ENVESTNET, INC.
Form 10-Q
May 08, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

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

Commission file number 001-34835

Envestnet, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-1409613**
(State or other jurisdiction of incorporation or organization)	(I.R.S Employer Identification No.)
35 East Wacker Drive, Suite 2400, Chicago, IL	**60601**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code:

(312) 827-2800

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

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

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

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

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

As of May 1, 2015, 35,292,156 shares of the common stock with a par value of $0.005 per share were outstanding.

Table of Contents

TABLE OF CONTENTS

	Page
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
Condensed Consolidated Balance Sheets as of March 31, 2015 and December 31, 2014	3
Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014	4
Condensed Consolidated Statement of Equity for the three months ended March 31, 2015	5
Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and 2014	6
Notes to Condensed Consolidated Financial Statements	7
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	20
Forward-Looking Statements	20
Overview	21
Results of Operations	24
Liquidity and Capital Resources	29
Item 3. Quantitative and Qualitative Disclosures About Market Risk	30
Item 4. Controls and Procedures	30
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	32
Item 1A. Risk Factors	32
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	32
Item 6. Exhibits	32

Table of Contents

Envestnet, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share information)

(unaudited)

	March 31, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 209,914	$ 209,754
Fees and other receivable, net	26,198	20,345
Deferred tax assets, net	4,635	4,654
Prepaid expenses and other current assets	20,091	7,242
Total current assets	260,838	241,995
Property and equipment, net	17,087	16,629
Internally developed software, net	7,555	7,023
Intangible assets, net	58,514	58,654
Goodwill	104,976	104,976
Deferred tax assets, net		565
Other non-current assets	9,846	9,516
Total assets	$ 458,816	$ 439,358
Liabilities and Equity		
Current liabilities:		
Accrued expenses	$ 47,146	$ 48,247
Accounts payable	5,151	4,869
Contingent consideration	7,139	6,405
Deferred revenue	5,702	5,159
Total current liabilities	65,138	64,680
Convertible notes	146,411	145,203
Contingent consideration	5,624	7,462
Deferred revenue	10,499	6,954
Deferred rent	3,861	3,588
Lease incentive	5,445	5,550
Deferred tax liabilities, net	1,304	
Other non-current liabilities	2,374	2,430
Total liabilities	240,656	235,867
Commitments and contingencies		
Redeemable units in ERS, LLC	1,500	1,500
Equity:		
Stockholders equity:		
Preferred stock, par value $0.005, 50,000,000 shares authorized		
Common stock, par value $0.005, 500,000,000 shares authorized; 47,119,054 and 46,345,376 shares issued as of March 31, 2015 and December 31, 2014, respectively; 35,201,151 and 34,544,653 shares outstanding as of March 31, 2015 and December 31, 2014, respectively	236	232

Additional paid-in capital		252,483		233,888
Accumulated deficit		(16,932)		(19,443)
Treasury stock at cost, 11,917,903 and 11,800,723 shares as of March 31, 2015 and December 31, 2014, respectively		(19,683)		(13,242)
Total stockholders equity		216,104		201,435
Non-controlling interest		556		556
Total equity		216,660		201,991
Total liabilities and equity	$	458,816	$	439,358

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

Table of Contents

Envestnet, Inc.

Condensed Consolidated Statements of Operations

(in thousands, except share and per share information)

(unaudited)

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Revenues:		
Assets under management or administration	$ 81,077	$ 67,081
Licensing and professional services	15,377	11,458
Total revenues	96,454	78,539
Operating expenses:		
Cost of revenues	38,695	34,437
Compensation and benefits	31,535	23,459
General and administration	14,209	12,150
Depreciation and amortization	5,333	4,422
Total operating expenses	89,772	74,468
Income from operations	6,682	4,071
Other (expense) income	(2,203)	81
Income before income tax provision	4,479	4,152
Income tax provision	1,968	1,284
Net income	2,511	2,868
Add: Net loss attributable to non-controlling interest		126
Net income attributable to Envestnet, Inc.	$ 2,511	$ 2,994
Net income per share attributable to Envestnet, Inc.:		
Basic	$ 0.07	$ 0.09
Diluted	$ 0.07	$ 0.08
Weighted average common shares outstanding:		
Basic	35,147,043	34,115,444
Diluted	37,316,934	36,558,983

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

Table of Contents

Envestnet, Inc.

