AVNET INC
Form 424B2
November 21, 2012
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Filed Pursuant to Rule 424(b)(2)
Registration No. 333-184871

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities Offered	Maximum Aggregate Offering Price	Amount of Registration Fee (1)
4.875% Notes due 2022	**$350,000,000**	**$47,740**

(1) Calculated in accordance with Rule 456(b) and Rule 457(r) of the Securities Act of 1933.

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Prospectus Supplement

November 20, 2012

(To Prospectus dated November 9, 2012)

$350,000,000

Avnet, Inc.

4.875% Notes due 2022

Avnet will pay interest on the notes on June 1 and December 1 of each year, commencing on June 1, 2013. The notes will mature on December 1, 2022, unless earlier redeemed.

Avnet may redeem some or all of the notes at any time at the make-whole redemption price set forth under Description of the Notes Optional Redemption in this prospectus supplement, plus accrued and unpaid interest, if any, to the redemption date. If Avnet experiences a change of control triggering event, Avnet may be required to purchase the notes from holders at a price equal to 101% of their principal amount plus accrued and unpaid interest to the repurchase date as described under Description of the Notes Change of Control in this prospectus supplement.

The notes will be Avnet s senior unsecured obligations and will rank equally with Avnet s other existing and future senior unsecured indebtedness.

See Risk Factors beginning on page S-7 of this prospectus supplement and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012, incorporated herein by reference, to read about risks you should consider before investing in the notes.

The notes will not be listed on any securities exchange. There is currently no market for the notes.

	Price to Public (1)	Underwriting Discount	Proceeds (Before Expenses) to Avnet
Per note	99.788%	0.650%	99.138%
Total	$ 349,258,000	$ 2,275,000	$ 346,983,000

(1) Plus accrued interest from November 27, 2012, if settlement occurs after that date.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus to which it relates is truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect that delivery of the notes in book-entry form will be made through the facilities of The Depository Trust Company and its participants, including Euroclear Bank S.A./N.V., and Clearstream Banking, société anonyme, on or about November 27, 2012.

Joint Book-Running Managers

BofA Merrill Lynch **RBS**

Co-Managers

BNP PARIBAS **Mitsubishi UFJ Securities** **Scotiabank**

HSBC **J.P. Morgan** **PNC Capital Markets LLC** **Wells Fargo Securities**

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PROSPECTUS SUPPLEMENT

PROSPECTUS

This document is in two parts. The first part is the prospectus supplement, which describes the specific terms of this offering and certain other matters relating to us and our financial condition. The second part is the prospectus, which gives more general information, some of which may not apply to this offering. You should read the entire prospectus supplement and the accompanying prospectus, including the documents incorporated by reference that are described under Where You Can Find More Information in this prospectus supplement.

You should rely only on the information contained or incorporated by reference in this prospectus supplement or the accompanying prospectus and any written communication from us specifying the final terms of the offering. Avnet has not, and the underwriters have not, authorized anyone to provide you with information that is different. To the extent the information in this prospectus supplement differs from the information contained in the prospectus, you should rely on information in this prospectus supplement. This prospectus supplement and the accompanying prospectus may only be used where it is legal to sell these securities. The information contained or incorporated by reference in this prospectus supplement or the accompanying prospectus and any written communication from us specifying the final terms of the offering, is only accurate as of the date of the applicable document.

References in this prospectus supplement and the accompanying prospectus to we, us, our, the Company and Avnet are to Avnet, Inc. and its consolidated subsidiaries, unless otherwise specified or unless the context otherwise requires.

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FORWARD-LOOKING STATEMENTS

This prospectus supplement and the accompanying prospectus contain or incorporate by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), with respect to the financial condition, results of operations and business of Avnet. These statements are based on management s current expectations and are subject to uncertainties and changes in factual circumstances. Because forward-looking statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by them. You can find many of these statements by looking for words like believes, plans, expects, anticipates, should, will, may, estimates or similar expressions in this supplement and the accompanying prospectus or in documents incorporated by reference in this prospectus supplement and the accompanying prospectus.

The forward-looking statements are subject to numerous assumptions, risks and uncertainties. You should not place undue reliance on forward-looking statements, each of which speaks only as of the date on which such statement is made. Avnet does not assume any obligation to update any forward-looking statement to reflect events or circumstances that occur after the date on which the statement is made. The following factors and the Risk Factors beginning on page S-7 of this prospectus supplement and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012, incorporated herein by reference, as well as other potential risks and uncertainties that are discussed in our reports and documents filed with the Securities and Exchange Commission (the SEC), could affect Avnet s future results, and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements:

- the effect of global economic conditions, including the current global economic uncertainty;
- general economic and business conditions (domestic and foreign) affecting Avnet s financial performance and, indirectly, Avnet s credit ratings, debt covenant compliance, and liquidity and access to financing;
- competitive pressures among distributors of electronic components and computer products resulting in increased competition for existing customers or otherwise;
- adverse effects on our supply chain, shipping costs, customers and suppliers, including as a result of issues caused by natural and weather-related disasters;
- risks relating to our international sales and operations, including risks relating to the ability to repatriate funds, foreign currency fluctuations, duties and taxes and compliance with international and U.S. laws that apply to our international operations;
- cyclicality in the technology industry, particularly in the semiconductor sector;
- allocation of products by suppliers; and
- legislative or regulatory changes affecting Avnet s businesses.

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WHERE YOU CAN FIND MORE INFORMATION

This prospectus supplement and the accompanying prospectus are a part of a registration statement on Form S-3, which Avnet filed with the SEC under the Securities Act. Avnet refers you to this registration statement for further information concerning Avnet and this offering.

Avnet files annual, quarterly and special reports, proxy statements and other information with the SEC (File No. 1-4224). These filings contain important information which does not appear in this prospectus supplement or the accompanying prospectus. For further information about Avnet, you may obtain these filings over the Internet at the SEC s website at *http://www.sec.gov*. Avnet also posts certain of these filings on its web site at *www.avnet.com*. Information contained on our website is not intended to be incorporated by reference in this prospectus supplement or the accompanying prospectus and you should not consider that information a part of this prospectus supplement or the accompanying prospectus. Our website address is included in this prospectus supplement as an inactive textual reference only. You may also read and copy these filings at the SEC s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the public reference room by calling the SEC at 800-732-0330.

INCORPORATION BY REFERENCE

The SEC allows Avnet to incorporate by reference information into this prospectus supplement and the accompanying prospectus, which means that Avnet can disclose important information to you by referring you to other documents which Avnet has filed or will file with the SEC. Avnet is incorporating by reference in this prospectus supplement and the accompanying prospectus (other than, in each case, documents or information deemed to have been furnished and not filed in accordance with SEC rules):

- Avnet s Annual Report on Form 10-K for the fiscal year ended June 30, 2012;
- Avnet s Quarterly Report on Form 10-Q for the quarter ended September 29, 2012; and
- a portion of Avnet s Current Report on Form 8-K filed on August 8, 2012 (Item 8.01 only) and Avnet s Current Reports on Form 8-K filed on August 10, 2012, August 24, 2012 and November 5, 2012.

All documents which Avnet files with the SEC pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act (excluding information furnished pursuant to Item 2.02 or Item 7.01, or corresponding information furnished under Item 9.01 or included as an exhibit, on any current report on Form 8-K), after the date of this prospectus supplement and before the termination of this offering of securities will be deemed to be incorporated by reference in this prospectus supplement and the accompanying prospectus and to be a part of it from the filing date of such documents. Certain statements in or portions of a future document incorporated by reference in this prospectus supplement and the accompanying prospectus may update and replace statements in and portions of this prospectus supplement and the accompanying prospectus or the above listed documents. Nothing in this prospectus supplement and the accompanying prospectus will be deemed to incorporate information furnished but not filed with the SEC.

