COMPUTER PROGRAMS & SYSTEMS INC
Form 10-Q
August 07, 2012
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# 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 June 30, 2012.**

¨ **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: 000-49796**

# COMPUTER PROGRAMS AND SYSTEMS, INC.

**(Exact Name of Registrant as Specified in Its Charter)**

| | |
|---|---|
| **Delaware** | **74-3032373** |
| **(State or Other Jurisdiction of Incorporation or Organization)** | **(I.R.S. Employer Identification No.)** |
| **6600 Wall Street, Mobile, Alabama** | **36695** |
| **(Address of Principal Executive Offices)** | **(Zip Code)** |

**(251) 639-8100**

**(Registrant s Telephone Number, Including Area Code)**

**N/A**

**(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 ¨

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | x |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

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

As of August 6, 2012, there were 11,065,380 shares of the issuer s common stock outstanding.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**Form 10-Q**

**(For the three and six months ended June 30, 2012)**

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**PART I**

**FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**CONDENSED BALANCE SHEETS**

| | June 30, 2012 (Unaudited) | December 31, 2011 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 5,219,281 | $ 6,664,482 |
| Investments | 17,584,550 | 16,486,688 |
| Accounts receivable, net of allowance for doubtful accounts of $1,161,000 and $1,276,000, respectively | 20,549,932 | 21,521,260 |
| Financing receivables, current portion, net | 5,701,116 | 3,780,621 |
| Inventories | 1,899,943 | 1,838,937 |
| Deferred tax assets | 2,658,734 | 2,543,624 |
| Prepaid income taxes | 1,078,899 | 834,750 |
| Prepaid expenses and other | 1,250,166 | 498,172 |
| Total current assets | 55,942,621 | 54,168,534 |
| Property and equipment | | |
| Land | 2,848,276 | 2,848,276 |
| Buildings and improvements | 8,574,293 | 8,779,673 |
| Maintenance equipment | 2,442,228 | 4,638,219 |
| Computer equipment | 5,452,374 | 9,391,704 |
| Leasehold improvements | 1,972,042 | 1,937,524 |
| Office furniture and equipment | 2,153,010 | 2,959,534 |
| Automobiles | 314,905 | 190,542 |
| | 23,757,128 | 30,745,472 |
| Less accumulated depreciation | (6,067,047) | (13,326,241) |
| Property and equipment, net | 17,690,081 | 17,419,231 |
| Financing receivables | 6,939,092 | 4,056,748 |
| Total assets | $ 80,571,794 | $ 75,644,513 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 2,786,042 | $ 2,469,157 |
| Deferred revenue | 6,435,859 | 5,589,792 |
| Accrued vacation | 3,636,570 | 3,211,693 |
| Other accrued liabilities | 4,412,020 | 5,399,996 |
| Total current liabilities | 17,270,491 | 16,670,638 |
| Deferred tax liabilities | 1,619,242 | 1,589,838 |
| Stockholders equity: | | |

| | | |
|---|---|---|
| Common stock, $0.001 par value; 30,000,000 shares authorized; 11,065,380 and 11,063,220 shares issued and outstanding | 11,065 | 11,063 |
| Additional paid-in capital | 32,132,355 | 31,582,108 |
| Accumulated other comprehensive income | 22,971 | 7,380 |
| Retained earnings | 29,515,670 | 25,783,486 |
| Total stockholders equity | 61,682,061 | 57,384,037 |
| Total liabilities and stockholders equity | $ 80,571,794 | $ 75,644,513 |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**CONDENSED STATEMENTS OF INCOME (Unaudited)**