Condensed Consolidated Statement of Equity

(in thousands, except share information)

(unaudited)

	Common Stock		Treasury Stock		Additional			
	Shares	Amount	Common Shares	Amount	Paid-in Capital	Accumulated Deficit	Non-controlling Interest	Total Equity
Balance, December 31, 2014	46,345,376	$ 232	(11,800,723)	$ (13,242)	$ 233,888	$ (19,443)	$ 556	$ 201,991
Exercise of stock options	415,512	2			3,708			3,710
Issuance of common stock - vesting of restricted stock	358,166	2						2
Stock-based compensation expense					3,419			3,419
Excess tax benefits from stock-based compensation expense					11,468			11,468
Purchase of treasury stock for stock-based minimum tax withholdings			(117,180)	(6,441)				(6,441)
Net income						2,511		2,511
Balance, March 31, 2015	47,119,054	236	(11,917,903)	(19,683)	252,483	(16,932)	556	216,660

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

Table of Contents

Envestnet, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
OPERATING ACTIVITIES:		
Net income	$ 2,511	$ 2,868
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,333	4,422
Deferred rent and lease incentive	168	(97)
Deferred income taxes	1,888	
Stock-based compensation	3,419	2,568
Excess tax benefits from stock-based compensation	(11,468)	
Interest expense	2,356	
Accretion on contingent consideration	342	412
Fair market value adjustment on contingent consideration	(1,446)	
Changes in operating assets and liabilities, net of acquisitions:		
Fees receivable	(5,853)	(2,128)
Prepaid expenses and other current assets	(1,375)	(123)
Other non-current assets	(661)	(284)
Accrued expenses	(2,180)	(3,700)
Accounts payable	188	1,269
Deferred revenue	4,088	1,091
Other non-current liabilities	(58)	21
Net cash provided by (used in) operating activities	(2,748)	6,319
INVESTING ACTIVITIES:		
Purchase of property and equipment	(2,058)	(2,002)
Capitalization of internally developed software	(1,132)	(860)
Acquisition of business, net of cash acquired	(2,641)	
Net cash used in investing activities	(5,831)	(2,862)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	3,710	839
Purchase of treasury stock for stock-based minimum tax withholdings	(6,441)	(1,609)
Excess tax benefits from stock-based compensation expense	11,468	
Issuance of restricted stock	2	
Net cash provided by (used in) financing activities	8,739	(770)
INCREASE IN CASH AND CASH EQUIVALENTS	160	2,687
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	209,754	49,942
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 209,914	$ 52,629
Supplemental disclosure of cash flow information - cash paid during the period for income taxes, net of refunds	$ 475	$ 114

Supplemental disclosure of cash flow information - cash paid during the period for interest	65	
Supplemental disclosure of non-cash operating, investing and financing activities:		
Settlement of contingent consideration liability upon issuance of ERS, LLC membership interest		284
Acquired purchase option		400

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

1. Organization and Description of Business

Envestnet, Inc. (Envestnet) and its subsidiaries (collectively, the Company) provide open-architecture wealth management services and technology to independent financial advisors and financial institutions. These services and related technology are provided via Envestnet s wealth management software, Envestnet | PMC®, Envestnet | Tamarac , Vantage Reporting Solution , Envestnet | WMS and Envestnet | Placemark .

Envestnet s wealth management software is a platform of integrated, internet-based technology applications and related services that provide portfolio diagnostics, proposal generation, investment model management, rebalancing and trading, portfolio performance reporting and monitoring solutions, billing, and back-office and middle-office operations and administration.

The Company s investment consulting group, Envestnet | PMC, provides investment manager due diligence and research, a full spectrum of investment offerings supported by both proprietary and third-party research and manager selection, and overlay portfolio management services.

