

COMPUTER PROGRAMS & SYSTEMS INC

Form 10-Q

August 07, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2009.

**.. 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 Sections 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

Smaller reporting company

(Do not check if a 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

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As of August 6, 2009, there were 10,972,757 shares of the issuer's common stock outstanding.

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**Form 10-Q**

**(For the three and six months ended June 30, 2009)**

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

|  | <b>June 30,<br/>2009<br/>(Unaudited)</b> | <b>December 31,<br/>2008</b> |
|--|--|------------------------------|
| <b>Assets</b>  |  |                              |
| Current assets:  |  |                              |
| Cash and cash equivalents  | \$ 9,269,208                             | \$ 11,744,466                |
| Investments  | 14,575,236                               | 11,845,646                   |
| Accounts receivable, net of allowance for doubtful accounts of \$886,000 and \$628,000, respectively | 14,945,810                               | 15,600,865                   |
| Financing receivables, current portion   | 3,045,894                                | 2,357,014                    |
| Inventories  | 1,836,974                                | 1,374,302                    |
| Deferred tax assets  | 1,539,121                                | 1,331,708                    |
| Prepaid income taxes   | 391,882                                  | 319,152                      |
| Prepaid expenses   | 532,071                                  | 501,265                      |
| <b>Total current assets</b>  | <b>46,136,196</b>                        | <b>45,074,418</b>            |
| Property and equipment   |  |                              |
| Land   | 936,026                                  | 936,026                      |
| Maintenance equipment  | 3,616,585                                | 3,442,925                    |
| Computer equipment   | 6,230,496                                | 5,818,875                    |
| Office furniture and equipment   | 2,086,097                                | 1,749,348                    |
| Automobiles  | 132,926                                  | 132,926                      |
|  | 13,002,130                               | 12,080,100                   |
| Less accumulated depreciation  | (8,159,903)                              | (7,267,069)                  |
| Net property and equipment   | 4,842,227                                | 4,813,031                    |
| Financing receivables, net of current portion  | 3,108,867                                | 2,979,639                    |
| <b>Total assets</b>  | <b>\$ 54,087,290</b>                     | <b>\$ 52,867,088</b>         |
| <b>Liabilities and Stockholders Equity</b>   |  |                              |
| Current liabilities:   |  |                              |
| Accounts payable   | \$ 1,619,013                             | \$ 1,829,505                 |
| Deferred revenue   | 3,438,429                                | 3,728,356                    |
| Accrued vacation   | 2,495,504                                | 2,297,116                    |
| Other accrued liabilities  | 3,609,651                                | 3,996,547                    |
| <b>Total current liabilities</b>   | <b>11,162,597</b>                        | <b>11,851,524</b>            |
| Deferred tax liabilities   | 501,710                                  | 456,394                      |
| Stockholders equity:   |  |                              |
|  | 10,973                                   | 10,894                       |

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Common stock, par value \$0.001 per share; 30,000,000 shares authorized; 10,972,757 and 10,893,751 shares issued and outstanding

|  |               |               |
|--|---------------|---------------|
| Additional paid-in capital                 | 29,188,913    | 27,006,573    |
| Accumulated other comprehensive income     | 38,747        | 56,715        |
| Retained earnings                          | 13,184,350    | 13,484,988    |
| Total stockholders' equity                 | 42,422,983    | 40,559,170    |
| Total liabilities and stockholders' equity | \$ 54,087,290 | \$ 52,867,088 |

See accompanying notes.

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

|  | <b>Three months ended June 30,</b> |                     | <b>Six months ended June 30,</b> |                     |
|--|------------------------------------|---------------------|----------------------------------|---------------------|
|  | <b>2009</b>                        | <b>2008</b>         | <b>2009</b>                      | <b>2008</b>         |
| <b>Sales revenues:</b>                     |                                    |                     |                                  |                     |
| System sales                               | \$ 9,721,386                       | \$ 8,458,384        | \$ 19,338,240                    | \$ 19,113,744       |
| Support and maintenance                    | 13,820,046                         | 13,132,851          | 27,653,440                       | 26,218,620          |
| Business management services               | 7,305,856                          | 6,160,287           | 13,991,358                       | 11,936,426          |
| <b>Total sales revenues</b>                | <b>30,847,288</b>                  | <b>27,751,522</b>   | <b>60,983,038</b>                | <b>57,268,790</b>   |
| <b>Costs of sales:</b>                     |                                    |                     |                                  |                     |
| System sales                               | 8,481,586                          | 7,214,583           | 16,288,363                       | 15,117,166          |
| Support and maintenance                    | 5,380,479                          | 4,772,077           | 10,321,337                       | 9,569,421           |
| Business management services               | 4,357,789                          | 3,639,456           | 8,239,664                        | 7,224,874           |
| <b>Total costs of sales</b>                | <b>18,219,854</b>                  | <b>15,626,116</b>   | <b>34,849,364</b>                | <b>31,911,461</b>   |
| <b>Gross profit</b>                        | <b>12,627,434</b>                  | <b>12,125,406</b>   | <b>26,133,674</b>                | <b>25,357,329</b>   |
| <b>Operating expenses:</b>                 |                                    |                     |                                  |                     |
| Sales and marketing                        | 2,252,020                          | 2,129,736           | 4,327,983                        | 4,389,494           |
| General and administrative                 | 5,040,378                          | 5,286,870           | 10,182,364                       | 10,761,221          |
| <b>Total operating expenses</b>            | <b>7,292,398</b>                   | <b>7,416,606</b>    | <b>14,510,347</b>                | <b>15,150,715</b>   |
| <b>Operating income</b>                    | <b>5,335,036</b>                   | <b>4,708,800</b>    | <b>11,623,327</b>                | <b>10,206,614</b>   |
| <b>Other income:</b>                       |                                    |                     |                                  |                     |
| Interest income                            | 238,750                            | 230,708             | 471,927                          | 495,956             |
| <b>Total other income</b>                  | <b>238,750</b>                     | <b>230,708</b>      | <b>471,927</b>                   | <b>495,956</b>      |
| <b>Income before taxes</b>                 | <b>5,573,786</b>                   | <b>4,939,508</b>    | <b>12,095,254</b>                | <b>10,702,570</b>   |
| <b>Income taxes</b>                        | <b>2,032,631</b>                   | <b>1,948,321</b>    | <b>4,528,817</b>                 | <b>4,205,377</b>    |
| <b>Net income</b>                          | <b>\$ 3,541,155</b>                | <b>\$ 2,991,187</b> | <b>\$ 7,566,437</b>              | <b>\$ 6,497,193</b> |
| <b>Net income per share - basic</b>        | <b>\$ 0.32</b>                     | <b>\$ 0.28</b>      | <b>\$ 0.69</b>                   | <b>\$ 0.60</b>      |
| <b>Net income per share - diluted</b>      | <b>\$ 0.32</b>                     | <b>\$ 0.28</b>      | <b>\$ 0.69</b>                   | <b>\$ 0.60</b>      |
| <b>Weighted average shares outstanding</b> |                                    |                     |                                  |                     |
| Basic                                      | 10,962,386                         | 10,829,037          | 10,934,422                       | 10,827,188          |
| Diluted                                    | 10,962,386                         | 10,843,081          | 10,937,285                       | 10,845,072          |
| <b>Dividends declared per share</b>        | <b>\$ 0.36</b>                     | <b>\$ 0.36</b>      | <b>\$ 0.72</b>                   | <b>\$ 0.72</b>      |

See accompanying notes.





