

COMPUTER PROGRAMS & SYSTEMS INC

Form 10-Q

May 08, 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 March 31, 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)

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**Delaware**  
(State or Other Jurisdiction of

**74-3032373**  
(I.R.S. Employer

**Incorporation or Organization)**

**Identification No.)**

**6600 Wall Street, Mobile, Alabama**  
(Address of Principal Executive Offices)

**36695**  
(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 ☒ 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 ☒ 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 ☒

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 ☒

As of May 4, 2012, there were 11,063,220 shares of the issuer's common stock outstanding.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**Form 10-Q**

**(For the three months ended March 31, 2012)**

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**Table of Contents****PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.****COMPUTER PROGRAMS AND SYSTEMS, INC.****CONDENSED BALANCE SHEETS**

|                                                                                                          | March 31,<br>2012<br>(Unaudited) | December 31,<br>2011 |
|----------------------------------------------------------------------------------------------------------|----------------------------------|----------------------|
| <b>Assets</b>                                                                                            |                                  |                      |
| Current assets:                                                                                          |                                  |                      |
| Cash and cash equivalents                                                                                | \$ 8,557,769                     | \$ 6,664,482         |
| Investments                                                                                              | 17,567,201                       | 16,486,688           |
| Accounts receivable, net of allowance for doubtful accounts of \$1,264,000 and \$1,276,000, respectively | 22,478,258                       | 21,521,260           |
| Financing receivables, current portion, net                                                              | 3,721,683                        | 3,780,621            |
| Inventories                                                                                              | 2,011,885                        | 1,838,937            |
| Deferred tax assets                                                                                      | 2,538,237                        | 2,543,624            |
| Prepaid income taxes                                                                                     |                                  | 834,750              |
| Prepaid expenses and other                                                                               | 932,679                          | 498,172              |
| Total current assets                                                                                     | 57,807,712                       | 54,168,534           |
| Property and equipment                                                                                   |                                  |                      |
| Land                                                                                                     | 2,848,276                        | 2,848,276            |
| Buildings and improvements                                                                               | 8,434,708                        | 8,779,673            |
| Maintenance equipment                                                                                    | 2,311,380                        | 4,638,219            |
| Computer equipment                                                                                       | 4,993,895                        | 9,391,704            |
| Leasehold improvements                                                                                   | 1,937,524                        | 1,937,524            |
| Office furniture and equipment                                                                           | 2,013,673                        | 2,959,534            |
| Automobiles                                                                                              | 200,924                          | 190,542              |
|                                                                                                          | 22,740,380                       | 30,745,472           |
| Less accumulated depreciation                                                                            | (5,456,442)                      | (13,326,241)         |
| Property and equipment, net                                                                              | 17,283,938                       | 17,419,231           |
| Financing receivables                                                                                    | 4,929,769                        | 4,056,748            |
| Total assets                                                                                             | \$ 80,021,419                    | \$ 75,644,513        |
| <b>Liabilities and Stockholders' Equity</b>                                                              |                                  |                      |
| Current liabilities:                                                                                     |                                  |                      |
| Accounts payable                                                                                         | \$ 2,749,997                     | \$ 2,469,157         |
| Deferred revenue                                                                                         | 6,149,253                        | 5,589,792            |
| Accrued vacation                                                                                         | 3,458,728                        | 3,211,693            |
| Income taxes payable                                                                                     | 2,859,829                        |                      |
| Other accrued liabilities                                                                                | 5,128,208                        | 5,399,996            |
| Total current liabilities                                                                                | 20,346,015                       | 16,670,638           |

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|                                                                                                         |               |               |
|---------------------------------------------------------------------------------------------------------|---------------|---------------|
| Deferred tax liabilities                                                                                | 1,381,979     | 1,589,838     |
| Stockholders' equity:                                                                                   |               |               |
| Common stock, \$0.001 par value; 30,000,000 shares authorized; 11,063,220 shares issued and outstanding | 11,063        | 11,063        |
| Additional paid-in capital                                                                              | 31,905,111    | 31,582,108    |
| Accumulated other comprehensive income                                                                  | 33,796        | 7,380         |
| Retained earnings                                                                                       | 26,343,455    | 25,783,486    |
| Total stockholders' equity                                                                              | 58,293,425    | 57,384,037    |
| Total liabilities and stockholders' equity                                                              | \$ 80,021,419 | \$ 75,644,513 |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**  
**CONDENSED STATEMENTS OF INCOME (Unaudited)**

|                                            | Three months ended March 31,<br>2012 | 2011          |
|--------------------------------------------|--------------------------------------|---------------|
| <b>Sales revenues:</b>                     |                                      |               |
| System sales                               | \$ 17,074,518                        | \$ 15,606,726 |
| Support and maintenance                    | 18,136,620                           | 16,162,023    |
| Business management services               | 9,278,269                            | 8,611,484     |
| Total sales revenues                       | 44,489,407                           | 40,380,233    |
| <b>Costs of sales:</b>                     |                                      |               |
| System sales                               | 11,899,244                           | 12,120,834    |
| Support and maintenance                    | 7,668,767                            | 6,443,811     |
| Business management services               | 5,653,953                            | 4,679,748     |
| Total costs of sales                       | 25,221,964                           | 23,244,393    |
| Gross profit                               | 19,267,443                           | 17,135,840    |
| <b>Operating expenses:</b>                 |                                      |               |
| Sales and marketing                        | 3,640,460                            | 2,925,028     |
| General and administrative                 | 6,627,604                            | 5,719,574     |
| Total operating expenses                   | 10,268,064                           | 8,644,602     |
| Operating income                           | 8,999,379                            | 8,491,238     |
| <b>Other income:</b>                       |                                      |               |
| Interest income                            | 159,136                              | 153,335       |
| Total other income                         | 159,136                              | 153,335       |
| Income before taxes                        | 9,158,515                            | 8,644,573     |
| Income taxes                               | 3,509,465                            | 3,271,406     |
| Net income                                 | \$ 5,649,050                         | \$ 5,373,167  |
| Net income per share - basic               | \$ 0.51                              | \$ 0.49       |
| Net income per share - diluted             | \$ 0.51                              | \$ 0.49       |
| <b>Weighted average shares outstanding</b> |                                      |               |
| Basic                                      | 11,063,220                           | 10,962,874    |
| Diluted                                    | 11,063,220                           | 10,962,874    |
| Dividends declared per share               | \$ 0.46                              | \$ 0.36       |

See accompanying notes.



