NIC INC
Form 10-Q
May 01, 2012

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

Commission file number 000-26621

NIC INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	52-2077581 (I.R.S. Employer Identification No.)

25501 West Valley Parkway, Suite 300, Olathe, Kansas 66061
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (877) 234-3468

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

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

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

As of April 24, 2012, the number of shares outstanding of the registrant's common stock, $0.0001 par value per share, was 64,457,687.

PART I - FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

NIC INC.

CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
thousands except par value amount

	March 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,898	$ 61,639
Cash restricted for payment of dividend	-	16,231
Trade accounts receivable, net	48,205	49,306
Deferred income taxes, net	980	916
Prepaid expenses & other current assets	8,289	5,994
Total current assets	122,372	134,086
Property and equipment, net	8,917	8,853
Intangible assets, net	980	1,088
Deferred income taxes, net	-	83
Other assets	244	243
Total assets	$ 132,513	$ 144,353
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 43,086	$ 45,038
Accrued expenses	15,427	16,293
Dividend payable	-	16,231
Other current liabilities	348	310
Total current liabilities	58,861	77,872
Deferred income taxes, net	608	-
Other long-term liabilities	1,355	1,405
Total liabilities	60,824	79,277
Commitments and contingencies (Notes 1, 2 and 5)	-	-
Stockholders' equity:		
Common stock, $0.0001 par, 200,000 shares authorized, 64,458 and 64,178 shares issued and outstanding	6	6
Additional paid-in capital	97,784	96,799
Accumulated deficit	(26,101)	(31,729)
Total stockholders' equity	71,689	65,076
Total liabilities and stockholders' equity	$ 132,513	$ 144,353

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

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NIC INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
thousands except per share amounts

	Three months ended March 31, 2012	2011
Revenues:		
Portal revenues	$ 45,712	$ 40,355
Software & services revenues	3,031	2,379
Total revenues	48,743	42,734
Operating expenses:		
Cost of portal revenues, exclusive of depreciation & amortization	28,751	25,421
Cost of software & services revenues, exclusive of depreciation & amortization	957	997
Selling & administrative	7,935	6,686
Amortization of acquisition-related intangible assets	81	81
Depreciation & amortization	1,311	1,084
Total operating expenses	39,035	34,269
Operating income	9,708	8,465
Other income (expense), net	(1)	3
Income before income taxes	9,707	8,468
Income tax provision	4,079	3,413
Net income	$ 5,628	$ 5,055
Basic net income per share (Note 1)	$ 0.09	$ 0.08
Diluted net income per share (Note 1)	$ 0.09	$ 0.08
Weighted average shares outstanding:		
Basic	64,297	63,771
Diluted	64,297	63,831

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

NIC INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)
thousands

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Total
Balance, January 1, 2012	64,178	$ 6	$ 96,799	$ (31,729)	$ 65,076
Net income	-	-	-	5,628	5,628
Restricted stock vestings	306	-	204	-	204
Shares surrendered and cancelled upon vesting of restricted stock to satisfy tax withholdings	(104)	-	(1,241)	-	(1,241)
Stock-based compensation	-	-	723	-	723
Tax deductions relating to stock-based compensation	-	-	697	-	697
Shares issuable in lieu of dividend payments on unvested performance-based restricted stock awards	-	-	(204)	-	(204)
Issuance of common stock under employee stock purchase plan	78	-	806	-	806
Balance, March 31, 2012	64,458	$ 6	$ 97,784	$ (26,101)	$ 71,689

