

COMPUTER PROGRAMS & SYSTEMS INC

Form 10-Q

November 06, 2008

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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 September 30, 2008.

.. 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 Incorporation or Organization) | 74-3032373 (I.R.S. Employer 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 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

As of November 5, 2008, there were 10,884,759 shares of the issuer's common stock outstanding.

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COMPUTER PROGRAMS AND SYSTEMS, INC.

Form 10-Q

(For the three and nine months ended September 30, 2008)

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

| | September 30, 2008 (Unaudited) | December 31, 2007 |
|--|---|------------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 12,505,863 | \$ 11,806,017 |
| Investments | 11,576,621 | 11,352,457 |
| Accounts receivable, net of allowance for doubtful accounts of \$731,398 and \$948,712, respectively | 14,907,163 | 14,333,934 |
| Financing receivables, current portion | 1,925,728 | 1,734,954 |
| Inventories | 1,586,700 | 1,450,164 |
| Deferred tax assets | 1,497,462 | 1,393,602 |
| Prepaid income tax | 507,777 | |
| Prepaid expenses | 487,843 | 505,565 |
| Total current assets | 44,995,157 | 42,576,693 |
| Property and equipment | | |
| Land | 936,026 | 936,026 |
| Maintenance equipment | 4,097,976 | 3,821,013 |
| Computer equipment | 6,003,973 | 5,663,741 |
| Office furniture and equipment | 1,745,442 | 1,576,728 |
| Automobiles | 132,926 | 132,926 |
| | 12,916,343 | 12,130,434 |
| Less accumulated depreciation | (7,990,346) | (6,621,407) |
| Net property and equipment | 4,925,997 | 5,509,027 |
| Financing receivables, net of current portion | 1,784,319 | 2,322,471 |
| Total assets | \$ 51,705,473 | \$ 50,408,191 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,294,818 | \$ 1,716,882 |
| Deferred revenue | 4,583,425 | 3,580,709 |
| Accrued vacation | 2,359,001 | 2,112,256 |
| Income taxes payable | | 541,987 |
| Other accrued liabilities | 3,175,669 | 3,506,845 |
| Total current liabilities | 12,412,913 | 11,458,679 |
| Deferred tax liabilities | 169,871 | 571,142 |
| Stockholders equity: | | |

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| | | |
|--|-------------------|-------------------|
| Common stock, par value \$0.001 per share; 30,000,000 shares authorized; 10,884,003 and 10,807,444 shares issued and outstanding | 10,884 | 10,807 |
| Additional paid-in capital | 26,602,374 | 24,658,818 |
| Accumulated other comprehensive income (loss) | (47,659) | 44,825 |
| Retained earnings | 12,557,090 | 13,663,920 |
| Total stockholders' equity | 39,122,689 | 38,378,370 |
| Total liabilities and stockholders' equity | \$ 51,705,473 | \$ 50,408,191 |

See accompanying notes.

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|----------------------------------|---------------------|---------------------------------|---------------------|
| | 2008 | 2007 | 2008 | 2007 |
| Sales revenues: | | | | |
| System sales | \$ 10,741,956 | \$ 9,773,770 | \$ 29,855,699 | \$ 28,356,239 |
| Support and maintenance | 13,398,595 | 12,686,801 | 39,617,215 | 37,594,924 |
| Business management services | 6,212,705 | 5,531,530 | 18,149,132 | 15,950,446 |
| Total sales revenues | 30,353,256 | 27,992,101 | 87,622,046 | 81,901,609 |
| Costs of sales: | | | | |
| System sales | 8,674,854 | 7,819,978 | 23,792,019 | 22,765,381 |
| Support and maintenance | 4,862,183 | 4,932,859 | 14,431,604 | 14,995,784 |
| Business management services | 3,522,337 | 3,399,854 | 10,747,212 | 9,752,461 |
| Total costs of sales | 17,059,374 | 16,152,691 | 48,970,835 | 47,513,626 |
| Gross profit | 13,293,882 | 11,839,410 | 38,651,211 | 34,387,983 |
| Operating expenses: | | | | |
| Sales and marketing | 2,174,638 | 2,614,278 | 6,564,133 | 6,996,610 |
| General and administrative | 4,985,969 | 4,492,797 | 15,747,189 | 14,149,844 |
| Total operating expenses | 7,160,607 | 7,107,075 | 22,311,322 | 21,146,454 |
| Operating income | 6,133,275 | 4,732,335 | 16,339,889 | 13,241,529 |
| Other income: | | | | |
| Interest income | 243,921 | 293,669 | 739,877 | 842,778 |
| Total other income | 243,921 | 293,669 | 739,877 | 842,778 |
| Income before taxes | 6,377,196 | 5,026,004 | 17,079,766 | 14,084,307 |
| Income taxes | 2,283,831 | 1,798,390 | 6,489,207 | 4,995,274 |
| Net income | \$ 4,093,365 | \$ 3,227,614 | \$ 10,590,559 | \$ 9,089,033 |
| Net income per share - basic | \$ 0.38 | \$ 0.30 | \$ 0.98 | \$ 0.85 |
| Net income per share - diluted | \$ 0.38 | \$ 0.30 | \$ 0.98 | \$ 0.85 |
| Weighted average shares outstanding | | | | |
| Basic | 10,776,840 | 10,718,643 | 10,758,656 | 10,688,709 |
| Diluted | 10,796,217 | 10,757,137 | 10,777,041 | 10,736,174 |
| Dividends declared per share | \$ 0.36 | \$ 0.36 | \$ 1.08 | \$ 1.08 |

