STREAMLINE HEALTH SOLUTIONS INC.
Form 10-Q
December 14, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 October 31, 2012

or

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

For the transition period from to

Commission File Number: 0-28132

STREAMLINE HEALTH SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**31-1455414**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1230 Peachtree St. NE, Suite 1000

Atlanta, GA 30309

(Address of principal executive offices) (Zip Code)

(404)-446-0050

(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 x No ¨

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

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

Number of shares of Registrant s Common Stock ($.01 par value per share) issued and outstanding, as of December 14, 2012: 12,639,988.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STREAMLINE HEALTH SOLUTIONS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

Assets

	(Unaudited) October 31, 2012	January 31, 2012
Current assets:		
Cash and cash equivalents	$ 10,528,695	$ 2,243,054
Accounts receivable, net of allowance for doubtful accounts of $134,000 and $100,000, respectively	3,389,738	4,484,605
Contract receivables	648,736	430,370
Prepaid hardware and third party software for future delivery	22,777	38,193
Prepaid client maintenance contracts	1,038,035	788,917
Prepaid and other assets	555,310	256,104
Deferred income taxes		167,000
Total current assets	16,183,291	8,408,243
Non-current assets:		
Property and equipment:		
Computer equipment	3,418,500	2,892,885
Computer software	2,196,236	2,131,730
Office furniture, fixtures and equipment	818,231	756,375
Leasehold improvements	693,890	667,000
	7,126,857	6,447,990
Accumulated depreciation and amortization	(5,778,675)	(5,232,321)
Property and equipment, net	1,348,182	1,215,669
Contract receivables, less current portion	142,021	221,596
Capitalized software development costs, net of accumulated amortization of $16,733,274 and $14,805,236, respectively	13,119,354	9,830,175
Intangible assets, net	8,517,084	417,666
Deferred financing cost, net	1,211,912	145,857
Goodwill	12,038,226	4,060,504
Other, including deferred income taxes of $0 and $711,000, respectively	366,857	841,348
Total non-current assets	36,743,636	16,732,815
	$ 52,926,927	$ 25,141,058

See Notes to Condensed Consolidated Financial Statements

3

Table of Contents

STREAMLINE HEALTH SOLUTIONS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

Liabilities and Stockholders Equity

	(Unaudited) October 31, 2012	January 31, 2012
Current liabilities:		
Accounts payable	$ 832,657	$ 879,027
Accrued compensation	1,603,355	887,130
Accrued other expenses	1,373,307	479,526
Deferred revenues	6,262,960	6,496,938
Contingent consideration for earn-out	1,319,559	
Current portion of long term debt	1,250,000	
Total current liabilities	12,641,838	8,742,621
Non-current liabilities:		
Term loans	12,750,000	4,120,000
Convertible notes payable, net of unamortized discount of $1,822,255 and $0, respectively	3,877,322	3,000,000
Warrants liability	4,138,783	
Lease incentive liability	101,453	47,193
Contingent consideration for earn-out, less current portion		1,232,720
Total non-current liabilities	20,867,558	8,399,913
Total liabilities	33,509,396	17,142,534
Series A 0% Convertible Redeemable Preferred Stock, $.01 par value per share, $7,250,355 redemption value, 4,000,000 shares authorized, 2,416,785 issued and outstanding	2,979,170	
Stockholders equity:		
Common stock, $.01 par value per share, 25,000,000 shares authorized, and 12,582,598 and 10,433,716 shares issued and outstanding, respectively	125,826	104,338
Convertible Redeemable Preferred Stock, $0.01 par value per share, 1,000,000 authorized, no shares issued		
Additional paid in capital	44,351,334	38,360,980
Accumulated deficit	(28,038,799)	(30,466,794)
Total stockholders equity	16,438,361	7,998,524
	$ 52,926,927	$ 25,141,058

See Notes to Condensed Consolidated Financial Statements

Table of Contents

STREAMLINE HEALTH SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Three and Nine Months Ended October 31,

(Unaudited)

	Three Months		Nine Months	
	2012	**2011**	**2012**	**2011**
Revenues:				
Systems sales	$ 290,294	$ 232,395	$ 719,495	$ 526,597
Professional services	1,089,814	833,592	3,153,672	2,708,824
Maintenance and support	3,148,442	2,279,886	7,797,263	6,558,484
Software as a service	2,005,813	966,218	5,358,120	2,804,141
Total revenues	6,534,363	4,312,091	17,028,550	12,598,046
Operating expenses:				
Cost of systems sales	717,901	583,388	1,936,761	1,751,890
Cost of professional services	854,997	572,056	1,910,951	1,923,576
Cost of maintenance and support	918,750	513,868	2,349,745	1,651,884
Cost of software as a service	550,875	480,368	1,849,962	1,334,659
Selling, general and administrative	2,926,830	1,494,891	6,800,794	4,742,084
Product research and development	866,659	303,973	1,833,865	1,063,903
Total operating expenses	6,836,012	3,948,544	16,682,078	12,467,996
Operating income (loss)	(301,649)	363,547	346,472	130,050
Other income (expense):				
Interest expense	(895,142)	(25,896)	(1,494,161)	(67,529)
Miscellaneous income (expense)	43,549	(36,885)	55,805	(42,155)
Earnings (loss) before income taxes	(1,153,242)	300,766	(1,091,884)	20,366
Income tax benefit (expense)	3,552,879	(5,000)	3,519,879	(12,315)
Net earnings	$ 2,399,637	$ 295,766	$ 2,427,995	$ 8,051
Less: deemed dividends on Series A Preferred Shares	(139,133)		(139,133)	
Net earnings attributable to common shareholders	$ 2,260,504		$ 2,288,862	
Basic net earnings per common share	$ 0.18	$ 0.03	$ 0.20	$ 0.00
Number of shares used in basic per common share computation	12,393,352	9,943,567	11,346,428	9,823,937
Diluted net earnings per common share	$ 0.15	$ 0.03	$ 0.18	$ 0.00
Number of shares used in diluted per common share computation	15,365,238	9,958,947	12,417,256	9,837,750

See Notes to Condensed Consolidated Financial Statements

Table of Contents

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN

STOCKHOLDERS EQUITY

	Common stock shares	Common stock	Additional paid in capital	Accumulated (deficit)	Total stockholders equity
Balance at February 1, 2012	10,433,716	$ 104,338	$ 38,360,980	$ (30,466,794)	$ 7,998,524
Stock issued to Employee Stock Purchase Plan and exercise of stock options	88,742	887	160,920		161,807
Restricted stock issued	137,325	1,373	(1,373)		
Conversion of note payable, Interpoint	1,529,729	15,297	3,100,885		3,116,182
Stock consideration for acquisition	393,086	3,931	1,497,678		1,501,609
Issuance of common stock warrants			2,441,852		2,441,852
Issuance costs			(263,072)		(263,072)
Reclassification of common stock warrants to liability			(4,138,783)		(4,138,783)
Beneficial conversion feature of Series A Preferred Stock			2,685,973		2,685,973
Share-based compensation expense			645,407		645,407
Deemed dividends on Series A Preferred Stock			(139,133)		(139,133)
Net earnings				2,427,995	2,427,995
Balance at October 31, 2012	12,582,598	$ 125,826	$ 44,351,334	$ (28,038,799)	$ 16,438,361

6

Table of Contents

STREAMLINE HEALTH SOLUTIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Nine Months Ended October 31,

(Unaudited)

	2012	2011
Operating activities:		
Net earnings	$ 2,427,995	$ 8,051
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities, net of effect of acquisitions:		
Depreciation and amortization	2,847,665	2,008,432
Loss on disposal of equipment		26,667
Share-based compensation expense	645,407	529,104
Deferred tax benefit	(3,564,612)	
Provision for accounts receivable		40,000
Amortization of debt discount	111,584	
Fair value adjustment for contingent earnout	86,839	
Net loss from conversion of convertible note	56,682	
Change in assets and liabilities:		
Accounts and contract receivables	(1,351,935)	419,517
Other assets	(482,785)	(89,066)
Accounts payable	(137,107)	161,609
Accrued expenses	947,630	(574,012)
Deferred revenues	881,677	(1,904,641)
Net cash provided by operating activities	2,469,040	625,661
Investing activities:		
Purchases of property and equipment	(546,061)	(245,262)
Capitalization of software development costs	(1,571,420)	(1,970,000)
Payment for acquisition	(12,161,634)	
Net cash used in investing activities	(14,279,115)	(2,215,262)
Financing activities:		
Net change in borrowings	9,880,000	550,000
Payment of deferred financing costs	(1,246,107)	
Proceeds from exercise of stock options and stock purchase plan	161,823	92,711
Proceeds from private placement	12,000,000	
Payment of success fee	(700,000)	
Payment on capital lease obligation		(156,621)
Net cash provided by financing activities	20,095,716	486,090
Increase (decrease) in cash and cash equivalents	8,285,641	(1,103,511)
Cash and cash equivalents at beginning of period	2,243,054	1,403,949
Cash and cash equivalents at end of period	$ 10,528,695	$ 300,438
Supplemental cash flow disclosures:		

Interest paid	$ 1,181,929	$ 61,532
Income taxes paid	$ 78,041	$ 19,136

Supplemental Disclosure of Non-Cash Financing Activity

In June 2012, the $3,000,000 convertible note and accrued interest was converted to 1,529,729 common shares at $2.00 per share.