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

NIC INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
thousands

	Three months ended March 31, 2012	Three months ended March 31, 2011
Cash flows from operating activities:		
Net income	$5,628	$5,055
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of acquisition-related intangible assets	81	81
Depreciation & amortization	1,311	1,084
Stock-based compensation expense	723	1,291
Deferred income taxes	(130)	(165)
(Gain) loss on disposal of property and equipment	1	(2)
Changes in operating assets and liabilities:		
Decrease in trade accounts receivable, net	1,101	1,513
(Increase) in prepaid expenses & other current assets	(1,538)	(1,824)
(Increase) decrease in other assets	(1)	12
(Decrease) in accounts payable	(1,952)	(3,937)
(Decrease) in accrued expenses	(2,107)	(3,599)
Increase (decrease) in other current liabilities	38	(128)
Increase (decrease) in other long-term liabilities	(50)	108
Net cash provided by (used in) operating activities	3,105	(511)
Cash flows from investing activities:		
Purchases of property and equipment	(1,212)	(1,234)
Capitalized internal use software development costs	(137)	(81)
Net cash used in investing activities	(1,349)	(1,315)
Cash flows from financing activities:		
Proceeds from employee common stock purchases	806	652
Tax deductions related to stock-based compensation	697	483
Net cash provided by financing activities	1,503	1,135
Net increase (decrease) in cash and cash equivalents	3,259	(691)
Cash and cash equivalents, beginning of period	61,639	51,687
Cash and cash equivalents, end of period	$64,898	$50,996
Other cash flow information:		
Income taxes paid	$4,032	$3,000
Cash dividends on common stock previously restricted for payment of dividend	$16,231	$-

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The unaudited interim consolidated financial statements of NIC Inc. and its subsidiaries ("NIC" or the "Company") included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management's opinion, the unaudited interim consolidated financial statements reflect all adjustments (which include only normal recurring adjustments, except as disclosed) necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company and its subsidiaries as of the dates and for the interim periods presented. These unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes and Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC on February 24, 2012, and Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10-Q. The consolidated balance sheet data included herein as of December 31, 2011 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for the three-month period ended March 31, 2012 are not necessarily indicative of the results to be expected for the full year ending December 31, 2012.

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

NIC is a leading provider of eGovernment services that helps governments use the Internet to reduce internal costs, increase efficiencies, and provide a higher level of service to businesses and citizens. The Company accomplishes this currently through two channels: its primary outsourced portal businesses and its software & services businesses.

In its primary outsourced portal businesses, the Company generally designs, builds, and operates Internet-based portals on an enterprise-wide basis on behalf of state and local governments desiring to provide access to government information and to complete government-based transactions online. These portals consist of websites and applications the Company has built that allow businesses and citizens to access government information online and complete transactions, such as applying for a permit, retrieving government records, or filing a government-mandated form or report. Operating under multiple-year contracts (see Note 2), NIC markets the services and solicits users to complete government-based transactions and to enter into subscriber contracts permitting users to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. The Company typically manages operations for each contractual relationship through separate local subsidiaries that operate as decentralized businesses with a high degree of autonomy. NIC’s self-funded business model allows the Company to generate revenues by sharing in the fees the Company collects from eGovernment transactions. The Company’s government partners benefit through reducing their financial and technology risks, increasing their operational efficiencies, and gaining a centralized, customer-focused presence on the Internet, while businesses and citizens receive a faster, more convenient, and more cost-effective means to interact with governments. The Company is typically responsible for funding up-front investment and ongoing operations and maintenance costs of the outsourced government portals.

The Company’s software & services businesses primarily include its subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies.

Basis of presentation

The Company classifies its revenues and cost of revenues into two categories: (1) portal and (2) software & services. The portal category generally includes revenues and cost of revenues from the Company’s subsidiaries operating enterprise-wide outsourced portals on behalf of state and local governments. The software & services category primarily includes revenues and cost of revenues from the Company’s subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies. The primary categories of operating expenses include: cost of portal revenues, cost of software & services revenues, selling & administrative, amortization of acquisition-related intangible assets, and depreciation & amortization. Cost of portal revenues consists of all direct costs associated with operating government portals on an outsourced basis including employee compensation (including stock-based compensation), telecommunications, fees required to process debit/credit card and automated clearinghouse transactions, and all other costs associated with the provision of dedicated client service such as dedicated facilities. Cost of software & services revenues consists of all direct project costs to provide software development and services such as employee compensation (including stock-based compensation), subcontractor labor costs, and all other direct project costs including hardware, software, materials, travel and other out-of-pocket expenses. Selling & administrative costs consist primarily of corporate-level expenses relating to human resource management, administration, information technology, security, legal, finance and accounting, and all costs of non-customer service personnel from the Company’s software & services businesses, including information systems and office rent. Selling & administrative costs also consist of stock-based compensation and corporate-level expenses for market development and public relations. In addition, selling & administrative costs include legal fees and other third-party costs, net of directors’ and officers’ liability insurance and other reimbursements received, incurred in connection with the previously disclosed SEC matter (see Note 5).