See accompanying notes.

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

| | Common Shares | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income (loss) | Retained Earnings | Total Stockholders Equity |
|--|--------------------------|-------------------------|---|--|------------------------------|--|
| Balance at December 31, 2007 | 10,807,444 | \$ 10,807 | \$ 24,658,818 | \$ 44,825 | \$ 13,663,920 | \$ 38,378,370 |
| Net income | | | | | 10,590,559 | 10,590,559 |
| Issuance of common stock | 76,559 | 77 | 991,375 | | | 991,452 |
| Unrealized loss on available for sale investments, net of tax | | | | (92,484) | | (92,484) |
| Share-based compensation | | | 684,152 | | | 684,152 |
| Dividends | | | | | (11,697,389) | (11,697,389) |
| Income tax benefit from restricted stock dividends | | | 32,458 | | | 32,458 |
| Income tax benefit from stock option exercises | | | 235,571 | | | 235,571 |
| Balance at September 30, 2008 | 10,884,003 | \$ 10,884 | \$ 26,602,374 | \$ (47,659) | \$ 12,557,090 | \$ 39,122,689 |

See accompanying notes.

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

| | Nine months ended September 30, | |
|--|--|---------------|
| | 2008 | 2007 |
| Operating Activities | | |
| Net income | \$ 10,590,559 | \$ 9,089,033 |
| Adjustments to net income: | | |
| Provision for bad debt | 1,312,271 | 17,235 |
| Deferred taxes | (417,542) | (47,787) |
| Share-based compensation | 684,152 | 879,143 |
| Income tax benefit from stock option exercises | (235,571) | (315,382) |
| Income tax benefit from restricted stock dividends | (32,458) | |
| Depreciation | 1,368,939 | 1,488,928 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,885,500) | 306,075 |
| Financing receivables | 347,378 | 49,190 |
| Inventories | (136,536) | 64,330 |
| Prepaid expenses | 17,722 | 43,674 |
| Accounts payable | 577,936 | 160,491 |
| Deferred revenue | 1,002,716 | 1,068,129 |
| Other liabilities | (84,431) | (58,567) |
| Income taxes (prepaid) payable | (781,735) | 144,772 |
| Net cash provided by operating activities | 12,327,900 | 12,889,264 |
| Investing Activities | | |
| Purchases of property and equipment | (785,909) | (890,338) |
| Purchases of investments | (404,237) | (363,764) |
| Net cash used in investing activities | (1,190,146) | (1,254,102) |
| Financing Activities | | |
| Proceeds from exercise of stock options | 991,452 | 940,929 |
| Income tax benefit from restricted stock dividends | 32,458 | |
| Income tax benefit from stock option exercises | 235,571 | 315,382 |
| Dividends paid | (11,697,389) | (11,633,545) |
| Net cash used in financing activities | (10,437,908) | (10,377,234) |
| Increase in cash and cash equivalents | 699,846 | 1,257,928 |
| Cash and cash equivalents at beginning of period | 11,806,017 | 8,760,122 |
| Cash and cash equivalents at end of period | \$ 12,505,863 | \$ 10,018,050 |
| Cash paid for income taxes, net of refund | \$ 7,481,140 | \$ 4,898,528 |
| See accompanying notes. | | |

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COMPUTER PROGRAMS AND SYSTEMS, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

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

Certain 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 condensed financial statements should be read in conjunction with the audited financial statements of Computer Programs and Systems, Inc. (the Company) for the year ended December 31, 2007 and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2007.

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.

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.

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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

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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.

