned to developed technology rights with a weighted-average useful life of approximately 8 years, $20,800 was assigned to customer relationships with a useful life of 15 years, $15,210 was assigned to registered trade marks with a useful life of 10 years, $1,400 was assigned to A4 s backlog with a useful life of six months, $1,200 was assigned to non-competition agreements with a useful life of 2 years, and $500 was assigned to proprietary technology with a useful life of 5 years. Among the factors that contributed to a purchase price resulting in the recognition of goodwill were A4 s history of profitability and high operating margins, strong sales force and overall employee base, and leadership position in the healthcare information market.

The following unaudited pro forma information assumes the A4 acquisition occurred on January 1, 2005. These unaudited pro forma results have been prepared for informational purposes only and do not purport to represent what the results of operations would have been had the A4 acquisition occurred as of January 1, 2005, nor of future results of operations. The unaudited pro forma results for the three months and six months ended June 30, 2006 and 2005 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Total revenue	$ 60,898	$ 48,584	$ 118,113	$ 91,589
Net income	$ 3,808	$ 11,728	$ 14,050	$ 20,786
Earnings per share:				
Basic	$ 0.07	$ 0.23	$ 0.27	$ 0.41
Diluted	$ 0.07	$ 0.22	$ 0.25	$ 0.39

The unaudited pro forma information for the three months and six months ended June 30, 2006 and 2005 include the following adjustments:

Increase (decrease) to amortization expense of ($699) and $2,658 for the three months ended June 30, 2006 and 2005, respectively, and $374 and $5,316 for the six months ended June 30, 2006 and 2005, respectively, related to management s estimate of the fair value of intangible assets acquired as a result of the A4 acquisition less the elimination of original amortization recorded by A4.

Decrease to interest income of $0 and $754 for the three months ended June 30, 2006 and 2005, respectively, $574 and $1,428 for the six months ended June 30, 2006 and 2005, respectively, as a result of lower cash, cash equivalents and marketable securities balances at January 1, 2006 and 2005 as a result of assuming the acquisition of A4 occurred on January 1, 2005.

A transfer from Allscripts selling, general and marketing expense of $1,021 in the six months ended June 30, 2006 to the six months ended June 30, 2005 related to non-recurring A4 integration costs.

An increase (decrease) in revenue of $884 and ($630) for the three months ended June 30, 2006 and 2005, respectively, and $1,379 and ($1,260) for the six months ended June 30, 2006 and 2005, respectively, relating to the timing of deferred revenue purchase accounting adjustments.

An increase to the tax provision of $602 and $5,942 for the three months ended June 30, 2006 and 2005, respectively, and $6,068 and $10,676 for the six months ended June 30, 2006 and 2005, respectively, to reflect a 38% tax provision on a proforma basis.

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The weighted average number of shares outstanding used for the computation of basic and diluted earnings per share for the three and six months ended June 30, 2006 and 2005 assumes that the 8,395 shares issued in connection with Allscripts common stock offering completed in February 2006, in order to partially fund the cash portion of the A4 purchase price, and the 3,500 shares issued to A4 shareholders as part of the consideration to acquire A4 occurred on January 1, 2005.

3. Stock-Based Compensation

Effective January 1, 2006, Allscripts adopted the provisions of SFAS No. 123 (Revised), Share-Based Payment (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors, including employee stock options, based on estimated fair values. Allscripts previously applied Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB 25) and related interpretations and provided the pro forma disclosures required by SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures (SFAS 148), both of which were superseded by SFAS 123(R).

Prior to the Adoption of SFAS 123(R)

Prior to the adoption of SFAS 123(R), employee stock-based compensation was not reflected in Allscripts net income because all stock options granted under Allscripts equity plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Accordingly, Allscripts net income for the three months and six months ended June 30, 2005 does not reflect employee stock-based compensation.