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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

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

|                                                               | Three months ended March 31, |              |
|---------------------------------------------------------------|------------------------------|--------------|
|                                                               | 2012                         | 2011         |
| Net income                                                    | \$ 5,649,050                 | \$ 5,373,167 |
| Other comprehensive income, net of tax                        |                              |              |
| Unrealized gain on investments available for sale, net of tax | 26,416                       | 4,452        |
| Total other comprehensive income, net of tax                  | 26,416                       | 4,452        |
| Comprehensive income                                          | \$ 5,675,466                 | \$ 5,377,619 |

See accompanying notes.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

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

|                                                             | Common<br>Shares | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Total<br>Stockholders<br>Equity |
|-------------------------------------------------------------|------------------|-----------------|----------------------------------|-------------------------------------------------|----------------------|---------------------------------|
| Balance at December 31, 2011                                | 11,063,220       | \$ 11,063       | \$ 31,582,108                    | \$ 7,380                                        | \$ 25,783,486        | \$ 57,384,037                   |
| Net income                                                  |                  |                 |                                  |                                                 | 5,649,050            | 5,649,050                       |
| Unrealized gain on investments held for sale,<br>net of tax |                  |                 |                                  | 26,416                                          |                      | 26,416                          |
| Stock-based compensation                                    |                  |                 | 305,001                          |                                                 |                      | 305,001                         |
| Dividends                                                   |                  |                 |                                  |                                                 | (5,089,081)          | (5,089,081)                     |
| Income tax benefit from restricted stock<br>dividends       |                  |                 | 18,002                           |                                                 |                      | 18,002                          |
| Balance at March 31, 2012                                   | 11,063,220       | \$ 11,063       | \$ 31,905,111                    | \$ 33,796                                       | \$ 26,343,455        | \$ 58,293,425                   |

See accompanying notes.

**Table of Contents****COMPUTER PROGRAMS AND SYSTEMS, INC.****CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)**

|                                                         | Three months ended March 31,<br>2012 | 2011         |
|---------------------------------------------------------|--------------------------------------|--------------|
| <b>Operating Activities</b>                             |                                      |              |
| Net income                                              | \$ 5,649,050                         | \$ 5,373,167 |
| Adjustments to net income:                              |                                      |              |
| Provision for bad debt                                  | 60,812                               | (212,309)    |
| Deferred taxes                                          | (219,362)                            | 272,650      |
| Stock based compensation                                | 305,001                              | 70,833       |
| Income tax benefit from restricted stock dividends      | (18,002)                             |              |
| Depreciation                                            | 819,269                              | 608,672      |
| Changes in operating assets and liabilities:            |                                      |              |
| Accounts receivable                                     | (956,985)                            | 2,681,233    |
| Financing receivables                                   | (874,908)                            | (91,247)     |
| Inventories                                             | (307,841)                            | (692,194)    |
| Prepaid expenses and other                              | (434,507)                            | 318,125      |
| Accounts payable                                        | 280,840                              | 1,042,042    |
| Deferred revenue                                        | 559,461                              | 1,228,003    |
| Other liabilities                                       | (24,753)                             | 762,586      |
| Income taxes payable/receivable                         | 3,712,581                            | 2,928,357    |
| Net cash provided by operating activities               | 8,550,656                            | 14,289,918   |
| <b>Investing Activities</b>                             |                                      |              |
| Purchases of property and equipment                     | (549,083)                            | (298,201)    |
| Purchases of investments                                | (1,037,207)                          | (3,041,591)  |
| Net cash used in investing activities                   | (1,586,290)                          | (3,339,792)  |
| <b>Financing Activities</b>                             |                                      |              |
| Dividends paid                                          | (5,089,081)                          | (3,946,636)  |
| Income tax benefit from restricted stock dividends      | 18,002                               |              |
| Net cash used in financing activities                   | (5,071,079)                          | (3,946,636)  |
| Increase in cash and cash equivalents                   | 1,893,287                            | 7,003,490    |
| Cash and cash equivalents at beginning of period        | 6,664,482                            | 2,939,839    |
| Cash and cash equivalents at end of period              | \$ 8,557,769                         | \$ 9,943,329 |
| <b>Supplemental disclosure of cash flow information</b> |                                      |              |
| Cash paid for interest                                  | \$                                   | \$           |
| Cash paid for income taxes, net of refund               | \$ 5,000                             | \$ 24,327    |
| Reclassification of inventory to property and equipment | \$ 134,893                           | \$ 126,433   |
| 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 3 to 4 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, 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.

**Table of Contents*****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:

|                          | March 31,<br>2012 | December 31,<br>2011 |
|--------------------------|-------------------|----------------------|
| Salaries and benefits    | \$ 2,819,774      | \$ 3,257,663         |
| Commissions              | 832,159           | 503,172              |
| Self-insurance reserves  | 587,000           | 793,378              |
| Unrecognized tax benefit | 731,346           | 731,346              |
| Other                    | 157,929           | 114,437              |
|                          | \$ 5,128,208      | \$ 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 March 31, 2012:

|                                                                         | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|-------------------------------------------------------------------------|-------------------|---------------------|----------------------|---------------|
| Short term investments (cash and accrued income)                        | \$ 1,100,366      | \$                  | \$                   | \$ 1,100,366  |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | 6,889,143         | 11,864              | 1,975                | 6,899,032     |
| Mortgaged-backed securities                                             | 99,730            | 2,688               |                      | 102,418       |
| Corporate bonds                                                         | 9,422,558         | 47,171              | 4,344                | 9,465,385     |
|                                                                         | \$ 17,511,797     | \$ 61,723           | \$ 6,319             | \$ 17,567,201 |

Shown below are the amortized cost and estimated fair value of securities with fixed maturities at March 31, 2012, by contract maturity date. Actual maturities may differ from contractual maturities because issuers of certain securities retain early call or prepayment rights.

|                | Amortized<br>Cost | Fair<br>Value |
|----------------|-------------------|---------------|
| Due in 2012    | \$ 5,979,664      | \$ 5,994,429  |
| Due in 2013    | 5,196,304         | 5,218,628     |
| Due in 2014    | 4,762,879         | 4,776,887     |
| Due in 2015    | 1,473,220         | 1,474,839     |
| Due thereafter | 99,730            | 102,418       |
|                | \$ 17,511,797     | \$ 17,567,201 |

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

|                                                                         | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>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 |

## 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 month periods ended March 31, 2012 or March 31, 2011.



**Table of Contents****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 March 31, 2012 and December 31, 2011:

|                                    | March 31,<br>2012 | December 31,<br>2011 |
|------------------------------------|-------------------|----------------------|
| Deferred tax assets:               |                   |                      |
| Accounts receivable                | \$ 691,268        | \$ 672,056           |
| Accrued vacation                   | 1,348,904         | 1,252,560            |
| Stock-based compensation           | 453,333           | 334,383              |
| Accrued liabilities                | 501,229           | 629,906              |
| <br>Total deferred tax assets      | <br>\$ 2,994,734  | <br>\$ 2,888,905     |
| Deferred tax liabilities:          |                   |                      |
| Other comprehensive income         | \$ 21,608         | \$ 4,718             |
| Depreciation                       | 1,816,868         | 1,930,401            |
| <br>Total deferred tax liabilities | <br>\$ 1,838,476  | <br>\$ 1,935,119     |