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 ON BALANCE SHEET AMOUNTS

Other accrued liabilities are comprised of the following:

| | September 30, 2008 | December 31, 2007 |
|---------------------------------|-----------------------|----------------------|
| Accrued salaries and benefits | \$ 1,707,303 | \$ 2,560,116 |
| Accrued commissions | 367,033 | 392,033 |
| Accrued self-insurance reserves | 418,400 | 388,400 |
| Fair value of lease guaranty | 231,836 | |
| Unrecognized tax benefit | 207,344 | |
| Other | 243,753 | 166,296 |
| | \$ 3,175,669 | \$ 3,506,845 |

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 September 30, 2008:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|--|-------------------|---------------------|----------------------|---------------|
| Short term investments | \$ 639,414 | \$ | \$ 637 | \$ 638,777 |
| Obligations of U.S. Treasury, U.S. government corporation and agencies | 4,892,413 | 39,377 | 7,829 | 4,923,961 |
| Mortgaged backed securities | 209,306 | 1,727 | | 211,033 |

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| | | | | |
|-----------------|---------------|-----------|------------|---------------|
| Corporate bonds | 5,906,153 | 15,904 | 119,207 | 5,802,850 |
| | \$ 11,647,286 | \$ 57,008 | \$ 127,673 | \$ 11,576,621 |

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Shown below are the amortized cost and estimated fair value of securities with fixed maturities at September 30, 2008, by contract maturity date. Actual maturities may differ from contractual maturities because issuers of certain securities retain early call or prepayment rights.

| | Amortized Cost | Fair Value |
|----------------|-------------------|---------------|
| Due in 2008 | \$ 1,939,305 | \$ 1,939,046 |
| Due in 2009 | 6,745,684 | 6,715,836 |
| Due in 2010 | 1,927,545 | 1,899,586 |
| Due in 2011 | 825,446 | 811,120 |
| Due thereafter | 209,306 | 211,033 |
| | \$ 11,647,286 | \$ 11,576,621 |

Investments are comprised of the following at December 31, 2007:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|--|-------------------|---------------------|----------------------|---------------|
| Short term investments | \$ 377,360 | \$ | \$ | \$ 377,360 |
| Obligations of U.S. Treasury, U.S. government corporation and agencies | 5,571,662 | 55,860 | 804 | 5,626,718 |
| Mortgaged backed securities | 298,097 | | 436 | 297,661 |
| Municipal obligations | 800,000 | | | 800,000 |
| Corporate bonds | 4,219,731 | 36,840 | 5,853 | 4,250,718 |
| | \$ 11,266,850 | \$ 92,700 | \$ 7,093 | \$ 11,352,457 |

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 and unvested restricted stock grants. 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 and unvested restricted stock grants. Any options with an exercise price greater than the weighted average market price of our common stock or unvested restricted stock grants that are considered antidilutive are excluded from the computation of diluted earnings per share. The difference between basic and diluted EPS is attributable to stock options. For the three month periods ended September 30, 2008 and 2007, these dilutive shares were 19,377 and 38,494, respectively. For the nine month periods ended September 30, 2008 and 2007, these dilutive shares were 18,385 and 47,465, respectively. The number of unvested restricted stock grants considered antidilutive and thus excluded from the year to date dilutive earnings per share computation at September 30, 2008 were 76,086.

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. Deferred tax assets and liabilities are comprised of the following:

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| | September 30, 2008 | December 31, 2007 |
|---------------------------------------|-----------------------|----------------------|
| Deferred tax assets: | | |
| Accounts receivable | \$ 285,323 | \$ 369,998 |
| Accrued vacation | 920,010 | 823,780 |
| Stock-based compensation | 568,703 | 519,571 |
| Other comprehensive income | 60,382 | |
| Other accrued liabilities | 322,163 | 227,031 |
| Total deferred tax assets | \$ 2,156,581 | \$ 1,940,380 |
| Deferred tax liabilities: | | |
| Other comprehensive income | \$ | \$ 33,449 |
| Depreciation | 828,990 | 1,090,713 |
| Total deferred tax liabilities | \$ 828,990 | \$ 1,124,162 |

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

| | 2008 | 2007 |
|-----------------------------------|---------------------|---------------------|
| Current provision: | | |
| Federal | \$ 5,648,657 | \$ 4,018,563 |
| State | 1,258,092 | 1,024,498 |
| Deferred (benefit) provision: | | |
| Federal | (383,959) | (42,885) |
| State | (33,583) | (4,902) |
| Total income tax provision | \$ 6,489,207 | \$ 4,995,274 |

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

| | 2008 | 2007 |
|--|---------------------|---------------------|
| Income taxes at U. S. Federal statutory rate | \$ 5,977,918 | \$ 4,929,507 |
| State income tax, net of federal tax effect | 784,176 | 654,411 |
| Other | (272,887) | (588,644) |
| Total income tax provision | \$ 6,489,207 | \$ 4,995,274 |

The Company had unrecognized tax benefits of \$207,344 related to uncertain tax positions as of September 30, 2008 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 2006 and 2007 federal returns remain open to examination, and the tax years 2004 - 2007 remain open to other taxing jurisdictions to which the Company is subject.