| | Three months ended June 30, 2012 | Three months ended June 30, 2011 | Six months ended June 30, 2012 | Six months ended June 30, 2011 |
|---|---|---|---|---|
| **Sales revenues:** | | | | |
| System sales | $ 17,828,593 | $ 23,593,386 | $ 34,903,111 | $ 39,200,112 |
| Support and maintenance | 18,396,810 | 16,205,796 | 36,533,430 | 32,367,819 |
| Business management services | 9,505,686 | 9,039,513 | 18,783,955 | 17,650,998 |
| Total sales revenues | 45,731,089 | 48,838,695 | 90,220,496 | 89,218,929 |
| **Costs of sales:** | | | | |
| System sales | 12,679,266 | 13,529,202 | 24,578,510 | 25,650,036 |
| Support and maintenance | 7,513,598 | 6,494,966 | 15,182,365 | 12,938,777 |
| Business management services | 5,399,476 | 4,657,545 | 11,053,429 | 9,337,294 |
| Total costs of sales | 25,592,340 | 24,681,713 | 50,814,304 | 47,926,107 |
| Gross profit | 20,138,749 | 24,156,982 | 39,406,192 | 41,292,822 |
| **Operating expenses:** | | | | |
| Sales and marketing | 3,640,828 | 3,866,204 | 7,281,288 | 6,791,233 |
| General and administrative | 6,572,601 | 7,651,899 | 13,200,205 | 13,371,472 |
| Total operating expenses | 10,213,429 | 11,518,103 | 20,481,493 | 20,162,705 |
| Operating income | 9,925,320 | 12,638,879 | 18,924,699 | 21,130,117 |
| **Other income:** | | | | |
| Interest income | 189,355 | 158,177 | 348,491 | 311,511 |
| Total other income | 189,355 | 158,177 | 348,491 | 311,511 |
| Income before taxes | 10,114,675 | 12,797,056 | 19,273,190 | 21,441,628 |
| Income taxes | 1,853,378 | 4,880,908 | 5,362,843 | 8,152,314 |
| Net income | $ 8,261,297 | $ 7,916,148 | $ 13,910,347 | $ 13,289,314 |
| Net income per share basic | $ 0.75 | $ 0.72 | $ 1.26 | $ 1.21 |
| Net income per share diluted | $ 0.75 | $ 0.72 | $ 1.26 | $ 1.21 |
| Weighted average shares outstanding | | | | |
| Basic | 11,063,529 | 11,044,474 | 11,063,374 | 11,003,899 |
| Diluted | 11,063,529 | 11,044,474 | 11,063,374 | 11,003,899 |
| Dividends declared per share | $ 0.46 | $ 0.36 | $ 0.92 | $ 0.72 |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Net income | $ 8,261,297 | $ 7,916,148 | $ 13,910,347 | $ 13,289,314 |
| Other comprehensive income, net of tax | | | | |
| Unrealized gain(loss) on investments available for sale, net of tax | (10,825) | 151 | 15,591 | 4,603 |
| Total other comprehensive income, net of tax | (10,825) | 151 | 15,591 | 4,603 |
| Comprehensive income | $ 8,250,472 | $ 7,916,299 | $ 13,925,938 | $ 13,293,917 |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**CONDENSED STATEMENT OF STOCKHOLDERS EQUITY (Unaudited)**

| | Common Shares | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Retained Earnings | Total Stockholders Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2011 | 11,063,220 | $ 11,063 | $ 31,582,108 | $ 7,380 | $ 25,783,486 | $ 57,384,037 |
| Net income | | | | | 13,910,347 | 13,910,347 |
| Unrealized gain on investments held for sale, net of tax | | | | 15,591 | | 15,591 |
| Issuance of restricted stock | 2,160 | 2 | (2) | | | |
| Stock-based compensation | | | 614,779 | | | 614,779 |
| Dividends | | | | | (10,178,163) | (10,178,163) |
| Income tax benefit from restricted stock dividends | | | 32,404 | | | 32,404 |
| Deficient tax benefit from restricted stock | | | (96,934) | | | (96,934) |
| Balance at June 30, 2012 | 11,065,380 | $ 11,065 | $ 32,132,355 | $ 22,971 | $ 29,515,670 | $ 61,682,061 |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)**