**Table of Contents****COMPUTER PROGRAMS AND SYSTEMS, INC.****STATEMENT OF STOCKHOLDERS EQUITY (Unaudited)**

|  | <b>Common<br/>Shares</b> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> | <b>Retained<br/>Earnings</b> | <b>Total<br/>Stockholders<br/>Equity</b> |
|--|--------------------------|-------------------------|---|---|------------------------------|--|
| Balance at December 31, 2008                                     | 10,893,751               | \$ 10,894               | \$ 27,006,573                             | \$ 56,715   | \$ 13,484,988                | \$ 40,559,170                            |
| Net income   |                          |                         |   |   | 7,566,437                    | 7,566,437                                |
| Issuance of common stock   | 79,006                   | 79                      | 1,303,520                                 |   |                              | 1,303,599                                |
| Unrealized loss on available for sale investments,<br>net of tax |                          |                         |   | (17,968)  |                              | (17,968)                                 |
| Stock-based compensation   |                          |                         | 459,990                                   |   |                              | 459,990                                  |
| Dividends  |                          |                         |   |   | (7,867,075)                  | (7,867,075)                              |
| Excess tax benefit from stock option exercises                   |                          |                         | 418,830                                   |   |                              | 418,830                                  |
| Balance at June 30, 2009   | 10,972,757               | \$ 10,973               | \$ 29,188,913                             | \$ 38,747   | \$ 13,184,350                | \$ 42,422,983                            |

See accompanying notes.

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

|  | <b>Six months ended June 30,</b> |               |
|--|----------------------------------|---------------|
|  | <b>2009</b>                      | <b>2008</b>   |
| <b>Operating Activities</b>                        |                                  |               |
| Net income   | \$ 7,566,437                     | \$ 6,497,193  |
| Adjustments to net income:                         |                                  |               |
| Provision for bad debt                             | 304,344                          | 1,237,271     |
| Deferred taxes                                     | (150,772)                        | (206,960)     |
| Stock-based compensation                           | 459,990                          | 454,157       |
| Excess tax benefit from stock option exercises     | (418,830)                        | (11,813)      |
| Income tax benefit from restricted stock dividends |                                  | (21,639)      |
| Depreciation                                       | 892,834                          | 964,805       |
| Changes in operating assets and liabilities:       |                                  |               |
| Accounts receivable                                | 350,711                          | (82,133)      |
| Financing receivables                              | (818,108)                        | 898,060       |
| Inventories  | (462,672)                        | (173,749)     |
| Prepaid expenses                                   | (30,806)                         | 86,095        |
| Accounts payable                                   | (210,492)                        | (92,210)      |
| Deferred revenue                                   | (289,927)                        | 390,496       |
| Other liabilities                                  | (188,508)                        | 7,723         |
| Income taxes payable                               | 346,100                          | (432,799)     |
| Net cash provided by operating activities          | 7,350,301                        | 9,514,497     |
| <b>Investing Activities</b>                        |                                  |               |
| Purchases of property and equipment                | (922,030)                        | (577,332)     |
| Purchases of investments                           | (2,758,883)                      | (282,898)     |
| Net cash used in investing activities              | (3,680,913)                      | (860,230)     |
| <b>Financing Activities</b>                        |                                  |               |
| Proceeds from exercise of stock options            | 1,303,599                        | 152,245       |
| Income tax benefit from restricted stock dividends |                                  | 21,639        |
| Excess tax benefit from stock option exercises     | 418,830                          | 11,813        |
| Dividends paid                                     | (7,867,075)                      | (7,794,900)   |
| Net cash used in financing activities              | (6,144,646)                      | (7,609,203)   |
| (Decrease) Increase in cash and cash equivalents   | (2,475,258)                      | 1,045,064     |
| Cash and cash equivalents at beginning of period   | 11,744,466                       | 11,806,017    |
| Cash and cash equivalents at end of period         | \$ 9,269,208                     | \$ 12,851,081 |
| Cash paid for income taxes, net of refund          | \$ 4,343,603                     | \$ 4,845,136  |
| See accompanying notes.                            |                                  |               |

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**NOTES TO FINANCIAL STATEMENTS (Unaudited)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited 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 financial information and 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 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, 2008 and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2008.

The Company has considered subsequent events through August 7, 2009, the date of issuance, in preparing the interim financial statements and notes thereto.

**2. REVENUE RECOGNITION**

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, principally:

Statement of Position ( SOP ) No. 97 2, *Software Revenue Recognition*, issued by the American Institute of Certified Public Accountants ( AICPA ).

AICPA SOP No. 98 9, *Modification of SOP 97 2, Software Revenue Recognition, With Respect to Certain Transactions*.

Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements*, issued by the SEC, as amended by SAB No. 104.

The Emerging Issues Task Force ( EITF ) Issue 00 3, *Application of AICPA Statement of Position 97 2 to Arrangements That Include the Right to Use Software Stored on Another Entities Hardware*.

EITF Issue 03 5, *Applicability of AICPA Statement of Position 97 2 to Non Software Deliverables in an Arrangement Containing More Than Incidental Software*.

The Company s revenue is generated from three sources:

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

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the provision of system support services, which includes software application support, hardware maintenance, continuing education, application service provider ( ASP ) products, and internet service provider ( ISP ) products.