The pro forma disclosures required by SFAS 123 and SFAS 148 for the three months and six months ended June 30, 2005 are as follows:

	Three Months Ended June 30, 2005	**Six Months Ended June 30, 2005**
Net income, as reported	$2,033	$3,367
Stock-based compensation cost	(2,088)	(4,272)
Pro forma net loss	($55)	($905)
Net income per share basic, as reported	$0.05	$0.09
Net income per share diluted, as reported	$0.05	$0.08
Pro forma net loss per share basic and diluted	$0.00	($0.02)

Impact of the Adoption of SFAS 123(R)

Allscripts has elected to adopt the modified prospective application transition method as permitted by SFAS 123(R). Accordingly, during the three months and six months ended June 30, 2006, Allscripts recorded stock-based compensation cost totaling the amount that would have been recognized had the fair value method been applied since the effective date of SFAS 123. During the three and six months ended June 30, 2006, stock-based compensation expense of $416 and $823, respectively was recorded in operating expenses. Previously reported amounts have not been restated. For the three and six months ended June 30, 2006, the effect on Allscripts results of operations of recording stock-based compensation in accordance with SFAS 123(R) was as follows:

	Three Months Ended June 30, 2006	**Six Months Ended June 30, 2006**
Stock-based compensation:		
Restricted stock	$313	$584
Stock options	103	239
Total stock-based compensation	$416	$823

Effect on net income	$416	$823
Effect on net income per share:		
Basic	$0.01	$0.02
Diluted	$0.01	$0.02

In Allscripts pro forma disclosures prior to the adoption of SFAS 123(R), Allscripts accounted for forfeitures upon occurrence, and, using this method, Allscripts had an unrecorded deferred stock-based compensation balance related to stock options of $718 before estimated forfeitures as of January 1, 2006. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Pursuant to SFAS 123(R), as of January 1, 2006, Allscripts estimated that the stock-based compensation for options not expected to vest was $154, therefore, the unrecorded deferred stock-based compensation balance related to stock options was adjusted to $564 after estimated forfeitures.

As of June 30, 2006, the unrecorded deferred stock-based compensation balance related to stock options was $394 after estimated forfeitures, and such amount will be recognized over an estimated weighted average amortization period of approximately nine months.

No stock-based compensation has been capitalized for the six months ended June 30, 2006 or at January 1, 2006, when the provisions of SFAS 123(R) were adopted.

Allscripts did not grant any stock options during the six months ended June 30, 2006. The fair value of stock options granted prior to January 1, 2006 was determined using the Black-Scholes option pricing model. The weighted average assumptions used in determining such fair values for the six months ended June 30, 2005 are as follows:

	Six Months Ended June 30, 2005
Risk-free interest rate	3.01%
Volatility	139%
Dividend rate	%
Option life (years)	2.42

The following table summarizes the combined activity with respect to stock options granted under Allscripts equity incentive plans during the periods indicated:

	Options Outstanding	Weighted-Average Exercise Price	Options Exercisable	Weighted-Average Exercise Price
Balance at December 31, 2003	10,303	$6.11	4,602	$8.50
Options granted	2,155	$9.16		
Options exercised	(1,064)	$3.89		
Options forfeited	(518)	$8.08		
Balance at December 31, 2004	10,876	$6.84	6,503	$7.86
Options granted	41	$11.99		
Options exercised	(2,158)	$4.39		
Options forfeited	(216)	$10.36		
Balance at December 31, 2005	8,543	$7.39	8,356	$7.38
Options granted		$		
Options exercised	(856)	$5.40		
Options forfeited	(120)	$33.67		
Balance at June 30, 2006	7,567	$7.30	7,468	$7.29

The aggregate intrinsic value of stock options outstanding as of June 30, 2006 was $84,891, which is based on Allscripts closing stock price of $17.55 as of June 30, 2006. The intrinsic value of stock options outstanding represents the amount that would have been received by the option holders had all option holders exercised their stock options as of that date. The total number of vested, in-the-money stock options as of June 30, 2006 was 7,468, with an intrinsic value of $83,959.

