COMPUTER PROGRAMS & SYSTEMS INC
Form 10-Q
August 07, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012.

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

For the transition period from to .

Commission file number: 000-49796

COMPUTER PROGRAMS AND SYSTEMS, INC.

(Exact Name of Registrant as Specified in Its Charter)

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

(251) 639-8100

(Registrant s Telephone Number, Including Area Code)

N/A

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

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

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

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

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COMPUTER PROGRAMS AND SYSTEMS, INC.

Form 10-Q

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

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

COMPUTER PROGRAMS AND SYSTEMS, INC.

CONDENSED BALANCE SHEETS

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

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

See accompanying notes.

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COMPUTER PROGRAMS AND SYSTEMS, INC.

CONDENSED STATEMENTS OF INCOME (Unaudited)

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

See accompanying notes.

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COMPUTER PROGRAMS AND SYSTEMS, INC.

CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

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

See accompanying notes.

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COMPUTER PROGRAMS AND SYSTEMS, INC.

CONDENSED STATEMENT OF STOCKHOLDERS EQUITY (Unaudited)

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

See accompanying notes.

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COMPUTER PROGRAMS AND SYSTEMS, INC.

CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

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

See accompanying notes.

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COMPUTER PROGRAMS AND SYSTEMS, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

1. BASIS OF PRESENTATION

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

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

2. REVENUE RECOGNITION

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

The Company s revenue is generated from three sources:

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

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

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

System Sales and Support and Maintenance

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

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

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

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

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SaaS, ISP, and Other Professional IT Services

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

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

Business Management Services

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

3. OTHER ACCRUED LIABILITIES

Other accrued liabilities are comprised of the following:

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

4. INVESTMENTS

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

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

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

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

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

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

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

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

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

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

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

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

5. NET INCOME PER SHARE

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

6. INCOME TAXES

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

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

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

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

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

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

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

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

7. STOCK-BASED COMPENSATION AND EMPLOYEE INCENTIVE PROGRAMS

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

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

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

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

2005 Restricted Stock Plan

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

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

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

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

2012 Restricted Stock Plan for Non-Employee Directors

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

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

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

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

2012 Incentive Program

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

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

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

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8. FINANCING RECEIVABLES

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

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

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

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

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

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

Credit Quality of Financing Receivables and Allowance for Credit Losses

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

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

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

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

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

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

Extended Meaningful Use Installment Plans

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

9. COMMITMENTS AND CONTINGENCIES

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

10. FAIR VALUE

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

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

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

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

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

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

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

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

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

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

11. RECENT ACCOUNTING PRONOUNCEMENTS

New Accounting Standards Adopted in 2012

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

New Accounting Standards Yet to be Adopted

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

12. SUBSEQUENT EVENTS

On July 23, 2012, the Company announced a dividend for the third quarter of 2012 in the amount of $0.46 per share, payable on August 24, 2012, to stockholders of record as of the close of business on August 9, 2012.

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

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

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

- overall business and economic conditions affecting the healthcare industry;
- potential effects of the federal health care reform legislation enacted in 2010, and implementing regulations, on the businesses of our hospital customers;
- funding uncertainties associated with, and potential expenditures required by, the American Recovery and Reinvestment Act of 2009 in connection with the adoption of electronic health records;
- saturation of our target market and hospital consolidations;
- changes in customer purchasing priorities, capital expenditures and demand for information technology systems;
- competition with companies that have greater financial, technical and marketing resources than we have;
- failure to develop new technology and products in response to market demands;
- fluctuations in quarterly financial performance due to, among other factors, timing of customer installations;
- failure of our products to function properly resulting in claims for medical losses;
- government regulation of the healthcare and health insurance industries;
- government regulation of our products and customers, including changes in healthcare policy affecting Medicare reimbursement rates and qualifying technological standards;
- changes in accounting principles generally accepted in the United States of America;

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

potential intellectual property claims against us;

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

interruptions in our power supply and/or telecommunications capabilities.

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

Background

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

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

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

Management Overview

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

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

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

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

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

American Recovery and Reinvestment Act of 2009

While the ongoing challenging economic conditions and uncertainty surrounding credit markets and tightened lending standards have impacted and could continue to impact the community hospitals that comprise our target market, we believe that the American Recovery and Reinvestment Act of 2009 (the ARRA) has increased and will continue to increase demand for healthcare information technology and will have a positive impact on our business prospects through 2015 . The ARRA includes more than $19 billion in funding to aid healthcare organizations in modernizing their operations through the acquisition and widespread use of healthcare information technology. Included in the funding is approximately $17.2 billion in incentives through Medicare and Medicaid reimbursement systems to encourage and assist healthcare providers in adopting and using electronic health records (EHRs). These incentive payments began in February 2011 and are expected to last through 2015. If an eligible healthcare provider does not begin to demonstrate meaningful use of EHRs by 2015, then reimbursement under Medicare will begin to be reduced. Our hospital customers began receiving these incentive payments under the ARRA in February 2011. Through July 2012, approximately 180 of our hospital customers had received payments for EHR adoption totaling approximately $180 million.