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

The Company enters into contractual obligations to sell hardware, perpetual software licenses, installation and training services, and maintenance services. Revenue from hardware sales is recognized upon shipment, when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is probable. Revenue from the perpetual software licenses and installation and training services are recognized using the residual method. The residual method allocates an amount of the arrangement to the elements for which fair value can be determined and any remaining arrangement consideration (the residual revenue ) is then allocated to the delivered elements. The fair value of maintenance services is determined based on vendor specific objective evidence ( VSOE ) of fair value and is deferred and recognized as revenue ratably over the maintenance term. VSOE of fair value of maintenance services is determined by reference to the price the Company's customers are required to pay for the services when sold separately via renewals. The residual revenue is allocated to the perpetual license and installation and training services and is recognized over the term that the installation and training services are performed for the entire arrangement. The method of recognizing revenue for the perpetual license for the associated modules included in the arrangement and 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. The installation and training services are normally completed in three to four weeks.

Revenue derived from maintenance contracts primarily includes revenue from software application support, hardware maintenance, continuing education and related services. Maintenance contracts are typically sold for a separate fee with initial contract periods ranging from one to seven years, with renewal for additional periods thereafter. Maintenance revenue is recognized ratably over the term of the maintenance agreement.

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The Company accounts for ASP contracts in accordance with the EITF 00-3, *Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware*. EITF 00-3 states that the software element of ASP services is covered by SOP 97-2 only 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 related to the vendor to host the software. Each ASP 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 ASP term. Accordingly, the Company has concluded that ASP 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 ASP revenue of the Company does not fall within the scope of SOP 97-2. In accordance with SAB No. 104, revenue is recognized when the services are performed.

Revenue for ISP and business management services are recognized in the period in which the services are performed.

**3. DETAILS OF BALANCE SHEET AMOUNTS**

Other accrued liabilities are comprised of the following:

|                               | June 30,<br>2009 | December 31,<br>2008 |
|-------------------------------|------------------|----------------------|
| Accrued salaries and benefits | \$ 2,491,593     | \$ 2,686,862         |
| Commissions                   | 182,525          | 374,990              |
| Self-insurance reserves       | 438,500          | 395,900              |
| Other                         | 497,033          | 538,795              |
|                               | \$ 3,609,651     | \$ 3,996,547         |

**4. INVESTMENTS**

The Company accounts for investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in 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 maturity securities at the time of acquisition and re-evaluates the classifications at each balance sheet date. The Company's investments in fixed maturity securities are classified as available-for-sale.

Investments are comprised of the following at June 30, 2009:

|   | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|---------------------|----------------------|---------------|
| Short term investments  | \$ 549,847        | \$                  | \$                   | \$ 549,847    |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | 6,550,505         | 25,337              | 11,167               | 6,564,675     |
| Mortgage backed securities  | 183,712           |                     | 19                   | 183,693       |
| Corporate bonds   | 7,189,475         | 99,541              | 11,995               | 7,277,021     |
|   | \$ 14,473,539     | \$ 124,878          | \$ 23,181            | \$ 14,575,236 |



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Shown below are the amortized cost and estimated fair value of securities with fixed maturities at June 30, 2009, 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 2009    | \$ 5,895,438      | \$ 5,907,386  |
| Due in 2010    | 4,331,763         | 4,370,153     |
| Due in 2011    | 2,243,290         | 2,300,966     |
| Due in 2012    | 1,819,336         | 1,813,038     |
| Due thereafter | 183,712           | 183,693       |
|                | \$ 14,473,539     | \$ 14,575,236 |

Investments are comprised of the following at December 31, 2008:

|   | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|---------------------|----------------------|---------------|
| Short term investments  | \$ 650,092        | \$ 83               | \$                   | \$ 650,175    |
| Obligations of U.S. Treasury, U.S. government corporations and agencies | 4,753,603         | 86,135              |                      | 4,839,738     |
| Mortgage backed securities  | 197,026           |                     | 7,302                | 189,724       |
| Corporate bonds   | 6,151,949         | 44,569              | 30,509               | 6,166,009     |
|   | \$ 11,752,670     | \$ 130,787          | \$ 37,811            | \$ 11,845,646 |

**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. The Company uses the treasury stock method to calculate the impact of outstanding stock options. Potentially dilutive shares are derived from outstanding stock options that have an exercise price less than the weighted average market price of our common stock. The difference between basic and diluted EPS is solely attributable to stock options. There were no dilutive shares for the three month period ended June 30, 2009 and 2,863 dilutive shares for the six month period ended June 30, 2009. The dilutive shares for the three and six month periods ended June 30, 2008 were 14,044 and 17,884, respectively.

As described in Note 11, Recent Accounting Pronouncements, the Company adopted FSP EITF 03-6-1 on January 1, 2009. The Company's unvested restricted shares contain rights to receive nonforfeitable dividends, and thus, are participating securities required to be included in basic earnings per share using the two class method. The weighted average shares outstanding and net income per share for the three and six month periods ended June 30, 2009 and June 30, 2008 were computed in accordance with FSP EITF 03-6-1.

**Table of Contents****6. INCOME TAXES**

The Company accounts for income taxes using the liability method in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 109, *Accounting for Income Taxes*. Deferred income taxes arise from the temporary differences in the recognition of income and expenses for tax purposes. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Deferred tax assets and liabilities are comprised of the following at June 30, 2009 and December 31, 2008.

|                                    | June 30,<br>2009 | December 31,<br>2008 |
|------------------------------------|------------------|----------------------|
| Deferred tax assets:               |                  |                      |
| Accounts receivable                | \$ 345,593       | \$ 245,008           |
| Accrued vacation                   | 973,247          | 895,875              |
| Stock-based compensation           | 211,451          | 382,291              |
| Other accrued liabilities          | 303,009          | 322,248              |
| <br>Total deferred tax assets      | <br>\$ 1,833,300 | <br>\$ 1,845,422     |
| Deferred tax liabilities:          |                  |                      |
| Other comprehensive income         | \$ 24,923        | \$ 36,247            |
| Depreciation                       | 770,966          | 933,861              |
| <br>Total deferred tax liabilities | <br>\$ 795,889   | <br>\$ 970,108       |

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

|                                | 2009             | 2008             |
|--------------------------------|------------------|------------------|
| Current provision:             |                  |                  |
| Federal                        | \$ 3,771,348     | \$ 3,629,364     |
| State                          | 908,241          | 782,973          |
| Deferred benefit:              |                  |                  |
| Federal                        | (135,308)        | (185,733)        |
| State                          | (15,464)         | (21,227)         |
| <br>Total income tax provision | <br>\$ 4,528,817 | <br>\$ 4,205,377 |

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

|  | 2009             | 2008             |
|--|------------------|------------------|
| Income taxes at U. S. Federal statutory rate | \$ 4,233,339     | \$ 3,745,900     |
| State income tax, net of federal tax effect  | 574,186          | 487,706          |
| Other  | (278,708)        | (28,229)         |
| <br>Total income tax provision               | <br>\$ 4,528,817 | <br>\$ 4,205,377 |

The Company had unrecognized tax benefits of \$126,637 related to uncertain tax positions as of June 30, 2009 under the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), which is recorded in Other accrued liabilities on the Balance Sheet. No accrued interest or penalties for such positions is recorded. The tax year 2004, 2005 and 2006 federal returns are currently under examination by Internal Revenue Service, primarily in relation to research credits claimed on those returns by the Company. The 2008 federal return remains open to examination, and the tax years 2004 - 2008 remain open to other taxing jurisdictions to which the Company is subject.