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The total intrinsic value of stock options exercised during the six months ended June 30, 2006 was $9,609. The total cash received from employees as a result of employee stock option exercises during the three and six months ended June 30, 2006 was $4,489, net of related taxes. Allscripts settles employee stock option exercises with newly issued common shares.

In accordance with SFAS 123(R), we charged $374 of unearned compensation related to unvested awards of restricted stock against additional paid-in-capital on the date of adoption. During the six months ended June 30, 2006, management awarded 334 shares of restricted stock to certain employees under the Amended and Restated 1993 Stock Incentive Plan, with an average fair value of $16.46 per share. The awards of restricted stock have an average four-year vesting term. Upon termination of an employee s employment with the Company, any unvested shares of restricted stock will be forfeited. As of June 30, 2006, 358 shares of restricted stock were outstanding, of which 349 were unvested. The fair value of the shares of restricted stock on the date of the grant is amortized ratably over the vesting period. As of June 30, 2006, $4,223 of unearned compensation related to unvested awards of restricted stock was netted against the balance of additional paid in capital and will be recognized over the remaining vesting terms of the awards.

4. Employee Stock Purchase Plan

On May 30, 2006, the Shareholders at the Annual Meeting of Stockholders approved the adoption of an Employee Stock Purchase Plan (ESPP). The ESPP became effective on July 1, 2006 and allows eligible employees to authorize payroll deductions of up to 20% of their base salary to be applied toward the purchase of full shares of common stock on the last day of the offering period. Offering periods under the ESPP are three months in duration and begin on each January 1, April 1, July 1, and October 1. Shares will be purchased on the last day of each offering period at a price of 95% of fair market value of the common stock for such date as reported on Nasdaq. The aggregate number of shares of Allscripts common stock that may be issued under the ESPP may not exceed 250,000 shares and no one employee may purchase any shares under the ESPP having a collective fair market value greater than $25,000 in any one calendar year. The shares available for purchase under the ESPP may be drawn from either authorized but previously unissued shares of common stock or from reacquired shares of common stock, including shares purchased by Allscripts in the open market and held as treasury shares. Allscripts will treat the ESPP as a non-compensatory plan in accordance with SFAS No. 123(R). There were no shares purchased under the ESPP as of June 30, 2006.

5. Revenue Recognition

Revenue from Allscripts sales of pharmaceutical products, net of provisions for estimated returns, is recognized upon shipment of the pharmaceutical products, the point at which the customer takes ownership and assumes risk of loss, when no performance obligations remain and collection of the receivable is probable. Allscripts offers customers the right to return pharmaceutical products under various policies and estimates and maintains reserves for product returns based on historical experience following the provisions of FAS No. 48, Revenue Recognition When Right of Return Exists.

Revenue from software licensing arrangements, where the service element is considered essential to the functionality of the other elements of the arrangement, is accounted for under American Institute of Certified Public Accountants Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type Contracts and Certain Production-Type Contracts. Allscripts recognizes such revenue on an input basis using actual hours worked as a percentage of total expected hours required by the arrangement, provided that the fee is fixed and determinable and collection of the receivable is probable. If any such software licensing arrangement is deemed to have extended payment terms, revenue is recognized using the input method but is limited to the amounts due and payable. Maintenance and support revenue from software licensing arrangements is recognized over the term of the applicable support agreement based on vendor-specific objective evidence of fair value of the maintenance and support revenue, which is generally based upon contractual renewal rates.

Revenue from software licensing arrangements where the service element is not considered essential to the functionality of the other elements of the arrangement is accounted for under SOP 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. Such revenue is recognized upon shipment of the software or as services are performed, provided that persuasive evidence of an arrangement exists, fees are considered fixed and determinable, and collection of the receivable is considered probable. The revenue recognized for each separate element of a multiple-element software contract is based upon vendor-specific objective evidence of fair value, which is based upon the price the customer is required to pay when the element is sold separately.