Envestnet | Tamarac provides leading portfolio accounting, rebalancing, trading, performance reporting and client relationship management software, principally to high-end registered investment advisers (RIAs).

Vantage Reporting Solution software aggregates and manages investment data, provides performance reporting and benchmarking, giving advisors an in-depth view of clients various investments, empowering advisors to give holistic, personalized advice.

Envestnet | WMS offers financial institutions access to an integrated wealth platform, which helps construct and manage sophisticated portfolio solutions across an entire account life cycle, particularly in the area of unified managed account trading. Envestnet | WMS s Overlay Portfolio Management console helps wealth managers efficiently build customized client portfolios that consider both proprietary and open-architecture investment solutions.

Envestnet | Placemark develops unified managed account (UMA) programs and other portfolio management outsourcing solutions, including patented portfolio overlay and tax optimization services, for banks, full service broker-dealers and RIA firms.

Through these platform and service offerings, the Company provides open-architecture support for a wide range of investment products (separately managed accounts, multi-manager accounts, mutual funds, exchange-traded funds, stock baskets, alternative investments, and other fee-based investment solutions) from Envestnet | PMC and other leading investment providers via multiple custodians, and also account administration and reporting services.

Envestnet operates six RIAs and a registered broker-dealer. The RIAs are registered with the Securities and Exchange Commission (SEC). The broker-dealer is registered with the SEC, all 50 states and the District of Columbia and is a member of the Financial Industry Regulatory Authority (FINRA).

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company as of March 31, 2015 and for the three months ended March 31, 2015 and 2014 have not been audited by an independent registered public accounting firm. These unaudited condensed consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements for the year ended December 31, 2014 and reflect all normal recurring adjustments which are, in the opinion of management, necessary to present fairly the Company s financial position as of March 31, 2015 and the results of operations, equity and cash flows for the periods presented herein. The unaudited condensed consolidated balance sheet as of December 31, 2014 was derived from the Company s audited financial statements for the year ended December 31, 2014 but does not include all disclosures, including notes required by accounting principles generally accepted in the United States of America (GAAP). The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the operating results to be expected for other interim periods or for the full fiscal year.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 2, 2015.

The preparation of these unaudited condensed consolidated financial statements requires management to make estimates and assumptions related to the reporting of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Significant areas requiring the use of management estimates relate to estimating uncollectible receivables, revenue recognition, costs capitalized for internally developed software, valuations and assumptions used for impairment testing of goodwill, intangible and other long-lived assets, fair value of stock and stock options issued, fair value of contingent consideration, realization of deferred tax assets, uncertain tax positions and assumptions used to allocate purchase prices in business combinations. Actual results could differ materially from these estimates under different assumptions or conditions.

Recent Accounting Pronouncements - On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its consolidated financial statements.

3. Business Acquisition

Upside Holdings, Inc.

On February 24, 2015, Envestnet, Inc. (the Company) acquired all of the stock of Upside Holdings, Inc. (including its subsidiaries Upside) for cash consideration totaling $3,040, subject to certain post-closing adjustments.

Upside is a technology company that is registered as an Internet Investment Adviser under Rule 203A-2(f) of the Investment Advisers Act of 1940 (Advisers Act). Upside helps financial advisors compete against other digital advisors, or robo advisors, by leveraging technology and algorithms to advise, manage, and serve clients who want personalized investment services.

The Company acquired Upside to integrate its technology within the Company s unified wealth management platform, which will allow advisors to compete more aggressively to engage their clients online and reach a new class of investors.

As of March 31, 2015, the Company has not finalized the working capital adjustment amount, the opening balance sheet (including taxes), nor has the Company performed a valuation of Upside s possible intangible assets and/or goodwill associated with the transaction. The Company expects to finalize the valuation of the intangible assets, and complete the acquisition accounting as soon as practicable but no later than September 30, 2015.