**Table of Contents****7. STOCK BASED COMPENSATION**

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share Based Payment* ( SFAS No. 123R ). SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services.

Accordingly, 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 the effective date of SFAS 123R.

The following table shows total stock-based compensation expense for the three and six months ended June 30, 2009 and 2008, included in the Statements of Income:

|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 30, 2009      | June 30, 2008 | June 30, 2009    | June 30, 2008 |
| Costs of sales                           | \$ 74,997          | \$ 74,998     | \$ 149,994       | \$ 149,996    |
| Operating expenses                       | 154,998            | 154,998       | 309,996          | 304,161       |
| Pre-tax stock-based compensation expense | 229,995            | 229,996       | 459,990          | 454,157       |
| Less: income tax effect                  | 89,698             | 91,078        | 179,396          | 179,846       |
| Net stock-based compensation expense     | \$ 140,297         | \$ 138,918    | \$ 280,594       | \$ 274,311    |

**2002 Stock Option Plan**

Under the 2002 Stock Option Plan, as amended, the Company has authorized the issuance of equity-based awards for up to 865,333 shares of common stock to provide additional incentive to employees and officers. Pursuant to the plan, the Company can grant either incentive or non-qualified stock options. Options to purchase common stock under the 2002 Stock Option Plan have been granted to Company employees with an exercise price equal to the fair market value of the underlying shares on the date of grant.

Stock options granted under the 2002 Stock Option Plan to executive officers of the Company became vested as to all of the shares covered by such grant on the fifth anniversary of the grant date and expired on the seventh anniversary of the grant date. Stock options granted under the 2002 Stock Option Plan to employees other than executive officers became vested as to 50% of the shares covered by the option grant on the third anniversary of the grant date and as to 100% of such shares on the fifth anniversary of the grant date. In addition, such options became vested upon termination of employment resulting from death, disability or retirement. Such options expired on the seventh anniversary of the grant date.

Under the methodology of SFAS No. 123, the fair value of the Company's stock options was estimated at the date of grant using the Black-Scholes option pricing model. The multiple option approach was used, with assumptions for expected option life of 5 years and 44% expected volatility for the market price of the Company's stock in 2002. An estimated dividend yield of 3% was used. The risk-free rate of return was determined to be 2.79% in 2002. No options were granted during 2008 or the first six months of 2009. There are no outstanding options as of June 30, 2009.

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A summary of stock option activity under the plan during the six month periods ended June 30, 2009 and 2008 is as follows:

|  | June 30, 2009 |                | June 30, 2008 |                |
|--|---------------|----------------|---------------|----------------|
|  | Shares        | Exercise Price | Shares        | Exercise Price |
| Outstanding at beginning of year                                   | 82,608        | \$ 16.50       | 152,444       | \$ 16.50       |
| Granted  |               |                |               |                |
| Exercised  | (79,006)      | 16.50          | (9,227)       | 16.50          |
| Forfeited  | (3,602)       | 16.50          |               |                |
| Outstanding at end of period                                       |               | \$             | 143,217       | \$ 16.50       |
| Exercisable at end of period                                       |               | \$             | 143,217       | \$ 16.50       |
| Shares available for future grants under the plan at end of period |               | 495,134        |               | 495,134        |

The aggregate intrinsic value (as measured by the difference between the exercise and strike price) of options exercised during the quarters ended June 30, 2009 and June 30, 2008 was \$377,380 and \$15,513, respectively.

As of June 30, 2009, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the existing stock option plan.

**2005 Restricted Stock Plan**

On January 27, 2006, the Compensation Committee of the Board of Directors approved the grant of 116,498 shares of restricted stock, effective January 30, 2006, to certain executive officers of the Company under the 2005 Restricted Stock Plan. The grant date fair value was \$42.91 per share. The restricted stock vests in five equal annual installments commencing on the first anniversary of the 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 to the newly named Chief Operating Officer of the Company. The grant date fair value was \$42.11 per share. The restricted stock vests in five equal annual installments commencing 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 newly named Vice President Finance and Chief Financial Officer. The grant date fair value was \$21.25 per share. The restricted stock vests in five equal annual installments commencing January 30, 2009, and each January 30 thereafter.

|  | Six Months Ended June 30, 2009 |  | Six Months Ended June 30, 2008 |  |
|--|--------------------------------|--|--------------------------------|--|
|  | Shares                         | Weighted-Average Grant-Date Fair Value | Shares                         | Weighted-Average Grant-Date Fair Value |
| Nonvested stock outstanding at beginning of year | 76,086                         | \$ 38.11                               | 79,487                         | \$ 42.77                               |
| Granted  |                                |  | 16,471                         | 21.25                                  |
| Vested   | (23,166)                       | 39.71                                  | (19,872)                       | 42.77                                  |
| Nonvested stock outstanding at end of period     | 52,920                         | \$ 37.41                               | 76,086                         | \$ 38.11                               |

As of June 30, 2009, there was \$1,592,217 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2005 Restricted Stock Plan. This cost is expected to be recognized over a weighted-average period of 1.7 years.