| | Six months ended June 30, 2012 | 2011 |
|---|---|---|
| **Operating Activities** | | |
| Net income | $ 13,910,347 | $ 13,289,314 |
| Adjustments to net income: | | |
| Provision for bad debt | 234,735 | 1,648,245 |
| Deferred taxes | (95,674) | (632,501) |
| Stock based compensation | 614,779 | 318,222 |
| Deficient (excess) tax benefit from restricted stock | 96,934 | (62,569) |
| Income tax benefit from restricted stock dividends | (32,404) | (14,089) |
| Depreciation | 1,666,838 | 1,231,781 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 954,546 | (2,390,268) |
| Financing receivables | (5,020,792) | (422,482) |
| Inventories | (326,747) | (247,226) |
| Prepaid expenses and other | (751,994) | 143,467 |
| Accounts payable | 316,885 | 714,169 |
| Deferred revenue | 846,067 | 1,115,928 |
| Other liabilities | (563,099) | 2,141,315 |
| Income taxes payable/receivable | (308,679) | 306,565 |
| Net cash provided by operating activities | 11,541,742 | 17,139,871 |
| **Investing Activities** | | |
| Purchases of property and equipment | (1,671,947) | (670,437) |
| Purchases of investments | (1,072,303) | (3,083,823) |
| Net cash used in investing activities | (2,744,250) | (3,754,260) |
| **Financing Activities** | | |
| Dividends paid | (10,178,163) | (7,929,394) |
| Excess (deficient) tax benefit from restricted stock | (96,934) | 62,569 |
| Income tax benefit from restricted stock dividends | 32,404 | 14,089 |
| Net cash used in financing activities | (10,242,693) | (7,852,736) |
| (Decrease) increase in cash and cash equivalents | (1,445,201) | 5,532,875 |
| Cash and cash equivalents at beginning of period | 6,664,482 | 2,939,839 |
| Cash and cash equivalents at end of period | $ 5,219,281 | $ 8,472,714 |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid for interest | $ | $ |
| Cash paid for income taxes, net of refund | $ 5,755,951 | $ 8,423,327 |
| Reclassification of inventory to property and equipment | $ 265,741 | $ 185,998 |
| Write-off of fully depreciated assets | $ 8,687,631 | $ |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

## 1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ) and include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments are considered of a normal recurring nature. Quarterly results of operations are not necessarily indicative of annual results.

Certain footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These unaudited condensed financial statements should be read in conjunction with the audited financial statements of Computer Programs and Systems, Inc. (the Company ) for the year ended December 31, 2011 and the notes thereto contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

## 2. REVENUE RECOGNITION

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, principally those required by the *Software* topic and *Revenue Recognition* subtopic of the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification (the Codification ) and those prescribed by the SEC.

The Company s revenue is generated from three sources:

- the sale of information systems, which includes software licenses, conversion and installation services, hardware, peripherals, forms and supplies;

- the provision of system support services, which includes software application support, hardware maintenance, continuing education, Software as a Service (or SaaS ) products, Internet service provider ( ISP ) products, and information technology management and professional services; and

- the provision of business management services, which includes electronic billing, statement processing, payroll processing and accounts receivable management.

***System Sales and Support and Maintenance***

The Company enters into contractual obligations to sell hardware, perpetual software licenses, installation and training services, and support and maintenance services. On average, the Company is able to complete a system installation in three to four weeks. The methods employed by the Company to recognize revenue, which are discussed by element below, achieve results materially consistent with the provisions of Accounting Standards Update ( ASU ) 2009-13, *Multiple-Deliverable Revenue Arrangements,* due to the relatively short period during which there are multiple undelivered elements, the relatively small amount of non-software related elements in the system sale arrangements, and the limited number of contracts in-process at the end of each reporting period. The Company recognizes revenue on the elements noted above as follows:

- Support and maintenance we have established vendor-specific objective evidence ( VSOE ) of the fair value of our support and maintenance services by reference to the price our customers are required to pay for the services when sold separately via renewals. Support and maintenance revenue is recognized on a straight-line basis over the term of the maintenance contracts, which is generally three to five years.

Hardware   we recognize revenue for hardware upon shipment. The selling price of hardware is based on management s best estimate of selling price, which consists of cost plus a targeted margin.

Software licenses and installation and training   the selling price of software licenses and installation and training is based on management s best estimate of selling price. In determining management s best estimate of selling price, we consider the following: (1) competitor pricing, (2) supply and demand of installation staff, (3) overall economic conditions, and (4) our pricing practices as it relates to discounts. With the exception of those arrangements with extended payment terms that are not comparable to our historical arrangements (see Note 8), the method of recognizing revenue for the perpetual license of the associated modules included in the arrangement and the related installation and training services over the term the services are performed is on a module by module basis as the respective installation and training for each specific module is completed as this is representative of the pattern of provision of these services.