Earnings per share

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are considered participating securities and are included in the computation of earnings per share pursuant to the two-class method for all periods presented. The two-class method is an earnings allocation formula that treats a participating security as having rights to undistributed earnings that would otherwise have been available to common stockholders. The Company's service-based restricted stock awards contain non-forfeitable rights to dividends and are considered participating securities. Accordingly, service-based restricted stock awards were included in the calculation of earnings per share using the two-class method for all periods presented. Unvested service-based restricted shares totaled approximately 0.9 million and 1.0 million at March 31, 2012 and 2011, respectively. Basic earnings per share is calculated by first allocating earnings between common stockholders and participating securities. Earnings attributable to common stockholders are divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by giving effect to dilutive potential common shares outstanding during the period. The dilutive effect of shares related to the Company's employee stock purchase plan is determined based on the treasury stock method. The dilutive effect of service-based restricted stock awards is based on the more dilutive of the treasury stock method or the two-class method assuming a reallocation of undistributed earnings to common stockholders after considering the dilutive effect of potential common shares other than the participating unvested restricted awards. The dilutive effect of performance-based restricted stock awards is based on the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended March 31,	
	2012	2011
Numerator:		
Net income	$5,628	$5,055
Less: Income allocated to participating securities	(73)	(75)
Net income available to common stockholders	$5,555	$4,980
Denominator:		
Weighted average shares - basic	64,297	63,771
Restricted stock awards	-	60
Weighted average shares - diluted	64,297	63,831
Basic net income per share:		
Net income	$0.09	$0.08
Diluted net income per share:		
Net income	$0.09	$0.08

Concentration of credit risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company limits its exposure to credit loss by depositing its cash with high credit quality financial institutions. In November 2010, the Federal Deposit Insurance Corporation ("FDIC") adopted a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which provides temporary unlimited deposit insurance coverage for non-interest bearing transaction accounts at all FDIC-insured depository institutions effective December 31, 2010 through December 31,

2012. At March 31, 2012, the Company's cash was held entirely in domestic non-interest bearing transaction accounts, which limits its exposure to credit loss. The Company performs ongoing credit evaluations of its customers and generally requires no collateral to secure accounts receivable.

2. OUTSOURCED GOVERNMENT CONTRACTS

Outsourced State Portal Contracts

The Company's outsourced government portal contracts generally have an initial multi-year term with provisions for renewals for various periods at the option of the government. The Company's primary business obligation under these contracts is generally to design, build, and operate Internet-based portals on an enterprise-wide basis on behalf of governments desiring to provide access to government information and to complete government-based transactions online. NIC typically markets the services and solicits users to complete government-based transactions and to enter into subscriber contracts permitting the user to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. The Company enters into separate agreements with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These agreements preliminarily establish the pricing of the electronic transactions and data access services the Company provides and the division of revenues between the Company and the government agency. The government oversight authority must approve prices and revenue sharing agreements. The Company has limited control over the level of fees it is permitted to retain. Any changes made to the amount or percentage of fees retained by NIC, or to the amounts charged for the services offered, could materially affect the profitability of the respective contract to NIC.