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

Health Care Reform

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

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

Deficit Reduction

President Obama signed legislation on August 2, 2011, the Budget Control Act of 2011, to increase the U.S. debt ceiling. This legislation imposed significant cuts in federal spending over the next decade, as the special bipartisan Congressional committee appointed under the legislation failed to take any action on deficit reduction. Although Medicaid is specifically exempted from the federal spending cuts mandated by the legislation, it calls for a maximum reduction of 2% in federal Medicare spending, all of which will be achieved by reduced reimbursements to health care providers. The reduced reimbursements will take effect starting in January 2013, unless Congress takes specific action to override the spending cuts. As our hospital customers rely heavily on reimbursements from Medicare to fund their operations, the anticipated reduction in reimbursement rates, although capped at 2%, could negatively affect the businesses of our customers and our business.

Results of Operations

In the six months ended June 30, 2012, we generated revenues of $90.2 million from the sale of our products and services, as compared to $89.2 million in the six months ended June 30, 2011, an increase of 1.1%. We installed our core financial and patient accounting system in 18 new hospitals in the first six months of 2012 compared to 11 in the first six months of 2011. Additionally, our expanding customer base resulted in continued growth in support and maintenance revenues and business management services revenues. We also recognized favorable provision-to-return adjustments of $1.8 million related to our 2011 federal and state income tax returns. Our net income for the six months ended June 30, 2012 increased 4.7% from the first six months of 2011, while cash flow from operations decreased 32.7% primarily as a result of increases in our financing receivables.

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

Meaningful use is measured in three stages over five years. Each stage represents a level of adoption of EHR. To qualify for stimulus payments for each stage, the provider is required to report compliance for a consecutive 90-day period during the calendar year. The dollar amount of stimulus payments during stage one of the EHR incentive program is scheduled to begin decreasing in 2013. Due to the deadlines associated with the 90-day compliance requirement, our results have become and will remain uneven during the term of the ARRA program, with system sales activity relating to ARRA likely being higher in the first two quarters of our fiscal year and lower in the last two quarters of our fiscal year. However, based on factors such as that presented below, the recognition of revenue may not be in a pattern consistent with changes in system sales activity.

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At the beginning of 2012, we began including language in certain of our customer license agreements that more evenly matched customers anticipated cash inflows under the EHR incentive program with the necessary cash outflows for purchasing our EHR solution. Under these arrangements, customers are required to remit to us incentive payments (not to exceed the remaining balance) received for adoption of qualifying EHRs, with only nominal payment amounts required until the customer s receipt of such incentive payments. If no such incentive payments are received by the customer or if such payments are not sufficient to pay the remaining balance under the arrangement, payments continue at contracted nominal amounts until the balance of the contract price is paid in full. Revenue from these arrangements is recognized as the amounts become due. As of June 30, 2012, we have accumulated unrecognized revenue of $9.8 million to be recognized as the amounts become due under these contracts. We expect most of the customers under these contracts to successfully achieve stage one of meaningful use on or before October 1, 2012, with our experience suggesting an average time from successful attestation to receipt of funds under the EHR incentive program of approximately six weeks. Overall, with respect to these contracts, we typically experience a timeframe of 6 to 12 months from the date of installation to receipt of funds under the EHR incentive program.