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***SaaS, ISP, and Other Professional IT Services***

The Company accounts for SaaS contracts in accordance with the requirements of the *Hosting Arrangement* section under the *Software* topic and *Revenue Recognition* subtopic of the Codification. The Codification states that the software elements of SaaS products should not be accounted for as a hosting arrangement if the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software. Each SaaS contract includes a system purchase and buyout clause, and this clause specifies the total amount of the system buyout. In addition, a clause is included which states that should the system be bought out by the customer, the customer would be required to enter into a general support agreement (for post-contract support services) for the remainder of the original SaaS term. Accordingly, the Company has concluded that SaaS customers do not have the right to take possession of the system without significant penalty (i.e., the purchase price of the system), and thus SaaS revenue of the Company falls within the scope of the *Hosting Arrangement* section of the Codification. In accordance with SEC regulations, revenue for SaaS arrangements is recognized when the services are performed.

The Company will occasionally provide ISP and other professional IT services. We consider these services to be non-software elements. The selling price of these services is based on third-party evidence of selling price of similar services. Revenue from this element is recognized as the services are performed.

***Business Management Services***

Business management services consist of electronic billing services, statement processing services, accounts receivable management services, payroll processing, contract management and insurance services. While business management service arrangements are contracts separate from the system sale and support and maintenance contracts, these contracts are sometimes executed within a short time frame of each other. The selling price of these services is based on VSOE of fair value by reference to the rate our customers renew as well as the rate the services are sold to customers when the business management services agreement is not executed within a short time frame. Because the pricing is transaction based (per unit pricing), customers are billed and revenue recognized as services are performed based on transaction levels.

**3. OTHER ACCRUED LIABILITIES**

Other accrued liabilities are comprised of the following:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Salaries and benefits | $ 2,279,723 | $ 3,257,663 |
| Commissions | 660,870 | 503,172 |
| Self-insurance reserves | 583,400 | 793,378 |
| Unrecognized tax benefit | 731,346 | 731,346 |
| Other | 156,681 | 114,437 |
| | $ 4,412,020 | $ 5,399,996 |

**4. INVESTMENTS**

The Company accounts for investments in accordance with FASB Codification topic, *Investments Debt and Equity Securities*. Accordingly, investments are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders equity. The Company s management determines the appropriate classifications of investments in fixed income securities at the time of acquisition and re-evaluates the classifications at each balance sheet date.

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Investments are comprised of the following at June 30, 2012:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Short term investments (cash and accrued income) | $ 2,184,048 | $ | $ | $ 2,184,048 |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | 6,346,237 | 9,441 | 1,041 | 6,354,637 |
| Mortgaged-backed securities | 96,398 | 2,669 | | 99,067 |
| Corporate bonds | 8,920,210 | 32,996 | 6,408 | 8,946,798 |
| | $ 17,546,893 | $ 45,106 | $ 7,449 | $ 17,584,550 |

Shown below are the amortized cost and estimated fair value of securities with fixed maturities at June 30, 2012, by contract maturity date. Actual maturities may differ from contractual maturities because issuers of certain securities retain early call or prepayment rights.

| | Amortized Cost | Fair Value |
|---|---|---|
| Due in 2012 | $ 4,906,263 | $ 4,911,857 |
| Due in 2013 | 5,181,692 | 5,200,466 |
| Due in 2014 | 4,965,413 | 4,978,011 |
| Due in 2015 | 2,397,127 | 2,395,149 |
| Due thereafter | 96,398 | 99,067 |
| | $ 17,546,893 | $ 17,584,550 |

Investments were comprised of the following at December 31, 2011:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Short term investments (cash and accrued income) | $ 1,577,190 | $ | $ | $ 1,577,190 |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | 5,944,885 | 11,369 | 364 | 5,955,890 |
| Mortgaged-backed securities | 100,620 | 2,212 | | 102,832 |
| Corporate bonds | 8,851,895 | 32,971 | 34,090 | 8,850,776 |
| | $ 16,474,590 | $ 46,552 | $ 34,454 | $ 16,486,688 |

The following table shows the Company s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous loss position, at June 30, 2012 and December 31, 2011, respectively:

| | At June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or More | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | $ 2,552,421 | $ 1,041 | $ | $ | $ 2,552,421 | $ 1,041 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Corporate bonds | 1,728,802 | 5,975 | 101,929 | 433 | 1,830,731 | 6,408 |
| | $ 4,281,223 | $ 7,016 | $ 101,929 | $ 433 | $ 4,383,152 | $ 7,449 |

| | At December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or More | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | $ 364,385 | $ 364 | $ | $ | $ 364,385 | $ 364 |
| Corporate bonds | 2,522,030 | 24,113 | 508,588 | 9,977 | 3,030,618 | 34,090 |
| | $ 2,886,415 | $ 24,477 | $ 508,588 | $ 9,977 | $ 3,395,003 | $ 34,454 |