**Table of Contents****8. COMPREHENSIVE INCOME**

Statement of Financial Accounting Standards No. 130, *Reporting Comprehensive Income*, requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with accounting principles generally accepted in the United States of America. Total comprehensive income for the three and six months ended June 30, 2009 and 2008 is as follows:

|  | Three months ended June 30, |              | Six months ended June 30, |              |
|--|-----------------------------|--------------|---------------------------|--------------|
|  | 2009                        | 2008         | 2009                      | 2008         |
| Net income as reported                       | \$ 3,541,155                | \$ 2,991,187 | \$ 7,566,437              | \$ 6,497,193 |
| Other comprehensive income:                  |                             |              |                           |              |
| Unrealized loss on investments, net of taxes | (9,772)                     | (46,780)     | (17,968)                  | (8,082)      |
| Total comprehensive income                   | \$ 3,531,383                | \$ 2,944,407 | \$ 7,548,469              | \$ 6,489,111 |

**9. COMMITMENTS AND CONTINGENCIES**

As of June 30, 2009, the Company is contingently liable as guarantor on a lease obligation between Solis Healthcare, LP ( Solis Healthcare ) and Winthrop Resources Corporation ( Winthrop ). Solis Healthcare purchased a software system from the Company in the first quarter of 2008 and then entered into a sale-leaseback transaction with Winthrop. 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 \$2,145,000, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney's fees and costs). The Company recorded \$2,154,389, the amount billed for the new system installation, as revenue during the first quarter of 2008. 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 \$148,220, the estimated fair value of the guaranty, is recorded on the balance sheet as an other accrued liability at June 30, 2009. As of June 30, 2009, we were not aware of any conditions that would effect the payment or performance risk of the lease obligation.

Effective for the quarter ending June 30, 2009, the Company began including language in its customer license agreements that its electronic health record (EHR) system, when used as prescribed by the Company, will provide the customer with the ability to achieve meaningful use of a certified electronic health records as specified in the American Recovery and Reinvestment Act of 2009 (the ARRA ). These specifications have yet to be pronounced by the U.S. Department of Health and Human Services, but should be promulgated before December 31, 2009 according to the ARRA. The Company believes that the possibility of its EHR system not meeting the promulgated meaningful use provisions is remote based on the fact that we have already obtained certification from the Certification Commission for Healthcare Information Technology (CCHIT<sup>SM</sup>), the leading certification authority for healthcare information systems.

**10. FAIR VALUE**

The Company adopted the provisions of Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ), on January 1, 2008. SFAS 157 establishes a framework for measuring fair value and expands financial statement disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. The FASB also amended SFAS 157 to exclude FASB Statement No. 13 and its related interpretive accounting pronouncements that address leasing transactions. SFAS 157 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.

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The fair values of the Company's available-for-sale securities are based on quoted prices in active markets for identical assets. 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 SFAS No. 13, and (2) valuing potential impairment loss related to long-lived assets accounted for pursuant to SFAS No. 144.

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The following table summarizes the carrying amounts and fair values of certain assets and liabilities at June 30, 2009:

|                               | Carrying<br>Amount | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable Inputs<br>(Level 3) |
|-------------------------------|--------------------|---|---|---|
| Available-for-sale securities | \$ 14,575,236      | \$ 14,575,236   | \$  | \$  |

There was no cumulative effect of adoption related to SFAS 157, and the adoption did not have an impact on the Company's financial position, results of operations, or cash flows.

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 maturity of these instruments.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – including and amendment of FASB Statement No. 115*. This statement permits entities to choose to measure many financial instruments and certain items at fair value. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, including interim periods within that fiscal year. The Company did not elect the fair value option for any of its existing financial instruments as of June 30, 2009 and the Company has not determined whether or not it will elect this option for financial instruments it may acquire in the future.

**11. RECENT ACCOUNTING PRONOUNCEMENTS*****Accounting Standards Adopted in 2009***

In June 2008, the FASB issued Staff Position ( FSP ) Emerging Issues Task Force 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP EITF 03-6-1 ). This FSP requires unvested share-based payment awards containing non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) to be included in the computation of basic earnings per share according to the two-class (basic and diluted) method. The Company adopted FSP EITF 03-6-1 for the fiscal year beginning January 1, 2009. This FSP required all prior-period earnings per share data presented to be adjusted retrospectively (including interim financial statements, summaries of earnings, and selected financial data) to conform with the provisions of this FSP. The adoption of this FSP did not have a material impact on our earnings per share calculation.

In September 2008, the FASB issued FSP No. 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. This FSP amends FASB Interpretation No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others* ( FIN 45 ), to require an additional disclosure about the current status of the payment/performance risk of a guarantee. The provisions of the FSP that amend FIN 45 were effective for reporting periods (annual or interim) beginning after November 15, 2008. Adoption of this FSP had no impact on our financial statements.

In April 2009, the FASB issued FSP SFAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. FSP SFAS 107-1 and APB 28-1 amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, to require an entity to provide disclosures about fair value of financial instruments in interim financial information and amends Accounting Principles Board ( APB ) Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. Under FSP SFAS 107-1 and APB 28-1, a publicly traded company shall include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. In addition, entities must disclose, in the body or in the accompanying notes of its summarized financial information for interim reporting periods and in its financial statements for annual reporting periods, the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position, as required by SFAS 107. The Company adopted this FSP in the second quarter of 2009.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* ( SFAS 165 ). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 provides guidance regarding the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; the

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circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The Company adopted SFAS 165 in the second quarter of 2009 and the adoption did not have a material effect on the Company's consolidated financial statements.

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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 similar words or phrases. 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;

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 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;

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, 2008, as filed with the Securities and Exchange Commission.

## **Background**



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CPSI was founded in 1979 and specializes in delivering comprehensive healthcare information systems and related services to community hospitals and other healthcare providers. Our systems and services are designed to support the primary functional areas of a hospital and to enhance access to needed financial and clinical information. 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 support and maintenance services. 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, enabling our customers to outsource certain data-related business processes which we can perform more efficiently. Our products and services provide solutions and enhance hospital performance in key areas, including patient management, financial and revenue cycle management, clinical care, cost control and regulatory compliance and clinical, enterprise and office automation, which improve clinical, financial and administrative outcomes for our customers.

Our target market includes acute care community hospitals with 300 or fewer beds and small specialty hospitals. Hospitals having 100 or fewer acute care beds comprise approximately 94% of our customers. In addition to servicing small-to-medium-sized hospitals, we provide technology services to other related entities in the healthcare industry, such as nursing homes, home health agencies and physician clinics. From our initial hospital installation in 1981, we have grown to serve more than 650 hospital customers across 47 states and the District of Columbia.

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### **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 8.0% and 14.1%, respectively. Selling new and additional products and services back into 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 an increased gross margin. We also periodically look to increase margins through cost containment measures where appropriate.

During the current economic recession, 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 Medicaid populations, such as community based hospitals, have been impacted by the challenging financial condition of 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, 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.

As a result of the economic recession and credit crisis, we have experienced over the past twenty-one months an increase in customers seeking financing arrangements from us for system installation. 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 and our facilitating third-party financing 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 economic upheaval, including the credit crisis, we have not experienced a considerable decline in demand for our products and services, nor have we experienced any significant decrease in payment days or defaults from our customers. We hope this trend continues through the remainder of 2009, but we realize that, should the general economy continue to decline, a reversal of this trend could develop.