Avnet will provide you without charge, upon your written or oral request, a copy of the indenture relating to the notes offered hereby, and any of the documents incorporated by reference in this prospectus supplement and the accompanying prospectus, other than exhibits to such documents which are not specifically incorporated by reference into such documents. Please direct your written or telephone requests to the Corporate Secretary, Avnet, Inc., 2211 South 47th Street, Phoenix, Arizona 85034 (telephone (480) 643-2000).

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SUMMARY

The following summary contains information about Avnet and this offering. It does not contain all of the information that may be important to you in making a decision to purchase the notes. For a more comprehensive understanding of Avnet and this offering, Avnet urges you to read this entire prospectus supplement and the accompanying prospectus carefully, including the documents incorporated by reference herein, and Avnet s consolidated financial statements and related notes contained in such documents.

Avnet, Inc.

Avnet is one of the world s largest industrial distributors, based on sales, of electronic components, enterprise computer and storage products and embedded subsystems. Avnet creates a vital link in the technology supply chain that connects the world s leading electronic component and computer product manufacturers and software developers with a global customer base of original equipment manufacturers, or OEMs, electronic manufacturing services providers, original design manufacturers and value-added resellers, or VARs. Avnet distributes electronic components, computer products and software as received from its suppliers or with assembly or other value added by Avnet. Additionally, Avnet provides engineering design, materials management and logistics services, system integration and configuration, and supply chain services that can be customized to meet the requirements of both customers and suppliers.

Avnet has two primary operating groups Electronics Marketing and Technology Solutions. Both operating groups have operations in each of the three major economic regions of the world: the Americas; Europe, the Middle East and Africa; and Asia/Pacific, consisting of Asia, Australia and New Zealand. Each operating group has its own management team led by a group president and includes a regional president and senior executives within the operating group who manage the various functions within the businesses. Each operating group also has distinct financial reporting that is evaluated at the corporate level on which operating decisions and strategic planning for the company as a whole are made. Divisions exist within each operating group that serve primarily as sales and marketing units to further streamline the sales and marketing efforts within each operating group and enhance each operating group s ability to work with its customers and suppliers, generally along more specific product lines or geographies. However, each division relies heavily on the support services provided by the operating group as well as centralized support at the corporate level.

Electronics Marketing markets and sells semiconductors and interconnect, passive and electromechanical devices and embedded products for the world s leading electronic component manufacturers. Electronics Marketing markets and sells its products and services to a diverse customer base serving many end-markets, including automotive, communications, computer hardware and peripheral, industrial and manufacturing, medical equipment, military and aerospace. Electronics Marketing also offers an array of value-added services that help customers evaluate, design-in and procure electronic components throughout the lifecycle of their technology products and systems.

As a global IT solutions distributor, Technology Solutions collaborates with its customers and suppliers to create and deliver services, software and hardware solutions that address the business needs of end-user customers locally and around the world. Technology Solutions focuses on the global value-added distribution of enterprise computing servers and systems, software, storage, services and complex solutions from the world s foremost technology manufacturers, marketing and selling them to and through the VAR channel. Technology Solutions also serves the worldwide OEM market for computing technology, system integrators and non-PC OEMs that require embedded systems and solutions including engineering, product prototyping, integration and other value-added services. The operating group has sales and marketing divisions dedicated to these customer segments as well as independent software vendors.

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Avnet s common stock is quoted on the New York Stock Exchange under the symbol AVT.

Avnet s principal executive offices are located at 2211 South 47th Street, Phoenix, Arizona 85034. Avnet s main telephone number is (480) 643-2000.

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The Offering

The following summary contains basic information about the notes. It does not contain all the information that may be important to you. For a more complete understanding of the notes, see Description of the Notes in this prospectus supplement.

Issuer	Avnet, Inc., a New York corporation.
Notes Offered	$350 million in aggregate principal amount of 4.875 % Notes due 2022.
Maturity	December 1, 2022.
Interest	Interest on the notes will accrue from the date of their original issuance at the annual rate of 4.875% per year and will be payable in cash semi-annually in arrears on June 1 and December 1 of each year, commencing on June 1, 2013.
Ranking	The notes will be Avnet s senior unsecured obligations and will rank equally in right of payment with all of Avnet s other existing and future senior unsecured indebtedness. At September 29, 2012, Avnet had approximately $1,388.1 million of unsecured senior indebtedness outstanding, including indebtedness incurred under Avnet s senior unsecured credit facility. The notes will not be guaranteed by any of Avnet s subsidiaries. The subsidiary debt to which the notes would be effectively subordinated totaled $249.4 million at September 29, 2012.
Optional Redemption	Avnet may, at its option, redeem some or all of the notes at any time, or from time to time, at the make-whole redemption price described under Description of the Notes Optional Redemption, plus accrued and unpaid interest, if any, to the redemption date.
Change of Control	If a Change of Control Triggering Event (as defined herein) occurs, each holder will have the right to require Avnet to repurchase all or any part ($2,000 or an integral multiple of $1,000 in excess thereof) of such holder s notes at a redemption price equal to 101% of the aggregate principal amount of notes repurchased plus accrued and unpaid interest, if any, on the notes repurchased, to the repurchase date. See Description of the Notes Change of Control.
Covenants	The indenture governing the notes contains covenants for the benefit of noteholders. These covenants restrict our ability to: incur certain secured debt; enter into sale and lease-back transactions; or

consolidate, merge or sell or transfer all or substantially all of our assets.

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	These covenants are, however, subject to significant exceptions. See Description of the Notes Covenants.
Further Issuances	We may create and issue additional notes ranking equally and ratably with the notes in all respects, so that such additional notes shall be consolidated with the notes, including for purposes of voting and redemptions.
Use of Proceeds	Avnet expects to use the net proceeds of this offering to repay amounts owed under Avnet s senior unsecured revolving credit facility and Avnet s accounts receivable securitization program. Affiliates of the underwriters have commitments under Avnet s senior unsecured credit facility and certain affiliates of the underwriters have commitments under Avnet s accounts receivable securitization program. Consequently, certain affiliates of the underwriters may receive more than 5% of the net proceeds of this offering. See Use of Proceeds in this prospectus supplement.
Form, Denomination and Registration	The notes will be issued in fully registered form in minimum denominations of $2,000 principal amount and multiples of $1,000 in excess thereof. The notes will be represented by one global note, deposited with the trustee under the indenture governing the notes as custodian for The Depository Trust Company (DTC) and registered in the name of Cede & Co., DTC s nominee. Beneficial interests in the global note will be shown on, and any transfers thereof will be effected only through records maintained by DTC and its participants. See Description of the Notes Depositary, Global Notes.
Governing Law	State of New York.
Listing	The notes will not be listed on any securities exchange.
Trustee	Wells Fargo Bank, National Association.

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Summary Financial Information and Other Data

The summary consolidated financial information and other data below is derived from the consolidated financial statements of Avnet. You should read those financial statements, accompanying notes and Management s Discussion and Analysis of Financial Condition and Results of Operations, all of which are incorporated by reference in this prospectus supplement and the accompanying prospectus from our Annual Report on Form 10-K for the fiscal year ended June 30, 2012 and our Quarterly Report on Form 10-Q for the quarter ended September 29, 2012. This summary financial information should be read in conjunction with the footnotes below as there are various special items recorded in certain periods presented.