Significant components of the Company's income tax provision in the Condensed Statements of Income for the three months ended March 31 are as follows:

|                                | 2012             | 2011             |
|--------------------------------|------------------|------------------|
| Current provision:             |                  |                  |
| Federal                        | \$ 3,071,416     | \$ 2,442,244     |
| State                          | 657,411          | 556,512          |
| Deferred provision:            |                  |                  |
| Federal                        | (194,023)        | 244,686          |
| State                          | (25,339)         | 27,964           |
| <br>Total income tax provision | <br>\$ 3,509,465 | <br>\$ 3,271,406 |

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 three months ended March 31 is as follows:

|                                              | 2012             | 2011             |
|----------------------------------------------|------------------|------------------|
| Income taxes at U. S. Federal statutory rate | \$ 3,205,480     | \$ 3,025,601     |
| State income tax, net of federal tax effect  | 405,143          | 386,812          |
| Tax credits and other                        | (101,158)        | (141,007)        |
| <br>Total income tax provision               | <br>\$ 3,509,465 | <br>\$ 3,271,406 |

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The Company had unrecognized tax benefits of \$731,346 related to uncertain tax positions as of March 31, 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, 2008, 2009 and 2010 remain open to examination, and the tax years 2005 – 2010 remain open to other taxing jurisdictions to which the Company is subject.

**Table of Contents****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 requisite service period. The Company recorded compensation costs as the requisite service was rendered for the unvested portion of previously issued awards that remained outstanding at the initial date of adoption and any awards issued, modified, repurchased, or cancelled after January 1, 2006.

The following table shows total stock-based compensation expense for the three months ended March 31, 2012 and 2011, included in the Condensed Statements of Income:

|                                          | Three Months Ended |                |
|------------------------------------------|--------------------|----------------|
|                                          | March 31, 2012     | March 31, 2011 |
| Costs of sales                           | \$ 114,999         | \$ 24,999      |
| Operating expenses                       | 190,002            | 45,834         |
| Pre-tax stock-based compensation expense | 305,001            | 70,833         |
| Less: income tax effect                  | 118,950            | 27,624         |
| Net stock-based compensation expense     | \$ 186,051         | \$ 43,209      |

***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. 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.

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.

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A summary of activity under the 2005 Restricted Stock Plan during the three month periods ended March 31, 2012 and 2011 is as follows:

|                                                    | Three Months Ended March 31, 2012 |                          | Three Months Ended March 31, 2011 |                          |
|----------------------------------------------------|-----------------------------------|--------------------------|-----------------------------------|--------------------------|
|                                                    | Weighted-Average                  |                          | Weighted-Average                  |                          |
|                                                    | Shares                            | Grant-Date<br>Fair Value | Shares                            | Grant-Date<br>Fair Value |
| Nonvested stock outstanding at beginning of period | 100,346                           | \$ 60.79                 | 19,871                            | \$ 42.77                 |
| Granted                                            |                                   |                          |                                   |                          |
| Vested                                             |                                   |                          | (19,871)                          | 42.77                    |
| Nonvested stock outstanding at end of period       | 100,346                           | \$ 60.79                 |                                   | \$                       |

As of March 31, 2012, there was \$4,937,640 of unrecognized compensation cost related to non-vested restricted stock granted under the 2005 Restricted Stock Plan.

**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.

As of March 31, 2012, we had \$109,500 in accrued compensation cost for this program based on projected performance under this program as of such date.

**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.



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

|                                         | 3/31/2012    | 12/31/2011   |
|-----------------------------------------|--------------|--------------|
| Total minimum lease payments receivable | \$ 9,413,274 | \$ 8,254,652 |
| Less allowance for losses               | (508,145)    | (447,321)    |
| Less unearned income                    | (1,003,309)  | (692,027)    |
| Lease receivables                       | 7,901,820    | 7,115,304    |
| Less current portion                    | (2,972,051)  | (3,058,556)  |
| Amounts due after one year              | \$ 4,929,769 | \$ 4,056,748 |

Future minimum lease payments to be received subsequent to March 31, 2012 are as follows:

|                                             |              |
|---------------------------------------------|--------------|
| 2012                                        | \$ 2,905,791 |
| 2013                                        | 3,475,037    |
| 2014                                        | 1,722,608    |
| 2015                                        | 930,060      |
| 2016                                        | 361,606      |
| Thereafter                                  | 18,172       |
| Total minimum lease payments to be received | 9,413,274    |
| Less unearned income                        | (1,003,309)  |
| Net leases receivable                       | \$ 8,409,965 |

## 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 March 31, 2012 and year ended December 31, 2011:

|                   | Beginning Balance | Provision  | Charge-offs  | Recoveries | Ending Balance |
|-------------------|-------------------|------------|--------------|------------|----------------|
| December 31, 2011 | \$ 233,396        | \$ 499,485 | \$ (285,560) | \$         | \$ 447,321     |
| March 31, 2012    | \$ 447,321        | \$ 60,824  | \$           | \$         | \$ 508,145     |

This allowance is based on the historical level of customer defaults under such arrangements. 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 receivable.

The Company has also sold information and patient care systems to certain healthcare providers under extended payment terms. These receivables, included in current portion of financing receivables, typically have terms from 3 to 12 months. Total amounts receivable under these arrangements at March 31, 2012 and December 31, 2011 were \$749,632 and \$722,065, respectively.

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

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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 \$536,921, included as a component of prepaid expenses and other in the accompanying Condensed Balance Sheets, have been capitalized as of March 31, 2012 related to these arrangements.

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### **9. COMMITMENTS AND CONTINGENCIES**

As of March 31, 2012, the Company is contingently liable as guarantor on a lease obligation between Solis Healthcare, LP ( Solis Healthcare ), as lessee, and Winthrop Resources Corporation ( Winthrop ), as lessor. Solis Healthcare purchased a software system from the Company and entered into a sale-leaseback transaction with Winthrop in the first quarter of 2008. The Company provided this guarantee in order to facilitate Solis Healthcare in leasing the new system. The lease has an initial term of five years and continues from year to year thereafter until terminated. The Company is contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, the Company will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guarantee runs for the entire term of the lease; however, the maximum potential amount of future payments that the Company would be required to make to Winthrop under the guaranty is \$777,800, the balance of the lease payments as of March 31, 2012, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney fees and costs). Due to the contingent nature of the guaranty, the maximum amount of the guaranty is not recorded on the balance sheet; however, when necessary, reserves are recorded to cover potential losses. A liability in the amount of approximately \$21,000, the amortized fair value of the guaranty, is recorded on the balance sheet as an other accrued liability at March 31, 2012. As of March 31, 2012, we were not aware of any conditions that would effect the payment or performance risk of the lease obligation.

