QUALITY SYSTEMS, INC
Form 10-Q
February 02, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended December 31, 2010

or

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

Commission file number: 001-12537

QUALITY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

California	**95-2888568**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*
18111 Von Karman Avenue, Suite 600, Irvine, California	**92612**
(Address of principal executive offices)	*(Zip Code)*

(949) 255-2600

(Registrant s telephone number, including area code)

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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of Common Stock, as of the latest practicable date.

28,977,036 shares of Common Stock, $0.01 par value, outstanding as of January 27, 2011

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For the Quarterly Period Ended December 31, 2010
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUALITY SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	December 31, 2010	March 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 118,221	$ 84,611
Restricted cash	2,956	2,339
Marketable securities		7,158
Accounts receivable, net	123,196	107,458
Inventories	1,942	1,340
Income taxes receivable		2,953
Deferred income taxes, net	5,470	5,678
Other current assets	7,356	8,684
Total current assets	259,141	220,221
Equipment and improvements, net	10,940	8,432
Capitalized software costs, net	14,931	11,546
Intangibles, net	17,720	20,145
Goodwill	46,189	46,189
Other assets	4,576	3,647
Total assets	$ 353,497	$ 310,180
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,525	$ 3,342
Deferred revenue	71,897	64,109
Accrued compensation and related benefits	9,322	8,951
Income taxes payable	1,157	
Dividends payable	8,693	8,664
Other current liabilities	20,955	16,220
Total current liabilities	117,549	101,286
Deferred revenue, net of current	870	474
Deferred income taxes, net	10,108	10,859
Deferred compensation	2,240	1,883

Other noncurrent liabilities	10,747	7,389
Total liabilities	141,514	121,891
Commitments and contingencies (Note 13)		
Shareholders equity:		
Common stock $0.01 par value; authorized 50,000 shares; issued and outstanding 28,976 and 28,879 shares at December 31, 2010 and March 31, 2010, respectively	290	289
Additional paid-in capital	128,964	122,271
Retained earnings	82,729	65,729
Total shareholders equity	211,983	188,289
Total liabilities and shareholders equity	$ 353,497	$ 310,180

The accompanying notes are an integral part of these consolidated financial statements.

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QUALITY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
Revenues:				
Software, hardware and supplies	$ 29,675	$ 24,346	$ 74,806	$ 64,978
Implementation and training services	4,262	3,313	13,069	10,150
System sales	33,937	27,659	87,875	75,128
Maintenance	27,908	22,139	80,973	65,254
Electronic data interchange services	10,360	8,897	30,266	25,855
Revenue cycle management and related services	11,496	9,602	33,443	27,482
Other services	8,170	6,665	23,698	19,579
Maintenance, EDI, RCM and other services	57,934	47,303	168,380	138,170
Total revenues	91,871	74,962	256,255	213,298
Cost of revenue:				
Software, hardware and supplies	5,667	2,810	16,575	9,251
Implementation and training services	3,677	2,898	10,142	9,075
Total cost of system sales	9,344	5,708	26,717	18,326
Maintenance	3,381	3,392	10,073	9,672
Electronic data interchange services	6,908	6,525	20,390	18,579
Revenue cycle management and related services	8,715	7,124	25,082	20,502
Other services	3,981	5,560	12,054	15,430
Total cost of maintenance, EDI, RCM and other services	22,985	22,601	67,599	64,183
Total cost of revenue	32,329	28,309	94,316	82,509

Gross profit	59,542	46,653	161,939	130,789
Operating expenses:				
Selling, general and administrative	27,958	21,574	79,025	61,728
Research and development costs	5,358	3,954	16,046	12,277
Amortization of acquired intangible assets	445	377	1,237	1,101
Total operating expenses	33,761	25,905	96,308	75,106
Income from operations	25,781	20,748	65,631	55,683
Interest income	55	43	244	180
Other income, net		136	59	194
Income before provision for income taxes	25,836	20,927	65,934	56,057
Provision for income taxes	8,305	7,775	22,881	20,739
Net income	$ 17,531	$ 13,152	$ 43,053	$ 35,318
Net income per share:				
Basic	$ 0.60	$ 0.46	$ 1.49	$ 1.24
Diluted	$ 0.60	$ 0.46	$ 1.48	$ 1.23
Weighted-average shares outstanding:				
Basic	28,978	28,667	28,936	28,586
Diluted	29,140	28,833	29,091	28,755
Dividends declared per common share	$ 0.30	$ 0.30	$ 0.90	$ 0.90

The accompanying notes are an integral part of these consolidated financial statements.