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 previously applied

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Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations and provided pro forma disclosures of SFAS No. 123, *Accounting for Stock Based Compensation*. The Company elected to adopt the modified prospective application method as provided by SFAS No. 123R, and, accordingly, prior periods are not restated for the effects of SFAS No. 123R. The Company recorded compensation costs as the requisite service is rendered for the unvested portion of previously issued awards that remain 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 nine months ended September 30, 2008 and 2007, included in the Condensed Statements of Income:

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2008 | September 30, 2007 | September 30, 2008 | September 30, 2007 |
| Costs of sales | \$ 74,997 | \$ 74,997 | \$ 224,991 | \$ 344,526 |
| Operating expenses | 154,998 | 162,498 | 459,161 | 534,617 |
| Pre-tax stock-based compensation expense | 229,995 | 237,495 | 684,152 | 879,143 |
| Less: income tax effect | 91,078 | 94,047 | 270,924 | 348,141 |
| Net stock-based compensation expense | \$ 138,917 | \$ 143,448 | \$ 413,228 | \$ 531,002 |

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 become vested as to all of the shares covered by such grant on the fifth anniversary of the grant date and expire on the seventh anniversary of the grant date. Stock options granted under the 2002 Stock Option Plan to employees other than executive officers become 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, options become vested upon termination of employment resulting from death, disability or retirement. Such options expire 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 2007 or the first nine months of 2008.

A summary of stock option activity under the plan during the nine month periods ended September 30, 2008 and 2007 is as follows:

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| | September 30, 2008 | | September 30, 2007 | |
|--|--------------------|----------------|--------------------|----------------|
| | Shares | Exercise Price | Shares | Exercise Price |
| Outstanding at beginning of year | 152,444 | \$ 16.50 | 222,597 | \$ 16.50 |
| Granted | | | | |
| Exercised | (60,088) | 16.50 | (57,026) | 16.50 |
| Forfeited | | | (9,770) | 16.50 |
| Outstanding at end of period | 92,356 | \$ 16.50 | 155,801 | \$ 16.50 |
| Exercisable at end of period | 92,356 | \$ 16.50 | 155,801 | \$ 16.50 |
| Shares available for future grants under the plan at end of period | | 495,134 | | 495,134 |
| Weighted-average grant date fair value | | \$ | | \$ |
| Weighted-average remaining contractual life | | 0.8 | | 1.8 |
| Aggregate intrinsic value outstanding options | | \$ 1,149,832 | | |
| Aggregate intrinsic value exercisable options | | \$ 1,149,832 | | |

The aggregate intrinsic value in the above table represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading date of the third quarter of 2008 and the exercise price, multiplied by the number of options.) The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

The aggregate intrinsic value of options exercised during the quarters ended September 30, 2008 and September 30, 2007 was \$567,771 and \$170,951, respectively.

As of September 30, 2008, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under 2002 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 Michael Jones, 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 Darrell G. West, the Company's 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.

| | Nine Months Ended September 30, 2008 | | Nine Months Ended September 30, 2007 | |
|--|--------------------------------------|--|--------------------------------------|--|
| | Shares | Weighted-Average Grant-Date Fair Value | Shares | Weighted-Average Grant-Date Fair Value |
| Nonvested stock outstanding at beginning of year | 79,487 | \$ 42.77 | 111,009 | \$ 42.79 |
| Granted | 16,471 | 21.25 | | |
| Vested | (19,872) | 42.77 | (22,202) | 42.81 |
| Nonvested stock outstanding at end of period | 76,086 | \$ 38.11 | 88,807 | \$ 42.79 |

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As of September 30, 2008, there was \$2,131,814 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 2.4 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 nine months ended September 30, 2008 and 2007 are as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|----------------------------------|--------------|---------------------------------|--------------|
| | 2008 | 2007 | 2008 | 2006 |
| Net income as reported | \$ 4,093,365 | \$ 3,227,614 | \$ 10,590,559 | \$ 9,089,033 |
| Other comprehensive income: | | | | |
| Unrealized (loss) gain on investments, net of taxes | (84,402) | 51,033 | (92,484) | 58,639 |
| Total comprehensive income | \$ 4,008,963 | \$ 3,278,647 | \$ 10,498,075 | \$ 9,147,672 |

9. COMMITMENTS AND CONTINGENCIES

As of September 30, 2008, the Company is contingently liable as guarantor on a lease obligation between Solis Healthcare, LP (Solis Healthcare) and Winthrop Resources Corporation (Winthrop). Winthrop purchased a software system from The Company and leased it to Solis Healthcare in the first quarter of 2008. The Company provided this guarantee in order to facilitate Solis Healthcare in leasing the new system. The lease has an initial term of five years and continues from year to year thereafter until terminated. The Company is contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, the Company will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guaranty 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 \$231,836, the estimated fair value of the guaranty, is recorded on the balance sheet as an other accrued liability at September 30, 2008.

