HIRERIGHT INC
Form 10-Q
May 08, 2008

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, DC 20549**

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# FORM 10-Q

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

**For the quarterly period ended March 31, 2008**

**or**

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

**For the transition period from to**

**Commission File Number: 001-33613**

# HIRERIGHT, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **33-0465016** |
| (State or other jurisdiction of incorporation or organization) | (IRS employer identification no.) |

**5151 California Avenue, Irvine, CA 92617**

**www.hireright.com**

(Address of principal executive offices)

**(949) 428-5800**

(Telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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 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 o | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company x |

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares of the registrant s common stock, $0.01 par value, outstanding on May 1, 2008 was 11,461,148.

*HIRERIGHT, INC.*

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**HIRERIGHT, INC.**

**CONDENSED, CONSOLIDATED BALANCE SHEETS**

(Unaudited)

| (in thousands, except share amounts) | | March 31, 2008 | | December 31, 2007 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| CURRENT ASSETS: | | | | |
| Cash and cash equivalents | $ | 35,113 | $ | 17,819 |
| Short-term investments | | 2,630 | | 29,005 |
| Accounts receivable, net of allowance for doubtful accounts of $149 and $153 at March 31, 2008 and December 31, 2007, respectively, and reserve for sales allowances of $126 and $139 at March 31, 2008 and December 31, 2007, respectively | | 11,437 | | 10,002 |
| Prepaid expenses and other current assets | | 1,036 | | 1,216 |
| Deferred tax asset current | | 1,330 | | 1,331 |
| Total current assets | | 51,546 | | 59,373 |
| Property and equipment, net of accumulated depreciation and amortization of $6,012 and $5,597 at March 31, 2008 and December 31, 2007, respectively | | 2,034 | | 2,003 |
| Long-term investments | | 18,240 | | 8,595 |
| Other assets | | 526 | | 486 |
| Deferred tax asset non-current | | 964 | | 964 |
| TOTAL | $ | 73,310 | $ | 71,421 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | |
| CURRENT LIABILITIES: | | | | |
| Accounts payable | $ | 4,523 | $ | 3,428 |
| Accrued liabilities | | 1,235 | | 1,228 |
| Accrued payroll and benefits | | 2,558 | | 3,790 |
| Total current liabilities | | 8,316 | | 8,446 |
| OTHER LIABILITIES | | 151 | | 203 |
| COMMITMENTS AND CONTINGENCIES (Note 7) | | | | |
| STOCKHOLDERS EQUITY: | | | | |
| Common stock, $0.01 par value 100,000,000 shares authorized; 11,452,924 and 11,233,597 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively | | 115 | | 112 |
| Additional paid-in capital | | 68,631 | | 68,071 |
| Other comprehensive gain currency translation | | 16 | | 11 |
| Accumulated deficit | | (3,919) | | (5,422) |
| Net stockholders equity | | 64,843 | | 62,772 |
| TOTAL | $ | 73,310 | $ | 71,421 |

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

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**HIRERIGHT, INC.**

**CONDENSED, CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

| **(in thousands, except per share data)** | **Three Months Ended March 31, 2008** | **2007** |
|---|---|---|
| REVENUE: | | |
| Service revenue | $ 15,763 | $ 14,515 |
| Reimbursed fee revenue | 1,563 | 1,505 |
| Total revenue | 17,326 | 16,020 |
| COST OF REVENUE: | | |
| Cost of service revenue | 7,369 | 7,016 |
| Reimbursed fees paid | 1,563 | 1,505 |
| Total cost of revenue | 8,932 | 8,521 |
| GROSS PROFIT | 8,394 | 7,499 |
| OPERATING EXPENSES: | | |
| Research and development | 1,048 | 909 |
| Sales and marketing | 2,938 | 2,379 |
| General and administrative | 2,621 | 2,287 |
| Total operating expenses | 6,607 | 5,575 |
| INCOME FROM OPERATIONS | 1,787 | 1,924 |
| OTHER INCOME (EXPENSE): | | |
| Interest income | 583 | 92 |
| Interest expense | | (1) |
| Other income (expense) net | (13) | (1) |
| Total other income net | 570 | 90 |
| INCOME BEFORE INCOME TAXES | 2,357 | 2,014 |
| INCOME TAX PROVISION | 854 | 837 |
| NET INCOME | 1,503 | 1,177 |
| Preferred stock dividends | | (543) |
| Income allocable to preferred stockholders | | (481) |
| NET INCOME ALLOCABLE TO COMMON STOCKHOLDERS | $ 1,503 | $ 153 |
| EARNINGS PER SHARE: | | |
| Basic | $ 0.13 | $ 0.08 |
| Diluted | $ 0.12 | $ 0.05 |
| WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES: | | |
| Basic | 11,338 | 1,957 |

