Canopy Financial 2008 Audited 0629 202043972.pdf

KPMG

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Directors
Canopy Financial

We have audited the accompanying consolidated balance sheets of Canopy Financial (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Canopy Financial as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

June 29, 2009

Canopy Financial, Inc.

Consolidated Financial Statements

December 31, 2008 and 2007

(With Independent Auditors' Report Thereon)

Canopy Financial, Inc.
Consolidated Balance Sheets
December 31, 2008 and 2007

Assets		2008	2007
Current assets:			
Cash and cash equivalents	$	6,921,934	7,139,482
Accounts receivable, net		3,763,212	1,040,194
Other current assets		2,450,500	264,000
Total current assets		13,135,646	8,443,676
Property and equipment, net		10,644,375	2,356,428
Other assets		118,421	34,500
Total assets	$	23,898,442	10,834,604
Liabilities and Stockholders' Equity			
Current liabilities:			
Accounts payable	$	582,011	354,029
Deferred revenue		1,229,987	3,001,938
Promissory note due to related party		2,000,000	-
Short term debt obligations		2,119,238	1,076,077
Total current liabilities		5,931,236	4,432,044
Preferred stock :			
Series A Preferred Stock, $.001 par value. Authorized, 7,305,609; outstanding, 7,305,609 at December 31, 2008 and 2007			
Series B Preferred Stock, $.001 par value. Authorized, 4,374,135; outstanding, 4,374,135 at December 31, 2008 and 2007			
Series C Preferred Stock, $.001 par value. Authorized, 1,701,108 and 2,592,163 at December 31, 2008 and 2007, respectively; outstanding, 1,620,102 at December 31, 2008 and 2007			
Series C-1 Preferred Stock, $.001 par value. Authorized, 2,401,977; outstanding, 2,401,977 at December 31, 2008			
Common stock :			
Common Stock, $.001 par value. Authorized, 32,000,000 and 30,000,000 at December 31, 2008 and 2007, respectively; outstanding, 10,785,636 and 10,741,886 at December 31, 2008 and 2007, respectively			
Capital in excess of par value		14,555,247	6,563,247
Retained earnings		3,411,959	(160,687)
Total stockholders' equity		17,967,206	6,402,560
Total liabilities and stockholders' equity	$	23,898,442	10,834,604

Canopy Financial, Inc.
Consolidated Statements of Operations
Years ended December 31, 2008 and 2007

		2008	2007
Revenue before reimbursements	$	19,467,300	9,387,572
Reimbursements		61,420	35,081
Total revenue		19,528,720	9,422,653
Selling, general, and administrative expenses		15,481,489	6,835,544
Depreciation and amortization expense		451,808	612,804
Operating income		3,595,423	1,974,305
Interest income, net		296,958	(286,540)
Income before taxes		3,892,381	1,687,765
Income taxes		319,735	448,618
Net income	$	3,572,646	1,239,147

Canopy Financial, Inc.
Consolidated Statements of Cash Flows
Years ended December 31, 2008 and 2007

		2008	2007
Cash flows from operating activities:			
Net income	$	3,572,646	1,239,147
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization		451,808	612,804
Changes in operating assets and liabilities:			
Accounts receivable		(1,684,775)	(1,467,299)
Accounts payable		(1,698,495)	(2,005,049)
Other accrued expenses		(540,622)	(388,520)
Net cash provided by operating activities		100,562	(2,008,917)
Cash flows from investing activities:			
Proceeds from sale of furniture and equipment		11,365	15,455
Purchases of furniture and equipment		(6,910,235)	(610,743)
Purchases of assets from related party		(2,000,000)	-
Capitalization of internal use software development costs		(721,890)	-
Net cash used in investing activities		(9,620,760)	(595,288)
Cash flows from financing activities:			
Proceeds from issuance of stock		8,000,000	5,000,000
Proceeds from debt financing		1,302,650	1,050,284
Net cash provided by financing activities		9,302,650	6,050,284
Net increase (decrease) in cash and cash equivalents	$	(217,548)	3,446,079
Cash and cash equivalents at beginning of year	$	7,139,482	3,693,403
Cash and cash equivalents at end of year	$	6,921,934	7,139,482

(1) Nature of the Business

Canopy Financial, Inc. ("the Company") was incorporated on December 14, 2004 in the State of Delaware. On October 9, 2008 the Company purchased the CareGain business unit from Fiserv, Inc. and the surviving corporation is named Canopy Financial, Inc.

The Company offers a hosted software platform that facilitates the management and administration of health insurance benefit elections using Health Savings Account (HSA), Flexible Spending Account (FSA), and/or Health Reimbursement Arrangement (HRA) options. The Company's customers flexibly configure and brand the management and administration platform to their specifications and requirements.

The Company primarily offers its products and services to financial institutions, insurance carriers, and benefit administrators. The Company also offers its products and services on a limited basis through channel partners.

The Company's web site, http://www.canopyfi.com, provides additional information on the Company and the products and services it provides.

The Company is subject to risks and uncertainties common to a technology-based company, including technological change, growth, and commercial acceptances of its software, dependence on principal products, new product development and performance, new product introductions, and other activities of sometimes well-established competitors, as well as the Company's limited operating history.