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 March 31, 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 March 31, 2012 and December 31, 2011:

| Description                                                                | Carrying<br>Amount at<br>3/31/2012 | Fair Value at March 31, 2012 Using                                            |                                                     |                                                    |
|----------------------------------------------------------------------------|------------------------------------|-------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|
|                                                                            |                                    | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Available-for-sale securities                                              |                                    |                                                                               |                                                     |                                                    |
| Short-term investments (cash and accrued income)                           | \$ 1,100,366                       | \$                                                                            | \$ 1,100,366                                        | \$                                                 |
| Mortgage backed securities                                                 | 102,418                            |                                                                               | 102,418                                             |                                                    |
| Obligations of U.S. Treasury, U.S. government corporations<br>and agencies | 6,899,032                          |                                                                               | 6,899,032                                           |                                                    |
| Corporate bonds                                                            | 9,465,385                          |                                                                               | 9,465,385                                           |                                                    |
| Total available-for-sale securities                                        | \$ 17,567,201                      | \$                                                                            | \$ 17,567,201                                       | \$                                                 |

| Description                                                                | Carrying<br>Amount at<br>12/31/2011 | Fair Value at December 31, 2011 Using                                                     |                                                           |                                                    |
|----------------------------------------------------------------------------|-------------------------------------|-------------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                                            |                                     | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Available-for-sale securities                                              |                                     |                                                                                           |                                                           |                                                    |
| Short-term investments (cash and accrued income)                           | \$ 1,577,190                        | \$                                                                                        | \$ 1,577,190                                              | \$                                                 |
| Mortgage backed securities                                                 | 102,832                             |                                                                                           | 102,832                                                   |                                                    |
| Obligations of U.S. Treasury, U.S. government corporations<br>and agencies | 5,955,890                           |                                                                                           | 5,955,890                                                 |                                                    |
| Corporate bonds                                                            | 8,850,776                           |                                                                                           | 8,850,776                                                 |                                                    |
| Total available-for-sale securities                                        | \$ 16,486,688                       | \$                                                                                        | \$ 16,486,688                                             | \$                                                 |

Accrued income in the above tables represents earnings due and payable to our investment portfolio at any point in time but not yet received.

The carrying amount of other financial instruments reported in the balance sheet for current assets and current liabilities approximate their fair values because of the short-term nature of these instruments.

## 11. RECENT ACCOUNTING PRONOUNCEMENTS

### *New Accounting Standards Adopted in 2012*

Effective January 1, 2012, the Company retrospectively adopted ASU 2011-05, *Presentation of Comprehensive Income*, as amended by ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This update requires entities to present comprehensive income either in a single continuous financial statement or in two separate but consecutive statements. Entities no longer have the option to present components of other comprehensive income ( OCI ) as part of the statement of changes in shareholders' equity. The Company's adoption of this update did not have a material impact on our financial statements and resulted in the accompanying condensed statements of comprehensive income.

*New Accounting Standards Yet to be Adopted*

There are no new standards required to be adopted in future periods that will have a material impact on our financial statements.

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**12. SUBSEQUENT EVENTS**

On April 23, 2012, the Company announced a dividend for the second quarter of 2012 in the amount of \$0.46 per share, payable on May 25, 2012, to stockholders of record as of the close of business on May 10, 2012.

In April 2012, the Company suffered a fire at its main campus headquarters building located in Mobile, Alabama. The fire, believed to be electrical in nature, was contained by building firewalls until firefighters arrived and extinguished the fire. No injuries occurred as a result of the fire, no significant loss of inventory was suffered, and we experienced no disruption in our operations, although certain of the Company's property and equipment were damaged or destroyed. We estimate that approximately 1,000 of the 66,000 square feet of our campus headquarters building was destroyed and approximately 28,000 square feet were impacted by minor smoke damage. Although the exact amount of the loss is not currently determinable, the Company expects to recover a significant portion of the damaged or destroyed assets and restoration costs through insurance proceeds.

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

You should read the following discussion and analysis of our financial condition and results of operations together with the unaudited financial statements and related notes appearing elsewhere herein.

This discussion and analysis contains forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified generally by the use of forward-looking terminology and words such as "expects," "anticipates," "estimates," "believes," "predicts," "intends," "plans," "potential," "may," "continue," "should," "will" and "could." Without limiting the generality of the preceding statement, all statements in this report relating to estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and future financial results are forward-looking statements. We caution investors that any such forward-looking statements are only predictions and are not guarantees of future performance. Certain risks, uncertainties and other factors may cause actual results to differ materially from those projected in the forward-looking statements. Such factors may include:

overall business and economic conditions affecting the healthcare industry;

potential effects of the federal health care reform legislation enacted in 2010, and implementing regulations, on the businesses of our hospital customers;

funding uncertainties associated with, and potential expenditures required by, the American Recovery and Reinvestment Act of 2009 in connection with the adoption of electronic health records;

saturation of our target market and hospital consolidations;

changes in customer purchasing priorities, capital expenditures and demand for information technology systems;

competition with companies that have greater financial, technical and marketing resources than we have;

failure to develop new technology and products in response to market demands;

fluctuations in quarterly financial performance due to, among other factors, timing of customer installations;

failure of our products to function properly resulting in claims for medical losses;

government regulation of the healthcare and health insurance industries;

government regulation of our products and customers, including changes in healthcare policy affecting Medicare reimbursement rates and qualifying technological standards;

changes in accounting principles generally accepted in the United States of America;

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breaches of security and viruses in our systems resulting in customer claims against us;

potential intellectual property claims against us;

general economic conditions, including changes in the financial markets that may affect the availability and cost of credit to us or our customers; and

interruptions in our power supply and/or telecommunications capabilities.

Additional information concerning these and other factors which could cause differences between forward-looking statements and future actual results is discussed under the heading **Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission.

### **Background**

CPSI was founded in 1979 and specializes in delivering comprehensive healthcare information systems and related services to community hospitals. Our systems and services are designed to support the primary functional areas of a hospital and to enhance access to necessary financial and clinical information. Our comprehensive system enables healthcare providers to improve clinical, financial and administrative outcomes. Our products and services provide solutions in key areas, including patient management, financial management, patient care and clinical, enterprise and office automation. In addition to servicing small to medium-sized hospitals, we provide information technology services to other related entities in the healthcare industry, such as nursing homes, home health agencies and physician clinics.

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We sell a fully integrated, enterprise-wide financial and clinical hospital information system comprised of all necessary software, hardware, peripherals, forms and office supplies, together with comprehensive customer service and support. We also offer business management services, including electronic billing submissions, patient statement processing and accounts receivable management, as part of our overall information system solution. We believe that as our customer base grows, the demand for our business management services will also continue to grow, supporting further increases in recurring revenues.