In August 2012, we issued 393,086 shares of our common stock, at a price of $4.07, as part of the Meta purchase price.

In October 2012, we issued 200,000 common stock warrants, exercisable for common stock shares at $4.06 per share.

During the third quarter of 2012, we recorded approximately $139,000 of deemed dividends from preferred share discount accretion.

See Notes to Condensed Consolidated Financial Statements

Table of Contents

STREAMLINE HEALTH SOLUTIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared by Streamline Health Solutions, Inc. (we , us , or our), pursuant to the rules and regulations applicable to quarterly reports on Form 10-Q of the U. S. Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. In the opinion of our management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Condensed Consolidated Financial Statements have been included. These Condensed Consolidated Financial Statements should be read in conjunction with the financial statements and notes thereto included in our most recent annual report on Form 10-K, Commission File Number 0-28132. Operating results for the three and nine months ended October 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending January 31, 2013.

NOTE B SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of our significant accounting policies is presented in Note B Significant Accounting Policies in the fiscal year 2011 Annual Report on Form 10-K. Users of financial information for interim periods are encouraged to refer to the footnotes contained in the Annual Report on Form 10-K when reviewing interim financial results.

Acquisitions

On December 7, 2011, we completed the acquisition of substantially all of the assets of Interpoint Partners, LLC (Interpoint). The net acquired assets and liabilities, and related revenue and expense since December 7, 2011 are included in our condensed consolidated financial statements.

On August 16, 2012, we completed the acquisition of Meta Health Technology, Inc. (Meta), please see Note C for further details.

Fair Value of Financial Instruments

The FASB s authoritative guidance on fair value measurements establishes a framework for measuring fair value, and expands disclosure about fair value measurements. This guidance enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. Under this guidance, assets and liabilities carried at fair value must be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value based on the short-term maturity of these instruments. Cash and cash equivalents are classified as Level 1. The carrying amount of the Company s long-term debt approximates fair value since the interest rates being paid on the amounts approximate the market interest rate. Long-term debt is classified as Level 2. The fair value of contingent consideration for earn-out and warrants liability is determined by management with the assistance of an independent third party valuation specialist. The Company used a binomial model to estimate the fair value of the contingent consideration for earn-out and warrants liability. The contingent consideration for earn-out and warrants liability are classified as Level 3.

Revenue Recognition

We derive revenue from the sale of internally developed software either by licensing or by software as a service (SaaS), through our direct sales force or through third-party resellers. Clients with locally-installed software utilize our support and maintenance services for a separate fee, whereas SaaS fees include support and maintenance. We also derive revenue from professional services that support the implementation, configuration, training, and optimization of our applications. Additional revenues are also derived from reselling third-party software and hardware components.

We recognize revenue in accordance with ASC 985-605, *Software-Revenue Recognition* and ASC 605-25 *Revenue Recognition Multiple-element arrangements*. Revenue recognition typically commences when the following criteria have all been met:

Persuasive evidence of an arrangement exists,

Delivery has occurred or services have been rendered,

The arrangement fees are fixed or determinable, and

Collection is considered probable.

Table of Contents

If we determine that any of the above criteria has not been met, we will defer recognition of the revenue until all the criteria have been met. Maintenance and support, term license and SaaS agreements entered into are generally non-cancelable, or contain significant penalties for early cancellation, although clients typically have the right to terminate their contracts for cause if we fail to perform material obligations. However, if non-standard acceptance periods or non-standard performance criteria, cancellation or right of refund terms are required, revenue is recognized upon the satisfaction of such criteria, as applicable. Revenues from resellers are recognized gross of royalty payments to resellers.

Revenue Recognition Multiple-Deliverable Revenue Arrangements

We recognize revenue in accordance with Accounting Standards Update No. 2009-13, Revenue Recognition (Topic 605), Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force (ASU 2009-13). ASU 2009-13 amends the accounting standards for revenue recognition for multiple deliverable revenue arrangements to:

- Provide updated guidance on how deliverables of an arrangement are separated, and how consideration is allocated;
- Eliminate the residual method and require entities to allocate revenue using the relative selling price method; and;
- Require entities to allocate revenue to an arrangement using the estimated selling price (ESP) of deliverables if it does not have vendor specific objective evidence (VSOE) or third party evidence (TPE) of selling price.

Terms used in evaluation are as follows:

- VSOE the price at which an element is sold as a separate stand-alone transaction.
- TPE the price of an element, charged by another company that is largely interchangeable in any particular transaction.
- ESP our best estimate of the selling price of an element of the transaction.

We follow accounting guidance for revenue recognition of multiple-element arrangements to determine whether such arrangements contain more than one unit of accounting. Multiple-element arrangements require the delivery or performance of multiple solutions, services and/or rights to use assets. To qualify as a separate unit of accounting, the delivered item must have value to the client on a stand-alone basis. Stand-alone value to a client is defined in the guidance as those that can be sold separately by any vendor or the client could resell the item on a stand-alone basis. Additionally, if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item or items must be considered probable and substantially in the control of the vendor.

We have developed a pricing methodology for all elements of the arrangement and proper review of pricing to ensure adherence to our policies. Pricing decisions include cross-functional teams of senior management, which uses market conditions, expected contribution margin, size of the client s organization, and pricing history for similar solutions when establishing the selling price.

Software as a Service

We use ESP to determine the value of SaaS arrangements because we cannot establish VSOE, and TPE is not a practical alternative due to differences in functionality from our competitors. Similar to proprietary license sales, pricing decisions rely on the relative size of the client purchasing the solution, and include calculating the equivalent value of maintenance and support on a present value basis over the term of the initial agreement period. Typically revenue recognition commences once the client goes live on the system, and is recognized ratably over the contract term. The software portion of SaaS for our HIM (Health Information Management) products do not require material modification to achieve their contracted function. The software portion of SaaS for our PFS (Patient Financial Services) products require material customization and setup processes to achieve their contracted function.

System Sales

We use the residual method to determine fair value for a proprietary software license sold in a multi-element arrangement because we can establish fair value for all of the undelivered elements. Typically pricing decisions for proprietary software rely on the relative size and complexity of the client purchasing the solution. Third party components are resold at prices based on a cost plus margin analysis. The proprietary software and third party components do not need any significant modification to achieve their intended use. When these revenues meet all criteria for revenue recognition, and are determined to be separate units of accounting, revenue is recognized. Typically this is upon shipment of components or electronic download of software. Proprietary licenses are perpetual in nature, and license fees do not include rights to version upgrades, fixes or service packs.

Term Licenses

We use ESP to determine the value of term license arrangements because we cannot establish VSOE, and TPE is not a practical alternative due to differences in functionality from our competitors. Similar to proprietary license sales, pricing decisions rely on the relative size of the client purchasing the solution. Typically revenue recognition commences once the client goes live on the system, and is recognized ratably over the contract term. The software portion of our CAC (Computer Aided Coding) products generally do not require material modification to achieve their contracted function.

Table of Contents

Maintenance and Support Services

The maintenance and support components are not essential to the functionality of the software and clients renew maintenance contracts separately from software purchases at renewal rates materially similar to the initial rate charged for maintenance on the initial purchase of software. We use VSOE of fair value to determine fair value of maintenance and support services. Rates are set based on market rates for these types of services, and these rates are comparable to rates charged by our competitors, which are based on the knowledge of the marketplace by senior management. Generally, maintenance and support is calculated as a percentage of the list price of the proprietary license being purchased by a client. Clients have the option of purchasing additional annual maintenance service renewals each year for which rates are not materially different from the initial rate, but typically include a nominal rate increase based on the consumer price index. Annual maintenance and support agreements entitle clients to technology support, upgrades, bug fixes and service packs.