The following table sets forth certain items included in our results of operations for the three and six months ended June 30, 2012 and 2011, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2012		2011		2012		2011	
	Amount	% Sales	Amount	% Sales	Amount	% Sales	Amount	% Sales
INCOME DATA:								
Sales revenues:								
System sales	17,828	39.0%	$ 23,593	48.3%	$ 34,903	38.7%	$ 39,200	43.9%
Support and maintenance	18,397	40.2%	16,206	33.2%	36,533	40.5%	32,368	36.3%
Business management services	9,506	20.8%	9,040	18.5%	18,784	20.8%	17,651	19.8%
Total sales revenues	45,731	100.0%	48,839	100.0%	90,220	100.0%	89,219	100.0%
Costs of sales:								
System sales	12,679	27.7%	13,529	27.7%	24,579	27.2%	25,650	28.7%
Support and maintenance	7,514	16.4%	6,495	13.3%	15,182	16.8%	12,939	14.5%
Business management services	5,399	11.8%	4,658	9.5%	11,053	12.3%	9,337	10.5%
Total costs of sales	25,592	56.0%	24,682	50.5%	50,814	56.3%	47,926	53.7%
Gross profit	20,139	44.0%	24,157	49.5%	39,406	43.7%	41,293	46.3%
Operating expenses:								
Sales and marketing	3,641	8.0%	3,866	7.9%	7,281	8.1%	6,791	7.6%
General and administrative	6,573	14.4%	7,652	15.7%	13,200	14.6%	13,372	15.0%
Total operating expenses	10,214	22.3%	11,518	23.6%	20,481	22.7%	20,163	22.6%
Operating income	9,925	21.7%	12,639	25.9%	18,925	21.0%	21,130	23.7%
Other income:								
Interest income	189	0.4%	158	0.3%	348	0.4%	311	0.3%
Total other income	189	0.4%	158	0.3%	348	0.4%	311	0.3%
Income before taxes	10,114	22.1%	12,797	26.2%	19,273	21.4%	21,441	24.0%
Income taxes	1,853	4.1%	4,881	10.0%	5,363	5.9%	8,152	9.1%
Net income	$ 8,261	18.1%	$ 7,916	16.2%	$ 13,910	15.4%	$ 13,289	14.9%

Three Months Ended June 30, 2012 Compared with Three Months Ended June 30, 2011

Revenues. Total revenues for the three months ended June 30, 2012 decreased 6.4%, or $3.1 million, compared to the three months ended June 30, 2011. This was largely attributable to a decrease in system sales revenues, as nearly half of the installations of core systems at new hospital clients during the second quarter of 2012 contained provisions within the respective agreements requiring a substantial majority of the revenue to be recognized upon the customers successfully achieving meaningful use designation and receipt of related ARRA funds (Extended Meaningful Use Installment Plans). This resulted in additional unrecognized revenue of $4.7 million accumulated during the second quarter of 2012 to be recognized in future periods as the amounts become due. This decrease in recognized system sales revenues is largely offset by an increase in support and maintenance revenues and business management services revenues due to a larger customer base and increased applications within that customer base requiring support and maintenance services.

System sales revenues decreased by 24.4%, or $5.8 million, for the comparative three-month periods. We installed our core system at nine new hospital clients in the second quarter of 2012 (nearly half of which were under Extended Meaningful Use Installment Plans) compared to seven in the second quarter of 2011 (all of which were traditional installations). Sales to existing customers accounted for 72.0% of our system sales revenue for the second quarter of 2012 compared to 64.2% for the second quarter of 2011. During the second quarter of 2012, the Company continued to install systems under Extended Meaningful Use Installment Plans for which a substantial majority of the consideration will not be received or revenue recognized until the customers successfully achieve meaningful use designation and receive related ARRA incentive payments, resulting in additional unrecognized revenue of $4.7 million accumulated during the second quarter of 2012 to be recognized in future periods as the amounts become due. The Company recognized revenue during the second quarter of 2012 of $0.4 million for previously installed Software as a Service (SaaS) arrangements that were converted to perpetual licenses at the customers request.

Support and maintenance revenues increased by 13.5%, or $2.2 million, for the comparative three month periods. This increase was attributable to an increase in recurring revenues as a result of a larger customer base, an increase in support fees for add-on business sold to existing customers, increases in support rates from contractually agreed upon Consumer Price Index (CPI) rate increases and the addition of IT managed services to our suite of service offerings. Support service fees increased by 12.1%, or $1.7 million, for the comparative three month periods. SaaS, hosting and other fees decreased by 18.6%, or $0.4 million, for the comparative three month periods. IT managed service fees, which was a new service offering beginning in the third quarter of 2011, were $1.0 million for the three months ended June 30, 2012 compared to zero for the second quarter of 2011.

Business management services revenues increased by 5.2%, or $0.5 million, for the comparative three month periods. We experienced this increase in business management services revenues primarily as a result of growth in customer demand for accounts receivable management and revenue cycle management services. We were providing our full suite of business management services to 38 customers at June 30, 2012, compared to 29 customers at June 30, 2011.

Costs of Sales. Total costs of sales increased by 3.7%, or $0.9 million, for the comparative three month periods. As a percentage of total revenues, costs of sales increased approximately 550 basis points to 56.0% from 50.5%.