As a result of the acquisition of Upside, the Company provided for the future grant of unvested restricted stock awards to Upside employees at the end of each year in 2015, 2016 and 2017 upon Upside meeting certain performance conditions and then a subsequent two year service condition (Note 13). If 100 percent of the awards are earned for 2015, 2016 and 2017, the maximum number of shares that could be granted for 2015, 2016 and 2017 equals 22,064, 44,128 and 66,192 shares of common stock, respectively.

The preliminary estimated consideration transferred in the acquisition was as follows:

Upfront consideration	$	2,425
Purchase liabilities		615
Estimated working capital settlement		(385)
Cash acquired		(14)
	$	2,641

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

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

Total tangible assets acquired	$	7
Total liabilities assumed		(427)
Identifiable intangible assets		3,061
Total net assets acquired	$	2,641

The results of Upside s operations are included in the condensed consolidated statement of operations beginning February 24, 2015, and are not considered material to the Company s results of operations.

For the three months ended March 31, 2015, acquisition related costs for Upside totaled $202 and are included in general and administration expenses.

Pro forma results for Envestnet, Inc. giving effect to the Placemark acquisition

The following pro forma financial information presents the combined results of operations of Envestnet and Placemark, acquired on October 1, 2014, for the three months ended March 31, 2014. The pro forma financial information presents the results as if the acquisition had occurred as of the beginning of 2014. The results of Upside are not included in the pro forma financial information presented below as the Upside acquisition was not considered material to the Company s results of operations.

The unaudited pro forma results presented include amortization charges for acquired intangible assets, imputed interest expense, stock-based compensation expense and the related tax effect on the aforementioned items.

Pro forma financial information is presented for informational purposes and is not indicative of the results of operations that would have been achieved if the acquisition had taken place as of the beginning of 2014.

	Three Months Ended March 31, 2014

Revenues	$	83,930
Net income		2,453
Net income per share:		
Basic		0.07
Diluted		0.06

4. Property and Equipment

	Estimated Useful Life		March 31, 2015		December 31, 2014
Cost:					
Office furniture and fixtures	5-7 years	$	5,052	$	4,993
Computer equipment and software	3 years		19,929		18,540
Other office equipment	5 years		86		144
Leasehold improvements	Shorter of the lease term or useful life of the asset		11,015		10,805
			36,082		34,482
Less accumulated depreciation and amortization			(18,995)		(17,853)
Property and equipment, net		$	17,087	$	16,629

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

Depreciation and amortization expense was as follows:

	Three Months Ended March 31, 2015	2014
Depreciation and amortization expense	$ 1,600	$ 1,489

5. Internally Developed Software

Internally developed software consists of the following:

	Estimated Useful Life	March 31, 2015	December 31, 2014
Internally developed software	5 years	$ 20,709	$ 19,577
Less accumulated amortization		(13,154)	(12,554)
Internally developed software, net		$ 7,555	$ 7,023

Amortization expense was as follows:

	Three Months Ended March 31, 2015	2014
Amortization expense	$ 600	$ 489

6. Intangible Assets

Intangible assets consist of the following:

		March 31, 2015			December 31, 2014		
	Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer lists	4 - 12 years	$ 68,603	$ (24,015)	$ 44,588	$ 68,603	$ (21,699)	$ 46,904
Proprietary technologies	1.5 - 8 years	18,671	(6,458)	12,213	15,678	(5,808)	9,870
Trade names	5 years	3,090	(1,377)	1,713	3,090	(1,210)	1,880
Total intangible assets		$ 90,364	$ (31,850)	$ 58,514	$ 87,371	$ (28,717)	$ 58,654

Amortization expense was as follows:

	Three Months Ended March 31, 2015	2014
Amortization expense	$ 3,133	$ 2,444

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

7. Other Non-Current Assets

Other non-current assets consist of the following:

	March 31, 2015	December 31, 2014
Investment in private company	$ 1,250	$ 1,250
Deposits:		
Lease	1,811	1,811
Other	474	436
Unamortized convertible debt issuance costs	4,418	4,612
Other	1,893	1,407
	$ 9,846	$ 9,516

8. Fair Value Measurements

The Company follows ASC 825-10, *Financial Instruments*, which provides companies the option to report selected financial assets and liabilities at fair value. ASC 825-10 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of the company s choice to use fair value on its earnings. ASC 825-10 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet. The Company has not elected the ASC 825-10 option to report selected financial assets and liabilities at fair value.