Professional Services

Professional services components that are not essential to the functionality of the software, from time to time, are sold separately by us. Similar services are sold by other vendors, and clients can elect to perform similar services in-house. When professional services revenues are a separate unit of accounting, revenues are recognized as the services are performed.

Professional services components that are essential to the functionality of the software, and are not considered a separate unit of accounting, are recognized in revenue ratably over the life of the client, which we approximate as the duration of the initial contract term. We defer the associated direct costs for salaries and benefits expense for PFS contracts. As of October 31, 2012 we have deferred approximately $239,000. These deferred costs will be amortized over the identical term as the associated SaaS revenues.

We use VSOE of fair value based on the hourly rate charged when services are sold separately, to determine fair value of professional services. We typically sell professional services on a fixed fee basis. We monitor projects to assure that the expected and historical rate earned remains within a reasonable range to the established selling price.

Table of Contents

NOTE C ACQUISITIONS

On August 16, 2012, we acquired substantially all of the outstanding stock of Meta Health Technology, Inc., a New York corporation (Meta). We paid a total purchase price of approximately $15,000,000, consisting of cash payment of $13,400,000 and the issuance of 393,086 shares of our common stock at a price of $4.07 per share. The fair value of the common stock at the date of issuance was $3.82. For the three and nine month periods ending October 31, 2012, we recorded $406,000 and $957,000, respectively, of acquisition costs related to the Meta transaction, which were recorded in selling, general and administrative expense. These costs were primarily related to services provided by legal, financial, and accounting professional advisors. At October 31, 2012 we have acquired 100% of Meta s outstanding shares.

The acquisition of Meta represents our on-going growth strategy, and is reflective of our solutions development process, which is led by the needs and requirements of our clients and the marketplace in general. The Meta suite of solutions, when bundled with our existing solutions, will help current and prospective clients better prepare for compliance with the ICD-10 transition. As we move forward, we believe that the integration of our business analytics solutions with the coding solutions acquired in this transaction will position us to address the complicated issues of clinical analytics as our clients prepare for the proposed changes in commercial and governmental payment models.

The purchase price is subject to certain adjustments related principally to the delivered working capital level and/or indemnification provisions. Under the acquisition method of accounting, the purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date as follows:

		Balance at August 16, 2012
Assets purchased:		
Cash	$	1,126,000
Accounts receivable		2,300,000
Fixed assets		133,000
Other assets		513,000
Client relationships		4,464,000
Internally developed software		3,646,000
Trade name		1,588,000
Supplier agreements		1,582,000
Covenants not to compete		720,000
Goodwill(1)		7,978,000
Total assets purchased	$	24,050,000
Liabilities assumed:		
Accounts payable and Accrued liabilities		1,164,000
Deferred revenue obligation, net		3,494,000
Deferred tax liability		4,602,000
Net assets acquired	$	14,790,000
Consideration:		
Company common stock		1,502,000
Cash paid		13,288,000
Total Consideration	$	14,790,000

(1) Goodwill represents the excess of purchase price over the estimated fair value of net tangible and intangible assets acquired , which is not deductible for tax purposes.

The acquired operations of Meta are consolidated with the results of the Company from August 16, 2012. Due to the new deferred tax liabilities recorded as a result of the above purchase price allocation, we were able to reduce our valuation allowance by approximately $3,600,000 representing the significant deferred tax benefit recorded in the three and nine months ended October 31, 2012.

Pro Forma Results

The operating results of Meta for the period August 16, 2012 through October 31, 2012, which include sales of $1,259,000 and net income of approximately $177,000, have been included in our consolidated financial statements.

The following unaudited pro forma information assumes the Meta acquisition occurred as of the beginning of the earliest period presented. The unaudited pro forma financial information for all periods presented also includes the business combination accounting effects resulting from the acquisition including, historical interest expense, adjustments to interest expense for certain provisions in the asset purchase agreement, adjustments for transaction-related expenses, adjustments for salary and benefits for certain employees, and amortization charges from acquired intangible assets were combined at the beginning of the earliest period presented. The unaudited pro forma supplemental results have been prepared based on estimates and assumptions, which the Company believes are reasonable and are not necessarily indicative of the consolidated financial position or results of operations had the acquisition occurred at the beginning of the earliest period presented, nor of future results of operations. For purposes of the pro forma presentation, the financial results of Interpoint for the three and nine months ended September 30, 2011 have been combined with the results of the Company for the three and nine months ended October 31, 2011. The Meta results for the three and nine months ended October 31, 2011 and 2012 are based on the three and nine months ended

Table of Contents

September 30, 2011 and 2012. Subsequent to the acquisition, the Meta results will be recorded based on the Company s fiscal year-end. The unaudited pro forma results are as follows (in thousands):

	Three Months Ended October 31,	
	2012	2011
Revenue	$ 7,129	$ 6,817
Net income (loss)	1,231	(1,393)
Net income (loss) attributable to common shareholders	1,197	(1,572)
Income (loss) per share:		
Basic	$ 0.10	$ (0.22)
Diluted	$ 0.08	$ (0.22)

	Nine Months Ended October 31,	
	2012	2011
Revenue	22,733	19,196
Net income (loss)	1,249	(6,762)
Net income (loss) attributable to common shareholders	798	(7,302)
Income (loss) per share:		
Basic	$ 0.07	$ (0.73)
Diluted	$ 0.06	$ (0.73)

NOTE D EQUITY AWARDS AND PRIVATE PLACEMENT INVESTMENT

On August 16, 2012, we completed a $12,000,000 private placement investment (private placement investment) with affiliated funds and accounts of Great Point Partners, LLC, and Noro-Moseley Partners VI, L.P., and another investor. The investment consisted of the following instruments: issuance of 2,416,785 shares of a new Series A 0% Redeemable Convertible Preferred Stock (Series A Preferred Stock) at $3.00 per share, common stock warrants (warrants) exercisable for up to 1,200,000 shares of our common stock at an exercise price of $3.99 per share, and convertible subordinated notes payable in the aggregate principal amount of $5,699,577, which upon shareholder approval, convert into 1,583,220 shares of Series A Preferred Stock. The proceeds were allocated among the instruments as follows.

	Balance at August 16, 2012	
Instruments:		
Series A Preferred Stock	$	6,546,146
Convertible subordinated notes payable		3,765,738
Warrants		1,688,116
Total investment	$	12,000,000

We incurred legal, placement and other advisor fees of approximately $1,894,000, including $754,000 in costs for warrants issued to placement agents. The total transaction costs were allocated among the instruments of the private placement investment based on their relative fair values as follows: approximately $611,000 to subordinated convertible notes as deferred financing costs, approximately $1,020,000 to Series A Preferred Stock as discount on Series A Preferred Stock and approximately $263,000 to warrants as a charge to additional paid in capital.

Series A Convertible Preferred Stock

In connection with the private placement investment, we issued 2,416,785 shares of Series A Preferred Stock at $3.00 per share. Each share of the Series A Preferred Stock is convertible into one share of our common stock. The price per share of Series A Preferred Stock and the conversion price for the common stock was less than the market value of the common stock (as defined in the rules of the Nasdaq Stock Market) on the date of execution of the definitive agreements. The Series A Preferred Stock does not pay a dividend, however the holders are entitled to receive dividends on shares of Preferred Stock equal (on an as-if-converted-to-common-stock basis) to and in the same form as dividends (other than dividends in the form of common stock) actually paid on shares of the common stock. The Series A Preferred Stock have voting rights on a modified as-if-converted-to-common-stock-basis. The Series A Preferred Stock has a non-participating liquidation right equal to the original issue price plus accrued unpaid dividends, which are senior to the Company s common stock. The Series A Preferred Stock can be converted to common shares at any time by the holders, or at the option of the Company if the arithmetic average of the daily volume weighted average price of the common stock for the ten day period prior to the measurement date is greater than $8.00 per share, and the average daily trading volume for the sixty day period immediately prior to the measurement date exceeds 100,000 shares.