The Company is typically responsible for funding up-front investment and ongoing operations and maintenance costs of the government portals, and generally owns all of the software developed under these contracts. After completion of the initial contract term, the government partner typically receives a perpetual, royalty-free license to use the software only in its own portal. However, certain customer management, billing and payment processing software applications that the Company has developed and standardized centrally and that are utilized by the Company’s portal businesses, are being provided to an increasing number of government partners on a software-as-a-service, or “SaaS,” basis, and thus would not be included in any royalty-free license. If the Company's contract were not to be renewed after a defined term, the government agency would be entitled to take over the portal in place with no future obligation of the Company, except as otherwise provided in the contract and except for services provided by the Company on a SaaS basis, which would be available to the partners on a fee-for-service basis.

Any renewal of these contracts beyond the initial term by the government is optional and a government may terminate its contract prior to the expiration date upon specific cause events that are not cured within a specified period. In addition, 15 contracts under which the Company provides outsourced state portal services can be terminated by the other party without cause on a specified period of notice. Collectively, revenues generated from these contracts represented 58% of the Company’s total consolidated revenues for the three-month period ended March 31, 2012. In the event that any of these contracts is terminated without cause, the terms of the respective contract may require the government to pay a fee to the Company in order to continue to use the Company’s software in its portal. In addition, the loss of one or more of the Company’s larger state portal partners, such as Alabama, Arkansas, Colorado, Indiana, Kansas, Oklahoma, Tennessee, Texas, or Utah, as a result of the expiration, termination or failure to renew the respective contract, if such partner is not replaced, could significantly reduce the Company’s revenues and profitability. See the discussion below under “Expiring Contracts” regarding the expiration of the contract with the Commonwealth of Virginia.

At March 31, 2012, the Company was bound by performance bond commitments totaling approximately $5.3 million on certain outsourced portal contracts. Under a typical portal contract, the Company is required to fully indemnify its government clients against claims that the Company’s services infringe upon the intellectual property rights of others and against claims arising from the Company’s performance or the performance of the Company’s subcontractors under the contract. The Company has never had any defaults resulting in draws on performance bonds.

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The following is a summary of the portals through which the Company provides outsourced portal services to state governments at March 31, 2012 (which does not include the portal contract in the state of New Jersey, which has not yet become financially viable):

NIC Portal Entity	Portal Website (State)	Year Services Commenced	Contract Expiration Date (Renewal Options Through)
NICUSA, MD Division	www.maryland.gov (Maryland)	2011	8/10/2016 (8/10/2019)
NICUSA, OR Division	www.oregon.gov (Oregon)	2011	11/22/2021
Delaware Interactive, LLC	www.delaware.gov (Delaware)	2011	9/25/2014 (9/25/2017)
Mississippi Interactive, LLC	www.ms.gov (Mississippi)	2011	12/31/2015 (12/31/2021)
New Mexico Interactive, LLC	www.mvd.newmexico.gov (New Mexico)	2009	6/1/2013
Texas NICUSA, LLC	www.Texas.gov (Texas)	2009	8/31/2016
West Virginia Interactive, LLC	www.WV.gov (West Virginia)	2007	6/30/2012 (6/30/2013)
NICUSA, AZ Division	www.AZ.gov (Arizona)	2007	6/26/2012 (6/26/2013)
Vermont Information Consortium, LLC	www.Vermont.gov (Vermont)	2006	10/14/2012
Colorado Interactive, LLC	www.Colorado.gov (Colorado)	2005	5/18/2014
South Carolina Interactive, LLC	www.SC.gov (South Carolina)	2005	7/15/2014
Kentucky Interactive, LLC	www.Kentucky.gov (Kentucky)	2003	8/19/2013 (8/19/2015)
Alabama Interactive, LLC	www.Alabama.gov (Alabama)	2002	2/28/2015 (2/28/2017)
Rhode Island Interactive, LLC	www.RI.gov (Rhode Island)	2001	8/7/2012
Oklahoma Interactive, LLC	www.OK.gov (Oklahoma)	2001	12/31/2012 (12/31/2014)
Montana Interactive, LLC	www.MT.gov (Montana)	2001	12/31/2015 (12/31/2020)
NICUSA, TN Division	www.TN.gov (Tennessee)	2000	9/30/2014 (3/30/2016)
Hawaii Information Consortium, LLC	www.eHawaii.gov (Hawaii)	2000	1/3/2013 (unlimited 3-year renewal options)
Idaho Information Consortium, LLC	www.Idaho.gov (Idaho)	2000	6/30/2013 (6/30/2015)
Utah Interactive, LLC	www.Utah.gov (Utah)	1999	6/5/2013 (6/5/2019)
Maine Information Network, LLC	www.Maine.gov (Maine)	1999	6/29/2012 (3/14/2018)
Arkansas Information Consortium, LLC	www.Arkansas.gov (Arkansas)	1997	6/30/2018
Iowa Interactive, LLC	www.Iowa.gov (Iowa)	1997	3/31/2013
Virginia Interactive, LLC	www.Virginia.gov (Virginia)	1997	8/31/2012
Indiana Interactive, LLC	www.IN.gov (Indiana)	1995	7/1/2014
Nebraska Interactive, LLC	www.Nebraska.gov (Nebraska)	1995	1/31/2014 (1/31/2016)
Kansas Information Consortium, Inc.	www.Kansas.gov (Kansas)	1992	12/31/2012 (12/31/2016)