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. In February 2008, the FASB issued a final Staff Position to allow a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company has elected this one-year deferral and thus will not apply the provisions of SFAS 157 to nonfinancial assets and nonfinancial liabilities that are recognized at fair value in the financial statements on a nonrecurring basis until its fiscal year beginning January 1, 2009. The Company is in the process of evaluating the impact of applying SFAS 157 to nonfinancial assets and nonfinancial liabilities measured on a nonrecurring basis. 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.

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.

The following table summarizes the carrying amounts and fair values of certain assets and liabilities at September 30, 2008:

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| | Carrying Amount | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|-------------------------------|--------------------|---|---|---|
| Available-for-sale securities | \$ 11,576,621 | \$ 11,576,621 | \$ | \$ |
| Lease Guaranty | \$ 231,836 | \$ | \$ | \$ 231,836 |

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.

11. RECENT ACCOUNTING PRONOUNCEMENTS

The Company adopted the provisions of Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), on January 1, 2008. SFAS 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). Under this pronouncement, a business entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. The Company did not elect the fair value option for any items on our Condensed Balance Sheets and we have not determined whether or not we will elect this option for any financial instruments that we may acquire in the future.

The Company adopted the provisions of the FASB Emerging Issues Task Force (EITF) Issue No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* (EITF No. 07-3), on January 1, 2008. EITF No. 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. The adoption of EITF No. 07-3 did not have an impact on the Company's financial position, results of operations, or cash flows.

The Company adopted the provisions of the FASB EITF Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (EITF No. 06-11), on January 1, 2008. EITF No. 06-11 requires that the income tax benefits from dividends on equity-classified employee share-based payment awards be reflected as an increase in paid-in-capital. The effects of the adoption are disclosed in the Condensed Statement of Stockholders' Equity and Condensed Statements of Cash Flows in the financial statements.

In May 2008, FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*, in September 2008. The Company is currently evaluating the impact of SFAS 162 on its financial statements.

In June 2008, the FASB issued 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 would require 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 EPS according to the two-class (basic and diluted) method. The effective date of FSP EITF 03-6-1 is for fiscal years beginning after December 15, 2008 and requires all prior-period EPS 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. FSP EITF 03-6-1 does not permit early application. This FSP changes the calculation of basic and diluted EPS and may lower previously reported basic and diluted EPS as weighted-average shares outstanding used in the EPS calculation will increase. The Company is currently evaluating the impact of this statement on its financial statements.

In September 2008, the FASB issued Staff Position (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* (FSP No. 133-1 and FIN 45-4). 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 are effective for reporting periods (annual or interim) ending after November 15, 2008. The Company is currently evaluating the additional disclosure requirements of FSP No. 133-1 and FIN 45-4 to its 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 condensed 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. 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 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

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, 2007, as filed with the Securities and Exchange Commission.

Overview

We are a healthcare information technology company that designs, develops, markets, installs, maintains and supports computerized information technology systems to meet the unique demands of small and midsize hospitals. Our target market includes acute care community hospitals with 300 or fewer beds and small specialty hospitals. We are a single-source vendor providing comprehensive software and hardware products, complemented by data conversion, complete installation and extensive support. Our fully integrated, enterprise-wide system automates the management of clinical and financial data across the primary functional areas of a hospital. In addition, we provide business management services that enable our customers to outsource certain data-related business processes which we can perform more efficiently. We believe our products and services enhance hospital performance in the critical areas of clinical care, revenue cycle management, cost control and regulatory compliance. From our initial hospital installation in 1981, we have grown to serve more than 640 hospital customers across 46 states and the

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District of Columbia. In the three months ended September 30, 2008, we generated revenues of \$30.4 million from the sale of our products and services.