The allocation of the proceeds and transaction costs based on relative fair values of the instruments resulted in recognition of a discount on the Series A Preferred Stock of approximately $4,410,000, including discount from beneficial conversion feature of approximately $2,686,000, which will be amortized from the date of issuance to the earliest redemption date. For the three and nine months period ended October 31, 2012, we recognized approximately $139,000 of amortization of the discount on Series A Preferred Stock as deemed dividends charged to additional paid in capital. The value of the beneficial conversion feature is calculated as the difference between the effective conversion price of the Series A Preferred Stock and the fair market value of the common stock into which the Series A Preferred Stock are convertible at the commitment date.

At any time following August 31, 2016, each share of Series A Preferred Stock is redeemable at the option of the holder for an amount equal to the initial issuance price of $3.00 (adjusted to reflect stock splits, stock dividends or like events) plus any accrued and unpaid dividends thereon. The Series A Preferred Stock are classified as temporary equity as the securities are redeemable solely at the option of the holder.

Common Stock Warrants

In conjunction with the private placement investment, we issued common stock warrants exercisable for up to 1,200,000 of our common stock at an exercise price of $3.99 per share. The warrants can be exercised in whole or in part during the period beginning on February 17, 2013 until 5 years from such initial exercise date. The warrants also include a cashless exercise option which allows the holder to receive a number of shares of common stock based on an agreed upon formula in exchange for the warrant rather than paying cash to exercise.

The proceeds, net of transaction costs, allocated to the warrants of approximately $1,425,000 were classified as equity on August 16, 2012, the date of issuance. Effective October 31, 2012, upon shareholder approval of antidilution provisions that reset the warrants exercise price if a dilutive issuance occurs, the warrants were reclassified as derivative liabilities. The provisions require the exercise price to reset to the lower price at which the dilutive issuance is consummated, if the dilutive issuance occurs prior to the second anniversary of the warrants issuance. If a dilutive issuance occurs after the second anniversary of the warrants issuance, then the exercise price will be reset in accordance with a weighted average formula that provides for a partial reset, based on the number of shares raised in the dilutive issuance relative to the number of common stock equivalents outstanding at the time of the dilutive issuance. The change in fair value of the warrants was accounted for as an adjustment to stockholders equity for the period between the date of the contract s last classification as equity to the date of reclassification to liability. The fair value of the warrants was approximately $4,139,000 at October 31, 2012.

On October 19, 2012 we also issued 200,000 warrants to our placement agents as a portion of the fees for services rendered in the private placement investment. The warrants have an initial exercise date of May 1, 2013 and are exercisable for a five year term thereafter at a stated exercise price of $4.06 per share and could be exercised in whole or in part at any time. The warrants also included a cashless exercise option which allowed the holder to receive a number of shares of common stock based on an agreed upon formula in exchange for the warrants rather than paying cash to exercise. The warrants have no reset provisions. The warrants had a grant date fair value of $754,000, and are classified as equity on the balance sheet.

Convertible Subordinated Notes

Please see Note G - Debt

Table of Contents

Equity Awards

During the nine months ended October 31, 2012, we granted 762,500 options with a weighted average exercise price of $3.08 per share. During the same period, 258,271 options expired with an average exercise price of $1.87 per share and 43,999 options were exercised under all plans.

During the nine months ended October 31, 2011, we granted 1,104,000 options with a weighted average exercise price of $1.90 per share. During the same period 127,916 options expired with an average exercise price of $1.88 per share and 32,598 options were exercised under all plans.

The fair value of each option grant during the nine months ended October 31, 2012 and October 31, 2011 was estimated at the date of the grants using a Black-Scholes option pricing model with the following weighted average assumptions:

At the October 31, 2012 special meeting of shareholders, 500,000 additional shares were approved for the 2005 Incentive Compensation Plan.

	For the nine months ended, October 31, 2012	For the nine months ended, October 31, 2011
Risk-free interest rate	0.33%	1.26%
Dividend yield		
Current weighted-average volatility factor of the expected market price of Common Stock	0.58	0.53
Weighted-average expected life of stock options	5 years	5 years
Forfeiture rate	0%	0%

During the nine months ended October 31, 2012, we granted 137,325 restricted shares of common stock with a weighted average fair value of $2.01. These shares are subject to the 2005 Incentive Compensation Plan as amended, and are granted to certain independent members of the Board of Directors and employees. The shares have an approximate one-year restriction period.

During the nine months ended October 31, 2011, we granted 110,412 restricted stock shares with a weighted average fair value of $1.68 per share, and 223,090 restricted stock shares with a weighted average fair value of $1.92 had their restriction period lapse. These shares were subject to the 2005 Incentive Compensation Plan as amended, and are granted to certain independent members of the Board of Directors and employees. The shares had an approximate one-year restriction period.

During the nine months ended October 31, 2011, the Company granted 25,000 restricted stock shares as executive inducement grants with a weighted average fair value of $1.91 per share. The restrictions lapsed immediately upon the grant of the shares, and the Company recognized $48,000 of compensation expense for the nine months ended October 31, 2011 relating to these inducement grants. These executive inducement grants were approved by the board pursuant to Nasdaq Marketplace Rule 5635(c)(4). The terms of the grants are nearly as practicable identical to the terms and conditions of the Company s 2005 Incentive Compensation Plan.

Table of Contents

NOTE E EARNINGS PER SHARE

Diluted net earnings (loss) per share of common stock reflects the potential dilution that could occur from restricted shares and if stock options, stock purchase plan commitments, and warrants were exercised (under the treasury stock method) and the Series A Preferred Stock were converted (on an as-if-converted basis) into shares of our common stock, under certain circumstances, that then would share in our earnings. A reconciliation of basic and diluted weighted average shares for basic and diluted EPS, as well as anti-dilutive securities is as follows:

	Three Months Ended,	
	October 31, 2012	October 31, 2011
Numerator for Basic and Diluted Earnings per Share:		
Net earnings	$ 2,399,637	$ 295,766
Less: deemed dividends on Series A Preferred Stock	(139,133)	
Net earnings attributable to common Shareholders	2,260,504	295,766
Denominator for basic earnings per share weighted average shares	12,393,352	9,943,567
Effect of dilutive securities		
Stock options	674,352	15,380
Restricted shares	36,962	
Series A Preferred Stock	1,996,475	
Warrants	264,097	
Denominator for basic earnings per share, with assumed conversions	15,365,238	9,958,947
Basic net earnings per common share	$ 0.18	$ 0.03
Diluted net earnings per common share	$ 0.15	$ 0.03
Anti-dilutive securities:		
Stock options, out-of-the-money	71,500	1,739,551
Warrants, out-of-the-money		

	Nine Months Ended,	
	October 31, 2012	October 31, 2011
Numerator for Basic and Diluted Earnings per Share:		
Net earnings	$ 2,427,995	$ 8,051
Less: deemed dividends on Series A Preferred Stock	(139,133)	
Net earnings attributable to common Shareholders	2,288,862	8,051
Denominator for basic earnings per share weighted average shares	11,346,428	9,823,937
Effect of dilutive securities		
Stock options	357,554	13,813
Restricted stock	42,925	
Series A Preferred Stock	670,349	
Warrants		
Denominator for basic earnings per share, with assumed conversions	12,417,256	9,837,750
Basic net earnings per common share	$ 0.20	$ 0.00

Diluted net earnings per common share	$ 0.18	$ 0.00
Anti-dilutive securities:		
Stock options, out-of-the-money	486,000	1,432,967
Warrants, out-of-the-money	1,400,000	

Table of Contents

NOTE F CONTRACTUAL OBLIGATIONS

The following table details the remaining obligations, by fiscal year, as of the end of the quarter (in thousands):

	2012	2013	2014	2015	2016	Thereafter	Totals
Operating leases	$ 310	874	723	322	162	251	2,642
Senior term loan	313	1,250	3,437				5,000
Subordinated term loan			9,000				9,000
Convertible subordinated notes payable (1)							
Total	$ 623	2,124	13,160	322	162	251	16,642

(1) The convertible subordinated notes payable were converted on November 1, 2012. See Note I for further details.

On April 10, 2012, we entered into an amended lease obligation to lease 8,582 square feet of office space in our current building at 1230 Peachtree NE in Atlanta, GA. The lease commences upon taking possession of the space and ends 72 months thereafter. We took possession of the space on August 1, 2012. Upon relocation, we completely vacated the previously leased premises within the building. The provisions of the lease provide for rent abatement for the first four months of the lease term, and a moving allowance of approximately $17,000. Upon taking possession of the premises, the rent abatement and allowance has been aggregated with the total expected rental expense, and amortized on a straight line basis over the term of the lease.