Our investment portfolio, including those securities in unrealized loss positions at June 30, 2012, is comprised almost entirely of investment-grade corporate and government debt securities. The Company does not intend to sell the investments that are in an unrealized loss position, and it is not likely that the Company will be required to sell any investments before recovery of their amortized cost basis. As a result, the Company has determined that the unrealized losses are deemed to be temporary impairments as of June 30, 2012. The Company believes that the unrealized losses generally are caused by liquidity discounts and increases in risk premiums required by market participants rather than an adverse change in cash flows or a fundamental weakness in the credit quality of the issuer or underlying assets.

## 5. NET INCOME PER SHARE

The Company presents both basic and diluted earnings per share ( EPS ) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted EPS amounts are based upon the weighted average number of common and common equivalent shares outstanding during the period presented. There were no dilutive shares for the three or six month periods ended June 30, 2012 or June 30, 2011.

## 6. INCOME TAXES

The Company accounts for income taxes in accordance with FASB s Codification topic, *Income Taxes*. Deferred income taxes arise from the temporary differences in the recognition of income and expenses for tax purposes. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Deferred tax assets and liabilities are comprised of the following at June 30, 2012 and December 31, 2011:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Deferred tax assets: | | |
| Accounts receivable | $ 712,200 | $ 672,056 |
| Accrued vacation | 1,418,262 | 1,252,560 |
| Stock-based compensation | 98,349 | 334,383 |
| Accrued liabilities | 528,272 | 629,906 |
| Total deferred tax assets | $ 2,757,083 | $ 2,888,905 |
| Deferred tax liabilities: | | |
| Other comprehensive income | $ 14,686 | $ 4,718 |
| Depreciation | 1,702,905 | 1,930,401 |
| Total deferred tax liabilities | $ 1,717,591 | $ 1,935,119 |

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Significant components of the Company s income tax provision in the Condensed Statements of Income for the six months ended June 30 are as follows:

| | 2012 | 2011 |
|---|---|---|
| Current provision: | | |
| Federal | $ 5,020,474 | $ 7,201,071 |
| State | 438,043 | 1,583,744 |
| Deferred provision: | | |
| Federal | (85,859) | (567,629) |
| State | (9,815) | (64,872) |
| Total income tax provision | $ 5,362,843 | $ 8,152,314 |

The difference between income taxes at the U. S. federal statutory income tax rate of 35% and those reported in the Condensed Statements of Income for the six months ended June 30 is as follows:

| | 2012 | 2011 |
|---|---|---|
| Income taxes at U. S. Federal statutory rate | $ 6,745,616 | $ 7,504,570 |
| Provision-to-return adjustments | $ (1,815,067) | |
| State income tax, net of federal tax effect | 824,850 | 964,562 |
| Tax credits and other | (392,556) | (316,818) |
| Total income tax provision | $ 5,362,843 | $ 8,152,314 |

The provision-to-return adjustments presented above for the six months ended June 30, 2012 are primarily related to differences between the Domestic Production Activities Deduction reported on the 2011 federal income tax return and amounts previously estimated.

The Company had unrecognized tax benefits of $731,346 related to uncertain tax positions as of June 30, 2012 under the provisions of FASB Codification topic, *Income Taxes*, which is recorded in other accrued liabilities on the Condensed Balance Sheet. No accrued interest or penalties for such positions is recorded. The federal returns for the tax years 2004, 2005, and 2006 are currently under examination by the Internal Revenue Service, primarily in relation to research credits claimed on those returns by the Company. The federal returns for tax years 2007 through 2011 remain open to examination, and the tax years 2006 through 2011 remain open to other taxing jurisdictions to which the Company is subject.

**7. STOCK-BASED COMPENSATION AND EMPLOYEE INCENTIVE PROGRAMS**

Stock-based compensation cost is measured at the grant date based on the fair value of the award, and is recognized as an expense over the employee s or non-employee director s requisite service period.