Table of Contents**Results of Operations**

The following table sets forth certain items included in our results of operations for the three and nine months ended September 30, 2008 and 2007, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

| | Three Months Ended September 30, 2008 | | 2007 | | Nine Months Ended September 30, 2008 | | 2007 | |
|------------------------------|--|---------|----------|---------|---|---------|-----------|---------|
| | Amount | % Sales | Amount | % Sales | Amount | % Sales | Amount | % Sales |
| INCOME DATA: | | | | | | | | |
| Sales revenues: | | | | | | | | |
| System sales | \$ 10,742 | 35.4% | \$ 9,774 | 34.9% | \$ 29,856 | 34.1% | \$ 28,356 | 34.6% |
| Support and maintenance | 13,398 | 44.1% | 12,687 | 45.3% | 39,617 | 45.2% | 37,595 | 45.9% |
| Business management services | 6,213 | 20.5% | 5,531 | 19.8% | 18,149 | 20.7% | 15,951 | 19.5% |
| Total sales revenues | 30,353 | 100.0% | 27,992 | 100.0% | 87,622 | 100.0% | 81,902 | 100.0% |
| Costs of sales: | | | | | | | | |
| System sales | 8,675 | 28.6% | 7,820 | 27.9% | 23,792 | 27.2% | 22,765 | 27.8% |
| Support and maintenance | 4,862 | 16.0% | 4,933 | 17.6% | 14,432 | 16.5% | 14,996 | 18.3% |
| Business management services | 3,522 | 11.6% | 3,400 | 12.1% | 10,747 | 12.3% | 9,753 | 11.9% |
| Total costs of sales | 17,059 | 56.2% | 16,153 | 57.7% | 48,971 | 55.9% | 47,514 | 58.0% |
| Gross profit | 13,294 | 43.8% | 11,839 | 42.3% | 38,651 | 44.1% | 34,388 | 42.0% |
| Operating expenses: | | | | | | | | |
| Sales and marketing | 2,175 | 7.2% | 2,614 | 9.3% | 6,564 | 7.5% | 6,997 | 8.5% |
| General and administrative | 4,986 | 16.4% | 4,493 | 16.1% | 15,747 | 18.0% | 14,150 | 17.3% |
| Total operating expenses | 7,161 | 23.6% | 7,107 | 25.3% | 22,311 | 25.5% | 21,147 | 25.8% |
| Operating income | 6,133 | 20.2% | 4,732 | 16.9% | 16,340 | 18.6% | 13,241 | 16.2% |
| Other income: | | | | | | | | |
| Interest income | 244 | 0.8% | 294 | 1.1% | 740 | 0.8% | 843 | 1.0% |
| Total other income | 244 | 0.8% | 294 | 1.1% | 740 | 0.8% | 843 | 1.0% |
| Income before taxes | 6,377 | 21.0% | 5,026 | 18.0% | 17,080 | 19.5% | 14,084 | 17.2% |
| Income taxes | 2,284 | 7.5% | 1,798 | 6.4% | 6,489 | 7.4% | 4,995 | 6.1% |
| Net Income | \$ 4,093 | 13.5% | \$ 3,228 | 11.5% | \$ 10,591 | 12.1% | \$ 9,089 | 11.1% |

Three Months Ended September 30, 2008 Compared with Three Months Ended September 30, 2007

Revenues. Total revenues increased by 8.4%, or \$2.4 million, to \$30.4 million for the three months ended September 30, 2008, from \$28.0 million for the three months ended September 30, 2007.

System sales revenues increased by 9.9%, or \$1.0 million, to \$10.8 million for the three months ended September 30, 2008, from \$9.8 million for the three months ended September 30, 2007. This increase was primarily due to increased add-on sales to existing customers compared to the third quarter of the prior year. We completed software system installations at 7 new hospital clients in the third quarter of 2008 compared to 8 new hospital clients in the third quarter of 2007.

Support and maintenance revenues increased by 5.6%, or \$0.7 million, to \$13.4 million for the three months ended September 30, 2008, from \$12.7 million for the three months ended September 30, 2007. 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.

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Business management services revenues increased by 12.3%, or \$0.7 million, to \$6.2 million for the three months ended September 30, 2008, from \$5.5 million for the three months ended September 30, 2007. 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 21 customers at September 30, 2008 compared to 19 customers at September 30, 2007.

Costs of Sales. Total costs of sales increased by 5.6%, or \$0.9 million, to \$17.1 million for the three months ended September 30, 2008, from \$16.2 million for the three months ended September 30, 2007. As a percentage of total revenues, costs of sales decreased to 56.2% for the three months ended September 30, 2008 from 57.7% for the three months ended September 30,

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2007. The gross margin on sales increased to 43.8% for the three months ended September 30, 2008 from 42.3% for the three months ended September 30, 2007.

Cost of system sales increased by 10.9%, or \$0.9 million, to \$8.7 million for the three months ended September 30, 2008, from \$7.8 million for the three months ended September 30, 2007. Cost of equipment and software increased \$0.8 million as a result of an increase in system sales from additional installations. The gross margin on system sales decreased to 19.2% for the three months ended September 30, 2008, from 20.0% for the three months ended September 30, 2007. The slight decrease in gross margin is generally due to higher discounting of software which results in a lower gross margin percentage.