	Three Months Ended		Fiscal Years Ended		
	September 29, 2012	October 1, 2011	June 30, 2012	July 2, 2011	July 3, 2010
	unaudited				
			(In millions)		
Statement of Operations Data:					
Sales	$ 5,870.1	$ 6,426.0	$ 25,707.5	$ 26,534.4	$ 19,160.2
Cost of sales	5,185.7	5,672.4	22,657.0	23,426.6	16,880.0
Gross profit	684.4	753.6	3,050.6	3,107.8	2,280.2
Selling, general and administrative expenses	547.0	530.5	2,092.8	2,100.7	1,619.2
Restructuring, integration and other charges (1)	37.4		73.6	77.2	25.4
Operating income	100.0	223.1	884.2	930.0	635.6
Other income (expense), net	1.5	(5.4)	(5.4)	10.7	2.5
Interest expense	(23.9)	(21.9)	(90.9)	(92.5)	(61.7)
Gain on bargain purchase and other (2)	31.3		2.9	22.7	
Gain on sale of assets (3)					8.8
Income before income taxes	108.9	195.8	790.8	871.0	585.1
Income tax provision	8.6	56.8	223.8	201.9	174.7
Net income	$ 100.3	$ 139.0	$ 567.0	$ 669.1	$ 410.4

	September 29, 2012	June 30, 2012	July 2, 2011
	unaudited		
		(In millions)	
Balance Sheet Data:			
Cash and cash equivalents	$ 1,043.0	$ 1,006.9	$ 675.3
Working capital (4)	3,573.4	3,455.7	3,749.5
Total assets	10,103.1	10,167.9	9,905.6
Total debt	2,348.4	2,144.4	1,516.6
Total liabilities	6,123.3	6,262.1	5,849.5
Shareholders equity	3,979.8	3,905.7	4,056.1

(1) During the first quarter of fiscal 2013, Avnet initiated expense reduction actions in both operating groups in response to continued weakness in business conditions. In addition, Avnet incurred acquisition and integration costs associated with recently acquired businesses. As a result, Avnet recorded restructuring, integration and other charges of $37.4 million pre-tax and $27.1 million after tax.

During fiscal 2012, Avnet took certain actions to reduce costs in both operating groups in response to market conditions and incurred acquisition and integration costs associated with recently acquired businesses. As a result, Avnet recorded restructuring, integration and other charges of $73.6 million pre-tax and $53.0 million after tax.

(footnotes continued on next page)

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During fiscal 2011, Avnet incurred restructuring, integration and other charges totaling $77.2 million pre-tax and $56.2 million after tax related primarily to acquisition and integration activities associated with acquired businesses and also recorded credits related to prior restructuring reserves and acquisition adjustments.

During fiscal 2010, Avnet incurred restructuring, integration and other charges totaling $25.4 million pre-tax and $18.8 million after tax related to the remaining cost reduction actions announced in fiscal 2009, which were taken in response to market conditions, as well as integration costs associated with acquired businesses in addition to a value-added tax exposure and acquisition-related costs partially offset by a credit related to prior restructuring reserves.

(2) During the first quarter of fiscal 2013, Avnet acquired Internix, Inc., a company publicly traded on the Tokyo stock exchange, through a tender offer. After assessing the assets acquired and liabilities assumed, the consideration paid was below book value even though the price paid per share represented a premium to the trading levels at that time. Accordingly, Avnet recognized a gain on bargain purchase in the first quarter of fiscal 2013 of $31.3 million pre- and after tax.

During fiscal 2012, Avnet acquired Unidux Electronic Limited, a Singapore publicly traded company, through a tender offer for which the consideration paid was below book value. Accordingly, Avnet recognized a gain on bargain purchase of $4.3 million pre- and after tax. In addition, during fiscal 2012, Avnet recognized a loss of $1.4 million pre-tax and $0.9 million after tax related to a write-down of an investment in a small technology company and the write-off of certain deferred financing costs associated with the early termination of a credit facility.

During fiscal 2011, Avnet acquired Unidux, Inc., a Japanese publicly traded electronics distributor, through a tender offer for which the purchase price was below book value. As a result, Avnet recognized a gain on bargain purchase of $31.0 million pre- and after tax. Also during fiscal 2011, Avnet recognized a loss of $6.3 million pre-tax and $3.9 million after tax related to the write-down of prior investments in smaller technology start-up companies and recognized other charges of $2.0 million pre-tax and $1.4 million after tax primarily related to an impairment of buildings in Europe.

(3) During fiscal 2010, Avnet recognized a gain on sale of assets totaling $8.8 million pre-tax and $5.4 million after-tax as a result of certain earn-out provisions associated with the prior sale of an equity investment.

(4) Working capital is defined as current assets less current liabilities.

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RISK FACTORS

An investment in the notes involves risks. You should carefully consider the following risk factors relating to the offering of the notes, including the information under Risk Factors in our Annual Report on Form 10-K for the fiscal year ended June 30, 2012, before making an investment in the notes. You also should carefully consider any other discussion of risks or uncertainties contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. The information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus includes forward-looking statements that involve risks and uncertainties. See Forward-Looking Statements in this prospectus supplement. Avnet s actual results could differ materially from those anticipated in the forward-looking statements as a result of certain factors, including the risks described below and elsewhere in this prospectus supplement. Additional risks and uncertainties not currently known to Avnet or that Avnet currently believes are immaterial also may have a material adverse effect on its business, financial condition or results of operations, or could adversely affect the value of the notes offered by this prospectus supplement.

Any secured debt of Avnet will have claims with respect to the secured assets that are superior to that of the notes.

The indenture contains a covenant that restricts the incurrence of secured debt, although that restriction is subject to significant exceptions. Avnet s other debt instruments permit Avnet and its subsidiaries to incur a substantial amount of indebtedness that can be secured by Avnet s assets. Any secured debt issued by Avnet will be superior to the notes. In the event of a bankruptcy, liquidation, dissolution, reorganization or similar proceeding, Avnet s pledged assets would be available to satisfy obligations of the secured debt before any payment could be made on the notes. To the extent that these assets cannot satisfy in full Avnet s secured debt, the holders of such debt would have a claim for any shortfall that would rank equally in right of payment with the notes. In that event, Avnet may not have sufficient assets remaining to pay amounts due on any or all of the notes. At September 29, 2012, Avnet did not have any outstanding consolidated secured debt; however, it may issue secured debt in the future and such secured debt will have a right of payment superior to that of the notes.

Additionally, under Avnet s accounts receivable securitization program, Avnet is able to sell on an ongoing basis most of its domestic trade accounts receivables to a bankruptcy remote subsidiary, which, in turn, sells a portion of these receivables to a bank conduit. Receivables sold under the securitization program, and the proceeds from these receivables, will not be available for repayment of the notes and the indenture governing the notes does not restrict Avnet s ability to securitize its receivables. At September 29, 2012, Avnet had $711.0 million in borrowings outstanding under its securitization program.

The claims of creditors of Avnet s subsidiaries are superior to the claims of Avnet s equity interests in its subsidiaries.

Avnet s equity interest in its subsidiaries is subordinate to any debt and other liabilities and commitments, including trade payables and lease obligations, of Avnet s subsidiaries, whether or not secured. The notes will not be guaranteed by Avnet s subsidiaries and Avnet may not have direct access to the assets of its subsidiaries unless these assets are transferred by dividend or otherwise to Avnet. At September 29, 2012, Avnet s subsidiary debt to which the notes would effectively be subordinated totaled $249.4 million. Most of Avnet s subsidiary debt is guaranteed by Avnet. Avnet s subsidiaries also have the ability to borrow an additional $400.0 million under various lines of credit, which are cancelable on short-term notice. The ability of the subsidiaries to pay dividends or otherwise transfer assets to Avnet is subject to various restrictions under applicable law. Avnet s right to receive assets of any of its subsidiaries upon the subsidiary s liquidation or reorganization is subordinated effectively to the claim of that subsidiary s creditors. As noteholders claims to the assets of Avnet s subsidiaries are derivative of Avnet s equity claims in its subsidiaries, the claims of Avnet s subsidiaries creditors are superior to any claims of the noteholders to any assets of Avnet s subsidiaries and any subsidiaries that Avnet may in the future acquire or establish.

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An active trading market may not develop for the notes. left:15px; text-indent:-15px">

Total
$85,829 $(17) $85,812

Investments include $3,500 of long-term U.S. government backed securities and $2,081 of long-term corporate bonds that have been classified in investments and other assets on the condensed consolidated balance sheet at December 31, 2010.

7. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

The summary of outstanding debt and capital lease obligations is as follows:

	As of March 31, 2011	As of December 31, 2010
Term loan	$ 5,250	$ 5,325
Capital lease obligation	3,173	3,891
	8,423	9,216
Less current portion of long-term debt and capital lease obligations	(2,666)	(2,909)
Long-term debt and capital lease obligations, net of current portion	$ 5,757	$ 6,307

2008 Term and Revolving Loans On September 30, 2008, the Company entered into a Credit Agreement (the Credit Agreement) with a financial institution. The Credit Agreement consists of a revolving credit facility in the amount of $15,000 and a term loan facility in the amount of $6,000 (collectively, the Credit Facility). The revolving credit facility may be extended by an additional $15,000 on the satisfaction of certain conditions and includes a $10,000 sublimit for the issuance of standby letters of credit. The revolving credit facility matures on September 30, 2011, and the term loan facility matures on September 30, 2013, although either facility may be voluntarily prepaid in whole or in part at any time without premium or penalty. As of March 31, 2011, there were no amounts outstanding under the revolving credit facility. On September 30, 2008, the Company borrowed a total of $6,000 under the term loan facility for general working capital purposes. The term loan has a 5 year term which is payable quarterly starting March 31, 2009, for $75 each quarter. The Company has the option to extend the loan, subject to agreement of the lender, at the end of the 5 year term.

The revolving credit loan facility and term loan facility bear interest, at the Company s option, at either (i) the financial institution s London Interbank Offered Rate (LIBOR), or (ii) the higher of (a) the Federal Funds Rate plus 0.50% or (b) the financial institution s prime rate (the higher of the two being the Base Rate). For term loans, these rates are adjusted down 100 basis points

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

for Base Rate loans and up 100 basis points for LIBOR loans. For revolving credit loans, a margin is added to the chosen interest rate that is based on the Company s consolidated leverage ratio, as defined in the Credit Agreement, which margin can range from 100 to 275 basis points for LIBOR loans and from 0 to 50 basis points for Base Rate loans. A default rate shall apply on all obligations in the event of a default under the Credit Agreement at a rate per annum equal to 2% above the applicable interest rate. The Company was also required to pay commitment fees and upfront fees for this Credit Facility. The interest rate as of March 31, 2011, and December 31, 2010, for the term loan was 4.5%.

The obligations of the Company and its subsidiaries under the Credit Agreement are collateralized by substantially all assets.

The Credit Agreement also contains certain financial and nonfinancial covenants, including limitations on our consolidated leverage ratio and capital expenditures, defaults relating to non-payment, breach of covenants, inaccuracy of representations and warranties, default under other indebtedness (including a cross-default with our interest rate swap), bankruptcy and insolvency, inability to pay debtors, attachment of assets, adverse judgments, ERISA violations, invalidity of loan and collateral documents, payments of dividends, and change of control. Upon an event of default, the lenders may terminate the commitment to make loans and the obligation to extend letters of credit, declare the unpaid principal amount of all outstanding loans and interest accrued under the Credit Agreement to be immediately due and payable, require us to provide cash and deposit account collateral for our letter of credit obligations, and exercise their security interests and other rights under the Credit Agreement.

Capital Lease Obligations In June 2007, the Company entered into a master lease and security agreement (the Equipment Line) with a financing company. The Equipment Line allows for the Company to lease from the financing company eligible equipment purchases, submitted within 90 days of the applicable equipment s invoice date. Each lease has a 36 month term which is payable in equal monthly installments, commencing on the first day of the fourth month after the date of the disbursements of such loan and continuing on the first day of each month thereafter until paid in full. The Company has accounted for these as capital leases. At March 31, 2011 and December 31, 2010, the Company had $3,173 and $3,891, respectively, of outstanding capital leases. As of March 31, 2011, the weighted average interest rate implicit in the leases was 4.1%.

8. INTEREST RATE SWAP

The Company entered into a derivative instrument which has a decreasing notional value over the term to offset the cash flow exposure associated with its interest payments on certain outstanding debt. In October 2008, we entered into an interest rate swap to mitigate the cash flow exposure associated with our interest payments on certain outstanding debt. Our interest rate swap is not designated as a hedging instrument. The derivative is accounted for at fair value with gains or losses reported in earnings.

The swap had a notional amount of $5,850 to hedge changes in cash flows attributable to changes in the LIBOR rate associated with the September 30, 2008, issuance of the Term Loan due September 30, 2028. We pay a fixed rate of 4.5% and receive a variable rate based on one month LIBOR. The fair value of derivatives as of March 31, 2011, and December 31, 2010, is summarized in the following table.

	Liability Derivatives	Fair Value as of	
	Balance Sheet Location	March 31, 2011	December 31, 2010
Interest rate derivative contract	Interest rate derivative liability	$ 425	$ 490
Total derivative		$ 425	$ 490

The effect of derivative instruments on the consolidated statement of operations is summarized in the following table.

	Location of Gain (Loss) Recognized in Earnings	Gain Recognized in Earnings for Three Months Ended March 31, 2011	(Loss) Recognized in Earnings for Three Months Ended March 31, 2010
Interest rate contracts	Gain (loss) on interest rate derivative contract	$ 65	$ (60)

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

Derivatives are carried at fair value, as determined using standard valuation models, and are adjusted, when necessary, for credit risk and are separately presented on the balance sheet. The following is a description/summary of the derivative financial instrument we have entered into to manage the interest rate exposure:

Description	Underlying	Remaining Notional Amount	Receive	Pay	Fiscal Year Entered Into	Maturity (Fiscal Year)	Fair Value at March 31, 2011
Interest rate swap variable to fixed	Interest on Term Loan	$5,250	LIBOR	4.55% fixed	2008	2028	$ (425)

9. COMMITMENTS AND CONTINGENCIES

On March 2, 2010, a complaint was filed by *Prompt Medical Systems, L.P.* naming the Company and several other defendants in a patent infringement case (Prompt Medical Systems, L.P. v. AllscriptsMisys Healthcare Solutions, Inc. et al., Civil Action No. 6:2010cv00071, United States District Court for the Eastern District of Texas). The complaint alleges that the Company has infringed on U.S. Patent No. 5,483,443 with a listed issue date of January 9, 1996 entitled Method for Computing Current Procedural Terminology Codes from Physician Generated Documentation. The complaint seeks an injunction enjoining infringement, damages, and pre- and post-judgment costs and interest. The Company and other several defendants filed motions to dismiss the complaint. On February 11, 2011, the Court issued an Order granting-in-part and denying-in-part the motions to dismiss. The Court ordered the plaintiff to replead certain claims within fourteen days of the Order, and the plaintiff filed its amended complaint on February 23, 2011. The Company filed its answer to the amended complaint and declaratory judgment counterclaims of non-infringement, invalidity, and unenforceability on March 9, 2011.

On November 24, 2010, several defendants filed (i) a motion for summary judgment of invalidity against the patent-in-suit on the basis that it claims only non-patentable subject matter; and (ii) a motion to stay all proceedings pending the resolution of the motion for summary judgment. The Company filed a motion to join in the motion to stay the proceedings. The motions are fully briefed and awaiting a decision by the Court.

The case is currently in the discovery phase. A claim construction hearing is scheduled for November 11, 2011. Trial is scheduled for June 11, 2012.

The Company is being indemnified in this lawsuit from and against any liability and reasonable costs, including attorneys fees, incurred by the Company in its defense, pursuant to a license agreement with its vendor.

The Company believes that it has meritorious defenses to the lawsuit and continues to contest it vigorously.

On March 19, 2010, a putative shareholder class action complaint was filed in the United States District Court for the District of Massachusetts against the Company and certain of its current and former officers entitled Casula v. athenahealth, Inc. et al, Civil Action No. 1:10-cv-10477. On June 3, 2010, the court appointed Waterford Township General Employees Retirement System as the lead plaintiff. On August 2, 2010, the lead plaintiff filed an amended complaint. The amended complaint alleges that the defendants violated the federal securities laws by disseminating false and misleading statements through press releases, statements by senior management, and SEC filings. The alleged false and misleading statements concern, among other things, the amortization period for deferred implementation revenues. The amended complaint seeks unspecified damages, costs, and expenses. The defendants filed a motion to dismiss the amended complaint on October 1, 2010, and a reply brief in further support of the motion to dismiss the amended complaint on December 30, 2010. The Company believes that it has meritorious defenses to the amended complaint and will contest the claims vigorously.