Costs of system sales decreased by 6.3%, or $0.8 million, for the comparative three month periods. The decrease in costs of system sales was due to a $0.8 million decrease in cost of equipment due largely to a 25.9% decrease in equipment sales, coupled with the capitalization of $0.3 million in cost of equipment related to Extended Meaningful Use Installment Plan installations for which no revenue has been recognized. The second quarter of 2011 saw an unusually high number of equipment sales to existing customers and related cost of equipment due to the Company s migration to a new operating platform, which required many customers to upgrade existing hardware in order to support the new platform. Payroll and related costs remained unchanged at $6.2 million. The gross margin on system sales decreased to 28.9% for the three month period ended June 30, 2012 from 42.7% in the three month period ended June 30, 2011, as revenue for nearly half of the systems installed during the three months ended June 30, 2012 will not be recognized until the customers successfully achieve meaningful use designation and receive related ARRA incentive payments. Excluding the effects of the unrecognized revenue noted above and the deferral of the related cost of equipment, the adjusted gross margin on system sales (as hereinafter defined in the Non-GAAP Financial Measures section below) decreased to 42.4% in the three month period ended June 30, 2012. The timing of revenue recognition on these installations also resulted in an increase in payroll and related expenses as a percentage of system sales to 34.5% in the three month period ended June 30, 2012 from 26.3% in the three month period ended June 30, 2011, and an increase in travel expense as a percentage of system sales to 20.3% from 13.9% for the comparative three month periods. As a percentage of system sales, cost of equipment decreased to 9.8% in the three month period ended June 30, 2012 from 11.0% in the three month period ended June 30, 2011. If the Company had recognized the $4.7 million of unrecognized revenue accumulated during the quarter from Extended Meaningful Use Installment Plans, payroll and related expenses, travel expense, and adjusted cost of equipment (as hereinafter defined in the Non-GAAP Financial Measures section below) would represent 27.3%, 16.1%, and 9.0%, respectively, of adjusted system sales (as hereinafter defined in the Non-GAAP Financial Measures section below) for the second quarter of 2012. Please see the tables set forth below under the caption Non-GAAP Financial Measures reconciling each of these non-GAAP financial measures to the comparable financial measure determined in accordance with generally accepted accounting principles in the United States (GAAP).

Cost of support and maintenance increased 15.7%, or $1.0 million, for the comparative three month periods, primarily due to an increase in payroll and related costs of 18.6%, or $1.1 million. The increase in payroll and related costs was driven by the addition of personnel to provide IT managed services, which was a new service offering beginning in the third quarter of 2011. The gross margin on support and maintenance revenues decreased to 59.2% for the three month period ended June 30, 2012 from 59.9% for the three month period ended June 30, 2011, as our IT managed services offering has yet to achieve the economies of scale that currently benefit the remainder of our support and maintenance service mix.

Our costs associated with business management services increased 15.9%, or $0.7 million, for the comparative three month periods due primarily to an increase in payroll and related costs. The gross margin on business management services decreased to 43.2% for the three month period ended June 30, 2012 from 48.5% for the three month period ended June 30, 2011 due to the disproportionate increase in payroll and related costs versus revenues. Payroll and related expenses increased 19.3%, or $0.5 million, as a result of adding more employees in order to support and develop our growing customer base.

Sales and Marketing Expenses. Sales and marketing expenses decreased 5.8%, or $0.2 million, for the comparative three month periods. The decrease was attributable to decreased commissions resulting from a decrease in billings for system sales revenues.

General and Administrative Expenses. General and administrative expenses decreased 14.1%, or $1.1 million, for the comparative three month periods primarily due to a $1.7 million decrease in bad debt expense. Bad debt expense for the second quarter of 2011 was significantly higher than historical trends as several customers declared bankruptcy and we increased reserves for specific customers with which we had experienced collection problems. The decrease in bad debt expense is partially offset by a $0.5 million increase in group health insurance expense due to negative claims experience in our self-insurance program.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses decreased to 22.3% for the three month period ended June 30, 2012 compared to 23.6% for the three month period ended June 30, 2011.

As a result of the foregoing factors, income before taxes decreased by 21.0%, or $2.7 million, from the three months ended June 30, 2011.

Income Taxes. Our effective income tax rate for the three months ended June 30, 2012 and 2011 was 18.3% and 38.1%, respectively. The significant decrease in our effective income tax rate is primarily due to favorable provision-to-return adjustments related to our 2011 federal and state income tax returns. These adjustments were primarily related to differences between the Domestic Production Activities Deduction (DPAD) reported on the 2011 federal income tax return and amounts previously estimated. The federal research and development tax credit expired effective December 31, 2011, and has yet to be extended by Congress. As a result, no tax benefit from these potential tax credits has been recorded for the three months ended June 30, 2012. Aside from the potential extension of federal research and development tax credits, we are unaware of any pending legislation that would affect our current income tax rate for the remainder of 2012.