The following table shows total stock-based compensation expense for the three and six months ended June 30, 2012 and 2011, included in the Condensed Statements of Income:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2012 | June 30, 2011 | June 30, 2012 | June 30, 2011 |
| Costs of sales | $ 114,999 | $ 93,277 | $ 229,998 | $ 118,276 |
| Operating expenses | 194,779 | 154,113 | 384,781 | 199,946 |
| Pre-tax stock-based compensation expense | 309,778 | 247,390 | 614,779 | 318,222 |
| Less: income tax effect | 120,813 | 96,485 | 239,764 | 124,107 |

| | | | | |
|---|---|---|---|---|
| Net stock-based compensation expense | $ 188,965 | $ 150,905 | $ 375,015 | $ 194,115 |

***2005 Restricted Stock Plan***

On January 27, 2006, the Compensation Committee of the Board of Directors approved the grant of 116,498 shares of restricted stock, effective January 30, 2006, to certain executive officers of the Company under the Company s 2005 Restricted Stock Plan. The grant date fair value was $42.91 per share. The restricted stock vested in five equal annual installments commencing on the first anniversary date of grant.

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On May 17, 2006, the Compensation Committee of the Board of Directors approved the grant of 17,810 shares of restricted stock, effective May 17, 2006, to the then Chief Operating Officer of the Company. The grant date fair value was $42.11 per share. The restricted stock vested in five equal annual installments commencing on January 30, 2007, and each January 30 thereafter.

On January 23, 2008, the Compensation Committee of the Board of Directors approved the grant of 16,471 shares of restricted stock to the Company s then Vice President Finance and Chief Financial Officer. The grant date fair value was $21.25 per share. The restricted stock was scheduled to vest in five equal annual installments commencing on January 30, 2009, and each January 30 thereafter. On June 30, 2010, 9,883 shares of unvested restricted stock were forfeited, cancelled and returned to the authorized and unissued shares of the Company as a result of the termination of employment of this individual on such date.

On April 18, 2011, the Compensation Committee of the Board of Directors approved the grant of a total of 100,346 shares of restricted stock, effective April 18, 2011, to certain executive officers of the Company. Under the terms of the restricted stock award agreements with the executive officers, the shares of restricted stock are scheduled to vest in five equal annual installments commencing on April 18, 2012 and each April 18 thereafter, assuming that the recipient of the award continues to serve as an executive officer of the Company on each applicable vesting date. Compensation expense for this grant will be recognized on a straight-line basis over five years.

***2012 Restricted Stock Plan for Non-Employee Directors***

On June 18, 2012, the Compensation Committee of the Board of Directors approved the grant of 2,160 shares of restricted stock, effective June 18, 2012, to five non-employee directors of the Company under the Company s 2012 Restricted Stock Plan for Non-Employee Directors. The grant date fair value was $55.55 per share. Under the terms of the restricted stock award agreements with the non-employee directors, the shares of restricted stock are scheduled to vest on the third anniversary of the date of grant, assuming that the recipient of the grant continues to serve as a director of the Company on the vesting date. Compensation expense for this grant will be recognized on a straight-line basis over three years.

A summary of activity under the 2005 Restricted Stock Plan and the 2012 Restricted Stock Plan for Non-Employee Directors (the Plans ) for the six-month periods ended June 30, 2012 and 2011 is as follows:

| | Six Months Ended June 30, 2012 | | Six Months Ended June 30, 2011 | |
|---|---|---|---|---|
| | Shares | Weighted-Average Grant-Date Fair Value | Shares | Weighted-Average Grant-Date Fair Value |
| Nonvested stock outstanding at beginning of period | 100,346 | $ 60.79 | 19,871 | $ 42.77 |
| Granted | 2,160 | 55.55 | 100,346 | 60.79 |
| Vested | (20,069) | 60.79 | (19,871) | 42.77 |
| Nonvested stock outstanding at end of period | 82,437 | $ 60.65 | 100,346 | $ 60.79 |

As of June 30, 2012, there was $4,747,850 of unrecognized compensation cost related to non-vested restricted stock granted under the Plans.

***2012 Incentive Program***

On January 23, 2012, the Board of Directors, upon the recommendation of the Compensation Committee, adopted a short-term incentive program for 2012 for certain executive officers of the Company (the 2012 Incentive Program ). Under the 2012 Incentive Program, each executive officer of the Company, other than executive officers earning any commission-based compensation, have a short-term incentive cash bonus opportunity based on the achievement of a specified level of financial performance, specifically the Company s earnings before interest, income taxes, depreciation or amortization ( EBITDA ) in 2012 ( 2012 EBITDA ) compared to the Company s EBITDA in 2011 ( 2011 EBITDA ).