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

While the current economic recession and credit crisis has 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), which became law on February 17, 2009, will increase demand for healthcare information technology and will have a positive impact on our business prospects. The ARRA includes more than \$19 billion in funding to aid healthcare organizations in modernizing their operations through the acquisition and wide-spread use of healthcare information technology. Included in the funding is approximately \$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 are set to begin as early as 2010 and 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.

While many elements of the ARRA are still unclear or undefined, we are focused on ensuring that we take the necessary steps now to meet the needs of community hospitals to help them gain access to those incentives. Primary among those steps is ensuring that our technology meets the ARRA's EHR certification requirements. The initial set of certification requirements is expected to be promulgated by the Secretary of Health and Human Services before December 31, 2009, with draft recommendations having been issued by the Meaningful Use Workgroup of the HIT Policy Committee under authority of the Office of the National Coordinator for Health Information Technology, Department of Health and Human Services on June 16, 2009. In this regard, we created our new Product Development Division earlier this year to help ensure that our technology remains on the leading edge of the development curve and can react quickly and effectively to any technical requirements that arise under the ARRA. We have also hired approximately 90 new employees so far this year so that we have a sufficient number of adequately trained

and technically proficient support staff in place when our existing customers and any prospective hospital customers proceed to implement EHRs.

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While we do not expect an immediate increase in revenue from the healthcare information technology provisions of the ARRA, we believe that the longer-term potential could be significant. The ARRA is expected to provide states with badly needed Medicaid dollars, which should help improve the financial health of hospitals and incentivize them to make investments in information technology. Additionally, we expect that community hospitals, which rely more heavily on Medicare and Medicaid to fund their operations than larger hospitals, will be seeking to invest in any information technology applications that will increase their Medicaid funding. We believe that our footprint among community hospitals positions us well to benefit from these incentives.

**Health Care Reform**

The U.S. Congress is currently pursuing various legislative proposals for the reform of the U.S. healthcare and health insurance industries. While these proposals are currently in their initial stages, it appears that some form of healthcare and health insurance reform will be enacted within the next year. It is still too early for us to determine whether and to what extent this may effect the healthcare information technology industry as well as our current and any potential future customers.

**Results of Operations**

In the six months ended June 30, 2009, we generated revenues of \$61.0 million from the sale of our products and services, as compared to \$57.3 million in the six months ended June 30, 2008, an increase of 6.5%. We installed our financial and patient accounting system in 11 new hospitals in each of the first six months of 2009 and 2008. Our net income for the six months ended June 30, 2009 increased 16.5% from the first six months of 2008, principally as a result of the increase in sales. Cash flow from operations decreased 22.7% from the first six months of 2008 due to an increase in financing receivables. While our operating cash flows did decline during the first six months of 2009 compared to the first six months of 2008, we have maintained a strong cash position sufficient to meet our operating requirements and continue our dividends at historic levels. We believe that a strong cash position enables us to compete better in the marketplace and maintain the quality of our customer service and product offerings.

The following table sets forth certain items included in our results of operations for the three and six months ended June 30, 2009 and 2008, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

|                              | Three Months Ended June 30, |         | 2008     |         | Six Months Ended June 30, |         | 2008      |         |
|------------------------------|-----------------------------|---------|----------|---------|---------------------------|---------|-----------|---------|
|                              | Amount                      | % Sales | Amount   | % Sales | Amount                    | % Sales | Amount    | % Sales |
| <b>INCOME DATA:</b>          |                             |         |          |         |                           |         |           |         |
| <b>Sales revenues:</b>       |                             |         |          |         |                           |         |           |         |
| System sales                 | \$ 9,721                    | 31.5%   | \$ 8,458 | 30.5%   | \$ 19,338                 | 31.7%   | \$ 19,114 | 33.4%   |
| Support and maintenance      | 13,820                      | 44.8%   | 13,133   | 47.3%   | 27,654                    | 45.3%   | 26,219    | 45.8%   |
| Business management services | 7,306                       | 23.7%   | 6,160    | 22.2%   | 13,991                    | 22.9%   | 11,936    | 20.8%   |
| Total sales revenues         | 30,847                      | 100.0%  | 27,751   | 100.0%  | 60,983                    | 100.0%  | 57,269    | 100.0%  |
| <b>Costs of sales:</b>       |                             |         |          |         |                           |         |           |         |
| System sales                 | 8,482                       | 27.5%   | 7,215    | 26.0%   | 16,288                    | 26.7%   | 15,117    | 26.4%   |
| Support and maintenance      | 5,380                       | 17.4%   | 4,772    | 17.2%   | 10,321                    | 16.9%   | 9,570     | 16.7%   |
| Business management services | 4,358                       | 14.1%   | 3,639    | 13.1%   | 8,240                     | 13.5%   | 7,225     | 12.6%   |
| Total costs of sales         | 18,220                      | 59.1%   | 15,626   | 56.3%   | 34,849                    | 57.1%   | 31,912    | 55.7%   |
| Gross profit                 | 12,627                      | 40.9%   | 12,125   | 43.7%   | 26,134                    | 42.9%   | 25,357    | 44.3%   |
| <b>Operating expenses:</b>   |                             |         |          |         |                           |         |           |         |
| Sales and marketing          | 2,252                       | 7.3%    | 2,130    | 7.7%    | 4,328                     | 7.1%    | 4,390     | 7.7%    |
| General and administrative   | 5,040                       | 16.3%   | 5,287    | 19.1%   | 10,183                    | 16.7%   | 10,761    | 18.8%   |
| Total operating expenses     | 7,292                       | 23.6%   | 7,417    | 26.6%   | 14,511                    | 23.8%   | 15,151    | 26.5%   |
| Operating income             | 5,335                       | 17.3%   | 4,708    | 17.0%   | 11,623                    | 19.1%   | 10,206    | 17.8%   |
| <b>Other income:</b>         |                             |         |          |         |                           |         |           |         |

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|                     |          |       |          |       |          |       |          |       |
|---------------------|----------|-------|----------|-------|----------|-------|----------|-------|
| Interest income     | 239      | 0.8%  | 231      | 0.8%  | 472      | 0.8%  | 496      | 0.9%  |
| Total other income  | 239      | 0.8%  | 231      | 0.8%  | 472      | 0.8%  | 496      | 0.9%  |
| Income before taxes | 5,574    | 18.1% | 4,939    | 17.8% | 12,095   | 19.8% | 10,702   | 18.7% |
| Income taxes        | 2,033    | 6.6%  | 1,948    | 7.0%  | 4,529    | 7.4%  | 4,205    | 7.3%  |
| Net Income          | \$ 3,541 | 11.5% | \$ 2,991 | 10.8% | \$ 7,566 | 12.4% | \$ 6,497 | 11.3% |

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**Three Months Ended June 30, 2009 Compared with Three Months Ended June 30, 2008**

*Revenues.* Total revenues for the three months ended June 30, 2009 increased 11.0%, or \$3.1 million, compared to the three months ended June 30, 2008. There were no significant changes in the makeup or mix of our revenue streams during the second quarter of 2009.