Net Income. Net income for the three months ended June 30, 2012 increased by 4.4%, or $0.3 million, to $8.3 million, or $0.75 per basic and diluted share, as compared with net income of $7.9 million, or $0.72 per basic and diluted share, for the three months ended June 30, 2011. Net income represented 18.1% of revenue for the three months ended June 30, 2012, as compared to 16.2% of revenue for the three months ended June 30, 2011.

Six Months Ended June 30, 2012 Compared with Six Months Ended June 30, 2011

Revenues. Total revenues for the six months ended June 30, 2012 increased 1.1%, or $1.0 million, compared to the six months ended June 30, 2011. This was largely attributable to an increase in support and maintenance revenues and business management services revenues due to a larger customer base and increased applications within that customer base requiring support and maintenance services. The increase in support and maintenance revenues and business management services revenues is largely offset by a decrease in system sales revenues as over one third of the installations of core systems at new hospital clients during the six months ended June 30, 2012 were under Extended Meaningful Use Installment Plans. This resulted in unrecognized revenue of $9.8 million being accumulated during the six months ended June 30, 2012, which will be recognized in future periods as the amounts become due.

System sales revenues decreased by 11.0%, or $4.3 million, for the comparative six month periods. We installed our core system at 18 new hospital clients in the first six months of 2012 (over one third of which were under Extended Meaningful Use Installment Plans) compared to 11 in the first six months of 2011 (all of which were traditional installations). Sales to existing customers accounted for 74.8% of our system sales revenue for the first six months of 2012 compared to 67.7% for the first six months of 2011. During the first six months of 2012, the Company installed systems under Extended Meaningful Use Installment Plans for which a substantial majority of the consideration will not be received and revenue recognized until the customers successfully achieve meaningful use designation and receive related ARRA incentive payments, resulting in unrecognized revenue of $9.8 million accumulated during the six months ended June 30, 2012 to be recognized in future periods as the amounts become due. The Company recognized revenue during the first six months of 2012 of $0.8 million for previously installed Software as a Service (SaaS) arrangements that were converted to perpetual licenses at the customers request.

Support and maintenance revenues increased by 12.9%, or $4.2 million, for the comparative six month periods. This increase was attributable to an increase in recurring revenues as a result of a larger customer base, an increase in support fees for add-on business sold to existing customers, increases in support rates from contractually agreed upon Consumer Price Index (CPI) rate increases and the addition of IT managed services to our suite of service offerings. Support service fees increased by 10.6%, or $3.0 million, for the comparative six month periods. SaaS, hosting and other fees decreased by 12.7%, or $0.5 million, for the comparative six month periods. IT managed service fees, which was a new service offering beginning in the third quarter of 2011, were $1.8 million for the six months ended June 30, 2012 compared to zero for the six months ended June 30, 2011.

Business management services revenues increased by 6.4%, or $1.1 million, for the comparative six month periods. We experienced this increase in business management services revenues primarily as a result of growth in customer demand for accounts receivable management, revenue cycle management and claims eligibility services.

Costs of Sales. Total costs of sales increased by 6.0%, or $2.9 million, for the comparative six month periods. As a percentage of total revenues, costs of sales increased approximately 260 basis points to 56.3% from 53.7%.

Costs of system sales decreased by 4.2%, or $1.1 million, for the comparative six month periods. The decrease in costs of system sales was due to a $1.9 million decrease in cost of equipment due largely to a 16.3% decrease in equipment sales, coupled with the capitalization of $0.8 million in cost of equipment related to installations for which no revenue has been recognized. During the six months ended June 30, 2011, we experienced an unusually high number of equipment sales to existing customers and related cost of equipment due to the Company s migration to a new operating platform, which required many customers to upgrade existing hardware in order to support the new platform. This decrease in cost of equipment was partially offset by a $1.2 million increase in travel and related costs due to increased system installations during the six months ended June 30, 2012. Payroll and related costs remained unchanged at $12.1 million. The gross margin on system sales decreased to 29.6% for the six month period ended June 30, 2012 from 34.6% in the six month period ended June 30, 2011, as revenue for over one-third of the systems installed during the six months ended June 30, 2012 will not be recognized until the customers successfully achieve meaningful use designation and receive related ARRA incentive payments. Excluding the effects of the unrecognized revenue noted above and the deferral of the related cost of equipment, the adjusted gross margin on system sales (as hereinafter defined in the Non-GAAP Financial Measures section below) increased to 43.2% in the six month period ended June 30, 2012. The timing of revenue recognition on these installations also resulted in an increase in payroll and related expenses as a percentage of system sales to 34.7% in the six month period ended June 30, 2012 from 30.8% in the six month period ended June 30, 2011, and an increase in travel expense as a percentage of system sales to 19.6% from 14.5% for the comparative six month periods. As a percentage of system sales, cost of equipment decreased to 10.2% in the six month period ended June 30, 2012, from 13.9% in the six month period ended June 30, 2011. If the Company had recognized the $9.8 million of unrecognized revenue accumulated during the six months ended June 30, 2012 from Extended Meaningful Use Installment Plans, payroll and related expenses, travel expense, and adjusted cost of equipment (as hereinafter defined in the Non-GAAP Financial Measures section below) would represent 27.0%, 15.3%, and 9.8%, respectively, of adjusted system sales (as hereinafter defined in the Non-GAAP Financial Measures section below) for the six months ended June 30, 2012. Please see the tables set forth below under the caption Non-GAAP Financial Measures reconciling each of these non-GAAP financial measures to the comparable financial measure determined in accordance with GAAP.