Certain of Allscripts customer arrangements in its information services segment encompass multiple deliverables. Allscripts accounts for these arrangements in accordance with Emerging Issues Task Force (EITF) No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables (EITF 00-21). If the deliverables meet the criteria in EITF 00-21, the deliverables are separated into separate units of accounting, and revenue is allocated to the deliverables based on their

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relative fair values. The criteria specified in EITF 00-21 are that the delivered item has value to the customer on a stand-alone basis, there is objective and reliable evidence of the fair value of the undelivered item, and if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor. Applicable revenue recognition criteria is considered separately for each separate unit of accounting.

Management applies judgment to ensure appropriate application of EITF 00-21, including value allocation among multiple deliverables, determination of whether undelivered elements are essential to the functionality of delivered elements and timing of revenue recognition, among others. For those arrangements where the deliverables do not qualify as a separate unit of accounting, revenue from all deliverables is treated as one accounting unit and recognized on a straight-line basis over the term of the arrangement. Changes in circumstances and customer data may affect management s analysis of EITF 00-21 criteria, which may cause Allscripts to adjust upward or downward the amount of revenue recognized under the arrangement.

In accordance with EITF issued Consensus 01-14, Income Statement Characterization of Reimbursements for Out-of-Pocket Expenses Incurred, revenue includes reimbursable expenses charged to Allscripts clients.

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As of June 30, 2006 and December 31, 2005, there were $12,118 and $6,668, respectively, of revenue earned on contracts in excess of billings, which are included in the balance of accounts receivable. Billings on contracts where revenue has been earned in excess of billings are expected to occur according to the contract terms. Deferred revenue consisted of the following:

	June 30, 2006	December 31, 2005
Prepayments and billings in excess of revenue earned on contracts in progress for software, services and support provided by Allscripts Clinical Solutions Group and included in the software and related services segment	$12,380	$12,860
Prepayments and billings in excess of revenue earned on contracts in progress for software, services and support provided by A4 and included in Allscripts software and related services segment	16,735	
Prepayments and billings in excess of revenue earned for interactive physician education sessions and related services provided by the Allscripts Physicians Interactive Group and included in the information services segment	3,852	4,446
Total deferred revenue	$32,967	$17,306

6. Cash, Cash Equivalents and Marketable Securities

Cash and cash equivalent balances at June 30, 2006 and December 31, 2005 consist of cash and highly liquid corporate debt securities with original maturities at the time of purchase of less than 90 days. Allscripts cash, cash equivalents, short-term and long-term marketable securities are invested in overnight repurchase agreements, money market funds and corporate debt securities. The carrying values of cash and cash equivalents, short-term and long-term marketable securities held by Allscripts are as follows:

	June 30, 2006	December 31, 2005
Cash and cash equivalents:		
Cash	$21,972	$24,274
Money market funds	11,006	1,367
Corporate debt securities		35,264
	32,978	60,905
Short-term marketable securities:		
U.S. government and agency debt obligations	9,646	13,151
Corporate debt securities	4,566	41,257
	14,212	54,408
Long-term marketable securities:		
U.S. government and agency debt obligations	6,021	7,810
Corporate debt securities	12,605	22,940
	18,626	30,750
Total cash, cash equivalents and marketable securities	$65,816	$146,063

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7. Comprehensive Income

Comprehensive income includes all changes in stockholders equity during a period except those resulting from investments by owners and distributions to owners.

The components of comprehensive income are as follows:

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net income	$2,827	$2,033	$4,150	$3,367
Other comprehensive income:				
Unrealized gain (loss) on marketable securities, net of taxes	93	241	307	(114)
Comprehensive income	$2,920	$2,274	$4,457	$3,253

The components of accumulated other comprehensive income, net of income tax, consist of unrealized gains (losses) on Allscripts marketable securities. The components of net unrealized gain (loss) on marketable securities are as follows:

	June 30, 2006	December 31, 2005
Short-term marketable securities:		
Gross unrealized gains	$	$14
Gross unrealized losses	(94)	(258)
Net short-term unrealized losses	(94)	(244)
Long-term marketable securities:		
Gross unrealized gains		
Gross unrealized losses	(259)	(416)
Net long-term unrealized losses	(259)	(416)
Total net unrealized losses on marketable securities	($353)	($660)