Our system currently is installed and operating in over 650 hospitals in 45 states and the District of Columbia. Our customers consist of community hospitals with 300 or fewer beds, with hospitals having 100 or fewer acute care beds comprising approximately 94% of our customers.

## **Management Overview**

We primarily seek revenue growth through sales of healthcare information technology systems and related services to existing and new customers within our historic target market. Our strategy has produced consistent revenue growth over the long-term, as reflected in five-and ten-year compounded annual growth rates in revenues of approximately 8.4% and 11.3%, respectively. Selling new and additional products and services to our existing customer base is an important part of CPSI's future revenue growth. We believe that as our customer base grows, the demand for additional products and services, including business management services, will also continue to grow, supporting further increases in recurring revenues. We also expect to drive revenue growth from new product development that we may generate from our research and development activities.

In addition to revenue growth, our business model is focused on earnings growth. Once a hospital has installed our system, we continue to provide support and maintenance services to our customers on an ongoing basis. These services are typically provided by the same personnel who perform our system installations but at a reduced cost to us, and therefore at an increased gross margin. We also look to increase margins through cost containment measures where appropriate.

As a result of the recent economic recession and the uncertainty surrounding the economy and credit markets and tightened lending standards, hospitals have experienced reduced availability of third party credit and an overall reduction in their investment portfolios. In addition, healthcare organizations with a large dependency on Medicare and Medicaid populations, such as community based hospitals, have been impacted by the challenging financial condition of the federal government and many state governments and government programs. Accordingly, we recognize that prospective hospital customers often do not have the necessary capital to make investments in information technology. Additionally, in response to these challenges, hospitals have become more selective regarding where they invest capital, resulting in a focus on strategic spending that generates a return on their investment. Despite the current economic environment, we believe healthcare information technology is often viewed as more strategic to hospitals than other possible purchases because the technology offers the possibility of a quick return on investment. Information technology also plays an important role in healthcare by improving safety and efficiency and reducing cost. Additionally, we believe most hospitals recognize that they must invest in healthcare information technology to meet current and future regulatory, compliance and government reimbursement requirements.

We have experienced an increase in customers seeking financing arrangements from us over the past four years for system installations as a result of ongoing economic conditions and the uncertainty surrounding the credit markets and tightened lending standards. Historically, we have made financing arrangements available to customers on a case-by-case basis depending upon various aspects of the proposed contract and customer attributes. These financing arrangements include short-term payment plans, longer-term lease financing through us or third-party financing companies, and Software as a Service ( SaaS ) arrangements. We intend to continue to work with prospective customers to provide for financing arrangements to purchase our systems so long as such arrangements do not adversely affect our financial position and liquidity. We believe that meeting the financial needs of community-based hospitals while allowing for the profitable expansion of our footprint in this market will remain both an opportunity and a challenge for us in the foreseeable future.

Despite the current challenging economic conditions generally, including the uncertainty surrounding credit markets and tightened lending standards, we have not experienced a decline in demand for our products and services and our collections of receivables remains consistent with historical trends.

## **American Recovery and Reinvestment Act of 2009**

While the ongoing challenging economic conditions and uncertainty surrounding credit markets and tightened lending standards have impacted and could continue to impact the community hospitals that comprise our target market, we believe that the American Recovery and Reinvestment Act of 2009 (the ARRA ) has increased and will continue to increase demand for healthcare information technology and will have a positive impact on our business prospects through the next few years. The ARRA includes more than \$19 billion in funding to aid healthcare

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organizations in modernizing their operations through the acquisition and widespread use of healthcare information technology. Included in the funding is approximately

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\$17.2 billion in incentives through Medicare and Medicaid reimbursement systems to encourage and assist healthcare providers in adopting and using electronic health records ( EHRs ). These incentive payments began in February 2011 and are expected to last through 2015. If an eligible healthcare provider does not begin to demonstrate meaningful use of EHRs by 2015, then reimbursement under Medicare will begin to be reduced. Our hospital customers began receiving these incentive payments under the ARRA in February 2011. Through April 2012, approximately 150 of our hospital customers had received payments for EHR adoption totaling approximately \$149 million.

We have been focused on ensuring that we take the necessary steps to meet the needs of community hospitals to help them gain access to the incentives made available under the ARRA. Primary among those steps was ensuring that our technology meets the ARRA's EHR certification requirements. During 2010, both our hospital and medical practice EHR solutions were certified as a complete EHR by CCHIT®. Receiving this certification for both our hospital and ambulatory EHR products ensures that both hospitals and providers using our EHR systems can attain meaningful use of EHRs and qualify for ARRA reimbursements. As a result of our obtaining this certification, the ARRA has had and should continue to have a positive impact on our business and the businesses of the community hospitals that comprise our target market.

### **Health Care Reform**

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, collectively referred to as the Health Reform Laws. This sweeping legislation implements changes to the healthcare and health insurance industries over the next several years through 2015, with the ultimate goal of requiring substantially all U.S. citizens and legal residents to have qualifying health insurance coverage by 2014 and providing the means by which it will be made available to them. We anticipate that the Health Reform Laws will have little direct impact on our internal operation but may have a significant impact on the businesses of our hospital customers. We have not been able to determine at this point whether the impact will be positive, negative or neutral; however, it is likely that the Health Reform Laws will affect hospitals differently depending upon the populations they service. Community hospitals typically service higher uninsured populations than larger urban hospitals and rely more heavily on Medicare and Medicaid for reimbursement. It remains to be seen whether the increase in the insured populations for community hospitals, as well as the increase in Medicare and Medicaid reimbursements under ARRA for hospitals that implement EHR technology, will be enough to offset proposed cuts in Medicare and Medicaid reimbursements contained in the Health Reform Laws.

We believe healthcare initiatives will continue during the foreseeable future. If adopted, some aspects of previously proposed reforms, such as further reductions in Medicare and Medicaid payments, could adversely affect the businesses of our customers and thereby harm our business.

### **Deficit Reduction**

President Obama signed legislation on August 2, 2011, the Budget Control Act of 2011, to increase the U.S. debt ceiling. This legislation imposed significant cuts in federal spending over the next decade, as the special bipartisan Congressional committee appointed under the legislation failed to take any action on deficit reduction. Our hospital customers rely heavily on Medicare and Medicaid programs to fund their operations. Any cuts to these programs could negatively affect the business of our customers and our business.

### **Results of Operations**

In the three months ended March 31, 2012, we generated revenues of \$44.5 million from the sale of our products and services, as compared to \$40.4 million in the three months ended March 31, 2011, an increase of 10.2%. We installed our core financial and patient accounting system in nine new hospitals in the first three months of 2012 compared to four in the first three months of 2011, resulting in incremental revenues of \$2.5 million. Additionally, our expanding customer base resulted in continued growth in support and maintenance revenues and business management services revenues. Our net income for the three months ended March 31, 2012 increased 5.1% from the first three months of 2011, while cash flow from operations decreased 40.2% primarily as a result of increases in our accounts receivable and financing receivables.