| | | |
|---|---|---|
| Diluted | 12,084 | 3,036 |

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

**HIRERIGHT, INC.**

**CONDENSED, CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

| **(in thousands)** | **Three Months Ended March 31, 2008** | **2007** |
|---|---|---|
| CASH PROVIDED BY OPERATING ACTIVITIES: | | |
| Net income | $ 1,503 | $ 1,177 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 377 | 302 |
| Stock-based compensation expense | 133 | 77 |
| Deferred income taxes | 1 | 717 |
| Excess tax benefit from exercise of stock options | (59) | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (1,435) | (870) |
| Prepaid expenses and other current assets | 180 | 314 |
| Other assets | (38) | 75 |
| Accounts payable | 1,121 | (622) |
| Accrued liabilities | 66 | 601 |
| Accrued payroll and benefits | (1,250) | (1,152) |
| Other liabilities | (52) | 241 |
| Net cash provided by operating activities | 547 | 860 |
| CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES: | | |
| Purchases of investments | (15,000) | (1,468) |
| Sales of investments | 31,730 | 750 |
| Purchases of fixed assets | (425) | (563) |
| Net cash provided by (used in) investing activities | 16,305 | (1,281) |
| CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options | 371 | 23 |
| Payment of deferred offering costs | | (687) |
| Excess tax benefit from exercise of stock options | 59 | |
| Net cash provided by (used in) financing activities | 430 | (664) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 12 | 1 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 17,294 | (1,084) |
| CASH AND CASH EQUIVALENTS Beginning of period | 17,819 | 4,201 |
| CASH AND CASH EQUIVALENTS End of period | $ 35,113 | $ 3,117 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Interest paid | $ | $ 1 |
| NON-CASH FINANCING TRANSACTIONS: | | |
| Vesting of stock options early exercised | $ | $ 35 |
| Accrued purchases of fixed assets | $ 81 | $ |

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

**HIRERIGHT, INC.**

**NOTES TO CONDENSED, CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. General**

**Business.** HireRight, Inc. (the Company ) was incorporated in California in 1990 and reincorporated in Delaware in July 2007. Our shares of common stock are listed on the NASDAQ Global Market and trade under the symbol HIRE. We are a provider of on-demand employment screening solutions. Our customers use our comprehensive screening services in conjunction with our web-based software applications to conduct and manage their employment screening programs efficiently and effectively, make more informed employment decisions, improve workplace safety and mitigate risk. We offer a comprehensive set of background screening services including criminal, motor vehicle and other public records searches, employment, education and professional license verifications and credit checks, as well as drug and health screening services.

**Basis of Presentation.** The accompanying condensed, consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) in the United States for interim financial information, and in accordance with the rules and regulations of the United States Securities and Exchange Commission (the SEC ). Accordingly, they do not include all of the information and notes required by GAAP in the United States for annual financial statements as permitted under applicable rules and regulations, and should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2007 included in the Company s Annual Report on Form 10-K.

The condensed, consolidated financial statements included herein are unaudited; however, they contain all adjustments, including normal recurring adjustments, which in the opinion of management are necessary for a fair presentation. The results of operations for the three months ended March 31, 2008 are not necessarily indicative of results that can be expected for the full year.

The preparation of our condensed, consolidated financial statements in accordance with GAAP in the United States requires management to make estimates and assumptions that affect the amounts reported in our condensed, consolidated financial statements and notes thereto. Actual results could differ materially from those estimates.

**Initial Public Offering.** The Registration Statement for the Company s initial public offering (the Public Offering ) was declared effective on August 7, 2007 (the Effective Date ). The Company consummated the Public Offering on August 13, 2007 and sold 2,954,115 shares of its common stock, at a price of $15.00 per share. An additional 1,420,885 shares were sold by selling stockholders. The Company received approximately $39.4 million, net of underwriting discounts, commissions, and other offering costs. Upon the closing of the Public Offering, all of the Company s outstanding preferred stock automatically converted into an aggregate of 6,201,142 shares of the Company s common stock.