During the first quarter of 2012, the Company was awarded a three-year contract with the state of Alabama to manage the state's official government portal, which includes options for the government to extend the contract for two additional one-year renewal terms. In addition, the Company received a one-year contract extension from the state of Kentucky, and the Company's contract with the state of Iowa was extended for six months.

Outsourced Federal Contracts

The Company currently has contracts with two federal agencies to provide outsourced services through its NIC Technologies subsidiary. NIC Technologies has entered into a contract with the Federal Motor Carrier Safety

Administration (“FMCSA”) to develop and manage the FMCSA’s Pre-Employment Screening Program (“PSP”) for motor carriers nationwide, using the self-funded, transaction-based business model. During the first quarter of 2012, the FMCSA exercised the second of its four one-year renewal options for the PSP contract, extending its term through February 16, 2013. NIC Technologies also designs and develops online federal campaign expenditure and ethics compliance systems for federal government agencies through its contract with the Federal Election Commission (“FEC”). The contract with the FEC expires on February 28, 2013, and includes an option for the government to extend the contract for an additional three months.

Any renewal of these contracts beyond the initial term is optional and a federal agency may terminate its contract prior to the expiration date upon specific cause events that are not cured within a specified period. The contract with the FMCSA can be terminated by the other party without cause on a specified period of notice. The loss of the contract with the FMCSA, as a result of the expiration, termination or failure to renew the contract, if not replaced, could significantly reduce the Company’s revenues and profitability. In addition, the Company has limited control over the level of fees it is permitted to retain under the contract with the FMCSA. Any changes made to the amount or percentage of fees retained by the Company, or to the amounts charged for the services offered, could materially affect the profitability of this contract to the Company.

Expiring Contracts

As of March 31, 2012, there were 13 contracts under which the Company provides outsourced portal services or software development and services that have expiration dates within the 12-month period following March 31, 2012. Collectively, revenues generated from these contracts represented 28% of the Company’s total consolidated revenues for the three-month period ended March 31, 2012. As described above, if a contract is not renewed after a defined term, the government partner would be entitled to take over the portal in place with no future obligation of the Company, except as otherwise provided in the contract and except for the services the Company provides on a SaaS basis, which would be available to the government agency on a fee-for-service basis. One of the 13 expiring contracts is the contract under which the Company's indirect subsidiary, Virginia Interactive, LLC ("VI"), provides outsourced portal services to agencies of the Commonwealth of Virginia, which will expire on August 31, 2012. As more fully disclosed in a Form 8-K filed by the Company with the SEC on April 18, 2012, VI did not agree to terms mandated for a new contract by the Commonwealth of Virginia. In the bidding process for new contracts to replace current portal contract functions, the three Requests for Proposals issued decentralized to the agency level and disaggregated some of the enterprise-wide portal functions currently managed by VI. Other functions covered by the expiring VI contract were not bid out. Under the expiring contract, VI is required to provide transition services for up to one year following the contract expiration to the extent requested by agencies of the Commonwealth of Virginia. For both the three-month periods ended March 31, 2012 and 2011, revenues from the Virginia portal contract accounted for approximately 4% of the Company's total consolidated revenues.