On March 17, 2011, a complaint was filed by *PPS Data, LLC* naming the Company and several other defendants in a patent infringement case (PPS Data, LLC v. Allscripts Healthcare Solutions, Inc. et al, Civil Action No. 3:11-CU-273-J-99MMH-TEM, United States District Court for the Middle District of Florida). The complaint alleges that the Company has infringed on U.S. Patent No. 6,343,271 with a listed issue date of January 29, 2002 entitled Electronic Creation, Submission, Adjudication, and Payment of Health Insurance Claims. The complaint seeks an injunction enjoining infringement, damages, pre- and post-judgment costs and interest, and attorneys fees. On April 14, 2011, the Company filed a motion to dismiss, or, in the alternative a motion for summary judgment. The Company believes that it has meritorious defenses to the complaint and will contest the claims vigorously.

In addition, from time to time the Company may be subject to other legal proceedings, claims, and litigation arising in the ordinary course of business. The Company does not, however, currently expect that the ultimate costs to resolve any pending matter will have a material adverse effect on the Company s consolidated financial position, results of operations, or cash flows. There are no accruals for such claims recorded at March 31, 2011.

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

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

Forward-looking statements are only current predictions and are subject to known and unknown risks, uncertainties, and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from those anticipated by such statements. These factors include, among other things, those set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, under the heading Part I, Item 1A Risk Factors and any set forth below under Part II, Item 1A, Risk Factors.

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

Overview

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

The services provided through our single-instance cloud are currently packaged as three integrated components: athenaCollector for revenue cycle management, athenaClinicals for clinical cycle management, and athenaCommunicator for patient cycle management. The use of our single-instance platform allows all clients to benefit from the collective knowledge of all of our other clients through our patented billing Rules Engine and our clinical Quality Management Engine. Our clients use these rules engines to monitor and benchmark their performance with peer practices across the network. Our business intelligence application, Anodyne Analytics, also supports our clients in their pursuit of financial health by equipping users with data visualization tools and insight into their practice s performance.

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

For the three months ended March 31, 2011, we generated revenue of $69.9 million from the sale of our services compared to $54.5 million for the three months ended March 31, 2010. In 2010, we generated revenue of $245.5 million from the sale of our services compared to $188.5 million in 2009. Given the scope of our market opportunity, we have increased our spending each year on growth, innovation, and infrastructure. Despite increased spending in these areas, higher revenue and lower operating expenses as a percentage of revenue typically lead to greater operating income.

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

Critical Accounting Policies

The preparation of our consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but are not limited to: (1) revenue recognition; including our estimated expected customer life; (2) allowance for doubtful accounts; (3) asset impairments; (4) depreciable lives of assets; (5) economic lives and fair value of leased assets; (6) income tax reserves; (7) fair value of stock options; (8) allocation of direct and indirect cost of sales; (9) fair value of contingent consideration; and (10) litigation reserves. Future events and their effects cannot be predicted with certainty, and accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. Actual results could differ from the estimates we have used.

Critical accounting policies are those policies that affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements. We believe our critical accounting policies include our policies regarding revenue recognition, software development costs, share-based compensation, and income taxes. For a more detailed discussion of our critical accounting policies, please refer to our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as filed with the SEC on February 18, 2011. For recent accounting pronouncements, please refer to Note 2.

Financial Operations Overview

Revenue. We derive our revenue from two sources: from business services associated with our revenue cycle, clinical cycle, patient cycle and Anodyne Analytics offerings and from implementation and other services. Implementation and other revenue consists primarily of professional services fees related to assisting clients with the initial implementation of our services and for ongoing training and related support services. Business services accounted for approximately 97% and 96% of our total revenues for the three months ended March 31, 2011 and 2010, respectively. Business services revenue are typically 2% to 8% of a practice s total collections depending upon the services purchased, the size, complexity, and other characteristics of the practice, plus a per-statement charge for billing statements that are generated for patients. Accordingly, business services revenue is largely driven by the number of physician practices and other service providers we serve, the number of physicians and other medical providers working in those physician practices, the volume of activity and related collections of those physicians and other medical providers, the services used by the practice, and other medical providers, and our contracted rates. We expect to increase the number of physician practices we serve through increased sales and marketing expense, and we expect our existing clients to use more of our services through cross-selling efforts and growth in the number of combined services sales. There is moderate seasonality in the activity level of physician practices. Typically, discretionary use of physician services declines in the late summer and during the holiday season, which leads to a decline in collections by our physician clients about 30 to 50 days later. Additionally, the volume of activity and related collections vary from year to year based in large part on the severity, length and timing of the onset of the flu season. While we believe that the severity, length and timing of the onset of the cold and flu season will continue to impact collections by our physician clients, there can be no assurance that our future sales of these products will necessarily follow historical patterns. Implementation and other revenue is largely driven by the increase in the volume of our new business. As a result, we expect implementation and other revenue to increase in absolute terms for the foreseeable future but to remain relatively consistent as a percentage of total revenue. None of our clients accounted for more than 10% of our total revenues for the three months ended March 31, 2011, and March 31, 2010.

Direct Operating Expense. Direct operating expense consists primarily of salaries, benefits, claim processing costs, other direct expenses, and stock-based compensation related to personnel who provide services to clients, including staff who implements new clients. We expense implementation costs as incurred. We include in direct operating expense all service costs associated with athenaCollector, athenaClinicals, athenaCommunicator and Anodyne Analytics. In addition, over the longer term, we expect to increase our overall level of automation and to reduce our direct operating expense as a percentage of revenues as we become a larger operation, with higher volumes of work in particular functions, geographies, and medical specialties. We include in direct operating expense the service costs associated with our athenaClinicals offering, which includes transaction handling related to lab requisitions, lab results entry, fax classification, and other services. Although we expect that direct operating expense will increase in absolute terms for the foreseeable future, the direct operating expense is expected to decline as a percentage of revenues as we further increase the percentage of transactions that are resolved on the first attempt and as we decrease the cost of implementation for new clients. This decrease will also be driven by increased levels of automation and economies of scale. Direct operating expense does not include allocated amounts for rent, occupancy and other indirect costs (including building maintenance and utilities), depreciation, and amortization, except for amortization related to purchased intangible assets.

Selling and Marketing Expense. Selling and marketing expense consists primarily of marketing programs (including trade shows, brand messaging, and on-line initiatives) and personnel-related expense for sales and marketing employees (including salaries, benefits, commissions, stock-based compensation, non-billable travel, lodging, and other out-of-pocket employee-related expense). Although we recognize substantially all of our revenue when services have been delivered, we recognize a large portion of our sales commission expense at the time of contract signature and at the time our services commence. Accordingly, we incur a portion of our sales and marketing expense prior to the recognition of the corresponding revenue. We have increased our sales and marketing expenses from year to year and we expect to continue to increase our investment in sales and marketing by hiring additional direct sales and support personnel to add new clients and increase sales to our existing clients and expanding awareness through paid search and other similar initiatives. We also plan to expand our marketing activities, such as attending trade shows, expanding user groups, and creating new printed materials. As a result, we expect that, sales and marketing expense will increase in absolute terms and will increase as a percentage of total revenue in the near-term.

Research and Development Expense. Research and development expense consists primarily of personnel-related expenses for research and development employees (including salaries, benefits, stock-based compensation, non-billable travel, lodging, and other out-of-pocket employee-related expense) and consulting fees for third-party developers. We expect that in the future, research and development expense will increase in absolute terms but not as a percentage of total revenue as new services and more mature products require incrementally less new research and development investment.

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

Depreciation and Amortization Expense. Depreciation and amortization expense consists primarily of depreciation of fixed assets and amortization of capitalized software development costs, which we amortize over a two-year period from the time of release of related software code. As we grow, we will continue to make capital investments in the infrastructure of the business and we will continue to develop software that we capitalize. At the same time, because we are spreading fixed costs over a larger client base, we expect related depreciation and amortization expense to decline as a percentage of total revenues over time.