Cost of support and maintenance increased 17.3%, or $2.2 million, for the comparative six month periods, primarily due to an increase in payroll and related costs of 19.1%, or $2.2 million. The increase in payroll and related costs was driven by the addition of personnel to provide IT managed services, which was a new service offering beginning in the third quarter of 2011. The gross margin on support and maintenance revenues decreased to 58.4% for the six month period ended June 30, 2012 from 60.0% for the six month period ended June 30, 2011, as our IT managed services offering has yet to achieve the economies of scale that currently benefit the remainder of our support and maintenance service mix.

Our costs associated with business management services increased 18.4%, or $1.7 million, for the comparative six month periods due primarily to an increase in payroll and related costs. The gross margin on business management services decreased to 41.2% for the six month period ended June 30, 2012 from 47.1% for the six month period ended June 30, 2011 due to the disproportionate increase in payroll and related costs versus revenues. Payroll and related expenses increased 23.5%, or $1.1 million, as a result of adding more employees in order to support and develop our growing customer base. Similarly, temporary labor expenses increased 42.5%, or $0.2 million.

Sales and Marketing Expenses. Sales and marketing expenses increased 7.2%, or $0.5 million, for the comparative six month periods. The increase was attributable to increased payroll and related expense as a result of additional personnel.

General and Administrative Expenses. General and administrative expenses decreased 1.3%, or $0.2 million, for the comparative six month periods primarily due to a $1.4 million decrease in bad debt expense. Bad debt expense for the six months ended June 30, 2011 was significantly higher than historical trends as several customers declared bankruptcy and we increased reserves for specific customers with which we had experienced collection problems. The decrease in bad debt expense is mostly offset by a $0.5 million increase in expenses related to application-specific user group meetings hosted by the Company during the first six months of 2012, a $0.5 million increase in retirement plan costs (as during the first six months of 2012 we changed the employer match component of our defined contribution retirement plan such that our matching contributions to participant accounts are more heavily weighted towards the earlier periods in the year), and a $0.4 million increase in group health insurance expense due to negative claims experience in our self-insurance program.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses increased to 22.7% for the six month period ended June 30, 2012 compared to 22.6% for the six month period ended June 30, 2011.

As a result of the foregoing factors, income before taxes decreased by 10.1%, or $2.2 million, from the six months ended June 30, 2011.

Income Taxes. Our effective income tax rate for the six months ended June 30, 2012 and 2011 was 27.8% and 38.0%, respectively. The significant decrease in our effective income tax rate is primarily due to favorable provision-to-return adjustments related to our 2011 federal and state income tax returns. These adjustments were primarily related to differences between the DPAD reported on the 2011 federal income tax return and amounts previously estimated. The federal research and development tax credit expired effective December 31, 2011, and has yet to be extended by Congress. As a result, no tax benefit from these potential tax credits has been recorded for the three months ended June 30, 2012. Aside from the potential extension of federal research and development tax credits, we are unaware of any pending legislation that would affect our current income tax rate for the remainder of 2012.

Net Income. Net income for the six months ended June 30, 2012 increased by 4.7%, or $0.6 million, to $13.9 million, or $1.26 per basic and diluted share, as compared with net income of $13.3 million, or $1.21 per basic and diluted share, for the six months ended June 30, 2011. Net income represented 15.4% of revenue for the six months ended June 30, 2012, as compared to 14.9% of revenue for the six months ended June 30, 2011.

Liquidity and Capital Resources

As of June 30, 2012, we had cash and cash equivalents of $5.2 million, compared to $8.5 million at June 30, 2011. Management believes that cash and investments plus cash generated from our normal operating activities should be adequate to fund our business through the remainder of 2012. Our principal source of liquidity has been cash provided by operating activities. Cash provided by operating activities has been used primarily to fund the growth in our business and return cash to shareholders in the form of dividends. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash. However, the declaration of dividends by CPSI is subject to the discretion of our Board of Directors. Our Board of Directors will continue to take into account such matters as general business conditions, our financial results and such other factors as our Board of Directors may deem relevant.