QUALITY SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended December 31,	
	2010	2009
Cash flows from operating activities:		
Net income	$ 43,053	$ 35,318
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,198	2,717
Amortization of capitalized software costs	5,264	4,326
Amortization of other intangibles	2,425	1,101
Provision for bad debts	2,901	2,753
Share-based compensation	2,713	1,448
Deferred income tax benefit	(543)	(1,831)
Tax benefit associated with stock options	463	1,166
Excess tax benefit from share-based compensation	(463)	(1,166)
Gain on disposal of equipment and improvements	(33)	
Changes in assets and liabilities, net of amounts acquired:		
Accounts receivable	(18,639)	(14,186)
Inventories	(602)	(308)
Income taxes receivable	2,953	2,488
Other current assets	169	(342)
Other assets	(929)	(1,425)
Accounts payable	2,183	(682)
Deferred revenue	8,184	7,996
Accrued compensation and related benefits	371	(2,257)
Income taxes payable	1,157	
Other current liabilities	4,735	2,645
Deferred compensation	357	59
Other noncurrent liabilities	1,388	
Net cash provided by operating activities	60,305	39,820
Cash flows from investing activities:		
Additions to capitalized software costs	(8,649)	(4,732)
Additions to equipment and improvements	(4,039)	(3,923)
Proceeds from disposal of equipment and improvements	336	
Proceeds from sale of marketable securities	7,700	
Purchase of NextGen IS		(300)
Payment of contingent consideration related to purchase of PMP		(2,700)

Net cash used in investing activities	(4,652)	(11,655)
Cash flows from financing activities:		
Excess tax benefit from share-based compensation	463	1,166
Proceeds from exercise of stock options	3,518	5,283
Dividends paid	(26,024)	(25,683)
Net cash used in financing activities	(22,043)	(19,234)
Net increase in cash and cash equivalents	33,610	8,931
Cash and cash equivalents at beginning of period	84,611	70,180
Cash and cash equivalents at end of period	$ 118,221	$ 79,111

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QUALITY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(In thousands)
(Unaudited)

	Nine Months Ended December 31, 2010		Nine Months Ended December 31, 2009	
Supplemental disclosures of cash flow information:				
Cash paid during the period for income taxes, net of refunds	$	18,857	$	18,782
Non-cash investing activities:				
Tenant improvement allowance received from landlord	$	1,970	$	
Issuance of stock options with fair value of $433 in connection with the acquisition of PMP	$		$	433
Effective August 12, 2009, the Company acquired NextGen IS in a transaction summarized as follows:				
Fair value of net assets acquired	$		$	1,453
Cash paid				(300)
Fair value of contingent consideration				(1,074)
Liabilities assumed	$		$	79

The accompanying notes are an integral part of these consolidated financial statements.

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QUALITY SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except shares and per share data)
(Unaudited)

1. Summary of Significant Accounting Policies

Principles of Consolidation. The consolidated financial statements include the accounts of Quality Systems, Inc. and its wholly-owned subsidiaries, which consists of NextGen Healthcare Information Systems (NextGen), Lackland Acquisition II, LLC dba Healthcare Strategic Initiatives (HSI), Practice Management Partners, Inc. (PMP), NextGen Inpatient Solutions, LLC (NextGen IS f/k/a Sphere), and Opus Healthcare Solutions, Inc. (Opus) (collectively, the Company). All intercompany accounts and transactions have been eliminated.

Business Segments. The Company has prepared operating segment information in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 280, *Segment Reporting,* or ASC 280, which requires that companies disclose operating segments based on the manner in which management disaggregates the Company s operations for making internal operating decisions. See Note 11.

Basis of Presentation. The accompanying unaudited consolidated financial statements as of December 31, 2010 and for the three and nine months ended December 31, 2010 and 2009, have been prepared in accordance with the requirements of Form 10-Q and Article 10 of Regulation S-X, and therefore do not include all information and notes which would be presented were such consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These consolidated financial statements should be read in conjunction with the audited consolidated financial statements presented in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2010. Amounts related to disclosures of March 31, 2010 balances within these interim consolidated financial statements were derived from the aforementioned Form 10-K. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments which are necessary for a fair presentation of the results of operations and cash flows for the periods presented. The results of operations for such interim periods are not necessarily indicative of results of operations to be expected for the full year.

Certain prior period amounts have been reclassified to conform with fiscal year 2011 presentation.