8. Common Stock

Public Offering of Common Stock

On February 28, 2006, Allscripts completed its offering of 8,395 shares of common stock and received approximately $140,674 in net proceeds, based on a public offering price of $17.75 per share after deducting underwriting discounts and commissions and professional expenses. Of the 8,395 shares issued, 1,399 shares were issued from treasury. All of the net proceeds received from the sale of common stock were used to fund the acquisition of A4.

Acquisition of A4 Health Systems, Inc.

On March 2, 2006, Allscripts acquired all of the outstanding equity interests of A4 for aggregate consideration of $232,415 in cash, which includes $4,685 of acquisition-related transaction costs, an additional working capital cash payment of $12,370, and the issuance of 3,500 shares of Allscripts common stock.

Repurchase of Common Stock

On March 9, 2006, Allscripts repurchased 1,250 shares of its common stock directly from IDX Investment Corporation, a wholly owned subsidiary of General Electric Company. Allscripts paid $21,078, which is based on 95% of the February 22, 2006 public offering price of $17.75.

9. Net Income Per Share

Allscripts accounts for net income per share in accordance with SFAS No. 128, Earnings per Share (SFAS 128). SFAS 128 requires the presentation of basic income per share and diluted income per share. Basic income per share is computed by dividing net income by the weighted-average shares of outstanding common stock. For purposes of calculating diluted earnings per share, the denominator includes both the weighted average shares of common stock outstanding and

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dilutive potential common stock equivalents. Dilutive common stock equivalent shares consist primarily of stock options and unvested restricted stock. The components of the diluted weighted average common shares outstanding are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Weighted average shares outstanding:				
Basic	52,202	39,824	48,573	39,451
Effect of dilutive securities	3,080	3,320	3,092	3,134
Diluted	55,282	43,144	51,665	42,585

In accordance with EITF Issue No. 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings Per Share (EITF 04-8), contingently convertible debt instruments are subject to the if-converted method under FAS 128, Earnings Per Share, regardless of the contingent features included in the instrument assuming the shares are not anti-dilutive. Under the provisions of EITF 04-8, the as-if convertible 7,300 shares and interest expense related to the 3.5% Senior Convertible Debentures due 2024 that were issued in July 2005 were excluded from the basic and diluted earnings per share calculation for the three months and six months ended June 30, 2006 and 2005, as the effects were anti-dilutive.

10. Investment in Promissory Note Receivable and Minority Interest

In August 2004, Allscripts entered into a convertible secured promissory note purchase agreement (2004 Note Purchase Agreement) with Medem, Inc. (Medem) and certain other investors. Under the 2004 Note Purchase Agreement, Allscripts acquired a convertible secured promissory note in the aggregate principal amount of $2,100 (2004 Promissory Note) under which Medem may borrow up to $2,100 from Allscripts. The Promissory Note bears interest at an annual rate of 3% and is payable on a quarterly basis. The Promissory Note becomes due and payable upon the earlier to occur of (i) a sale of Medem, as defined in the 2004 Note Purchase Agreement, or the filing of a registration statement with the SEC for the public offering of any class of securities of Medem (a Liquidity Event), and (ii) August 12, 2007. As of December 31, 2005, Allscripts had funded the full $2,100 under the 2004 Note Purchase Agreement. The Promissory Note receivable balance is included in other assets in the consolidated balance sheets as of June 30, 2006 and December 31, 2005.

In connection with the transaction described above, Allscripts entered into a share purchase agreement with Medem (Share Purchase Agreement) pursuant to which Allscripts purchased shares of Medem s Series A Common Stock and shares of Medem s Series B Common Stock for an aggregate purchase price equal to $500 in cash, and the estimated fair market value of these shares is recorded in other assets on the consolidated balance sheets as of June 30, 2006 and December 31, 2005. In addition, pursuant to the terms of the Share Purchase Agreement, Allscripts has a three-year option to acquire an additional interest in Medem for an aggregate price of $600.