Net cash provided by operating activities for the six months ended June 30, 2012 was $11.5 million, compared to $17.1 million for the six months ended June 30, 2011. The decrease was primarily due to an increase in financing receivables, coupled with the cash outflows necessary to install systems for which a substantial majority of the consideration will not be received or revenue recognized until the customers successfully achieve meaningful use designation and receive related ARRA incentive payments. During the first six months of 2012, we have again experienced an increase in requests by customers for payment terms and financing arrangements as a result of the challenging economic environment and limited availability of credit from third parties. Although we will provide capital lease financing arrangements to our customers, we prefer and encourage customers to use a SaaS operating lease arrangement in lieu of capital financing lease arrangements.

Net cash used in investing activities totaled $2.7 million for the six months ended June 30, 2012, compared to $3.8 million for the six months ended June 30, 2011. We used cash for the purchase of $1.7 million of property and equipment and for the purchase of investments of $1.1 million during the six months ended June 30, 2012. We move idle cash to our investment portfolio that we do not anticipate needing within a one-year time frame. We anticipate the need for approximately$2.0 million in capital expenditures during the remainder of 2012, including approximately $1.5 million for the addition of office space in Baldwin County, Alabama.

Net cash used in financing activities totaled $10.2 million for the six months ended June 30, 2012, compared to $7.9 million for the six months ended June 30, 2011. During the six months ended June 30, 2012, we increased our divided rate 27.8% to $0.46 per share from $0.36 per share.

Our days sales outstanding, which represents the average collection time for accounts receivable, for the six months ended June 30, 2012 and 2011 were 43 and 58 days, respectively. This significant decrease in days sales outstanding is primarily attributable to the increasing preference among new customers to enter into financing arrangements for the purchase of their EHRs, resulting in fewer sales dollars entering accounts receivable.

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

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

Off Balance Sheet Arrangements

As of December 31, 2011, our only off-balance sheet arrangement, as defined by Item 303(a)(4) of SEC Regulation S-K, consisted of our guarantee of certain lease obligations of Solis Healthcare, LP (Solis Healthcare) to Winthrop Resources Corporation (Winthrop) under a lease agreement. Solis Healthcare purchased a software system from us and then entered into a sale-leaseback transaction with Winthrop in the first quarter of 2008. We provided this guarantee in order to facilitate Solis Healthcare in leasing the new system. During May 2012, all amounts outstanding under the lease were paid in full, resulting in the termination of our obligations under the guarantee.

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

Critical Accounting Policies

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

In our Annual Report on Form 10-K for the year ended December 31, 2011, we identified our critical accounting polices related to cash and cash equivalents, investments, income taxes, accounts receivable and allowance for doubtful accounts, inventories, property and equipment, deferred revenue, revenue recognition, stock based compensation, research and development costs, advertising, and shipping and handling costs. There have been no significant changes to these critical accounting policies for the three months ended June 30, 2012.

Non-GAAP Financial Measures

We have included in the discussion under the captions ***Three Months Ended June 30, 2012 Compared with Three Months Ended June 30, 2011*** and ***Six Months Ended June 30, 2012 Compared with Six Months Ended June 30, 2011*** above financial measures that were not

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prepared in accordance with GAAP. Any analysis of non-GAAP financial measures should made only in conjunction with results presented in accordance with GAAP. Below, we define these non-GAAP financial measures, provide reconciliations of the non-GAAP financial measures to the most directly comparable financial measure calculated in accordance with GAAP, and discuss the reasons that we believe this information is useful to management and may be useful to investors.

We use the non-GAAP financial measures adjusted gross margin on system sales, adjusted cost of equipment, and adjusted system sales. Management believes these non-GAAP financial measures provide our board of directors, investors, potential investors, securities analysts and others with useful information to evaluate our performance because they exclude the impact of unrecognized revenue and related deferral of cost of equipment resulting from our use of Extended Meaningful Use Installment Plans. Extended Meaningful Use Installment Plans are new to the Company for 2012, resulting in the Company not having sufficient experience with comparable arrangements to establish evidence of a standard business practice of historically collecting under the original payment terms of such contracts without making concessions. As a result, the provisions of the *Software* topic and *Revenue Recognition* subtopic of the Financial Accounting Standards Board Accounting Standards Codification result in a conclusion that the fee is not fixed or determinable and, as a result, the revenue is to be recognized as the amounts become due. Because the timing of our recognition of revenue under Extended Meaningful Use Installment Plans is not related to any remaining obligation on the part of the Company, the Company and our board of directors use these non-GAAP financial measures to evaluate our performance relative to other periods. We believe that the most directly comparable GAAP measures to adjusted gross margin on system sales, adjusted cost of equipment, and adjusted system sales are gross margin on system sales, cost of equipment, and system sales, respectively. Set forth below are reconciliations of adjusted gross margin on system sales, adjusted cost of equipment, and adjusted system sales to the comparable financial measures calculated in accordance with GAAP (dollar amounts in thousands):