Cost of support and maintenance decreased by 1.4%, or \$0.1 million, to \$4.9 million for the three months ended September 30, 2008, from \$5.0 million for the three months ended September 30, 2007. The gross margin on support and maintenance revenues increased to 63.7% for the three months ended September 30, 2008, compared to 61.1% for the three months ended September 30, 2007. The increase in gross margin was primarily due to the addition of new customers and increased sales of add-on business to our existing customer base without a proportional increase in support personnel.

Our costs associated with business management services increased by 3.6%, or \$0.1 million, to \$3.5 million for the three months ended September 30, 2008, from \$3.4 million for the three months ended September 30, 2007. This increase was caused primarily by an increase in payroll related expenses as a result of an increase in the number of employees needed to support our growing business management services operations, including our electronic billing operations.

Sales and Marketing Expenses. Sales and marketing expenses decreased by 16.8%, or \$0.4 million, to \$2.2 million for the three months ended September 30, 2008, from \$2.6 million for the three months ended September 30, 2007. The decrease is attributable to a reduction in commission expense due to sales force attrition.

General and Administrative Expenses. General and administrative expenses increased 11.0%, or \$0.5 million, to \$5.0 million for the three months ended September 30, 2008, from \$4.5 million for the three months ended September 30, 2007. This increase was attributable to a \$0.3 million increase in group health insurance during the third quarter of 2008 as well as an increase in expenses related to our national customer user group conference which was held in September 2008.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses decreased to 23.6% for the three months ended September 30, 2008 from 25.3% for three months ended September 30, 2007.

Net Income. Net income for the three months ended September 30, 2008 increased by 26.8%, or \$0.9 million, to \$4.1 million, or \$0.38 per diluted share, as compared with net income of \$3.2 million, or \$0.30 per diluted share, for the three months ended September 30, 2007. Net income represented 13.5% of revenue for the three months ended September 30, 2008, as compared to 11.5% of revenue for the three months ended September 30, 2007.

Nine Months Ended September 30, 2008 Compared with Nine Months Ended September 30, 2007

Revenues. Total revenues increased by 7.0%, or \$5.7 million, to \$87.6 million for the nine months ended September 30, 2008, from \$81.9 million for the nine months ended September 30, 2007.

System sales revenues increased by 5.3%, or \$1.5 million, to \$29.9 million for the nine months ended September 30, 2008, from \$28.4 million for the nine months ended September 30, 2007. This increase was primarily due to larger new system installations compared to the prior year as well as increased add-on system sales to existing customers.

Support and maintenance revenues increased by 5.4%, or \$2.0 million, to \$39.6 million for the nine months ended September 30, 2008, from \$37.6 million for the nine months ended September 30, 2007. This increase was attributable to an increase in recurring revenues as a result of a larger customer base and an increase in support fees from sales of add-on business to existing customers.

Business management services revenues increased by 13.8%, or \$2.2 million, to \$18.1 million for the nine months ended September 30, 2008, from \$15.9 million for the nine months ended September 30, 2007. 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.

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Costs of Sales. Total costs of sales increased by 3.1%, or \$1.5 million, to \$49.0 million for the nine months ended September 30, 2008, from \$47.5 million for the nine months ended September 30, 2007. As a percentage of total revenues, costs of sales decreased to 55.9% for the nine months ended September 30, 2008 from 58.0% for the nine months ended September 30, 2007. The gross margin on sales increased to 44.1% for the nine months ended September 30, 2008 from 42.0% for the nine months ended September 30, 2007.

Cost of system sales increased by 4.5%, or \$1.0 million, to \$23.8 million for the nine months ended September 30, 2008, from

\$22.8 million for the nine months ended September 30, 2007. Cost of equipment increased by \$0.7 million for the nine months ended September 30, 2008 compared to the same period of the prior year due to larger system installations. Travel and related costs increased by \$0.5 million for the nine months ended September 30, 2008 due to increased airline costs. These costs were offset slightly by decreased salary and related costs. The gross margin on system sales increased to 20.3% for the nine

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months ended September 30, 2008, from 19.7% for the nine months ended September 30, 2007. The gross margin on larger system installations is generally higher due to a high percentage of fixed expenses included in cost of sales which results in a higher gross margin percentage as revenue increases.

Cost of support and maintenance decreased by 3.8%, or \$0.6 million, to \$14.4 million for the nine months ended September 30, 2008, from \$15.0 million for the nine months ended September 30, 2007. The gross margin on support and maintenance revenues increased to 63.6% for the nine months ended September 30, 2008, compared to 60.1% for the nine months ended September 30, 2007. The increase in gross margin was primarily due to the addition of new customers and increased sales of add-on business to our existing customer base without a proportional increase in support personnel.