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The accompanying consolidated financial statements include the results of Canopy Financial and CareGain.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) ***Cash Equivalents***

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. As of December 31, 2008 and 2007, the Company has \$854,159 and \$683,834 cash equivalents, respectively.

(d) ***Trade Accounts Receivable***

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on a specific analysis of each receivable's collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts is \$204,375 and \$55,900 as of December 31, 2008 and 2007, respectively. The Company does not have any off-balance sheet credit exposure related to its customers.

(e) ***Other Current Assets***

The Company holds deposit accounts with financial institutions that act as primary processors for the Company's Automated Clearing House (ACH) transactions. The deposit accounts act as a reserve should the Company experience any ACH returns related to processing foreign bank ACH transactions. The balance in the deposit accounts held for ACH transaction processing is \$2,450,500 and \$264,000 as of December 31, 2008 and 2007, respectively.

(f) ***Impairment of Long-Lived Assets***

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting /or the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as furniture and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held-for-sale would be

(Continued)

presented separately in the appropriate asset and liability sections of the consolidated balance sheets.

(g) *Furniture and Equipment*

Furniture and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the various classes of property, which range from three to five years. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining terms of the respective leases or the estimated lives of the assets.

(h) *Income Taxes*

The Company applies the asset and liability method of accounting for income taxes in which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax law is recognized in income in the period that includes the enactment date.

(i) *Revenue Recognition*

The Company enters into master agreements with customers in which the Company grants to customers a nonexclusive license to use a hosted environment via remote access through the web. The Company generates revenue primarily from application hosting and maintenance, account management and transaction processing fees. Additional revenue is derived from professional services, which include implementation, integration and on going support services. The Company uses the relative fair value method to allocate revenue across the deliverables associated with the engagement, which requires revenue to be allocated based on the fair market value percentage of each deliverable to the total deliverable. Revenue for each of these elements is recognized when all of the following criteria have been satisfied: persuasive evidence of an arrangement exists; delivery has occurred; the price is fixed or determinable; and, collectibility is reasonably assured.

Account management fees pay for the residency of accounts hosted on the platform. Accountholders may have multiple account purses active on the platform. The Company charges account management fees on a monthly basis by calculating the number of active purses and multiplying that by the applicable account purse fee. Revenue from account management fees is recognized monthly for the previous billing period in which the account management fee calculations were performed.

Transaction processing fees pay for the processing and clearance of ACH, electronic bill payment, offline bill payment, customer identification processing, debit or credit card authorization, debit or credit card settlement, and debit or credit card clearance transactions. The Company charges transaction processing fees on a monthly basis by calculating the number of transactions in each processing category and multiplying that by the applicable transaction processing fee. Revenue from transaction processing fees is recognized monthly for the previous billing period in which the transaction processing fee calculations were performed.

Hosting and maintenance fees pay for the customer's use of the product, maintenance of the product through regular upgrades, hosting, and a limited number of on going training hours. Customers do not have the right to take possession of the software. Revenue generated from hosting and maintenance fees is recognized over the life of the arrangement in the form of a fixed hosting and maintenance fee recognized ratably over the service period.

Professional services offered independent of the customer's launch on the application follow a separate recognition process and are recognized as earned. Those professional services typically include integration, on going support and training services not included in the hosting and maintenance fees, and customized product enhancements.

Services are typically charged on a time and materials basis, with a smaller number being charged on a fixed fee basis. For those projects charged at a fixed fee, revenue is based on the percentage of hours incurred to the total hours projected to complete the project.

Reimbursements consist of revenues for travel and other out-of-pocket expenses incurred that are paid by customers.

(Continued)

(j) Stock-Based Compensation

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the prospective transition method. Under that transition method, compensation expense that the Company recognizes beginning on that date includes expense associated with the fair value of all awards granted on and after January 1, 2006, and expense for the unvested portion of previously granted awards outstanding on January 1, 2006, as originally accounted for under APB No. 25.

Stock-based awards granted to nonemployees are accounted for at fair value in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Forte (EITF) Issue No. 96-18, *Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services*. Changes in the fair value of stock-based awards to nonemployees between the date of the grant and the measurement dale result in a change in the measure of compensation for the awards.

(k) Internal-Use Software

In accordance with EITF No. 00-3, "Application of AICPA Statement of Position (SOP) No. 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware", the Company applies AICPA SOP No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" to the accounting for capitalization of internal use software. Software development costs are capitalized when application development begins, it is probable that the project will be completed, and the software will be used as intended. Costs associated with preliminary project stage activities, training, maintenance and all other post implementation stage activities are expensed as incurred. The Company also capitalizes costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. The capitalization policy provides for the capitalization of certain payroll, benefits and other payroll related costs for employees who are directly associated with internal use computer software development projects, as well as external direct costs of materials and services associated with developing or obtaining internal use software. Capitalizable employee costs are limited to the time directly spent on such projects.