As mentioned above, our operations have been significantly affected by the ARRA. Meaningful use of EHR under the ARRA refers to a set of 15 criteria that medical providers must meet in order to prove that they are using their EHR as an effective tool in their practice, plus 10 additional a la carte menu items, of which the medical provider must demonstrate it is using five. In total, each provider must satisfy 20 meaningful use criteria to qualify for stimulus payments under the ARRA during the first stage of the EHR incentive program.

Meaningful use is measured in three stages over five years. Each stage represents a level of adoption of EHR. To qualify for stimulus payments for each stage, the provider is required to report compliance for a consecutive 90-day period during the calendar year. The dollar amount of stimulus payments during stage one of EHR incentive program is scheduled to



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begin decreasing in 2013. Due to the deadlines associated with the 90-day compliance requirement, our results have become and will remain uneven during the term of the ARRA program, with system sales relating to ARRA likely being higher in the first two quarters of our fiscal year and lower in the last two quarters of our fiscal year.

In the three months ended March 31, 2012, we began including language in certain of our customer license agreements that more evenly matched customers' anticipated cash inflows under the EHR incentive program with the necessary cash outflows for purchasing our EHR solution. Under these arrangements, customers are required to remit to us incentive payments (not to exceed the remaining balance) received for adoption of qualifying 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 in full. Revenue from these arrangements is recognized as the amounts become due.

The following table sets forth certain items included in our results of operations for three months ended March 31, 2012 and 2011, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

|                              | Three Months Ended March 31,<br>2012 |         | 2011      |         |
|------------------------------|--------------------------------------|---------|-----------|---------|
|                              | Amount                               | % Sales | Amount    | % Sales |
| <b>INCOME DATA:</b>          |                                      |         |           |         |
| <b>Sales revenues:</b>       |                                      |         |           |         |
| System sales                 | \$ 17,074                            | 38.4%   | \$ 15,607 | 38.7%   |
| Support and maintenance      | 18,137                               | 40.8%   | 16,162    | 40.0%   |
| Business management services | 9,278                                | 20.9%   | 8,611     | 21.3%   |
| Total sales revenues         | 44,489                               | 100.0%  | 40,380    | 100.0%  |
| <b>Costs of sales:</b>       |                                      |         |           |         |
| System sales                 | 11,899                               | 26.7%   | 12,121    | 30.0%   |
| Support and maintenance      | 7,669                                | 17.2%   | 6,444     | 16.0%   |
| Business management services | 5,654                                | 12.7%   | 4,679     | 11.6%   |
| Total costs of sales         | 25,222                               | 56.7%   | 23,244    | 57.6%   |
| Gross profit                 | 19,267                               | 43.3%   | 17,136    | 42.4%   |
| <b>Operating expenses:</b>   |                                      |         |           |         |
| Sales and marketing          | 3,640                                | 8.2%    | 2,925     | 7.2%    |
| General and administrative   | 6,628                                | 14.9%   | 5,720     | 14.2%   |
| Total operating expenses     | 10,268                               | 23.1%   | 8,645     | 21.4%   |
| Operating income             | 8,999                                | 20.2%   | 8,491     | 21.0%   |
| <b>Other income:</b>         |                                      |         |           |         |
| Interest income              | 159                                  | 0.4%    | 153       | 0.4%    |
| Total other income           | 159                                  | 0.4%    | 153       | 0.4%    |
| Income before taxes          | 9,158                                | 20.6%   | 8,644     | 21.4%   |
| Income taxes                 | 3,509                                | 7.9%    | 3,271     | 8.1%    |
| Net income                   | \$ 5,649                             | 12.7%   | \$ 5,373  | 13.3%   |

### Three Months Ended March 31, 2012 Compared with Three Months Ended March 31, 2011

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*Revenues.* Total revenues for the three months ended March 31, 2012 increased 10.2%, or \$4.1 million, compared to the three months ended March 31, 2011. This was largely attributable to an increase in support and maintenance revenues due to a larger customer base and increased applications within that customer base requiring support and maintenance services, as well as an increase in system sales of clinical applications to new and existing customers attempting to attain meaningful use of EHRs under the ARRA.

System sales revenues increased by 9.4%, or \$1.5 million, for the comparative three month periods. We installed our core system at nine new hospital clients in the first quarter of 2012 compared to four in the first quarter of 2011. Sales to existing customers accounted for 72.1% of our system sales revenue for the first quarter of 2012 compared to 70.4% for the first quarter of 2011. System sales increases were largely attributable to incentives offered under the ARRA. Additionally, the Company installed systems during the quarter under contracts providing for an aggregate consideration of \$5.0 million for which a substantial majority of the consideration will be received and revenue recognized upon the customers successfully achieving meaningful use designation and receipt of related ARRA incentive payments. The Company recognized revenue during the first quarter of 2012 of \$0.5 million for a previously installed Software as a Service ( SaaS ) arrangement that was converted to a perpetual license at the customer s request.

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Support and maintenance revenues increased by 12.2%, or \$2.0 million, for the comparative three month periods. This increase was attributable to an increase in recurring revenues as a result of a larger customer base, an increase in support fees for add-on business sold to existing customers, increases in support rates from contractually agreed upon Consumer Price Index ( CPI ) rate increases and the addition of IT managed services to our suite of service offerings. Support service fees increased by 9.0%, or \$1.3 million, for the comparative three month periods. SaaS, hosting and other fees decreased by 7.2%, or \$0.2 million, for the comparative three month periods. IT managed service fees, which was a new service offering beginning in the second quarter of 2011, were \$0.9 million for the three months ended March 31, 2012 compared to zero for the first quarter of 2011.

Business management services revenues increased by 7.7%, or \$0.7 million, for the comparative three month periods. We experienced this increase in business management services revenues primarily as a result of growth in customer demand for account receivable management and claims eligibility services. We were providing our full suite of business management services to 36 customers at March 31, 2012, compared to 29 customers at March 31, 2011.

*Costs of Sales.* Total costs of sales increased by 8.5%, or \$2.0 million, for the comparative three month periods. As a percentage of total revenues, costs of sales decreased approximately 90 basis points to 56.7% from 57.6%.