Adjusted Gross Margin on System Sales

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Gross margin on system sales	$ 5,149	$ 10,064	$ 10,324	$ 13,550
Add: Unrecognized revenue accumulated related to Extended Meaningful Use Installment Plans	4,679		9,821	
Less: Revenue recognized related to Extended Meaningful Use Installment Plans				
Less: Deferred cost of equipment related to Extended Meaningful Use Installment Plans	(333)		(870)	
Add: Amortization of deferred cost of equipment related to Extended Meaningful Use Installment Plans	54		54	
Adjusted gross margin on system sales	9,549	10,064	19,329	13,550

Adjusted Cost of Equipment

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Cost of equipment	$ 1,748	$ 2,597	$ 3,547	$ 5,453
Add: Deferred cost of equipment related to Extended Meaningful Use Installment Plans	333		870	
Less: Amortization of deferred cost of equipment related to Extended Meaningful Use Installment Plans	(54)		(54)	
Adjusted cost of equipment	2,027	2,597	4,363	5,453

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Adjusted System Sales

	Three Months Ended		Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
System sales	$ 17,828	$ 23,593	$ 34,903	$ 39,200
Add: Unrecognized revenue accumulated related to Extended Meaningful Use Installment Plans	4,679		9,821	
Less: Revenue recognized related to Extended Meaningful Use Installment Plans				
Adjusted system sales	22,507	23,593	44,724	39,200

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Our exposure to market risk relates primarily to the potential change in the value of our investment portfolio as a result of fluctuations in interest rates. The primary purpose of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing risk of loss. As of June 30, 2012, our investment portfolio consisted of a variety of financial instruments, primarily including, but not limited to, money market securities and high quality government and corporate obligations. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We do not hold financial instruments for trading or other speculative purposes. The securities in our investment portfolio are classified as available-for-sale and, consequently, are recorded on our balance sheet at fair market value with their related unrealized gain or loss reflected as a component of accumulated other comprehensive income (loss) in stockholders equity.

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

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

The table that follows presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of June 30, 2012.

	Aggregate Fair Value	**Weighted Average Interest Rate**
Cash and Cash Equivalents:		
Cash and cash equivalents	$ 5,219,281	0.00%
Short-Term Investments: (1)		
Accrued income	$ 81,315	0.00%
Money market funds	2,102,733	0.17%
Obligations of the U.S. Treasury, U.S government corporations and agencies	2,581,622	0.59%
Corporate debt securities	2,987,197	3.77%
Total short-term investments	$ 7,752,867	

Long-Term Investments: (2)		
Obligations of the U.S. Treasury, U.S government corporations and agencies	$ 3,773,015	1.56%
Mortgage backed securities	99,067	1.63%
Corporate debt securities	5,959,601	2.90%
Total long-term investments	$ 9,831,683	

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

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As of June 30, 2012, the Company had no borrowings and, therefore, is not subject to interest rate risks related to debt instruments.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control over Financial Reporting

There were no changes in the Company s internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. Legal Proceedings.
From time to time, we are involved in routine litigation that arises in the ordinary course of business. We are not currently involved in any litigation that we believe could reasonably be expected to have a material adverse effect on our business, financial condition or results of operations.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
Not applicable.

Item 3. Defaults Upon Senior Securities.
Not applicable.

Item 4. Mine Safety Disclosures.
Not applicable.

Item 5. Other Information.
None.

Item 6. Exhibits.

3.1 Certificate of Incorporation (filed as Exhibit 3.4 to CPSI s Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)

3.2 Bylaws (filed as Exhibit 3.6 to CPSI s Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)

10.1 2012 Restricted Stock Plan for Non-Employee Directors (filed as Exhibit 10.1 to CPSI s Registration Statement on Form S-8 (Registration No. 333-181352) and incorporated herein by reference)

10.2	Form of Restricted Stock Award Agreement under the 2012 Restricted Stock Plan for Non-Employee Directors
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive Data Files for CPSI s Form 10-Q for the period ended June 30, 2012

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SIGNATURES

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

		COMPUTER PROGRAMS AND SYSTEMS, INC.
Date: August 7, 2012	By:	/s/ J. Boyd Douglas **J. Boyd Douglas** **President and Chief Executive Officer**
Date: August 7, 2012	By:	/s/ David A. Dye **David A. Dye** **Chief Financial Officer**

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