**2. Investments**

The Company accounts for its investments in marketable securities under Statements of Financial Accounting Standards ( SFAS ) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ( SFAS 115 ). Investments consist of auction rate municipal and equity securities with interest at rates that are reset periodically. These securities are recorded at fair value in the accompanying balance sheets. For the three months ended March 31, 2008 and 2007, the Company has not recorded any realized gains or losses on marketable investment securities. The Company evaluates its investments for other-than-temporarily impairment on a security by security basis. As of March 31, 2008, the Company determined that none of its securities were other-than-temporarily impaired. As of March 31, 2008, there was $7,000 in unrealized holding losses. The Company classifies all available-for-sale securities as current or non-current assets in the accompanying balance sheets based on management s intended holding period and liquidity considerations based on market conditions.

At March 31, 2008, the Company held $20.9 million of securities with an auction reset feature. The Dutch auction process that resets the applicable interest rate at predetermined calendar intervals is intended to provide liquidity to the holder of auction rate securities by matching buyers and sellers within a market context enabling the holder to gain immediate liquidity by selling such interests at par or rolling over their investment. If there is an imbalance between buyers and sellers the risk of a failed auction exists. The Company has had 10 securities fail at auction in 2008 with an aggregate par value of $17.4 million. Given the deteriorating credit markets, and the increased incidence of failure within the auction market in 2008, there can be no assurance as to when we will be able to liquidate a particular security. In the case of an auction failure we would not be able to access those funds until a future auction of these investments is successful, the security is called by the issuer or a buyer is found outside the auction process. As a result, we have classified these auction rate securities as long-term investments, except for $2.6 million of such securities which have been either sold or redeemed by the issuer at par value subsequent to quarter end.  Furthermore, if this situation were to persist despite our intent and ability to hold such investments until the security can be sold at its par value or until maturity, we may be required to record an impairment charge at a future date.

We will continue to monitor and evaluate these investments, noting that there is no assurance as to when the market for this investment class will return to orderly operations.

**3. Fair Value of Financial Instruments**

On January 1, 2008, the Company adopted the provisions of SFAS No. 157, *Fair Value Measurements (  SFAS 157  ),* related to its financial assets and liabilities. The Company measures certain assets and liabilities at fair value as discussed throughout the footnotes to its quarterly and annual financial statements. Assets or liabilities that have recurring measurements are shown below:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| **Description** | **March 31, 2008** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Assets | | | | |
| Cash and cash equivalents(1) | $ 35,113 | $ 35,113 | $ | $ |
| | | | | |
| Available-for-sale securities: | | | | |
| Short-term investments | 2,630 | 2,630 | | |
| Long-term investments | 18,240 | | 18,240 | |
| | 20,870 | 2,630(2) | 18,240(3) | |
| | | | | |
| Total | $ 55,983 | $ 37,743 | $ 18,240 | $ |

(1) The carrying amount approximates fair value because of the short maturity of these instruments.

(2) These investments consist of auction rate securities which are actively traded. Recent transaction activity has occurred within identical assets.

(3) These investments consist of auction rate securities which have had few transactions due to recent market conditions.  The fair value of such securities is determined by quoted prices for identical or similar assets in markets that are not active.

As discussed in Note 2 above, the Company  s short-term and long-term investments consist of auction rate municipal and equity securities with interest at rates that are reset periodically. These securities are publicly traded and the Company determines its fair value based on the latest available quoted market prices**.** See Note 2 for additional discussion of the Company s investment securities.

The Company also adopted the provisions of SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ) as of January 1, 2008. The adoption of SFAS 159 did not have a material impact on the Company s financial position, as the Company did not make any fair value elections under SFAS 159.

**4. Share-Based Compensation**

During the three months ended March 31, 2008, stock options for the purchase of 300,500 shares of common stock at a weighted average exercise price of $8.16 per share were awarded, with vesting generally over four years. For the comparable period in 2007, stock options for the purchase of 24,889 shares of common stock at a weighted average exercise price of $10.94 per share were awarded.

At March 31, 2008, there were 835,759 outstanding stock options granted under our Stock Option/Stock Issuance Plan (the 2000 Plan ) and 353,546 outstanding stock options under the 2007 Long Term Incentive Plan (the 2007 Plan ). The 2007 Plan became effective on the Effective Date of the Company s Public Offering. All stock option awards up until the Effective Date were made under the 2000 Plan. Commencing on the Effective Date, new options and other stock awards may only be granted under the 2007 Plan. The maximum aggregate number of shares of common stock or options to purchase shares of the Company s common stock that may initially be issued under the 2007 Plan is 1,000,000. Outstanding options granted under both our 2000 Plan and 2007 Plan expire ten years from the grant date and typically vest 25% upon completion of one year of service with the remaining options vesting in 36 successive equal monthly installments upon completion of each additional month of service thereafter.