Costs of system sales decreased by 1.8%, or \$0.2 million, for the comparative three month periods. The decrease in costs of system sales was due to a \$1.1 million decrease in cost of equipment due largely to the capitalization of \$0.5 million in cost of equipment related to installations for which no revenue has been recognized, coupled with the increase in add-on sales, which typically require much lower equipment investments than new customer installations, as a percentage of the overall sales mix. This decrease in cost of equipment was partially offset by a \$0.8 million increase in travel and related costs due to increased system installations during the three months ended March 31, 2012 compared to the three month period ended March 31, 2011. Payroll and related costs remained relatively unchanged at \$5.9 million. The gross margin on system sales increased to 30.3% for the three month period ended March 31, 2012 from 22.3% in the three month period ended March 31, 2011, due to the decreased costs of equipment and economies of scale achieved with increased system installations accompanied by a less than proportional increase in the required personnel. As a percentage of system sales, cost of equipment decreased to 10.5% in the three month period ended March 31, 2012 from 18.3% in the three month period ended March 31, 2011. As a percentage of system sales, payroll and related expenses decreased to 34.7% in the three month period ended March 31, 2012 from 38.2% in the three month period ended March 31, 2011 as increases in system sales activities do not require a proportionate increase in related personnel. As a percentage of system sales, travel expense increased to 18.9% from 15.7% for the comparative three month periods due to increased system installations.

Cost of support and maintenance increased 19.0%, or \$1.2 million, for the comparative three month periods, primarily due to an increase in payroll and related costs of 19.6%, or \$1.1 million. The increase in payroll and related costs was driven by the addition of personnel to provide IT managed services, which was a new service offering beginning in the second quarter of 2011. The gross margin on support and maintenance revenues decreased to 57.7% for the three month period ended March 31, 2012 from 60.1% for the three month period ended March 31, 2011, as our IT managed services offering has yet to achieve the economies of scale that currently benefit the remaining of our support and maintenance service mix.

Our costs associated with business management services increased 20.8%, or \$1.0 million, for the comparative three month periods due primarily to an increase in payroll and related costs. The gross margin on business management services decreased to 39.1% for the three month period ended March 31, 2012 from 45.7% for the three month period ended March 31, 2011 due to the disproportionate increase in payroll and related costs versus revenues. Payroll and related expenses increased 29.3%, or \$0.8 million, as a result of adding more employees in order to support and develop our growing customer base.

*Sales and Marketing Expenses.* Sales and marketing expenses increased 24.5%, or \$0.7 million, for the comparative three month periods. The increase was attributable to increased payroll and related expense as a result of additional personnel and increased commissions resulting from an increase in system sales.

*General and Administrative Expenses.* General and administrative expenses increased 15.9%, or \$0.9 million, for the comparative three month periods primarily due to increased retirement plan costs of \$0.5 million, or 79.9%. During the first quarter of 2012, we changed the employer match component of our defined contribution retirement plan such that our matching contributions to participant accounts are more heavily weighted towards the earlier periods in the year. Bad debt expense increased \$0.3 million for the comparative three month periods, as prior year receivables benefited from successful collections from delinquent customers. Payroll and related costs increased \$0.3 million as a result of additional personnel, and depreciation expense increased \$0.1 million as a result of the December 2011 purchase of our corporate headquarters which we had previously been leasing for \$9.5 million. These increases were offset by a \$0.4 million decrease in rent expense related to the acquisition of our corporate headquarters.



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As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses increased to 23.1% for the three month period ended March 31, 2012 compared to 21.4% for the three month period ended March 31, 2011.

As a result of the foregoing factors, income before taxes increased by 6.0%, or \$0.5 million, from the three months ended March 31, 2011.

*Income Taxes.* Our effective income tax rate for the three months ended March 31, 2012 and 2011 was 38.3% and 37.8%, respectively. The federal research and development tax credit expired effective December 31, 2011, and has yet to be extended by Congress. As a result, no tax benefit from these potential tax credits has been recorded for the three months ended March 31, 2012. Aside from the potential extension of federal research and development tax credits, we are unaware of any pending legislation that would affect our current income tax rate for the remainder of 2012.

*Net Income.* Net income for the three months ended March 31, 2012 increased by 5.1%, or \$0.2 million, to \$5.6 million, or \$0.51 per basic and diluted share, as compared with net income of \$5.4 million, or \$0.49 per basic and diluted share, for the three months ended March 31, 2011. Net income represented 12.7% of revenue for the three months ended March 31, 2012, as compared to 13.3% of revenue for the three months ended March 31, 2011.

## **Liquidity and Capital Resources**

As of March 31, 2012, we had cash and cash equivalents of \$8.6 million, compared to \$9.9 million at March 31, 2011. Management believes that cash and investments plus cash generated from our normal operating activities should be adequate to fund our business through the remainder of 2012. Our principal source of liquidity has been cash provided by operating activities. Cash provided by operating activities has been used primarily to fund the growth in our business and return cash to shareholders in the form of dividends. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash. However, the declaration of dividends by CPSI is subject to the discretion of our Board of Directors. Our Board of Directors will continue to take into account such matters as general business conditions, our financial results and such other factors as our Board of Directors may deem relevant.

Net cash provided by operating activities for the three months ended March 31, 2012 was \$8.6 million, compared to \$14.3 million for the three months ended March 31, 2011. The decrease was primarily due to an increase in accounts receivable and financing receivables. During the first quarter of 2012, we have again experienced an increase in requests by customers for payment terms and financing arrangements as a result of the challenging economic environment and limited availability of credit from third parties. Although we will provide capital lease financing arrangements to our customers, we prefer and encourage customers to use a software-as-a-service operating lease arrangements in lieu of capital financing lease arrangements.

Net cash used in investing activities totaled \$1.6 million for the three months ended March 31, 2012, compared to \$3.3 million for the three months ended March 31, 2011. We used cash for the purchase of \$0.5 million of property and equipment and for the purchase of investments of \$1.0 million during the three months ended March 31, 2012. We move idle cash to our investment portfolio that we do not anticipate needing within a one-year time frame. We anticipate the need for approximately \$2.5 million to \$3.5 million in capital expenditures during the remainder of 2012, including approximately \$2.0 million for the addition of office space in Baldwin County, Alabama.

Net cash used in financing activities totaled \$5.1 million for the three months ended March 31, 2012, compared to \$3.9 million for the three months ended March 31, 2011. During the three months ended March 31, 2012, we increased our dividend rate 27.8% to \$0.46 per share from \$0.36 per share.

Our days sales outstanding, which represents the average collection time for accounts receivable, for the three months ended March 31, 2012 and 2011 were 48 and 51 days, respectively.

We currently do not have a bank line of credit or other credit facility in place. Because we have no debt, we are not subject to contractual restrictions or other influences on our operations, such as payment demands and restrictions on the use of operating funds that are typically associated with debt. If we borrow money in the future, we will likely be subject to operating and financial covenants that could limit our ability to operate as profitably as we have in the past. Defaults under applicable loan agreements could result in the demand by lenders for immediate payment of substantial funds and substantial restrictions on expenditures, among other things. Due to the recent economic recession and disruption in the capital markets, additional capital, if needed, may not be available on terms favorable to us, or at all.

Our future capital requirements will depend upon a number of factors, including the rate of growth of our sales, cash collections from our customers and our future investments in fixed assets. We believe that our available cash and cash equivalents, investments and anticipated cash generated from operations will be sufficient to meet our operating requirements for at least the next 12 months.