As part of the Meta acquisition, we assumed a lease obligation for office space at 330 Seventh Avenue in New York, NY. The balance of the lease term runs through August of 2014.

NOTE G DEBT

Term Loan and Line of Credit

	Loan Balance at October 31, 2012	**Accrued interest at October 31, 2012**
Senior term loan	5,000,000	60,000
Subordinated term loan (1)	9,000,000	211,000
Line of credit		2,000

(1) Accrued interest includes accruals for success fees of $160,000.

In conjunction with the Meta acquisition, on August 16, 2012, we amended our current term loan and line of credit agreements with Fifth Third Bank, whereby Fifth Third Bank provided us with a $5,000,000 revolving line of credit, a $5,000,000 senior term loan and a $9,000,000 subordinated term loan, a portion of which was used to refinance the previously outstanding $4,120,000 subordinated term loan. These new term loans and revolving line of credit mature on August 16, 2014. Additionally, as part of the refinancing in August 2012, we mutually agreed to settle the success fee included in the previous subordinated term loan for $700,000. We paid a commitment fee in connection with the senior term loan of $75,000, which is included in deferred financing costs. We will be required to pay a success fee in accordance with the subordinated term loan, which is recorded in interest expense. The loans are secured by substantially all of our assets. Borrowings under the senior term loan bear interest at a rate of LIBOR (0.21% at October 31, 2012) plus 5.50%, and borrowings under the subordinated term loan bear interest at 10% from August 16, 2012 and thereafter. Borrowings under the revolving loan bear interest at a rate equal to LIBOR plus 3.00%. A commitment fee of 0.40% will be incurred on the unused revolving line of credit balance, and is payable quarterly. There are currently no draws on the line of credit, with $2,000 in accrued commitment fees. The proceeds of these loans were used to finance the cash portion of the acquisition purchase price and to cover any additional operating costs as a result of the Meta acquisition.

The significant covenants as set forth in the term loans and line of credit are as follows: (i) maintain adjusted EBITDA as of the end of any fiscal quarter greater than $5,000,000, (after consideration of certain acquisition and transaction costs) on a trailing four fiscal quarter basis beginning October 31, 2012; (ii) maintain a fixed charge coverage ratio for the fiscal quarter ending January 31, 2012 and each April 30, July 31, October 31, and January 31 of not less than 1.50:1 calculated quarterly for the period from October 31, 2011 to the date of measurement for the quarters ending January 31, 2012, April 30, 2012 and July 31, 2012 and on a trailing four quarter basis thereafter; (iii) on a consolidated basis, maintain ratio of funded debt to adjusted EBITDA as of the end of any fiscal quarter less than 3:1, calculated quarterly on a trailing four fiscal quarter basis beginning October 31, 2012. We were in compliance with all loan covenants at October 31, 2012.

Convertible Notes

On December 7, 2011, as part of the purchase of the assets of Interpoint, we issued a convertible promissory note (the Convertible Note) for $3,000,000. The note accrued interest at a per annum rate of 8% from the date of the note until the earlier of conversion or payment in full of all outstanding principal and accrued interest. Interest is payable quarterly in arrears on the first day of March, June, September, and December.

On June 15, 2012, Interpoint elected to convert the balance of principal and interest on the note outstanding, net of working capital adjustments and related accrued interest owed to us, for 1,529,729 shares of common stock at $2.00 per share. Net loss from conversion was approximately $57,000 for the three and nine months ended October 31, 2012.

In conjunction with the private placement, we issued convertible subordinated notes in the aggregate principal amount of $5,699,577, which upon shareholder approval, convert into 1,583,220 shares of Series A Preferred Stock. The allocation of the proceeds to the subordinated convertible notes resulted in a debt discount of approximately $1,934,000, which will be amortized over the period from issue date to maturity date. For the three and nine months ended October 31, 2012, we recorded approximately $112,000 of debt discount amortization. In addition, the notes accrue interest at a per annum rate of 12% from issue date until the earlier of conversion or payment in full of all outstanding principal and accrued interest. Half of the interest accrued is payable monthly, with the remaining in arrears and payable upon conversion of the note. The carrying amount of the convertible subordinated notes payable was approximately $3,877,000, net of approximately $1,822,000 unamortized discount, at October 31, 2012. On November 1, 2012, upon shareholder approval, the convertible subordinated notes were converted into shares of Series A Preferred Stock (see Note I).

Contingent Earn-Out Provision

As part of the asset purchase, Interpoint is entitled to receive additional consideration contingent upon certain financial performance measurements during a one year earn-out period commencing June 30, 2012 and ending on June 30, 2013. The earn-out consideration is calculated as twice the recurring revenue for the earn-out period recognized by the acquired Interpoint operations from specific contracts defined in the asset purchase agreement, plus one times Interpoint revenue derived from our customers, less $3,500,000. The earn-out consideration, if any, will be paid no later than July 31, 2013 in cash or through the issuance of a note with terms identical to the terms of the Convertible Note, except with respect to issue date, conversion date and prepayment date. The earn-out note restricts conversion or prepayment at any time prior to the one year anniversary of the issue date.

Interpoint is entitled to additional earn-out consideration of fifty percent of any license sales of the developed software acquired, to specific clients as defined in the asset purchase agreement, for any sales prior to December 31, 2012.

At October 31, 2012, we estimate the payment obligation in connection with the earn-out will be $1,320,000, an increase of approximately $87,000, which was recorded as additional expense in the third quarter of fiscal 2012.

NOTE H COMMITMENTS AND CONTINGENCIES

We have entered into employment agreements with our officers and certain employees that generally provide annual salary, a minimum bonus, discretionary bonus, and stock incentive provisions.

NOTE I SUBSEQUENT EVENTS

We evaluated all events or transactions that occurred after October 31, 2012 through the date we issued these financial statements.

On November 1, 2012, the convertible subordinated notes previously issued by us on August 16, 2012 were converted into shares of our Series A 0% Convertible Preferred Stock. The convertible subordinated notes had an aggregate principal amount of $5,699,577 and converted into an aggregate of 1,583,210 shares of Preferred Stock. The issuance of the convertible subordinated notes was previously disclosed in the Current Report on Form 8-K filed on August 21, 2012. We incurred a loss upon conversion of $5,898,000 on November 1, 2012.

Table of Contents

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

In addition to historical information contained herein, this quarterly report on Form 10-Q contains forward-looking statements relating to plans, strategies, expectations, intentions, etc. of Streamline Health Solutions, Inc. (we , us , or our) and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements contained herein are no guarantee of future performance and are subject to certain risks and uncertainties that are difficult to predict and actual results could differ materially from those reflected in the forward-looking statements. These risks and uncertainties include, but are not limited to, the impact of competitive products and pricing, product demand and market acceptance, new product development, key strategic alliances with vendors that resell our products, our ability to control costs, availability of products produced from third party vendors, the healthcare regulatory environment, potential changes in legislation, regulation and government funding affecting the healthcare industry, healthcare information system budgets, availability of healthcare information systems trained personnel for implementation of new systems, as well as maintenance of legacy systems, fluctuations in operating results, effects of critical accounting policies and judgments, changes in accounting policies or procedures as may be required by the Financial Accountings Standards Board or other similar entities, changes in economic, business and market conditions impacting the healthcare industry generally and the markets in which we operate, and our ability to maintain compliance with the terms of our credit facilities, and other risk factors that might cause such differences including those discussed herein, including, but not limited to, discussions in the sections entitled Part I, Item 1 Financial Statements and Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis only as of the date thereof. We undertake no obligation to publicly revise these forward-looking statements, to reflect events or circumstances that arise after the date hereof. Readers should carefully review the risk factors described in this and other documents we file from time to time with the Securities and Exchange Commission, including the annual report on Form 10-K, quarterly reports on Form 10-Q and any current reports on Form 8-K.

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to product revenues, bad debts, capitalized software development costs, income taxes, support contracts, contingencies, and litigation. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities, and revenue and expense recognition. Actual results may differ from these estimates under different assumptions or conditions.