3. STOCKHOLDERS' EQUITY

On October 24, 2011, the Company's Board of Directors declared a special cash dividend of $0.25 per share, payable to stockholders of record as of December 19, 2011. The dividend, totaling approximately $16.2 million, was paid on January 3, 2012 on 64,173,368 outstanding shares of common stock. A dividend equivalent of $0.25 per share was also paid simultaneously on 750,497 unvested shares of restricted stock granted under the Company's 2006 Stock Option and Incentive Plan. The dividend was paid out of the Company's available cash, which had been classified as restricted at December 31, 2011.

4. STOCK BASED COMPENSATION

During the first quarter of 2012, the Board of Directors of the Company granted certain management-level employees and executive officers service-based restricted stock awards totaling 284,862 shares with a grant-date fair value totaling approximately $3.6 million. Such restricted stock awards vest beginning one year from the date of grant in cumulative annual installments of 25%. Restricted stock is valued at the date of grant, based on the closing market price of the Company's common stock, and expensed using the straight-line method over the requisite service period.

During the first quarter of 2012, the Board of Directors of the Company also granted certain executive officers performance-based restricted stock awards pursuant to the terms of the Company's executive compensation program totaling 134,982 shares, with a grant date fair value of $12.36 per share, totaling approximately $1.7 million, which represents the maximum number of shares able to be earned by the executive officers at the end of a three-year performance period ending December 31, 2014. The actual number of shares earned will be based on the Company's performance related to the following performance criteria over the performance period:

Operating income growth (three-year compound annual growth rate)

Total consolidated revenue growth (three-year compound annual growth rate)

Cash flow return on invested capital (three-year average)

At the end of the three-year period, the executive officers will receive a specified number of shares based upon certain historical performance criteria. In addition, the executive officers will accrue dividend equivalents for any cash dividend declared during the performance period, payable in the form of shares of Company common stock, based upon the maximum number of shares to be earned by the executive officers for each performance-based restricted stock award. Such hypothetical cash dividend payment shall be divided by the fair value of the Company's common stock on the dividend payment date to determine the maximum number of notional shares to be awarded. At the end of the three-year performance period and on the date some or all of the shares are paid under the agreement, a pro rata number of notional dividend shares will be converted into an equivalent number of dividend shares paid and granted to the executive officers based upon the actual number of underlying shares earned during the performance period.

At December 31, 2011, the three-year performance period related to the performance-based restricted stock awards granted to certain executive officers on February 1, 2009 ended. Based on the Company's actual financial results from 2009 through 2011, 172,751 of the shares subject to the awards and 25,008 dividend shares were earned and vested on February 1, 2012.

Stock-based compensation cost for performance-based restricted stock awards is measured at the grant date based on the fair value of shares expected to be earned at the end of the performance period, and is recognized as expense over the performance period based upon the probable number of shares expected to vest. The Company estimates compensation cost related to awards not expected to vest.

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The following table presents stock-based compensation expense included in the Company's unaudited consolidated statements of income (in thousands):

	Three months ended March 31, 2012	Three months ended March 31, 2011
Cost of portal revenues, exclusive of depreciation & amortization	$213	$233
Cost of software & services revenues, exclusive of depreciation and amortization	9	15
Selling & administrative	501	1,043
Stock-based compensation expense before income taxes	723	1,291
Income tax benefit	(304)	(521)
Net stock-based compensation expense	$419	$770