System sales revenues increased by 14.9%, or \$1.3 million, for the comparative three month periods. We installed our core system at five new hospital clients in each of the second quarters of 2009 and 2008. Sales to existing customers accounted for 65% of our system sales revenue for the second quarter of 2009.

Support and maintenance revenues increased by 5.2%, or \$0.7 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 and an increase in support fees for add-on business sold to existing customers.

Business management services revenues increased by 18.6%, or \$1.1 million, for the comparative three month periods. We experienced an increase in business management services revenues as a result of continued growth in existing customer demand for electronic billing and accounts receivable management services. We were providing full business office management services to 22 customers at June 30, 2009, compared to 19 customers at June 30, 2008. We opened a new business management services office in Monroe, Louisiana toward the end of the second quarter of 2009, although it had not begun to contribute any revenue as of June 30, 2009. We expect the new office to be fully operational by the end of the year.

*Costs of Sales.* Total costs of sales increased by 16.6%, or \$2.6 million, for the comparative three month periods. As a percentage of total revenues, costs of sales increased 280 basis points from 56.3% to 59.1%.

Cost of system sales increased by 17.6%, or \$1.3 million, for the comparative three month periods. Gross margin on system sales fell to 12.7% in the second quarter from 14.7% in the same quarter of the prior year. Payroll and related costs increased by 17.0%, or \$0.7 million, for the comparative three month periods. This increase is primarily due to salary costs of additional support personnel hired during the first quarter of 2009 in anticipation of an increase in future installations stemming from electronic medical record requirements contained in the American Recovery and Reinvestment Act of 2009 (the ARRA). The training curve of a newly hired employee is generally 6 to 12 months and may depress gross margins on system sales in the short term. The remaining increase was primarily the result of increased travel costs. We had one installation delayed until the third quarter of 2009 for which we incurred some travel and payroll costs during the second quarter of 2009 for pre-training and set-up work.

Cost of support and maintenance increased by 12.7%, or \$0.6 million, for the comparative three month periods. The gross margin on support and maintenance revenues decreased to 61.1% from 63.6% in the same quarter of the prior year. The decrease in gross margin was primarily due to a 14.8%, or \$0.6 million, increase in payroll and related costs due to the addition of the new personnel in the first quarter of 2009.

Our costs associated with business management services increased by 19.8%, or \$0.9 million, for the comparative three month periods. This increase was caused by an increase in temporary labor as we move to utilizing temporary labor agencies for all new business management services employees due to historically high turnover costs. Temporary labor accounted for 22.2% of total labor and related costs for the second quarter of 2009 as compared to 4.2% during the second quarter of 2008. We expect this transition to contract labor services to improve costs and margins in the long term. We also incurred additional temporary labor and other costs in opening the new office in Monroe, Louisiana during the second quarter of 2009. The gross margin on business management services decreased to 40.4% from 40.9% in the same quarter of the prior year. Postage costs also increased \$0.1 million quarter to quarter due to a \$0.02 postage rate increase in May 2009.

*Sales and Marketing Expenses.* Sales and marketing expenses increased by 5.7%, or \$0.1 million, for the comparative three month periods. The increase is attributable to a \$0.1 million increase in salary and commission expense.

*General and Administrative Expenses.* General and administrative expenses decreased by 4.7%, or \$0.3 million, for the comparative three month periods. This decrease was attributable to a \$0.4 million decrease in bad debt expense offset by a \$0.2 million increase in group health insurance costs.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses decreased to 23.6% for the three months ended June 30, 2009 from 26.6% for the three months ended June 30, 2008.

*Net Income.* Net income for the three months ended June 30, 2009 increased by 18.4%, or \$0.5 million, to \$3.5 million, or \$0.32 per diluted share, as compared with net income of \$3.0 million, or \$0.28 per diluted share, for the three months ended June 30, 2008. Net income

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represented 11.5% of revenue for the three months ended June 30, 2009, as compared to 10.8% of revenue for the three months ended June 30, 2008.

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### **Six Months Ended June 30, 2009 Compared with Six Months Ended June 30, 2008**

*Revenues.* Total revenues for the six months ended June 30, 2009 increased by 6.4%, or \$3.4 million, compared to the six months ended June 30, 2008.

System sales revenues increased by 1.2%, or \$0.2 million, for the comparative six month periods. System sales remained relatively flat and may remain slightly depressed in the short term as customers delay system purchases until further information regarding the ARRA and its effects are understood. Sales to existing customers accounted for 61% of system sales revenue for the first six months of 2009.

Support and maintenance revenues increased by 5.4%, or \$1.4 million, for the comparative six month periods. This increase was attributable to an increase in recurring revenues as a result of a larger customer base and increased sales of add-on business to existing customers.

Business management services revenues increased by 17.2%, or \$2.1 million, for the comparative six month periods. We experienced an increase in business management services revenues as a result of continued growth in existing customer demand for electronic billing and accounts receivable management services.

*Costs of Sales.* Total costs of sales increased by 9.2%, or \$2.9 million, for the comparative six month periods. As a percentage of total revenues, costs of sales increased 140 basis points from 55.7% to 57.1%.

Cost of system sales increased by 7.7%, or \$1.2 million, for the comparative six month periods. Payroll and related costs increased by 10.9%, or \$0.9 million, due to the addition new personnel as described previously. All other system sales costs remained relatively in-line as a percentage of sales.

Cost of support and maintenance increased by 7.8%, or \$0.8 million, for the comparative six month periods. The gross margin on support and maintenance revenues decreased to 62.7% compared to 63.5% for the same six month period in the prior year. The decrease in gross margin was primarily due to a 19.6% increase in payroll and related costs due to the addition of personnel as described previously.

Our costs associated with business management services increased by 14.0%, or \$1.0 million, for the comparative six month periods. This increase was caused primarily by an increase of \$0.8 million in payroll, temporary labor and related expenses as a result of an increase in the number of employees needed to support our growing business management services operations. Temporary labor accounted for 19.4% of our labor costs for the six month period ended June 30, 2009 compared to 2.5% in the same period of the prior year as we move to a temp-to-hire basis for all new business management services employees due to historically high turnover costs. Postage expense also increased due to a \$.02 postage increase in May of 2009.