During the three months ended March 31, 2008, in accordance with the prospective method of adoption of SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123(R) ), the Company recognized share-based compensation expense of $133,000 compared to $77,000 for the comparable 2007 period. At March 31, 2008, there was approximately $2.0 million of unrecognized compensation cost related to unvested shares that will be recognized over a weighted average period of 2.0 years.

A summary of significant assumptions used in determining the fair value of the options granted is as follows:

| | **Three Months Ended March 31,** | |
|---|---|---|
| | **2008** | **2007** |
| Expected life (years) | 6.25 | 6.25 |
| Risk-free interest rate | 3.14% | 4.82% |
| Volatility | 41.56% | 41.50% |
| Dividend yield | 0% | 0% |

As of March 31, 2008, the total number of outstanding options vested and expected to vest (based on anticipated forfeitures) was 1,125,594, which had a weighted-average exercise price of $5.53. The average remaining life of these options was 7.66 years and the aggregate intrinsic value was $5.1 million at March 31, 2008.

As of March 31, 2008, the total number of outstanding options currently exercisable was 614,035, which had a weighted-average exercise price of $3.38. The average remaining life of these options was 6.4 years and the aggregate intrinsic value was $4.1 million at March 31, 2008.

**5. Calculation of Earnings per Common Share**

Basic earnings per common share is calculated by dividing net income allocable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income allocable to common stockholders by the weighted average number of common shares outstanding after giving effect to all potentially dilutive common shares outstanding during the period. Basic and diluted earnings per common share were calculated as follows:

| in thousands, except per share amounts | Three Months Ended March 31, 2008 | 2007 |
|---|---|---|
| **Numerator:** | | |
| Net income | $ 1,503 | $ 1,177 |
| Less preferred stock dividends | | (543) |
| Less income allocable to preferred stockholders | | (481) |
| Net income allocable to common stockholders | $ 1,503 | $ 153 |
| **Denominator:** | | |
| Weighted average common shares outstanding: | | |
| Basic | 11,338 | 1,957 |
| Effect of dilutive potential common shares: | | |
| Weighted average unvested common shares | | 10 |
| Common equivalent shares from warrants to purchase common stock | 245 | 359 |
| Common equivalent shares from options to purchase common stock | 501 | 710 |
| Diluted | 12,084 | 3,036 |
| Basic earnings per common share | $ 0.13 | $ 0.08 |
| Diluted earnings per common share | $ 0.12 | $ 0.05 |

The anti-dilutive effect of 459,583 shares from outstanding stock options have been excluded from the earnings per share calculations for the three months ended March 31, 2008.

**6. Recent Accounting Pronouncements**

In February 2008, the FASB issued FASB Staff Position No. 157-2 ( Staff Position 157-2 ), which deferred the effective date for certain portions of SFAS 157 related to nonrecurring measurements of nonfinancial assets and liabilities. That provision of SFAS 157 will be effective for the Company s fiscal year 2009. We are currently evaluating the effect, if any, that the adoption of Staff Position 157-2 will have on our results of operations, financial position and cash flows.

In December 2007, the FASB issued SFAS No. 141 revised 2007, *Business Combinations* ( SFAS 141R ). SFAS 141R establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable financial statement users to evaluate the nature and financial effects of the business combination. SFAS 141R applies to business combinations for which the acquisition date is on or after December 15, 2008. Early adoption is prohibited. We are currently evaluating the effect, if any, that the adoption of SFAS 141R will have on our results of operations, financial position and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51* ( SFAS 160 ). SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements, but separate from the equity of the parent company. The statement further requires that consolidated net income be reported at amounts attributable to the parent and the noncontrolling interest, rather than expensing the income attributable to the minority interest holder. This statement also requires that companies provide sufficient disclosures to clearly identify and distinguish between the interests of the parent company and the interests of the noncontrolling owners, including a disclosure on the face of the consolidated statements for income attributable to the noncontrolling interest holder. This statement is effective for fiscal years beginning on or after December 15, 2008. Early adoption is prohibited. We are currently evaluating the effect, if any, that the adoption of SFAS 160 will have on our results of operations, financial position and cash flows.

**7.**