Other Income (Expense). Interest expense consists primarily of interest costs related to our equipment-related term leases and our term loan and revolving loans under our credit facility, offset by interest income on investments. Interest income represents earnings from our cash, cash equivalents, and investments. The gain (loss) on the interest rate derivative contract represents the change in the fair market value of a derivative instrument that is not designated as a hedge. Although this derivative has not been designated for hedge accounting, we believe that such instrument is correlated with the underlying cash flow exposure related to variability in interest rate movements on our term loan.

Results of Operations

Comparison of the Three Months Ended March 31, 2011 and 2010

	Three Months Ended March 31,			
	Amount 2011	Amount 2010	Change Amount	Change Percent
	(in thousands)			
Business services	$ 67,486	$ 52,565	$ 14,921	28%
Implementation and other	2,444	1,912	532	28%
Total revenue	$ 69,930	$ 54,477	$ 15,453	28%

Revenue. Total revenue for the three months ended March 31, 2011, was $69.9 million, an increase of 28% over revenue of $54.5 million for the three months ended March 31, 2010. This increase was due almost entirely to an increase in business services revenue.

Business Services Revenue. Revenue from business services for the three months ended March 31, 2011, was $67.5 million, an increase of $14.9 million, or 28%, over revenue of $52.6 million for the three months ended March 31, 2010. This increase was primarily due to the growth in the number of physicians and other medical providers using our services. The summary of changes in the physicians and active medical providers using our revenue cycle management service, athenaCollector, clinical cycle management service, athenaClinicals, and patient cycle management service, athenaCommunicator are as follows:

	Three Months Ended March 31,			
	2011 Amount	2010 Amount	Change Amount	Change Percent
Physicians revenue cycle management service	19,778	16,369	3,409	21%
Active medical providers revenue cycle management service	27,944	23,978	3,966	17%
Physicians clinicals cycle management service	2,910	1,275	1,635	128%
Active medical providers clinicals cycle management service	4,161	1,867	2,294	123%
Physicians patient cycle management service	934	348	586	168%
Active medical providers patient cycle management service	1564	513	1,051	205%

Also contributing to this increase was the growth in related collections on behalf of these physicians and medical providers. Total collections generated by these physicians and other medical providers that were posted for the three months ended March 31, 2011, was $1.6 billion, an increase of $0.3 billion over posted collections of $1.3 billion for the three months ended March 31, 2010.

Implementation and Other Revenue. Revenue from implementations and other sources was $2.4 million for the three months ended March 31, 2011, an increase of $0.5 million, or 28%, over revenue of $1.9 million for the three months ended March 31, 2010. This increase was driven by new client implementations and increased professional services for our larger client base as described above. The increase in implementation and other revenue is the result of the increase in the volume of our business.

	Three Months Ended March 31,			
	2011	2010	Change	
	Amount	Amount	Amount	Percent
	(in thousands)			
Direct operating costs	$ 27,270	$ 23,519	$ 3,751	16%

Direct Operating Costs. Direct operating expense for the three months ended March 31, 2011, was $27.3 million, an increase of $3.8 million, or 16%, over costs of $23.5 million for the three months ended March 31, 2010. This increase was primarily due to an increase in the number of claims that we processed on behalf of our clients and the related expense of providing services, including transactions expense and salary and benefits expense. The amount of collections processed for the three months ended March 31, 2011, was $1.6 billion, an increase of $0.3 billion over posted collections of $1.3 billion for the three months ended March 31, 2010. Direct operating employee-related costs increased $1.7 million from the three months ended March 31, 2010 to the three months

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ended March 31, 2011. This increase is primarily due to the 14% increase in headcount since March 31, 2010. We increased the professional services headcount in order to meet the current and anticipated demand for our services as our customer base and service offering has expanded to include larger medical groups.

	Three Months Ended March 31,			
	2011	2010	Change	
	Amount	Amount	Amount	Percent
	(in thousands)			
Selling and marketing	$ 16,941	$ 12,060	$ 4,881	40%
Research and development	5,079	4,074	1,005	25%
General and administrative	11,719	11,677	42	0%
Depreciation and amortization	3,398	2,420	978	40%
Total	$ 37,137	$ 30,231	$ 6,906	23%

Selling and Marketing Expense. Selling and marketing expense for the three months ended March 31, 2011, was $16.9 million, an increase of $4.9 million, or 40%, over costs of $12.1 million for the three months ended March 31, 2010. This increase was primarily due to an increase in employee-related costs, stock-based compensation expense, internal sales commissions and external partner channel commission of $3.0 million due to an increase in headcount and external channel partners. Our sales and marketing headcount increased by 39% since March 31, 2010, as we hired additional sales personnel to focus on adding new customers and increasing penetration within our existing markets. The increase was also due to a $1.9 million increase in travel-related expenses, consulting and other software licenses, online marketing, offline marketing and other marketing events.

Research and Development Expense. Research and development expense for the three months ended March 31, 2011, was $5.1 million, an increase of $1.0 million, or 25%, over research and development expense of $4.1 million for the three months ended March 31, 2010. This increase was primarily due to a $1.0 million increase in employee-related costs and stock-based compensation expense due to an increase in headcount. Our research and development headcount increased 26% since March 31, 2010, as we hired additional research and development personnel in order to upgrade and extend our service offerings and develop new technologies.

General and Administrative Expense. General and administrative expense for the three months ended March 31, 2011, remained relatively flat over general and administrative expenses of $11.7 million for the three months ended March 31, 2010. General and administrative expense for the three months ended March 31, 2011, included an increase of $1.0 million due to increase in employee-related costs due to an increase in headcount and an increase in stock-based compensation expense. Our general and administrative headcount increased by 11% since March 31, 2010, as we added personnel to support our growth. The three months ended March 31, 2010, included $1.0 million of non-recurring additional costs relating to our restatement.

Depreciation and Amortization. Depreciation and amortization expense for the three months ended March 31, 2011, was $3.4 million, an increase of $1.0 million, or 40%, over depreciation and amortization expense of $2.4 million for the three months ended March 31, 2010. This was primarily due to higher depreciation from fixed asset expenditures in 2011 and 2010.

	Three Months Ended March 31,			
	2011	2010	Change	
	Amount	Amount	Amount	Percent
Interest income	$ 107	$ 78	$ 29	(37)%

Interest expense		(177)		(217)		40	(18)
Gain (loss) on interest rate derivative contract		65		(60)		125	*
Other income		38		30		8	27
Total other income (expense)	$	33	$	(169)	$	202	*

* not meaningful

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Other Income (Expense). Interest income for the three months ended March 31, 2011, and 2010 was $0.1 million for each period. The interest income was related to the low interest rates during 2011 and 2010. Interest expense for the three months ended March 31, 2011, and 2010 was $0.2 million for each period. The loss on interest rate derivative for the three months ended March 31, 2010, was less than $0.1 million, compared to a gain on interest rate derivative for the three months ended March 31, 2011, of $0.1 million. The gain or loss on the interest rate derivative was the result of the change in the fair market value of a derivative instrument that was not designated a hedge. Although this derivative does not qualify for hedge accounting, we believe that the instrument is closely correlated with the underlying exposure, thus managing the associated risk. The gains or losses from changes in the fair value of derivative instruments that are not accounted for as hedges are recognized in earnings.

Income Tax Provision. We recorded a provision for income taxes for the three months ended March 31, 2011, of approximately $2.3 million compared to $0.3 million for the three months ended March 31, 2010. The decrease in our effective tax rate was due to a decrease in our state tax rate and a decrease in the effect of our permanent differences as percent of the overall rate.

Liquidity and Capital Resources

Sources of Liquidity

Since our inception, we have funded our growth primarily through the private sale of equity securities, totaling approximately $50.6 million, as well as through long-term debt, working capital, equipment-financing loans, and, in September 2007, we completed our initial public offering which provided net proceeds of approximately $81.3 million.