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### **Off Balance Sheet Arrangements**

Our only off-balance sheet arrangement, as defined by Item 303(a)(4) of SEC Regulation S-K, consists of our guarantee of certain lease obligations of Solis Healthcare, LP ( Solis Healthcare ) to Winthrop Resources Corporation ( Winthrop ) under a lease agreement. Solis Healthcare purchased a software system from us and then entered into a sale-leaseback transaction with Winthrop in the first quarter of 2008. We provided this guarantee in order to facilitate Solis Healthcare in leasing the new system.

The lease has an initial term of five years and continues from year to year thereafter until terminated. We are contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, we will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guaranty runs for the entire term of the lease; however, the maximum potential amount of future payments that we would be required to make to Winthrop under the guaranty is \$777,800, the amount outstanding under the lease at March 31, 2012, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney fees and costs). Due to the contingent nature of the guaranty, the maximum amount of the guaranty is not recorded on our balance sheet; however, when necessary, we record reserves to cover potential losses. A liability in the amount of approximately \$21,000, the amortized fair value of the guaranty, is recorded on our balance sheet as an other accrued liability at March 31, 2012. See Note 9 to the financial statements for additional information.

The Company also has other lease rights and obligations that it accounts for as operating leases that may be reclassified as balance sheet arrangements under accounting pronouncements currently being considered by the FASB.

### **Critical Accounting Policies**

Our Management Discussion and Analysis is based upon our Condensed Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make subjective or complex judgments that may affect the reported financial condition and results of operations. We base our estimates on historical experience and other assumptions that we believe to be reasonable in the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We continually evaluate the information used to make these estimates as our business and the economic environment changes.

In our Annual Report on Form 10-K for the year ended December 31, 2011, we identified our critical accounting policies related to cash and cash equivalents, investments, income taxes, accounts receivable and allowance for doubtful accounts, inventories, property and equipment, deferred revenue, revenue recognition, stock based compensation, research and development costs, advertising, and shipping and handling costs. There have been no significant changes to these critical accounting policies for the three months ended March 31, 2012.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Our exposure to market risk relates primarily to the potential change in the value of our investment portfolio as a result of fluctuations in interest rates. The primary purpose of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing risk of loss. As of March 31, 2012, our investment portfolio consisted of a variety of financial instruments, primarily including, but not limited to, money market securities and high quality government and corporate obligations. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We do not hold financial instruments for trading or other speculative purposes. The securities in our investment portfolio are classified as available-for-sale and, consequently, are recorded on our balance sheet at fair market value with their related unrealized gain or loss reflected as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates.

We believe that the market risk arising from our holdings of these financial instruments is minimal. Due to the conservative allocation of our investment portfolio, we do not believe that an immediate 10% increase in interest rates would have a material effect on the fair market value of our portfolio. Additionally, since we believe we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows to be materially affected to any significant degree by a sudden change in market interest rates on our investment portfolio. We do not utilize

derivative financial instruments to manage our interest rate risks.

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The table that follows presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of March 31, 2012.

|                                                                            | Aggregate<br>Fair Value | Weighted<br>Average<br>Interest Rate |
|----------------------------------------------------------------------------|-------------------------|--------------------------------------|
| <b>Cash and Cash Equivalents:</b>                                          |                         |                                      |
| Cash and cash equivalents                                                  | \$ 8,557,769            | 0.00%                                |
| <b>Short-Term Investments: (1)</b>                                         |                         |                                      |
| Money market funds and accrued income                                      | \$ 1,100,366            | 0.22%                                |
| Obligations of the U.S. Treasury, U.S government corporations and agencies | 3,920,481               | 0.58%                                |
| Corporate debt securities                                                  | 2,562,185               | 3.55%                                |
| <b>Total short-term investments</b>                                        | <b>\$ 7,583,032</b>     |                                      |
| <b>Long-Term Investments: (2)</b>                                          |                         |                                      |
| Obligations of the U.S. Treasury, U.S government corporations and agencies | \$ 2,978,551            | 1.85%                                |
| Mortgage backed securities                                                 | 102,418                 | 1.63%                                |
| Corporate debt securities                                                  | 6,903,200               | 3.15%                                |
| <b>Total long-term investments</b>                                         | <b>\$ 9,984,169</b>     |                                      |

(1) Reflects instruments with a contractual maturity of less than one year.

(2) Reflects instruments with a contractual maturity of one year or more.

As of March 31, 2012, the Company had no borrowings and, therefore, is not subject to interest rate risks related to debt instruments.

**Item 4. Controls and Procedures.***Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that the information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations to the effectiveness of any system of disclosure controls and procedures, no evaluation of disclosure controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, with a company have been prevented or detected on a timely basis. Even disclosure controls and procedures determined to be effective can only provide reasonable assurance that their objectives are achieved.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

*Changes in Internal Control over Financial Reporting*

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There were no changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

From time to time, we are involved in routine litigation that arises in the ordinary course of business. We are not currently involved in any litigation that we believe could reasonably be expected to have a material adverse effect on our business, financial condition, or results of operations.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

Not applicable.

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information.**

None

**Item 6. Exhibits.**

- 3.1 Certificate of Incorporation (filed as Exhibit 3.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 3.2 Bylaws (filed as Exhibit 3.6 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and Incorporated herein by reference)
- 10.1 2012 Executive Officer Incentive Program (filed as Exhibit 10.1 to CPSI's Current Report on Form 8-K dated January 26, 2012 and incorporated herein by reference)

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|      |                                                                                                                                                                                    |
|------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1 | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                      |
| 31.2 | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                      |
| 32.1 | Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101  | Interactive Data Files for CPSI s Form 10-Q for the period ended March 31, 2012                                                                                                    |

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**SIGNATURES**

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

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

Date: May 8, 2012

By: */s/* J. BOYD DOUGLAS  
**J. Boyd Douglas**  
**President and Chief Executive Officer**

Date: May 8, 2012

By: */s/* DAVID A. DYE  
**David A. Dye**  
**Chief Financial Officer**

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**Exhibit Index**

| <b>No.</b> | <b>Exhibit</b>                                                                                                                                                                     |
|------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1        | Certificate of Incorporation (filed as Exhibit 3.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)                 |
| 3.2        | Bylaws (filed as Exhibit 3.6 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and Incorporated herein by reference)                                       |
| 10.1       | 2012 Executive Officer Incentive Program (filed as Exhibit 10.1 to CPSI's Current Report on Form 8-K dated January 26, 2012 and incorporated herein by reference)                  |
| 31.1       | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                      |
| 31.2       | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                      |
| 32.1       | Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101        | Interactive Data Files for CPSI's Form 10-Q for the period ended March 31, 2012                                                                                                    |