In November 2005, Allscripts entered into an additional convertible secured promissory note purchase agreement (2005 Note Purchase Agreement) with Medem and certain other investors. Under the 2005 Note Purchase Agreement, Allscripts acquired a convertible secured promissory note in the aggregate principal amount of $500 (2005 Promissory Note and together with the 2004 Promissory Note, Promissory Notes) under which Medem may borrow up to $500 from Allscripts. The 2005 Promissory Note bears interest at an annual rate of 3% and is payable on a quarterly basis. The 2005 Promissory Note becomes due and payable upon the earlier to occur of (i) a Liquidity Event, as defined above, and (ii) December 31, 2007. As of June 30, 2006, Allscripts had funded the full $500 under the 2005 Note Purchase Agreement.

At any time on or prior to maturity, Allscripts may convert all (but not a portion) of the Promissory Notes into 2,317 shares of Medem s Series A Common Stock. If Allscripts converts the Promissory Notes and exercises its full option to purchase additional equity in Medem, Allscripts will own approximately 41.1% of the voting capital of Medem and 33.2% of the capital stock of Medem. Allscripts continues to account for this investment under the cost basis of accounting. The total investment in the Promissory Notes and Share Purchase Agreement totaled $3,100 and $2,600 as of June 30, 2006 and December 31, 2005, respectively.

11. Long-Term Debt

In July 2004, Allscripts completed a private placement of $82,500 of 3.50% Senior Convertible Debentures due 2024 (Notes). The Notes can be converted, in certain circumstances, into approximately 7,300 shares of common stock based upon a conversion price of approximately $11.26 per share, subject to adjustment for certain events. Subject to the rights of holders of the Notes to require Allscripts to repurchase the Notes as described below, no payments of principal on the Notes are due until 2024.

The Notes are only convertible under certain circumstances, including: (i) during any fiscal quarter if the closing price of Allscripts common stock for at least 20 trading days in the 30 trading-day period ending on the last trading day of the preceding fiscal quarter exceeds $14.64 per share; (ii) if Allscripts calls the Notes for redemption; or (iii) upon the occurrence of certain specified corporate transactions, as defined in the indenture relating to the Notes. Upon conversion, Allscripts has the right to deliver common stock, cash or a combination of cash and shares of common stock. Allscripts may redeem some or all of the Notes for cash any time on or after July 20, 2009 at the Notes full principal amount plus accrued and unpaid interest, if any. Holders of the Notes may require Allscripts to repurchase some or all of the Notes on July 15, 2009, 2014 and 2019 or, subject to certain exceptions, upon a change of control of Allscripts.

The Notes were convertible in second quarter of 2006 and continue to be convertible in the third quarter of 2006 by virtue of the last reported sale price for Allscripts common stock having exceeded $14.64 for twenty consecutive days in the 30 trading-day period ending on June 30, 2006. There were no Notes converted as of June 30, 2006.

Allscripts received approximately $79,612 in net proceeds from the offering after deduction for issuance costs consisting of underwriting fees and professional expenses. The debt issuance costs of approximately $2,888 have been capitalized as an other asset and are being amortized as interest expense over five years using the effective interest method, through the first date that the holders have the option to require Allscripts to purchase the Notes.

In connection with the acquisition of A4, Allscripts assumed a secured promissory note with an aggregate principal amount of $3,400 as of March 2, 2006, maturing on October 31, 2015. The promissory note bears interest at 7.85% per annum, and principal and interest are due monthly. In the event of prepayment in full or in part, Allscripts will be subject to a prepayment fee of 1% or more, as described in the related promissory note agreement, of the amount of principal prepaid on the promissory note. The promissory note is secured by the former corporate facilities of A4 and any lease or rental payments as defined in the related agreements.