Participants in the 2012 Incentive Program will receive 100% of their target award if the Company s 2012 EBITDA is 105% of 2011 EBITDA, 75% of the target award if the Company achieves a minimum, threshold level of performance (2012 EBITDA reaching 95% of 2011 EBITDA), and a maximum of 150% of the target award for a maximum level of performance (2012 EBITDA equaling or exceeding 130% of 2011 EBITDA). No payments will be made for performance below the specified threshold amount. Payouts between the threshold and maximum will be calculated by the Compensation Committee using the interpolation process described in the 2012 Incentive Program. The Compensation Committee may make adjustments to the terms and conditions of, and the criteria included in, awards under the 2012 Incentive Program in recognition of unusual or nonrecurring events affecting a participant or the Company, or the financial statements of the Company, or in certain other instances specified in the 2012 Incentive Program.

Awards earned under the 2012 Incentive Program will be paid solely in cash. In addition, awards pursuant to the 2012 Incentive Program are subject to recovery or adjustments by the Company in certain circumstances in which the operating results on which payment was based are restated or otherwise adjusted or in the event that a participant s conduct is not in good faith and materially disrupts, damages, impairs or interferes with the business of the Company.

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## 8. FINANCING RECEIVABLES

The Company leases its information and patient care systems to certain healthcare providers under sales-type leases expiring in various years through 2017. These receivables typically have terms from two to five years, bear interest at various rates, and are usually collateralized by a security interest in the underlying assets. Since the Company has a history of successfully collecting amounts due under the original payment terms of these extended payment arrangements without making any concessions to its customers, the Company satisfies the requirement for revenue recognition. The Company s history with these types of extended payment term arrangements supports management s assertion that revenues are fixed and determinable and probable of collection.

The components of these lease receivables were as follows on June 30, 2012 and December 31, 2011:

| | 6/30/2012 | 12/31/2011 |
|---|---|---|
| Total minimum lease payments receivable | $ 13,487,487 | $ 8,254,652 |
| Less allowance for losses | (665,274) | (447,321) |
| Less unearned income | (1,254,161) | (692,027) |
| Lease receivables | 11,568,052 | 7,115,304 |
| Less current portion | (4,628,960) | (3,058,556) |
| Amounts due after one year | $ 6,939,092 | $ 4,056,748 |

Future minimum lease payments to be received subsequent to June 30, 2012 are as follows:

| | |
|---|---|
| 2012 | $ 2,852,680 |
| 2013 | 5,050,570 |
| 2014 | 2,599,337 |
| 2015 | 1,861,341 |
| 2016 | 885,294 |
| Thereafter | 238,265 |
| Total minimum lease payments to be received | 13,487,487 |
| Less unearned income | (1,254,161) |
| Net leases receivable | $ 12,233,326 |

The Company has also sold information and patient care systems to certain healthcare providers under extended payment terms. These receivables, included in the current portion of financing receivables, typically have terms from 3 to 12 months. Total amounts receivable under these arrangements at June 30, 2012 and December 31, 2011 were $1,072,156 and $722,065, respectively.

***Credit Quality of Financing Receivables and Allowance for Credit Losses***

The following table is a roll-forward of the allowance for financing credit losses for the period ended June 30, 2012 and year ended December 31, 2011:

| | Begining Balance | Provision | Charge-offs | Recoveries | Ending Balance |
|---|---|---|---|---|---|
| December 31, 2011 | $ 233,396 | $ 499,485 | $ (285,560) | $ | $ 447,321 |
| June 30, 2012 | $ 447,321 | $ 217,953 | $ | $ | $ 665,274 |

The Company s financing receivables are comprised of a single portfolio segment as the balances are all derived from sales-type leasing arrangements within our target market of community hospitals. The Company evaluates the credit quality of its financing receivables based on a combination of factors, including, but not limited to, customer collection experience, economic conditions, the customer s financial condition, and known risk characteristics impacting the respective customer base of community hospitals, the most notable of which related to enacted and potential changes in Medicare and Medicaid reimbursement rates as community hospitals typically generate a significant portion of their revenues and related cash flows from beneficiaries of these programs. In addition to specific account identification, the Company utilizes historical collection experience to establish the allowance for credit losses. Financing receivables are written off only after the Company has exhausted all collection efforts. The Company has been successful collecting its financing receivables and considers the credit quality of such arrangements to be good, especially as the underlying assets act as collateral for the receivables.