Financial assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon a fair value hierarchy established by GAAP, which prioritizes the inputs used to measure fair value into the following levels:

Level 1: Inputs based on quoted market prices in active markets for identical assets or liabilities at the measurement date.

Level 2: Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or inputs that are observable and can be corroborated by observable market data.

Level 3: Inputs reflect management s best estimates and assumptions of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the valuation of the instruments.

Fair Value on a Recurring Basis:

The Company periodically invests excess cash in money-market funds not insured by the FDIC. The Company believes that the investments in money market funds are on deposit with creditworthy financial institutions and that the funds are highly liquid. The fair values of the Company s investments in money-market funds are based on the daily quoted market prices for the net asset value of the various money market funds. These money-market funds totaled approximately $52,721 and $70,760 as of March 31, 2015 and December 31, 2014, respectively, and are included in cash and cash equivalents in the condensed consolidated balance sheets.

The fair value of the contingent consideration liability related to the WMS acquisition on July 1, 2013 was estimated using a discounted cash flow method with significant inputs that are not observable in the market and thus represents a Level 3 fair value measurement as defined in ASC 820, *Fair Value Measurements and Disclosures*. The significant inputs in the Level 3 measurement not supported by market activity included our assessments of expected future cash flows related to our acquisition of WMS during the subsequent three years from the date of acquisition, appropriately discounted considering the uncertainties associated with the obligation, and calculated in accordance with the terms of the agreement.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

The Company utilized a discounted cash flow method with expected future performance of WMS, and its ability to meet the target performance objectives as the main driver of the valuation, to arrive at the fair value of the contingent consideration. The Company will continue to reassess the fair value of the contingent consideration at each reporting date until settlement. Changes to the estimated fair value of the contingent consideration will be recognized in earnings of the Company.

The fair value of the contingent consideration liability related to the Klein acquisition on July 1, 2014 was estimated using a discounted cash flow method with significant inputs that are not observable in the market and thus represents a Level 3 fair value measurement as defined in ASC 820, *Fair Value Measurements and Disclosures*. The significant inputs in the Level 3 measurement not supported by market activity included our assessments of expected future cash flows related to our acquisition of Klein during the subsequent three years from the date of acquisition, appropriately discounted considering the uncertainties associated with the obligation, and calculated in accordance with the terms of the agreement.

The Company utilized a discounted cash flow method with expected future performance of Klein to arrive at the fair value of the contingent consideration. The Company will continue to reassess the fair value of the contingent consideration at each reporting date until settlement. Changes to the estimated fair value of the contingent consideration will be recognized in earnings of the Company.

The table below sets forth a summary of changes in the fair value of the Company s Level 3 liability for the three months ended March 31, 2015:

		Fair Value of Contingent Consideration Liabilities
Balance at December 31, 2014	$	13,867
Fair market value adjustments		(1,446)
Imputed interest		342
Balance at March 31, 2015	$	12,763

The Company assesses the categorization of assets and liabilities by level at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer, in accordance with the Company s accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. There were no transfers between Levels 1, 2 and 3 during the quarter.

Following are the carrying and fair value of the Company s debt obligation as of December 31, 2014. The fair value of the Convertible Notes was calculated using observable market data and is considered a Level 1 liability.