Operating Results

We recognized revenues in the three and nine month periods ending October 31, 2012 of $6,534,000 and $17,029,000, compared to $4,312,000 and $12,598,000 for the comparable prior year periods; an increase of $2,222,000 and $4,431,000 or 52% and 35%, respectively. Revenues are derived primarily from recurring revenues recognized from software as a service (referred to herein as SaaS) and maintenance contracts. We incurred a quarterly operating loss of $302,000, and a year-to-date operating profit of $346,000, for the periods ended October 31, 2012. In the prior year comparable periods we earned operating profits of $364,000 and $130,000, respectively. Operating expenses for the three and nine month periods ending October 31, 2012 were $6,836,000 and $16,682,000, compared to $3,949,000 and $12,468,000 in the comparable prior year periods; an increase of $2,887,000 and $4,214,000, or 73% and 34%, respectively, over the prior year comparable periods.

Our revenues from proprietary systems sales have varied, and may continue to vary, significantly from quarter-to-quarter because of the volume and timing of systems sales and delivery. Professional services revenues also fluctuate from quarter-to-quarter because of the timing of the implementation services, project management, and timing of the recognition of revenues under generally accepted accounting principles. Conversely, revenues from SaaS, and maintenance services do not fluctuate significantly from quarter-to-quarter, but have been increasing, on an annual basis, as the number of customers increase or customers expand their solutions. Substantial portions of the operating expenses are fixed; therefore operating profits are expected to vary depending primarily on the mix of proprietary system revenue versus SaaS revenue.

Statement of Operations[1]

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2012	2011	2012	2011
Systems sales	4%	5%	4%	4%
Professional services	17	19	19	21
Maintenance and support	48	52	46	52
Software as a service	31	22	31	22
Total revenues	100	100	100	100
Cost of sales	47	50	47	53
Selling, general and administrative	45	35	40	38
Product research and development	13	7	11	8
Total operating expenses	105	92	98	99
Operating profit (loss)	(5)	8	2	1
Other income (expense), net	(13)	(1)	(8)	(1)
Income tax benefit	54		21	
Net earnings	37%	7%	14%	(0)%
Cost of systems sales	247%	251%	269%	332%
Cost of professional services	78%	63%	61%	71%
Cost of maintenance and support	29%	22%	30%	25%
Cost of software as a service	27%	50%	35%	48%

(1) Because a significant percentage of the operating costs are incurred at levels that are not necessarily correlated with revenue levels, a variation in the timing of systems sales and installations and the resulting revenue recognition can cause significant variations in operating results. As a result, period-to-period comparisons may not be meaningful with respect to the past operations nor are they necessarily indicative of our future operations in the near or long-term. The data in the table is presented solely for the purpose of reflecting the relationship of various operating elements to revenues for the periods indicated.

Table of Contents

Revenues

Revenues consisted of the following (in thousands):

	Three Months Ended,			
	October 31, 2012	October 31, 2011	Change	% Change
Proprietary software [1]	$ 27	$ 24	$ 3	12%
Term licenses	144		144	%
Hardware & third party software [1]	119	209	(90)	(43)%
Professional services [2]	1,090	833	257	31%
Maintenance & support [3]	3,148	2,280	868	38%
Software as a service [4]	2,006	966	1,040	107%
Net revenues	$ 6,534	$ 4,312	$ 2,222	51%

	Nine Months Ended,			
	October 31, 2012	October 31, 2011	Change	% Change
Proprietary software [1]	$ 162	$ 76	$ 86	113%
Term licenses	144		144	%
Hardware & third party software [1]	414	450	(36)	(8)%
Professional services [2]	3,154	2,709	445	16%
Maintenance & support [3]	7,797	6,559	1,238	19%
Software as a service [4]	5,358	2,804	2,554	91%
Net revenues	$ 17,029	$ 12,598	$ 4,431	35%

(1) Proprietary software, hardware, and term licenses are the components of the system sales line item. Term licenses are comprised of Meta software only.

(2) Includes $74,000 and $138,000 of revenue earned from the acquired Interpoint operations for the three and nine month periods ended October 31, 2012, respectively. Includes $191,000 of revenue earned from the acquired Meta operations for the period from August 17, 2012 to October 31, 2012.

(3) Includes maintenance revenue for Meta perpetual licenses and third party software maintenance of $924,000 for the period from August 17, 2012 to October 31, 2012.

(4) Includes $821,000 and $1,941,000 of revenue earned from the acquired Interpoint operations for the three and nine month periods ended October 31, 2012, respectively.

Revenues for the three and nine month periods ended October 31, 2012 were $6,534,000 and $17,029,000 respectively; as compared to $4,312,000 and $12,598,000 respectively in the comparable periods of fiscal 2011. The quarterly and year to date increase was primarily attributable to revenues provided by the acquired Interpoint and Meta operations. Acquired Interpoint operations contributed $895,000 and $2,079,000 in incremental revenue for the three and nine month periods ended October 31, 2012. The acquired Meta operations contributed $1,259,000 for the period August 17, 2012 to October 31, 2012. Additional increases in recurring revenues from SaaS and maintenance contracts are primarily due to annual increases, new clients which have added incremental revenue, or expansion of services to current clients.

Backlog

	October 31, 2012	January 31, 2012	October 31, 2011
Streamline Health proprietary software [1]	$ 3,650,000	$ 181,000	$ 67,000
Hardware and third party software	84,000	194,000	190,000

Professional services	4,348,000	5,945,000	4,946,000
Maintenance and support (2)	21,535,000	10,504,000	5,374,000
Software as a service	19,117,000	10,542,000	6,237,000
Total	$ 48,734,000	$ 27,366,000	$ 16,814,000

(1) Includes $3,546,000 from Meta operations
(2) Includes $9,460,000 from Meta operations

Table of Contents

At October 31, 2012, we had master agreements and purchase orders from clients and remarketing partners for systems and related services which have not been delivered or installed which, if fully performed, would generate future revenues of approximately $48,734,000 compared with $16,814,000 at October 31, 2011.

Our proprietary software backlog consists of signed agreements to purchase software licenses. Typically, this is software that is not yet generally available, or the software is generally available and the client has not taken possession of the software. We added $3,546,000 in incremental backlog from Meta term licenses.

Third party hardware and software consists of signed agreements to purchase third party hardware or third party software licenses that have not been delivered to the client. These are products that we resell as components of solutions clients purchase. The decrease in backlog is primarily due to clients which have made fewer purchases for future systems implementations. These items are expected to be delivered in the next twelve months as implementations commence.

Professional services backlog consists of signed contracts for services that have yet to be performed, or revenues that are deferred. Typically backlog is recognized within twelve months of the contract signing for services, unless those services are deemed essential to the functionality of software; whereby they are deferred and recognized over a period greater than one year. The increase in backlog from the prior year comparable quarter is due to incremental backlog provided by SaaS-PFS clients acquired in the Interpoint acquisition, incremental backlog from Meta backlog, and is partially offset by revenue recognized out of backlog.

Maintenance and support backlog consists of maintenance agreements for licenses of our proprietary software and third party hardware and software with clients and remarketing partners for which either an agreement has been signed, a purchase order has been received, or payment has been received. Included in maintenance and support backlog are the signed client agreements through their respective renewal dates. Typical maintenance contracts are for a one year term and are renewed annually. Clients typically prepay maintenance and support which is billed 30-60 days prior to the beginning of the maintenance period. We do not expect any significant client attrition over the next 12 months. Maintenance and support backlog at October 31, 2012 was $21,535,000 as compared to $5,374,000 at October 31, 2011. A significant portion of the increase in maintenance and support backlog is due to one client which signed an extended maintenance contract for five years, as well as $9,460,000 in incremental backlog from Meta operations. Other factors which increased backlog are add-on solutions sold in fiscal 2011 and the first three quarters of fiscal 2012. Additionally, contract renewals are typically subject to an annual increase in fees based on market rates and inflationary metrics.

At October 31, 2012, we have entered into SaaS agreements, which are expected to generate revenues of $19,117,000 through their respective renewal dates in fiscal years 2012 through 2018. Typical SaaS terms are one to five years in length. The increase in SaaS backlog from October 31, 2011 is primarily the impact of assumed backlog from the Interpoint acquisition, as well as new contracts signed late in fiscal 2011 through the third quarter of fiscal 2012.