*Sales and Marketing Expenses.* Sales and marketing expenses decreased 1.4%, or \$0.1 million, for the comparative six month periods.

*General and Administrative Expenses.* General and administrative expenses decreased by 5.4%, or \$0.6 million, for the comparative six month periods. This decrease was attributable to a \$0.9 million decrease in bad debt expense. Bad debt expense in the prior year six month period was negatively impacted by a large write-off of a single customer. This decrease was partially offset by a \$0.6 million increase in health insurance related costs due to negative claims experience during the first six months of 2009. We began measures in the third quarter to help contain health insurance related costs.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses decreased to 23.8% for the six months ended June 30, 2009 from 26.5% for six months ended June 30, 2008.

*Net Income.* Net income for the six months ended June 30, 2009 increased by 16.5%, or \$1.1 million, to \$7.6 million, or \$0.69 per diluted share, as compared with net income of \$6.5 million, or \$0.60 per diluted share, for the six months ended June 30, 2008. Net income represented 12.4% of revenue for the six months ended June 30, 2009, as compared to 11.3% of revenue for the six months ended June 30, 2008.

### **Liquidity and Capital Resources**

We had cash and cash equivalents of \$9.3 million at June 30, 2009, compared to \$12.9 million at June 30, 2008. During the quarter, we moved \$2.5 million from cash and cash equivalents to our investment account in an effort to increase returns. Net cash provided by operating activities for the six months ended June 30, 2009 was \$7.4 million, compared to \$9.5 million for the six months ended June 30, 2008. The decrease was primarily due to an increase in financing receivables as we have experienced an increase in customers seeking financing arrangements over the



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past year. We expect this trend to continue until credit and lending conditions improve in the general economy.

Net cash used in investing activities totaled \$3.7 million for six months ended June 30, 2009 compared to \$0.9 million for the six months ended June 30, 2008. We used cash for the purchase of \$0.9 million of property and equipment and investments of \$2.8 million during the six months ended June 30, 2009. \$2.5 million of the investment purchases was a transfer from cash and cash equivalents. Property and equipment purchases were primarily to open our new office in Monroe, Louisiana as well as some reconstruction of existing facilities in Mobile, Alabama to increase potential occupancy.

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Net cash used in financing activities totaled \$6.1 million for the six months ended June 30, 2009, compared to \$7.6 million for the six months ended June 30, 2008. We declared and paid dividends of \$7.9 million during the first six months of 2009. We received proceeds from the exercise of stock options, including the related tax benefit, of \$1.7 million.

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 current 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.

### **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 in the first quarter of 2008 and then entered into a sale-leaseback transaction with Winthrop. 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 \$2,145,000, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney's fees and costs). We recorded \$2,154,389, the amount billed to date for the new system installation, as revenue during the first quarter of 2008. 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 \$148,220, the estimated fair value of the guaranty, is recorded on our balance sheet as an other accrued liability at June 30, 2009. See Note 9 to the financial statements for additional information.

### **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 June 30, 2009, our investment portfolio consisted of a variety of financial instruments, including, but not limited to, money market securities and high quality government, municipal 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 June 30, 2009.

|  | Aggregate<br>Fair Value | Weighted<br>Average<br>Interest Rate |
|--|-------------------------|--------------------------------------|
| <b>Cash and Cash Equivalents:</b>  |                         |                                      |
| Cash   | \$ 5,931,310            |                                      |
| Money market funds   | 571,428                 | 0.26%                                |
| Certificates of deposit  | 2,766,470               | 1.05%                                |
| <b>Total cash and cash equivalents</b>                                     | <b>\$ 9,269,208</b>     |                                      |
| <b>Short-Term Investments:(1)</b>  |                         |                                      |
| Accrued Income   | \$ 207,872              |                                      |
| Money market funds   | 341,975                 | 0.46%                                |
| Obligations of the U.S. Treasury, U.S government corporations and agencies | 4,841,811               | 4.56%                                |
| Corporate debt securities  | 3,744,022               | 5.45%                                |
| <b>Total short-term investments</b>  | <b>\$ 9,135,680</b>     |                                      |
| <b>Long-Term Investments:(2)</b>   |                         |                                      |
| Obligations of the U.S. Treasury, U.S government corporations and agencies | \$ 1,722,864            | 2.15%                                |
| Mortgage backed securities   | 183,693                 | 5.00%                                |
| Corporate debt securities  | 3,532,999               | 5.37%                                |
| <b>Total long-term investments</b>   | <b>\$ 5,439,556</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 June 30, 2009, the Company had no borrowings and, therefore, is not subject to interest rate risks related to debt instruments.

**Item 4. Controls and Procedures.**

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)), as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) are effective. There have not been any changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II****OTHER INFORMATION****Item 1. Legal Proceedings.**

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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.

**Table of Contents****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, 2008, 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. Submission of Matters to a Vote of Security Holders.**

The Company held its Annual Meeting of Stockholders on May 7, 2009. At the meeting, the Company's stockholders voted to elect three Class I directors to serve a three-year term on the Company's Board of Directors and to ratify the appointment of Grant Thornton LLP as the Company's independent registered public accounting firm for 2009. The results of the stockholder voting on these matters are summarized as follows:

**Proposal 1 Election of Three Class I Directors:**

| Name of Nominee         | For       | Withheld  |
|-------------------------|-----------|-----------|
| William R. Seifert, II  | 9,448,375 | 320,047   |
| W. Austin Mulherin, III | 4,468,263 | 5,300,159 |
| John C. Johnson         | 9,521,154 | 247,268   |

**Proposal 2 Ratification of Appointment of Independent Registered Public Accounting Firm:**

| For       | Against | Abstentions |
|-----------|---------|-------------|
| 9,339,673 | 5,479   | 423,270     |

Following the 2009 Annual Meeting, M. Kenny Muscat, J. Boyd Douglas and Charles P. Huffman continue to serve as Class II Directors with terms expiring at the 2010 Annual Meeting, and Ernest F. Ladd, III and David A. Dye continue to serve as Class III Directors with terms expiring at the 2011 Annual Meeting.

**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)

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(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)
- 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

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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: August 7, 2009

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

Date: August 7, 2009

By: /s/ Darrell G. West  
Darrell G. West  
Vice President - Finance and 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)                                       |
| 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 |