	March 31, 2015	
	Carrying Value	Fair Value
2019 Convertible Notes (principal amount outstanding of $172,500)	$ 146,411(1)	$ 195,489

(1) Represents the aggregate principal amount outstanding of the Convertible Notes less the unaccreted discount.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

9. Accrued Expenses

Accrued expenses consist of the following:

	March 31, 2015	December 31, 2014
Accrued investment manager fees	$ 26,433	$ 25,195
Accrued compensation and related taxes	13,931	18,344
Accrued professional services	697	536
Estimated accrued software license fees	800	800
Other accrued expenses	5,285	3,372
	$ 47,146	$ 48,247

10. Income Taxes

The following table includes the Company s income before income tax provision, income tax provision and effective tax rate:

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Income before income tax provision	$ 4,479	$ 4,152
Income tax provision	1,968	1,284
Effective tax rate	43.9%	30.9%

The Company s effective tax rate in the three months ended March 31, 2015, was higher than the effective tax rate in the three months ended March 31, 2014, primarily due to the increase in tax rate for federal purposes from 34% to 35%, the true-up on India unremitted earnings that was recorded in the three months ended March 31, 2014 and not in the same period in 2015, and the release of certain uncertain tax position reserves in the three months ended March 31, 2014 that were not repeated in the same period in 2015.

The liability for unrecognized tax benefits reported in other non-current liabilities was $2,081 and $2,092 at March 31, 2015 and December 31, 2014, respectively. At March 31, 2015, the amount of unrecognized tax benefits that would benefit the Company s effective tax rate, if recognized, was $1,962. At this time, the Company estimates it is reasonably possible that the liability for unrecognized tax benefits will decrease by as much as $1,217 in the next twelve months due to the completion of reviews by tax authorities, the voluntary filing of certain state income taxes and the expiration of certain statutes of limitations.

The Company recognizes potential interest and penalties related to unrecognized tax benefits in income tax expense. The Company had accrued interest and penalties of $568 and $594 as of March 31, 2015 and December 31, 2014, respectively.

The Company files a consolidated federal income tax return and separate tax returns with various states. Additionally, foreign subsidiaries of the Company file tax returns in foreign jurisdictions. The Company s tax returns for the calendar years ended December 31, 2013, 2012, and 2011 remain open to examination by the Internal Revenue Service in their entirety. With respect to state taxing jurisdictions, the Company s tax returns for calendar years ended December 31, 2013, 2012, 2011, 2010 and 2009 remain open to examination by various state revenue services.

The Company s Indian subsidiary is currently under examination by the India Tax Authority for the fiscal year ended March 31, 2009, 2011 and 2012. It is possible that one or more of these audits may be finalized within the next twelve months.

Included in prepaid expenses and other current assets on the condensed consolidated balance sheet as of March 31, 2015 is $13,355 primarily related to excess tax benefits from stock-based compensation.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

11. Debt

The Company s outstanding debt obligations were as follows:

	March 31, 2015	December 31, 2014
Convertible Notes	$ 172,500	$ 172,500
Unaccreted discount on Convertible Notes	(26,089)	(27,297)
	$ 146,411	$ 145,203

Credit Agreement

In 2014, the Company and certain of its subsidiaries entered into a credit agreement (the Credit Agreement) with a group of banks (the Banks), for which Bank of Montreal is acting as administrative agent, pursuant to which the Banks agreed to provide an unsecured revolving credit facility of $100,000 with a sublimit for the issuance of letters of credit of $5,000. Subject to certain conditions, the Company has the right to increase the facility by up to $25,000. The Credit Agreement is scheduled to mature on December 8, 2017, at which time any aggregate principal amount of borrowings outstanding would become payable in full. Any borrowings made under the Credit Agreement accrued interest at rates between 1.50 percent and 3.25 percent above LIBOR based on the Company s total leverage ratio. There is also a commitment fee equal to 0.25 percent per annum on the daily unused portion of the facility.

Borrowings under the Credit Agreement will be guaranteed by substantially all of the Company s U.S. subsidiaries. Proceeds under the Credit Agreement may be used to finance capital expenditures, to finance working capital, to finance permitted acquisitions and for general corporate purposes.