Cost of Sales

Cost of sales consisted of the following (in thousands):

	Three Months Ended,			
	October 31, 2012	**October 31, 2011**	**Change**	**% Change**
Cost of system sales	$ 718	$ 583	$ 135	23%
Cost of professional services	855	572	283	49%
Cost of maintenance and support	918	514	404	79%
Cost of software as a service	551	480	71	15%
Total cost of sales	$ 3,042	$ 2,149	$ 893	41%

	Nine Months Ended,			
	October 31, 2012	**October 31, 2011**	**Change**	**% Change**
Cost of system sales	$ 1,937	$ 1,752	$ 185	10%
Cost of professional services	1,911	1,924	(13)	(1)%

Cost of maintenance and support	2,350	1,652	698	42%
Cost of software as a service	1,850	1,335	515	38%
Total cost of sales	$ 8,048	$ 6,663	$ 1,385	21%

Table of Contents

Cost of systems sales includes amortization of capitalized software expenditures, royalties, and the cost of third-party hardware and software. The quarterly increase in the cost of systems sales is primarily the result of an increase in third-party hardware and software sales. The year-to-date increase of $185,000 in the cost of systems sales is primarily attributable to the sunsetting of certain products, the general release and subsequent amortization of products during the third quarter, and partially offset by older assets becoming fully amortized.

The cost of professional services includes compensation and benefits for personnel, and related expenses. The quarterly increase in expense is primarily due to a significant increase in staffing, which took place in the second quarter of fiscal 2012. A portion of the increase is also attributable to the incremental increase of $331,000 and $502,000, respectively, in quarterly and year-to-date expense attributable to the inclusion of Interpoint and Meta implementation services.

The cost of maintenance and support includes compensation and benefits for client support personnel and the cost of third party maintenance contracts. The quarterly and year-to-date increase in expense is primarily due to increased support costs experienced in the quarter for certain products in general release.

The cost of software as a service is relatively fixed, but is generally subject to annual increases for the goods and services required. Additionally, amortization of internally developed software purchased in the acquisition of Interpoint and Meta of $218,000 and $394,000 was recorded for the three and nine months ended October 31, 2012 respectively. The quarterly and year-to-date increase, net of amortization expense, is primarily attributable to increased personnel and infrastructure costs relative to data center operations to support revenue growth, as well as the incremental costs for SaaS data center operations.

Selling, General and Administrative Expense

Selling, general and administrative expenses consisted of the following (in thousands):

	Three Months Ended,			
	October 31, 2012	October 31, 2011	Change	% Change
Selling, general, and administrative	$ 2,927	$ 1,495	$ 1,432	96%

	Nine Months Ended,			
	October 31, 2012	October 31, 2011	Change	% Change
Selling, general, and administrative	$ 6,801	$ 4,742	$ 2,059	43%

Selling, general and administrative expenses consist primarily of compensation and related benefits and reimbursable travel and living expenses related to our sales, marketing and administrative personnel; advertising and marketing expenses, including trade shows and similar type sales and marketing expenses; and general corporate expenses, including occupancy costs. The quarterly and year-to-date increase over the comparable prior year periods is due to costs incurred as part of the Meta acquisition and integration, as well as general increases in investor relations expenses, professional fees, travel and living expenses, trade show expense, and amortization of intangible assets acquired in the Meta & Interpoint transactions.

Product Research and Development Expense

Product research and development expenses consisted of the following (in thousands):

	Three Months Ended,			
	October 31, 2012	October 31, 2011	Change	% Change
Product research and development expense	$ 867	$ 304	$ 563	185%
Capitalized software development cost	601	579	22	3%
Total R&D cost	$ 1,468	$ 883	$ 585	66%

	Nine Months Ended,			
	October 31, 2012	October 31, 2011	Change	% Change
Product research and development expense	$ 1,834	$ 1,064	$ 770	72%
Capitalized software development cost	1,571	1,970	(399)	(20)%
Total R&D cost	$ 3,405	$ 3,034	$ 371	12%

Product research and development expenses consist primarily of compensation and related benefits; the use of independent contractors for specific near-term development projects; and an allocated portion of general overhead costs, including occupancy. Quarterly and year-to-date research and development expenses increased $563,000 and $770,000, respectively, from the prior year comparable periods. The quarterly and year-to-date increases in research and development expense is a result of increased development time spent on non-capitalizable products as well as incremental expense of $391,000 attributable to Meta research and development. Quarterly and year-to-date capitalized software development costs (not including purchased internally developed software from Meta And Interpoint) decreased as compared to the prior year primarily due to a decrease in costs eligible for capitalization. The total research and development expenditures on a quarterly and year-to-date basis have increased by $585,000 and $371,000, respectively, when considering both capitalized software development costs and non-capitalizable research and development expense; this is primarily due to increases in post general release software hotfixes and reductions in staffing, as well as the addition of Meta research & development.

Other Income (Expense)

Quarterly and year-to-date interest expense for the period ending October 31, 2012 was $895,000 and $1,494,000, respectively, compared to $26,000 and $68,000 in the prior year comparable periods. Interest expense consists of interest and commitment fees on the line of credit, interest and success fees on the term loans entered into in conjunction with the Interpoint and Meta acquisitions, interest on the convertible notes entered into in conjunction with the Interpoint and Meta acquisitions, loss on the Interpoint note conversion, and amortization of deferred financing costs and discounts on convertible notes payable related to these transactions. The increase over prior comparable three and nine month periods is primarily due to the term loans and convertible note interest as well as accruals for success fees associated with the term loan. Interest expense also includes the impact of the amortization of deferred financing costs of $79,000 and $118,000, and $112,000 of amortization of debt discounts, for the three and nine month periods ended October 31, 2012, as compared to zero for the prior comparable periods. Other income and expense consists of foreign currency exchange gains and advertising sponsorships.

Income Taxes Benefit (Expense)

The quarterly and year-to-date tax provision in fiscal 2012 and 2011 is comprised of state and local provisions. As a result of the deferred tax liabilities recorded in conjunction with the Meta acquisition, we were able to reduce our valuation allowance by approximately $3,600,000 representing the significant deferred tax benefit recorded in the three and nine months ended October 31, 2012.

Use of Non-GAAP Financial Measures

In order to provide investors with greater insight, and allow for a more comprehensive understanding of the information used by management and the board of directors in its financial and operational decision-making, we may supplement the Condensed Consolidated Financial Statements presented on a GAAP basis in this quarterly report on Form 10-Q with the following non-GAAP financial measures: EBITDA, Adjusted EBITDA, and Adjusted EBITDA Margin.

These non-GAAP financial measures have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of our results as reported under GAAP. We compensate for such limitations by relying primarily on our GAAP results and using non-GAAP financial measures only as supplemental data. We also provide a reconciliation of non-GAAP to GAAP measures used. Investors are encouraged to carefully review this reconciliation. In addition, because these non-GAAP measures are not measures of financial performance under GAAP and are susceptible to varying calculations, these measures, as defined by us, may differ from and may not be comparable to similarly titled measures used by other companies.

EBITDA, Adjusted EBITDA, Adjusted EBITDA Margin, and Adjusted EBITDA per diluted share

We define: (i) EBITDA, as net income (loss) before net interest expense, income tax expense (benefit), depreciation and amortization; (ii) Adjusted EBITDA, as net income (loss) before net interest expense, income tax expense (benefit), depreciation, amortization, non-recurring transaction expenses, and stock-based compensation expense; (iii) Adjusted EBITDA Margin, as Adjusted EBITDA as a percentage of net revenue; and (iv) Adjusted EBITDA per diluted share as Adjusted EBITDA divided by adjusted diluted shares outstanding. EBITDA, Adjusted EBITDA, Adjusted EBITDA Margin and Adjusted EBITDA per diluted share are used to facilitate a comparison of our operating performance on a consistent basis from period to period and provide for a more complete understanding of factors and trends affecting our business than GAAP measures alone. These measures assist management and the board and may be useful to investors in comparing our operating performance consistently over time as they remove the impact of our capital structure (primarily interest charges), asset base (primarily depreciation and amortization) and items outside the control of the management team (taxes). Adjusted EBITDA removes the impact of non-recurring transaction costs that are not expected to be recurring in the normal course of our business. Adjusted EBITDA removes the impact of share-based compensation expense, which is another non-cash item outside of management s control. Adjusted EBITDA per diluted share will include incremental shares in the share count that would be considered anti-dilutive in a GAAP net loss position.

The board of directors and management also use these measures as (i) one of the primary methods for planning and forecasting overall expectations and for evaluating, on at least a quarterly and annual basis, actual results against such expectations; and, (ii) as a performance evaluation metric in determining achievement of certain executive and associate incentive compensation programs.

Our lenders use a variation of Adjusted EBITDA to assess our operating performance. Our credit agreements with our lender require delivery of compliance reports certifying compliance with financial covenants certain of which are based on an adjusted EBITDA measurement that is similar to the Adjusted EBITDA measurement reviewed by our management and board of directors.