As of March 31, 2011 our principal sources of liquidity consisted of cash, cash equivalents and short-term investments of $102.7 million and long-term investments of $23.0 million. Our cash investments consist of corporate debt securities, U.S. Treasury and government agency securities, and commercial paper. As specified in our investment policy, we place our investments in instruments that meet high credit quality standards, the policy limits the amount of our credit exposure to any one issue or issuer and seeks to manage these assets to achieve our goals of preserving principal, maintaining adequate liquidity at all times, and maximizing returns.

Our total indebtedness was $8.4 million at March 31, 2011. We have an unused revolving credit facility in the amount of $15.0 million. The credit facility may be extended by up to an additional $15.0 million on the satisfaction of certain conditions. There was no balance outstanding on the revolving credit facility during the three months ended March 31, 2011, and 2010. The credit facility expires on September 30, 2011. In addition, we have a term loan facility used for general working capital needs. At March 31, 2011 we had $5.3 million outstanding on the term facility. The term facility matures on September 30, 2013. At March 31, 2011, there was a net present value of $3.2 million in aggregate principal amount outstanding under a series of capital leases with one finance company. Each of the leases are payable on a monthly basis through December 2012.

The credit facility and term loan facility contains certain financial and nonfinancial covenants, including limitations on our consolidated leverage ratio and capital expenditures, defaults relating to non-payment, breach of covenants, inaccuracy of representations and warranties, default under other indebtedness (including a cross-default with our interest rate swap), bankruptcy and insolvency, inability to pay debts, attachment of assets, adverse judgments, ERISA violations, invalidity of loan and collateral documents, and change of control. Upon an event of default, the lenders may terminate the commitment to make loans and the obligation to extend letters of credit, declare the unpaid principal amount of all outstanding loans and interest accrued under the Credit Agreement to be immediately due and payable, require us to provide cash and deposit account collateral for our letter of credit obligations, and exercise their security interests and other rights under the Credit Agreement. As of March 31, 2011, we were in compliance with all financial and non financial covenants under this agreement.

We believe our sources of liquidity will be sufficient to sustain operations, to finance our strategic initiatives, make payments on our contractual obligations, and our purchases of property and equipment for at least the next twelve months. Our analysis is supported by the growth in our new customer base and a high rate of renewal rates with our existing customers and the corresponding increase in billings and collections. We may pursue acquisitions or investments in complementary businesses or technologies, in which case we may need to raise additional funds sooner than expected. There can be no assurance that we will continue to generate cash flows at or above current levels or that we will be able to maintain our ability to borrow under our existing credit facility or obtain additional financing.

Commitments

We enter into various purchase commitments with vendors in the normal course of business. We had no material purchase commitments of capital assets at March 31, 2011. We believe that our existing sources of liquidity will be adequate to fund these purchases during next twelve months. In the normal course of business, we make representations and warranties that guarantee the performance of services under service arrangements with clients. Historically, there has been no material losses related to such guarantees.

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Operating Cash Flow Activities

	For the Three Months Ended March 31,	
	2011	2010
Net Income	$ 3,251	$ 277
Non-cash adjusments to net income	6,513	6,774
Cash provided in changes in operating assets and liabilities	(5,781)	(5,932)
Net cash provided by operating activities	$ 3,983	$ 1,119

Cash flow from operations increased by $2.9 million to $4.0 million for the three months ended March 31, 2011, as compared to $1.1 million for the three months ended March 31, 2010. The increase is mainly attributable to increases in net income, add-backs of non-cash expense items, and decreases in cash used in changes in operating assets and liabilities. The increase in net income is primarily due to the growth in our customer base, stability in renewal rates with our existing customer base and increased adoption of our services, the associated increase in billings and collections, and selling additional services into our existing customer base. These increases are partially offset by an increase in operating expenses that require cash outlays such as salaries, higher commissions, direct operating expenses, and marketing expenses. These expenses increased in absolute terms but remain relatively consistent as a percentage of revenue. The increase in add-backs of non-cash expenses during the three months ended March 31, 2011 and 2010 are primarily due to increases in depreciation and amortization, stock-based compensation expense, and our provision for uncollectible accounts. This is off-set by an increase in excess tax benefits from stock-based awards. The increase in depreciation and amortization was primarily attributed to capital expenditures of $2.1 million during the three months ended March 31, 2011, and capital expenditures of $15.9 million during the year ended December 31, 2010. The increase in stock-based compensation expense is primarily due to the increase in the volume and the value of stock-based awards granted during 2011 over grants in 2010. The decrease to cash used in changes in operating assets and liabilities during the three months ended March 31, 2011, were due primarily to an increase in accounts receivable and a decrease in accrued expenses. Accounts receivable increased approximately $6.1 million to $42.7 million at March 31, 2011 as compared to $36.9 million as of December 31, 2010. The increase can be attributed to the timing of current billings and subsequent payment of those billings as of March 31, 2011 as compared to the same period and timing as of December 31, 2010. The decrease in accrued expenses relates to the timing of the payment of our annual bonuses.

Investing Cash Flow Activities

The cash provided by investing activities increased by $18.4 million to $4.6 million from cash used by investing activities of $13.8 million for the three months ended March 31, 2011, and 2010, respectively. Cash flows from investing activities consist primarily of purchases of property and equipment, capitalized software development costs and our investment activities. We make investments in property and equipment and in software development on an ongoing basis. Our investment in equipment consists primarily of purchases of technology infrastructure to provide service stability and additional capacity to support our expanding client base. We purchased $2.1 million of property and equipment during the three months ended March 31, 2011. Our investment in software development consist of company managed-design, development, and testing of new application functionality with our less mature service offerings, which primarily include our athenaClinicals and athenaCommunicator service offerings. Our capitalized software development amounted to $1.5 million for the three months ended March 31, 2011. Restricted cash decreased $2.9 million due to payments made for contingent consideration relating to acquisitions completed in 2008 and 2009.

Financing Cash Flow Activities

The cash provided by financing activities decreased by $1.4 million to $1.0 million from $2.4 million for the three months ended March 31, 2011, and 2010, respectively. The decrease is attributable to payments of contingent consideration accrued at acquisition date relating to the Anodyne acquisition. This is offset by the proceeds from the exercise of stock options and the increase in the excess tax benefit from stock-based awards. We recorded a reduction in income tax liability of $2.2 million related to excess tax deductions received from employee stock option exercises. The benefit was recorded as additional paid in capital.

Contractual Obligations

We have contractual obligations under our equipment line of credit, revolving and term loans and we also maintain operating leases for property and certain office equipment. The following table summarizes our long-term contractual obligations and commitments as of March 31, 2011:

	Payments Due by Period					
	Total	Less than 1 Year	1 - 3 Years	4 -5 Years	After 5 years	Other
Long-term debt obligations	$ 5,250	$ 300	$ 4,950	$	$	$
Capital lease obligations	3,173	2,366	807			
Operating lease obligations	24,437	5,683	10,721	7,208	825	
Other	1,610					1,610
Total	$ 34,470	$ 8,349	$ 16,478	$ 7,208	$ 825	$ 1,610

These amounts exclude interest payments of $0.3 million that are due in the next three years on the capital lease obligations and $1.0 million that are due in the next four years on our long-term debt obligations.

The commitments under our operating leases shown above consist primarily of lease payments for our Watertown, Massachusetts, headquarters; our Rome, Georgia, offices; our Alpharetta, Georgia, offices; and our Chennai, India, offices.

Other amount consists of uncertain tax benefits. We have not utilized these uncertain tax benefits, nor do we have an expectation of when these uncertain tax benefits would be challenged. As of March 31, 2011, we cannot reasonably estimate when any future cash outlays would occur related to these uncertain tax positions.