The Credit Agreement contains customary conditions, representations and warranties, affirmative and negative covenants and events of default. The covenants include certain financial covenants requiring the Company to maintain compliance with a maximum senior leverage ratio, a maximum total leverage ratio, a minimum interest coverage ratio and minimum adjusted EBITDA, and provisions that limit the ability of the Company and its subsidiaries to incur debt, make investments, sell assets, create liens, engage in transactions with affiliates, engage in mergers and acquisitions, pay dividends and other restricted payments, grant negative pledges and change their business activities. As of March 31, 2015, there were no amounts outstanding under the Credit Agreement. The Company was in compliance with all covenants of the Credit Agreement as of March 31, 2015.

Convertible Notes

On December 15, 2014, the Company issued $172,500 of Convertible Notes. Net proceeds from the offering were $166,967. The Convertible Notes bear interest at a rate of 1.75 percent per annum payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2015.

The Convertible Notes are general unsecured obligations, subordinated in right of payment to our obligations under our Credit Agreement. The Convertible Notes rank equally in right of payment with all of the Company s existing and future senior indebtedness and will be senior in right of payment to any of the Company s future subordinated indebtedness. The Convertible Notes will be structurally subordinated to the indebtedness and other liabilities of any of our subsidiaries, other than to the extent the Convertible Notes are guaranteed in the future by our subsidiaries as described in the indenture and will be effectively subordinated to and future secured indebtedness to the extent of the value of the assets securing such indebtedness. Certain of our subsidiaries guarantee our obligations under our Credit Agreement.

Upon the occurrence of a fundamental change , as defined in the indenture, the holders may require the Company to repurchase all or a portion of the Convertible Notes for cash at 100% of the principal amount of the Convertible Notes being purchased, plus any accrued and unpaid interest.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

The Convertible Notes are convertible into shares of the Company s common stock under certain circumstances prior to maturity at a conversion rate of 15.9022 shares per $1 principal amount of the Convertible Notes, which represents a conversion price of $62.88 per share, subject to adjustment under certain conditions. Holders may convert their Convertible Notes at their option at any time prior to the close of business on the business day immediately preceeding July 1, 2019, only under the following circumstances: (a) during any calendar quarter commencing after the calendar quarter ending on March 31, 2015 (and only during such calendar quarter), if the last reported sale price of our common stock, for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter immediately preceding the calendar quarter in which the conversion occurs, is more than 130% of the conversion price of the Convertible Notes in effect on each applicable trading day; (b) during the five consecutive business-day period following any five consecutive trading-day period in which the trading price for the Convertible Notes for each such trading day was less than 98% of the last reported sale price of our common stock on such date multiplied by the then-current conversion rate; or (c) upon the occurrence of specified corporate events as defined in the indenture.

Upon conversion, the Company may pay cash, shares of the Company s common stock or a combination of cash and stock, as determined by the Company in its discretion.

The Company has separately accounted for the liability and equity components of the Convertible Notes by allocating the proceeds from issuance of the Convertible Notes between the liability component and the embedded conversion option, or equity component. This allocation was done by first estimating an interest rate at the time of issuance for similar notes that do not include the embedded conversion option. The Company allocated $26,618 to the equity component, net of offering costs of $882. The Company recorded a discount on the Convertible Notes of $27,500 which will be accreted and recorded as additional interest expense over the life of the Convertible Notes. During the three-month period ended March 31, 2015, the Company recognized $1,210 in accretion related to the discount. The effective interest rate of the liability component of the Convertible Notes is equal to the stated interest rate plus the accretion of original issue discount. The effective interest rate on the liability component of the Convertible Notes for the three-month period ended March 31, 2015 was 6.1%.

In connection with the issuance of the Convertible Notes, the Company incurred $4,651 of issuance costs, which are recorded in other non-current assets (see Note 7). These costs are being amortized and are recorded as additional interest expense over the life of the Convertible Notes.

Interest expense on the Convertible Notes was comprised of the following:

		March 31, 2015
Coupon interest	$	755
Amortization of issuance costs		241

Accretion of debt discount		1,210
	$	2,206

See Note 13 for further discussion of the effect of conversion on net income per common share.