EBITDA, Adjusted EBITDA and Adjusted EBITDA Margin are not measures of liquidity under GAAP, or otherwise, and are not alternatives to cash flow from continuing operating activities; despite the advantages regarding the use and analysis of these measures

Table of Contents

as mentioned above. EBITDA, Adjusted EBITDA, Adjusted EBITDA Margin, and Adjusted EBITDA per diluted share as disclosed in this quarterly report on Form 10-Q, have limitations as analytical tools, and you should not consider these measures in isolation, or as a substitute for analysis of our results as reported under GAAP; nor are these measures intended to be measures of liquidity or free cash flow for our discretionary use. Some of the limitations of EBITDA, and its variations are:

- EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;

- EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

- EBITDA does not reflect the interest expense, or the cash requirements to service interest or principal payments under our credit agreement;

- EBITDA does not reflect income tax payments we are required to make; and

- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized often will have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements.

Adjusted EBITDA has all the inherent limitations of EBITDA. To properly and prudently evaluate our business, we encourage readers to review the GAAP financial statements included elsewhere in this quarterly report on Form 10-Q, and not rely on any single financial measure to evaluate our business. We also strongly urge readers to review the reconciliation of GAAP net earnings (loss) to Adjusted EBITDA, and GAAP earnings (loss) per diluted share to Adjusted EBITDA per diluted share in this section, along with the Condensed Consolidated Statement of Operations included elsewhere in this quarterly report on Form 10-Q.

The following table sets forth a reconciliation of EBITDA and Adjusted EBITDA to net income, a comparable GAAP-based measure, as well as earnings (loss) per diluted share to Adjusted EBITDA per diluted share. All of the items included in the reconciliation from net earnings (loss) to EBITDA to Adjusted EBITDA and the related per share calculations are either (i) recurring non-cash items or items that management does not consider in assessing our on-going operating performance. In the case of the non-cash items, management believes that investors may find it useful to assess our comparative operating performance because the measures without such items are less susceptible to variances in actual performance resulting from depreciation, amortization and other non-cash charges and more reflective of other factors that affect operating performance. In the case of the other non-recurring items, management believes that investors may find it useful to assess our operating performance if the measures are presented without these items because their financial impact does not reflect ongoing operating performance.

The following table reconciles net earnings (loss) to EBITDA, Adjusted EBITDA, Adjusted EBITDA Margin, and Adjusted EBITDA per diluted share for the three and nine months ended October 31, 2012 and 2011 (amounts in thousands, except per share data):

	Three Months Ended,		Nine Months Ended,	
	October 31, 2012	October 31, 2011	October 31, 2012	October 31, 2011
Adjusted EBITDA Reconciliation				
Net earnings	$ 2,400	$ 296	$ 2,428	$ 8
Interest expense	895	26	1,494	68
Income tax expense	(3,553)	5	(3,520)	12
Depreciation	184	163	548	553
Amortization of capitalized software development costs	708	454	1,930	1,455
Amortization of intangible assets	229		254	
EBITDA	863	944	3,134	2,096

Stock-based compensation expense		245		133		645		529
Transaction expenses		494				1,043		
Adjusted EBITDA	$	1,602	$	1,077	$	4,822	$	2,625
Adjusted EBITDA per diluted share								
Earnings per share - diluted	$	0.15	$	0.03	$	0.18	$	0.00
Adjusted EBITDA per diluted share	$	0.10	$	0.11	$	0.39	$	0.27
Diluted weighted average shares		15,365,238		9,958,947		12,417,256		9,837,750

Table of Contents

Liquidity and Capital Resources

Our liquidity is dependent upon numerous factors including: (i) the timing and amount of revenues and collection of contractual amounts from clients, (ii) amounts invested in research and development, capital expenditures, and (iii) the level of operating expenses, all of which can vary significantly from quarter-to-quarter. Our primary cash requirements include regular payment of payroll and other business expenses, interest payments on debt, and capital expenditures. Capital expenditures generally include computer hardware and computer software to support internal development efforts or infrastructure in the SaaS data center. Operations are funded by cash generated by operations and borrowings under credit facilities. We believe that the cash flows from operations and available credit facilities are adequate to fund our current obligations for the next twelve months. Cash balances at October 31, 2012 and January 31, 2012 were $10,529,000 and $2,243,000, respectively. Continued expansion may require us to take on additional debt, or raise capital through issuance of equities, or a combination of both. There can be no assurance that we will be able to raise the capital required to fund further expansion.

Operating Cash Flow Activities

(in thousands)	Nine months ended October 31, 2012	2011
Net income (loss)	$ 2,428	$ 8
Non-cash adjustments to income	184	2,604
Cash impact of changes in assets and liabilities	(143)	(1,986)
Operating cash flow	$ 2,469	$ 626

Net cash provided by operating activities for the nine months ended October 31, 2012 increased in the current year due to our increase in accounts receivable non-cash adjustments from increased depreciation and amortization expense of property and equipment, amortization of capitalized software development costs, intangibles amortization and debt discount amortization. This was partially offset by a decrease in profitability and an increase in deferred revenues which were recognized out of backlog.

Our clients typically have been well-established hospitals or medical facilities or major health information system companies that resell our solutions, which have good credit histories and payments have been received within normal time frames for the industry. However, some healthcare organizations have experienced significant operating losses as a result of limits on third-party reimbursements from insurance companies and governmental entities. Agreements with clients often involve significant amounts and contract terms typically require clients to make progress payments. Adverse economic events, as well as uncertainty in the credit markets, may adversely affect the availability of financing for some of our clients.

Investing Cash Flow Activities

(in thousands)	Nine months ended October 31, 2012	2011
Purchases of property and equipment	$ (546)	$ (245)
Capitalized software development costs	(1,571)	(1,970)
Payment for acquisition	(12,162)	
Investing cash flow	$ (14,279)	$ (2,215)

The use of investing cash flows is primarily attributable to the acquisition of Meta in August of 2012, as well as capitalization of software development costs. We estimate that replicating our existing software would cost significantly more than the stated net book value. Many of the programs related to capitalized software development continue to have significant value to our current solutions and those under development, as the concepts, ideas, and software code are readily transferable and are incorporated into new solutions.

22

Table of Contents

Financing cash flow activities

(in thousands)	Nine months ended October 31, 2012	2011
Net change in borrowings	$ 9,880	$ 550
Proceeds from exercise of stock options, stock purchase plan, and subscriptions	162	93
Payment of deferred financing costs	(1,246)	
Proceeds from private placement	12,000	
Payment of success fees	(700)	
Payments on capital lease obligation		(157)
Financing cash flow	$ 20,096	$ 486

The increase in cash provided by financing activities was primarily the result of the private placement financing that we completed in August 2012, as well as the increase in the term loan borrowings.

Item 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this quarterly report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our senior management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), of the effectiveness of the design and operation of our disclosure controls and procedures to provide reasonable assurance of achieving the desired objectives of the disclosure controls and procedures. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that there is reasonable assurance that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report on Form 10-Q.

There were no material changes in our internal controls over financial reporting during the three months ended October 31, 2012 that have affected or are reasonably likely to materially affect our internal controls over financial reporting.

Table of Contents

Part II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

We are, from time to time, a party to various legal proceedings and claims, which arise, in the ordinary course of business. We are not aware of any legal matters that will have a material adverse effect on our consolidated results of operations or consolidated financial position and cash flows.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On October 19, 2012, we issued 200,000 warrants to our placement agent as a portion of the fees for services rendered in the private placement investment. The warrants have an initial exercise date of May 1, 2013 and are exercisable for a five year term thereafter at a stated exercise price of $4.06 per share and could be exercised in whole or in part of any time. The warrants also included a cashless exercise option which allowed the holder to receive a number of shares of common stock based on an agreed formula in exchange for the warrants rather than paying cash to exercise. The warrants have no reset provisions.

Item 6. EXHIBITS

See Index to Exhibits.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

		STREAMLINE HEALTH
		SOLUTIONS, INC.
DATE: December 14, 2012	By:	/s/ Robert E. Watson Robert E. Watson
		Chief Executive Officer
DATE: December 14, 2012	By:	/s/ Stephen H. Murdock Stephen H. Murdock
		Chief Financial Officer

25

Table of Contents

INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by Chief Executive Officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification by Chief Financial Officer pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document