Internal-use software is amortized on a straight-line basis over its estimated useful life, generally three years. Management evaluates the useful lives of these assets on an annual basis and tests for impairment

(Continued)

whenever events or changes in circumstances occur that could impact the recoverability of these assets. Unamortized capitalized internal-use software development costs at December 31, 2008 were $721,890, and are included in property and equipment in the accompanying consolidated balance sheet.

(l) *Advertising Costs*

Advertising costs are expensed as incurred. Advertising expense was $160,306 and $428,966 for the years ended December 31, 2008 and 2007, respectively. These costs are attributable to advertising, public relations, and trade shows.

(m) ***Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements***

As of January 1, 2007, the Company adopted a policy of applying both a balance-sheet and income-statement approach when evaluating whether a misstatement is material in light of relevant quantitative and qualitative factors similar to the guidance in Securities and Exchange Commission Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements in Current Year Financial Statements.*

(3) Property and Equipment

Property and equipment, stated at cost, at December 31, 2008 and 2007, consisted of the following:

		2008	2007
Furniture and fixtures	$	2,293,294	1,039,485
Office equipment		1,521,934	645,865
Computer equipment		8,625,252	2,012,476
Computer software		1,467,980	515,784
		13,908,460	4,213,610
Accumulated depreciation and amortization		(3,264,085)	(1,857,182)
	$	10,644,375	2,356,428

(4) Commitments

The Company leases three office facilities under noncancelable operating leases. Rental expenses under the operating leases were $634,890 and $500,830 for the years ended December 31, 2008 and 2007, respectively.

Future minimum cash lease payments under noncancelable operating leases (with initial or remaining lease terns in excess of one year) as of December 31, 2008 are:

		Operating leases
Year ending December 31:		
2009	$	1,248,851
2010		1,395,975
2011		1,501,534
2012		1,638,596
2013		1,784,174
		7,569,130

(5) Summary of CareGain Acquisition

On October 9, 2008, the Company acquired the majority of the assets of the CareGain division from Fiserv, Inc.

CareGain provided software to health plans and third party administrators related to the management of healthcare accounts owned by individual consumers. CareGain provided its customers with a nonexclusive, installable license of the software.

The acquisition terms are:

		Acquisition terms
Year ending December 31, 2008:		
Cash consideration paid at acquisition closing	$	2,000,000
Promissory note payable to Fiserv, Inc.		2,000,000
		4,000,000

The value of the promissory note at December 31, 2008 is $2,000,000. The Company pays quarterly interest installments on the value of the promissory note at a rate of 8% per annum.

The entire principal amount of the promissory note is due and payable upon the earliest to occur of: (1) the fifth anniversary of the transaction closing date; (2) the consummation of a stock financing greater than $5,000,000; (3) the consummation of an initial public offering; or (4) the occurrence of a corporate change in control transaction.

(6) Stockholders' Equity

(a) Common Stock

The Company has authorized 32,000,000 and 30,000,000 shares at December 31, 2008 and 2007, respectively; has outstanding 10,785,636 and 10,741,886 shares at December 31, 2008 and 2007, respectively.

(b) Series A Preferred Stock

The Company has authorized 7,305,609 shares; has outstanding 7,305,609 shares at December 31, 2008 and 2007.

(c) Series B Preferred Stock

The Company has authorized 4,374,135 shares; has outstanding 4,374,135 shares at December 31, 2008 and 2007.

(d) Series C Preferred Stock

The Company has authorized 1,701,108 and 2,592,163 shares at December 31, 2008 and 2007, respectively; has outstanding 1,620,102 shares at December 31, 2008 and 2007.

(e) Series C-1 Preferred Stock

On July 22, 2008, the Company raised $8,000,000, exclusive of issuance costs, from the issuance of Series C-1 Preferred Stock. Accordingly, the Company has authorized 2,401,977 shares; has outstanding 2,401,977 shares at December 31, 2008.

(7) Employee Benefit Plan

The Company offers a 401(k) savings plan to all of its employees, whereby participants may contribute up to 90% of eligible compensation, subject to the limits imposed by the Internal Revenue Code. The Company presently does not provide a matching contribution.

The Company offers a medical benefit plan to all of its employees in which the Company pays the entirety of the monthly insurance premiums.

(Continued)

(8) Guarantees

In November 2002, the FASB issued FASB Interpretation (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness Others*. FIN 45 requires that the Company recognize the fair value of guarantee and indemnification arrangements issued or modified by the Company after December 31, 2002, if these arrangements are within the scope of the Interpretation. In addition, the Company must continue to monitor the conditions that are subject to the guarantees and indemnifications, as required under previously existing generally accepted accounting principles, in order to identify if a loss has occurred. If the Company determines it is probable that a loss has occurred then any such estimable loss be under those guarantees and indemnifications. Under the Company's master agreement with Blue Healthcare Bank, the Company agrees to indemnify, defend, and hold harmless its customers, its directors, officers, and agents from and against certain losses, damages, and costs arising from claims alleging the customer's use of the Company software infringes the intellectual property rights of a third party. Historically, the Company has not incurred any costs in connection with these provisions and, accordingly, has not recorded a liability as the Company estimated the fair value to be zero.