12. Stock-Based Compensation

The Company has stock options and restricted stock outstanding under the 2004 Stock Incentive Plan (the 2004 Plan), the 2010 Long-Term Incentive Plan (the 2010 Plan) and the Envestnet, Inc. Management Incentive Plan for Envestnet | Tamarac Management Employees (the 2012 Plan). As of March 31, 2015, the maximum number of stock options and restricted stock available for future issuance under the Company s plans is 411,411.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

Employee stock-based compensation expense under the Company s plans was as follows:

	Three Months Ended March 31, 2015	2014
Employee stock-based compensation expense	$ 3,419	$ 2,568
Tax effect on employee stock-based compensation expense	(1,502)	(1,027)
Net effect on income	$ 1,917	$ 1,541

Stock Options

The following weighted average assumptions were used to value options granted during the periods indicated:

	Three Months Ended March 31, 2015	2014
Grant date fair value of options	$ 21.15	$ 16.81
Volatility	37.5%	38.7%
Risk-free interest rate	1.7%	1.8%
Dividend yield	0.0%	0.0%
Expected term (in years)	6.0	6.0

The following table summarizes option activity under the Company s plans:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2014	4,265,337	$ 10.73		
Granted	148,677	54.02		
Exercised	(415,512)	8.93		
Forfeited	(9,941)	24.94		

Outstanding as of March 31, 2015	3,988,561	12.50	4.8	$	173,837
Options exercisable	3,539,385	9.31	4.2		165,525

Exercise prices of stock options outstanding as of March 31, 2015 range from $0.11 to $55.29. At March 31, 2015, there was $5,780 of unrecognized stock-based compensation expense related to unvested stock options, which the Company expects to recognize over a weighted-average period of 2.5 years.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

Restricted Stock

Periodically, the Company grants restricted stock awards to employees that vest one-third on each of the first three anniversaries of the grant date. The following is a summary of the activity for unvested restricted stock awards granted under the Company s plans:

	Number of Shares		Weighted-Average Grant Date Fair Value per Share
Balance at December 31, 2014	1,098,674	$	33.72
Granted	207,531		53.89
Vested	(176,532)		26.30
Forfeited	(6,637)		33.53
Balance at March 31, 2015	1,123,036		38.61

At March 31, 2015, there was $22,066 of unrecognized stock-based compensation expense related to unvested restricted stock awards, which the Company expects to recognize over a weighted-average period of 2.5 years. At March 31, 2015, there was an additional $2,038 of potential unrecognized stock-based compensation expense related to unvested restricted stock granted under the 2012 Plan that vests based upon Tamarac meeting certain performance conditions and then a subsequent two-year service condition, which the Company expects to recognize over the remaining estimated vesting period of 2.0 years.

On March 31, 2015, 87,381 shares of restricted stock granted under the 2012 Plan became performance vested under the third year performance condition. These shares will become fully vested upon employees meeting the subsequent two-year service condition.

13. Earnings Per Share

Basic net income per common share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding for the period. For the calculation of diluted earnings per share, the basic weighted average number of shares is increased by the dilutive effect of stock options, common warrants, restricted stock and Convertible Notes using the treasury stock method.

The Company accounts for the effect of the Convertible Notes on diluted net income per share using the treasury stock method since they may be settled in cash, shares or a combination thereof at the Company s option. As a result, the Convertible Notes have no effect on diluted net income per share until the Company s stock price exceeds the conversion price of $62.88 per share. In the period of conversion, the Convertible Notes will have no impact on diluted net income if the Convertible Notes are settled in cash and will have an impact on dilutive net income per share if the Convertible Notes are settled in shares upon conversion.

Table of Contents

Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

The following table provides a reconciliation of the numerators and denominators used in computing basic and diluted net income per share attributable to Envestnet, Inc.:

	Three Months Ended March 31, 2015	2014
Net income attributable to Envestnet, Inc.	$ 2,511	$ 2,994
Basic number of weighted-average shares outstanding	35,147,043	34,115,444
Effect of dilutive shares:		
Options to purchase common stock	1,988,124	2,230,313
Unvested restricted stock		