Our costs associated with business management services increased by 10.2%, or \$1.0 million, to \$10.7 million for the nine months ended September 30, 2008, from \$9.7 million for the nine months ended September 30, 2007. This increase was caused by an increase of \$1.0 million in payroll related expenses as a result of an increase in the number of employees needed to support our growing business management services operations, including our electronic billing operations.

Sales and Marketing Expenses. Sales and marketing expenses decreased by 6.2% or \$0.4 million, to \$6.6 million for the nine months ended September 30, 2008, from \$7.0 million for the nine months ended September 30, 2007. The decrease was attributable to a decrease in commission expense due to sales force attrition.

General and Administrative Expenses. General and administrative expenses increased 11.3%, or \$1.6 million, to \$15.8 million for the nine months ended September 30, 2008, from \$14.2 million for the nine months ended September 30, 2007. This increase was attributable to a \$1.3 million charge to bad debt expense during the year due to collection problems with specific customers during the year. Health insurance costs also increased by \$0.2 million over the prior nine month period.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses decreased slightly to 25.5% for the nine months ended September 30, 2008 from 25.8% for nine months ended September 30, 2007.

Net Income. Net income for the nine months ended September 30, 2008 increased by 16.5%, or \$1.5 million, to \$10.6 million, or \$0.98 per diluted share, as compared with net income of \$9.1 million, or \$0.85 per diluted share, for the nine months ended September 30, 2007. Net income represented 12.1% of revenue for the nine months ended September 30, 2008, as compared to 11.1% of revenue for the nine months ended September 30, 2007.

Liquidity and Capital Resources

We had cash and cash equivalents of \$12.5 million at September 30, 2008, compared to \$10.0 million at September 30, 2007. Net cash provided by operating activities for the nine months ended September 30, 2008 was \$12.3 million, compared to \$12.9 million for the nine months ended September 30, 2007. The decrease was primarily due to an increase in deferred revenue and prepaid income taxes.

Net cash used in investing activities totaled \$1.2 million for the nine months ended September 30, 2008, compared to \$1.3 million for the nine months ended September 30, 2007. We used cash for the purchase of \$0.8 million of property and equipment and investments of \$0.4 million during the nine months ended September 30, 2008.

Net cash used in financing activities totaled \$10.4 million for the nine months ended September 30, 2008, compared to \$10.3 million for the nine months ended September 30, 2007. We declared and paid dividends of \$11.7 million during the first nine months of 2008. We received proceeds from the exercise of stock options, including the related tax benefit, of \$1.2 million.

We currently do not have a bank line of credit or other credit facility in place. 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 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. Winthrop purchased a software system from us and leased it to Solis Healthcare in the first quarter of 2008. We provided this guarantee in order to

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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

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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 \$231,836, the estimated fair value of the guaranty, is recorded on our balance sheet as an other accrued liability at September 30, 2008. 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 September 30, 2008, 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.

The table that follows presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of September 30, 2008.

| | Aggregate Fair Value | Weighted Average Interest Rate |
|--|-------------------------|--------------------------------------|
| Cash and Cash Equivalents: | | |
| Cash | \$ 6,723,871 | |
| Money market funds | 59,301 | 3.38% |
| Certificates of deposit | 5,722,691 | 2.73% |
| Total cash and cash equivalents | \$ 12,505,863 | |
| Short-Term Investments:(1) | | |
| Accrued Income | \$ 147,316 | |
| Money market funds | 292,918 | 2.22% |
| Commercial Paper | 198,544 | 2.91% |
| Obligations of the U.S. Treasury, U.S government corporations and agencies | 4,118,243 | 4.39% |
| Corporate Bonds | 3,386,989 | 4.58% |
| Total short-term investments | \$ 8,144,010 | |
| Long-Term Investments:(2) | | |
| Obligations of the U.S. Treasury, U.S government corporations and agencies | \$ 805,718 | 5.00% |
| Mortgage backed securities | 211,033 | 5.00% |
| Corporate debt securities | 2,415,860 | 5.21% |

| | |
|-----------------------------|--------------|
| Total long-term investments | \$ 3,432,611 |
|-----------------------------|--------------|

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- (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 September 30, 2008, 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 Rules 13a-15(e) and 15d-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 are effective in timely alerting them to material information relating to the Company that is required to be included in our periodic SEC filings. There have not been any changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-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.

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

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, 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.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

- 3.1 Certificate of Incorporation (filed as Exhibit 3.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 3.2 Bylaws (filed as Exhibit 3.6 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-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)/15d-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: November 6, 2008

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

Date: November 6, 2008

By: /s/ Darrell G. West
Darrell G. West
Vice President - Finance and Chief Financial Officer

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Exhibit Index

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