Long-term debt outstanding as of June 30, 2006 and December 31, 2005 consists of the following:

	June 30, 2006	December 31, 2005
3.5% Senior convertible debt	$82,500	$82,500
7.85% Secured promissory note	3,321	
Total debt	85,821	82,500
Less: Current portion	248	
Long-term debt, net of current portion	$85,573	$82,500

Interest expense for the three months ended June 30, 2006 and 2005, consists of $788 and $722, respectively, in interest expense related to the Notes and the secured promissory note and $152 and $159, respectively, in debt issuance cost amortization. Interest expense for the six months ended June 30, 2006 and 2005, consists of $1,531 and $1,444, respectively, in interest expense related to the Notes and the secured promissory note and $304 and $314, respectively, in debt issuance cost amortization.

12. Income Taxes

As a result of the A4 acquisition in March 2006, management has determined under the provisions of SFAS 109, Accounting for Income Taxes , that it is more likely than not that Allscripts will generate adequate taxable income for the foreseeable future to realize the majority of its deferred tax assets. Accordingly, management reversed $58,984 of its valuation allowance against goodwill in purchase accounting for the A4 acquisition. Approximately $2,300 of the tax valuation allowance was not reversed during the first six months of 2006 due to management s assessment as of June 30, 2006 of potential limitations on Allscripts net operating losses (NOL) pursuant to Internal Revenue Code Section 382, which imposes an annual limitation on the future utilization of net operating losses. The $2,300 in remaining tax valuation reserve as of June 30, 2006 is management s estimate as of June 30, 2006 of the potential Section 382 NOL limitations. For the three and six months ended June 30, 2006, Allscripts recorded a tax provision of $1,733 and $2,543, respectively, using an effective tax rate of 38%.

13. Business Segments

FAS No. 131, Disclosures about Segments of a Business Enterprise and Related Information, establishes standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

Allscripts organizes its business around groups of similar products, which results in three reportable segments: software and related services, prepackaged medications, and information services. The software and related services segment derives its revenue from the sale and installation of software solutions, including EHR, practice management, electronic prescribing (e-prescribing), document imaging, emergency department and care management solutions, as well as transaction fees associated with the use of the software and the resale of related hardware. The prepackaged medications segment derives its revenue from the repackaging, sale, and distribution of medications and medical supplies. The information services segment primarily derives its revenue from the sale of interactive physician education sessions. Allscripts does not report its assets by segment. Allscripts does not allocate interest income, interest expense, other income or income taxes to its operating segments. In addition, Allscripts records corporate selling, general, and administration expenses, amortization of intangibles, restructuring and other related charges in its unallocated corporate costs. These costs are not included in the financial results of Allscripts operating segments.

	For the Three Months Ended June 30,		**For the Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Revenue:				
Software and related services	$46,745	$16,145	$75,059	$30,455
Prepackaged medications	10,508	11,489	22,018	21,324
Information services	2,761	1,900	5,141	3,950
Total revenue	$60,014	$29,534	$102,218	$55,729
Income from operations:				
Software and related services	$12,327	$4,541	$19,700	$8,313
Prepackaged medications	811	1,304	2,162	2,901
Information services	300	568	637	847
Unallocated corporate expenses	(8,569)	(4,426)	(15,683)	(8,700)
Income from operations	4,869	1,987	6,816	3,361
Net interest and other income, net	(309)	46	(123)	6
Income before income taxes	$4,560	$2,033	$6,693	$3,367

14. Related Party Transactions

Medem Note Purchase

On February 7, 2006, Allscripts funded an additional convertible secured promissory note from Medem in the principal amount of $500 under the 2005 Note Purchase Agreement (see Note 10).

Repurchase of Common Stock

On March 9, 2006, we repurchased 1,250 shares of Allscripts common stock directly from IDX, which is wholly owned by GE. Allscripts paid $21,078, which is based on 95% of the February 22, 2006 public offering price of $17.75. As of June 30, 2006, IDX owned approximately 4.6% of Allscripts common stock.

Relationship with Med3000, Inc. and Trip Logics