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Customer payments are considered past due if a scheduled payment is not received within contractually agreed upon terms, with amounts reclassified to accounts receivable when they become due. As a result, the Company utilizes an aging of trade accounts receivable as the primary credit quality indicator for its financing receivables. The following is an analysis of the age of the recorded investment in financing receivables with past due amounts as of June 30, 2012 and December 31, 2011, respectively:

| | 1 to 90 Days Past Due | 91 to 180 Days Past Due | 181 + Days Past Due | Total Past Due | Current | Total Receivable | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| June 30, 2012 | $ 9,938,708 | $ 1,216,893 | $ | $ 11,155,601 | $ 2,149,881 | $ 13,305,482 | $ 1,216,893 |
| December 31, 2011 | 3,757,915 | 838,791 | 999,635 | 5,596,341 | 2,688,349 | 8,284,690 | 1,838,426 |

For purposes of the aging analysis presented above, customer financing receivable balances were classified into the respective aging categories based on the oldest contractual payments outstanding within the Company s trade accounts receivable as of the respective dates and therefore represent the Company s total investment in financing receivables with payments outstanding within the respective aging categories, although the vast majority of the investment in financing receivables is not yet past due, per contractual terms.

***Extended Meaningful Use Installment Plans***

During 2012, the Company has entered into multiple customer license agreements with payment terms requiring the customer to remit to the Company incentive payments (not to exceed the remaining balance) received under the American Recovery and Reinvestment Act of 2009 ( ARRA ) for adoption of qualifying electronic health records ( EHRs ), with only nominal payment amounts required until the customer s receipt of such incentive payments. If no such incentive payments are received by the customer or if such payments are not sufficient to pay the remaining balance under the arrangement, payments continue at contracted nominal amounts until the balance of the contract price is paid full. Because of the significant difference in the underlying economics of these arrangements compared to our historical financing receivables, management has determined that these arrangements are not comparable to historical arrangements. In accordance with the *Software* topic and *Revenue Recognition* subtopic of the Codification, the Company recognizes revenue related to these arrangements as the amounts become due. Anticipated future cash flows from these arrangements are excluded from the Company s financing receivables and deferred revenue in the accompanying condensed balance sheets. Direct, incremental costs in the amount of $816,726, included as a component of prepaid expenses and other in the accompanying Condensed Balance Sheets, have been capitalized as of June 30, 2012 related to these arrangements.

**9. COMMITMENTS AND CONTINGENCIES**

From time to time, the Company is involved in routine litigation that arises in the ordinary course of business. Management does not expect this to have a material adverse effect on the Company s financial statements.

**10. FAIR VALUE**

FASB Codification topic, *Fair Value Measurements and Disclosures,* establishes a framework for measuring fair value and expands financial statement disclosures about fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The Codification does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. The Codification requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

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

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

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

The fair values of the Company s available-for-sale securities are based on matrix pricing for the periods ended June 30, 2012 and December 31, 2011, which uses observable market based inputs (such as benchmark yields) in addition to quoted prices in active markets to derive fair values. As a result, these inputs are classified as Level 2 within the fair value hierarchy. We generally apply fair value techniques on a non-recurring basis associated with (1) valuing potential impairment loss related to financing receivables accounted for pursuant to Codification topic, *Leases*, and (2) valuing potential impairment loss related to long-lived assets accounted for pursuant to Codification topic, *Property, Plant and Equipment*, when events or circumstances indicate a possible impairment.

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The following tables summarize the carrying amounts and fair values of certain assets and liabilities at June 30, 2012 and December 31, 2011:

| | | Fair Value at June 30, 2012 Using | | |
|---|---|---|---|---|
| **Description** | **Carrying Amount at 6/30/2012** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Available-for-sale securities | | | | |
| Short-term investments (cash and accrued income) | $ 2,184,048 | $ | $ 2,184,048 | $ |
| Mortgage backed securities | 99,067 | | 99,067 | |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | 6,354,637 | | 6,354,637 | |
| Corporate bonds | 8,946,798 | | 8,946,798 | |
| Total available-for-sale securites | $ 17,584,550 | $ | $ 17,584,550 | $ |

| | | Fair Value at December 31, 2011 Using |
|---|---|---|
| **Description** | **Carrying Amount at 12/31/2011** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** |