5. COMMITMENTS AND CONTINGENCIES

SEC Matter

Selling & administrative expenses for the three-month period ended March 31, 2012 include approximately $0.8 million of legal fees and other third-party costs related to the previously disclosed SEC matter. These expenses were reduced by approximately $0.7 million of reimbursement from the Company's directors' and officers' liability insurance carrier, resulting in a net increase in expense of approximately $0.1 million. Selling & administrative expenses for the three-month period ended March 31, 2011 include approximately $0.8 million of legal fees and other third party costs related to the SEC matter and related to the derivative action that was concluded in the fourth quarter of 2011. These expenses were reduced by approximately $1.2 million of insurance reimbursement that was approved for payment and was subsequently collected by the Company in the second quarter of 2011. The Company promptly submits any invoices potentially reimbursable under its directors' and officers' liability insurance policies to its carrier for reimbursement. For expenses that are subject to reimbursement, the Company does not generally receive reimbursement for 90 to 120 days. To the extent that the carrier agrees to reimburse the Company for expenses previously recorded in selling & administrative expenses, the Company treats any such reimbursement as a reduction of selling & administrative expenses in the period such reimbursement is determined to be estimable and probable. The SEC matter was concluded as to the Company and its Chairman of the Board and Chief Executive Officer in January 2011.

The Company expects to continue to incur obligations to advance legal fees and other expenses to the Company's Chief Financial Officer in connection with the previously disclosed civil action by the SEC against him. The Company is not party to the civil action, but is obligated to provide indemnification in certain circumstances (including advancing certain defense costs) to its Chief Financial Officer in accordance with the Company's certificate of incorporation and bylaws and its indemnification agreement with him. In addition, the Company expects to incur costs responding to subpoenas and other discovery requests relating to the civil action. The civil action seeks from the Company's Chief Financial Officer civil money penalties, and injunction against further violations of certain federal securities laws, a prohibition against his acting as an officer or director of a publicly-traded company, and disgorgement. The Company's directors' and officers' liability insurance carrier has agreed to reimburse the Company for reasonable costs of defense advanced by the Company to its Chief Financial Officer in the SEC civil action. Because the Company is not directly involved in the defense of the proceeding and because of the inherent uncertainty in predicting any future settlement or judicial decision and any indemnification obligation of the Company in connection with any such resolution, the Company is not able to estimate or predict the extent of any indemnification obligation of the Company to its Chief Financial Officer or other costs resulting from the civil action, the amount or timing of and eligibility for reimbursements from the Company's directors' and officers' liability insurance carrier associated with the civil action, any possible loss or possible range of loss associated with the civil action, or any potential effect on the Company’s business, results of operations, cash flows, or financial condition.

Litigation

The Company is involved from time to time in legal proceedings and litigation arising in the ordinary course of business. However, the Company is not currently a party to any other material legal proceedings.

6. SEGMENTS AND RELATED INFORMATION

The Outsourced Portals segment is the Company’s only reportable segment and generally includes the Company's subsidiaries operating enterprise-wide outsourced state and local government portals and the corporate divisions that directly support portal operations. The Other Software & Services category primarily includes the Company’s subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies. Each of the Company’s businesses within the Other Software & Services category is an operating segment and has been grouped together to form the Other Software & Services category, as none of the operating segments meets the quantitative threshold of a separately reportable segment. Unallocated corporate-level expenses are reported in the reconciliation of the segment totals to the related consolidated totals as "Other Reconciling Items." There have been no significant intersegment transactions for the periods reported. The summary of significant accounting policies applies to all reportable and operating segments.

The measure of profitability by which management, including the Company's chief operating decision maker, evaluates the performance of its segments and allocates resources to them is operating income (loss). Segment asset or other segment balance sheet information is not presented to the Company's chief operating decision maker. Accordingly, the Company has not presented information relating to segment assets.

The table below reflects summarized financial information for the Company's reportable and operating segments for the three months ended March 31 (in thousands):

	Outsourced Portals	Other Software & Services	Other Reconciling Items	Consolidated Total
2012				
Revenues	$45,712	$3,031	$-	$48,743
Costs & expenses	30,415	999	6,229	37,643
Amortization of acquisition-related intangible assets	81	-	-	81
Depreciation & amortization	1,234	14	63	1,311
Operating income (loss)	$13,982	$2,018	$(6,292)	$9,708

2011