Off-Balance Sheet Arrangements

As of March 31, 2011 and 2010, and December 31, 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Other than our operating leases for office space and computer equipment, we do not engage in off-balance sheet financing arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Foreign Currency Exchange Risk. Our results of operations and cash flows are subject to fluctuations due to changes in the Indian rupee. None of our consolidated revenues are generated outside the United States. None of our vendor relationships, including our contracts with our offshore service providers International Business Machines Corporation and Vision Business Process Solutions, Inc., a subsidiary of Dell, Inc. (formerly Perot Systems Corporation), for work performed in India and the Philippines, is denominated in any currency other than the U.S. dollar. For the three months ended March 31, 2011, less than 1% of our expenses occurred in our subsidiary in Chennai, India, and was incurred in Indian rupees. We therefore believe that the risk of a significant impact on our operating income from foreign currency fluctuations is not substantial.

Interest Rate Sensitivity. We had unrestricted cash, cash equivalents and short-term investments totaling $102.7 million and long-term investments totaling $23.0 million at March 31, 2011. These amounts are held for working capital purposes and were invested primarily in deposits, money market funds, and short-term, interest-bearing, investment-grade securities. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. The value of these securities, however, will be subject to interest rate risk and could fall in value if interest rates rise.

Interest Rate Risk. As of March 31, 2011, we had long-term debt and capital lease obligations totaling $8.4 million, which have both variable and fixed interest rate components. We have entered into an interest rate swap intended to mitigate variability in interest rate movements on our term loan. The swap has an amortizing notional amount over the swap agreement. For floating rate debt, interest rate changes generally do not affect the fair market value, but do impact future earnings and cash flows, assuming other factors are held constant.

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The table below summarizes the principal terms of our interest rate swap transaction, including the notional amount of the swap, the interest rate payment we receive from and pay to our swap counterparty, the term of the transaction, and its fair market value at March 31, 2011.

Description	Underlying	Remaining Notional Amount	Receive	Pay	Fiscal Year Entered Into	Maturity (Fiscal Year)	Fair Value at March 31, 2011
Interest rate swap - variable to fixed	Interest on Term Loan	$5,250	LIBOR	4.55% fixed	2008	2028	$ (425)

At March 31, 2011, there were no amounts outstanding under the revolving credit facility; however, we can draw up to $15.0 million under this line of credit at any time. At March 31, 2011, there was $5.3 million outstanding on the term loan. If we had drawn the total available amount, and if the prime rate thereon had fluctuated by 10%, the interest expense would have fluctuated by approximately $0.1 million.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities and Exchange Act of 1934 is (1) recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. As of March 31, 2011 (the Evaluation Date), our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934). Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our Chief Executive Officer and Chief Financial Officer have concluded based upon the evaluation described above that, as of the Evaluation Date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control

There were no changes in our internal control over financial reporting for the quarter ended March 31, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

On March 2, 2010, a complaint was filed by *Prompt Medical Systems, L.P.* naming the Company and several other defendants in a patent infringement case (Prompt Medical Systems, L.P. v. AllscriptsMisys Healthcare Solutions, Inc. et al., Civil Action No. 6:2010cv00071, United States District Court for the Eastern District of Texas). The complaint alleges that the Company has infringed on U.S. Patent No. 5,483,443 with a listed issue date of January 9, 1996 entitled Method for Computing Current Procedural Terminology Codes from Physician Generated Documentation. The complaint seeks an injunction enjoining infringement, damages, and pre- and post-judgment costs and interest. The Company and other several defendants filed motions to dismiss the complaint. On February 11, 2011, the Court issued an Order granting-in-part and denying-in-part the motions to dismiss. The Court ordered the plaintiff to replead certain claims within fourteen days of the Order, and the plaintiff filed its amended complaint on February 23, 2011. The Company filed its answer to the amended complaint and declaratory judgment counterclaims of non-infringement, invalidity, and unenforceability on March 9, 2011.

On November 24, 2010, several defendants filed (i) a motion for summary judgment of invalidity against the patent-in-suit on the basis that it claims only non-patentable subject matter; and (ii) a motion to stay all proceedings pending the resolution of the motion for summary judgment. The Company filed a motion to join in the motion to stay the proceedings. The motions are fully briefed and awaiting a decision by the Court.

The case is currently in the discovery phase. A claim construction hearing is scheduled for November 11, 2011. Trial is scheduled for June 11, 2012.

The Company is being indemnified in this lawsuit from and against any liability and reasonable costs, including attorneys fees, incurred by the Company in its defense, pursuant to a license agreement with its vendor.

The Company believes that it has meritorious defenses to the lawsuit and continues to contest it vigorously.

On March 19, 2010, a putative shareholder class action complaint was filed in the United States District Court for the District of Massachusetts against the Company and certain of its current and former officers entitled Casula v. athenahealth, Inc. et al, Civil Action No. 1:10-cv-10477. On June 3, 2010, the court appointed Waterford Township General Employees Retirement System as the lead plaintiff. On August 2, 2010, the lead plaintiff filed an amended complaint. The amended complaint alleges that the defendants violated the federal securities laws by disseminating false and misleading statements through press releases, statements by senior management, and SEC filings. The alleged false and misleading statements concern, among other things, the amortization period for deferred implementation revenues. The amended complaint seeks unspecified damages, costs, and expenses. The defendants filed a motion to dismiss the amended complaint on October 1, 2010, and a reply brief in further support of the motion to dismiss the amended complaint on December 30, 2010. The Company believes that it has meritorious defenses to the amended complaint and will contest the claims vigorously.

On March 17, 2011, a complaint was filed by *PPS Data, LLC* naming the Company and several other defendants in a patent infringement case (PPS Data, LLC v. Allscripts Healthcare Solutions, Inc. et al, Civil Action No. 3:11-CU-273-J-99MMH-TEM, United States District Court for the Middle District of Florida). The complaint alleges that the Company has infringed on U.S. Patent No. 6,343,271 with a listed issue date of January 29, 2002 entitled Electronic Creation, Submission, Adjudication, and Payment of Health Insurance Claims. The complaint seeks an injunction enjoining infringement, damages, pre- and post-judgment costs and interest, and attorneys fees. On April 14, 2011, the Company filed a motion to dismiss, or, in the alternative a motion for summary judgment. The Company believes that it has meritorious defenses to the complaint and will contest the claims vigorously.

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

Item 1A. Risk Factors.

During the three months ended March 31, 2011, there were no material changes to the risk factors that were disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010.

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

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

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Item 4. (Removed and Reserved).

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

(a) Exhibits.

Exhibit No.	Exhibit Index
10.1*	Employment Agreement by and between the Registrant and Stephen Kahane, dated February 18, 2011.
10.2(i)	The athenahealth Executive Plan.
#10.3*	Amendment No. 1 to Professional Services Agreement by and between the Registrant and International Business Machines Corporation, dated March 11, 2011.
31.1*	Rule 13a-14(a) or 15d-14 Certification of Chief Executive Officer
31.2*	Rule 13a-14(a) or 15d-14 Certification of Chief Financial Officer
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Exchange Act rules 13a-14(b) or 15d-14(b) and 18 U.S.C. Section 1350
101.INS**	XBRL Instance Document.
101.SCH**	XBRL Schema Document.
101.CAL**	XBRL Calculation Linkbase Document.
101.LAB**	XBRL Labels Linkbase Document.
101.PRE**	XBRL Presentation Linkbase Document.

Indicates a management contract or any compensatory plan, contract, or arrangement.

\# Application has been made to the Securities and Exchange Commission for confidential treatment of certain provisions. Omitted material for which confidential treatment has been requested has been filed separately with the Securities and Exchange Commission.

(i) Incorporated by reference to the Registrant s current report on Form 8-K, filed February 22, 2011.

* Filed herewith.

** Extensible Business Reporting Language (XBRL) information is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

SIGNATURES

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

ATHENAHEALTH, INC.

By: /s/ Jonathan Bush
Jonathan Bush
Chief Executive Officer, President, and Chairman

By: /s/ Timothy M. Adams
Timothy M. Adams
Chief Financial Officer, Senior Vice President

Date: April 29, 2011