References to amounts in the consolidated financial statement sections are in thousands, except shares and per share data, unless otherwise specified.

Revenue Recognition. The Company recognizes revenue for system sales pursuant to FASB ASC Topic 985-605, *Software, Revenue Recognition*, or ASC 985-605. The Company generates revenue from the sale of licensing rights to its software products directly to end-users and value-added resellers, or VARs. The Company also generates revenue from sales of hardware and third-party software, implementation, training, electronic data interchange (EDI), post-contract support (maintenance), and other services, including revenue cycle management (RCM), performed for customers who license its products.

A typical system contract contains multiple elements of the above items. FASB ASC Topic 985-605-25, *Software, Revenue Recognition, Multiple Elements,* or ASC 985-605-25, requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on vendor-specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management having the relevant authority to do so, for an element not yet sold separately. VSOE calculations are updated and reviewed quarterly or annually depending on the nature of the product or service. The Company has established VSOE for the related undelivered elements based on the bell-shaped curve method. Maintenance VSOE for the Company s largest customers is based on stated renewal rates only if the rate is determined to be substantive and falls within the Company s customary pricing practices.

When evidence of fair value exists for the delivered and undelivered elements of a transaction, then discounts for individual elements are aggregated and the total discount is allocated to the individual elements in proportion to the elements fair value relative to the total contract fair value.

When evidence of fair value exists for the undelivered elements only, the residual method, provided for under ASC 985-605, is used. Under the residual method, the Company defers revenue related to the undelivered elements in a system sale based on VSOE of fair value of each of the undelivered elements, and allocates the remainder of the contract price net of all discounts to revenue recognized from the delivered elements. If VSOE of fair value of any undelivered element does not exist, all revenue is deferred until VSOE of fair value of the undelivered element is established or the element has been delivered.

The Company bills for the entire system sales contract amount upon contract execution except for maintenance which is billed separately. Amounts billed in excess of the amounts contractually due are recorded in accounts receivable as advance billings. Amounts are contractually due when services are performed or in accordance with contractually specified payment dates. Provided the fees are fixed or determinable and collection is considered probable, revenue from licensing rights and sales of hardware and third-party software is generally recognized upon physical or electronic shipment and transfer of title. In certain transactions where collections risk is high, the cash basis method is used to recognize revenue. If the fee is not fixed or determinable, then the revenue recognized in each period (subject to application of other revenue recognition criteria) will be the lesser of the aggregate of amounts due and payable or the amount of the arrangement fee that would have been

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recognized if the fees were being recognized using the residual method. Fees which are considered fixed or determinable at the inception of the Company s arrangements must include the following characteristics:

§ The fee must be negotiated at the outset of an arrangement, and generally be based on the specific volume of products to be delivered without being subject to change based on variable pricing mechanisms such as the number of units copied or distributed or the expected number of users.

§ Payment terms must not be considered extended. If a significant portion of the fee is due more than 12 months after delivery or after the expiration of the license, the fee is presumed not fixed or determinable.

Revenue from implementation and training services is recognized as the corresponding services are performed. Maintenance revenue is recognized ratably over the contractual maintenance period.

Contract accounting is applied where services include significant software modification, development or customization. In such instances, the arrangement fee is accounted for in accordance with FASB ASC Topic 605-35, *Revenue Recognition, Construction-Type and Production-Type Contracts,* or ASC 605-35. Pursuant to ASC 605-35, the Company uses the percentage of completion method provided all of the following conditions exist:

§ the contract includes provisions that clearly specify the enforceable rights regarding goods or services to be provided and received by the parties, the consideration to be exchanged, and the manner and terms of settlement;

§ the customer can be expected to satisfy its obligations under the contract;

§ the Company can be expected to perform its contractual obligations; and

§ reliable estimates of progress towards completion can be made.

The Company measures completion using labor input hours. Costs of providing services, including services accounted for in accordance with ASC 605-35, are expensed as incurred.

If a situation occurs in which a contract is so short term that the financial statements would not vary materially from using the percentage-of-completion method or in which the Company is unable to make reliable estimates of progress of completion of the contract, the completed contract method is utilized.

Product returns are estimated in accordance with FASB ASC Topic 605-15, *Revenue Recognition, Products,* or ASC 605-15. The Company also ensures that the other criteria in ASC 605-15 have been met prior to recognition of revenue:

§ the price is fixed or determinable;

§ the customer is obligated to pay and there are no contingencies surrounding the obligation or the payment;

§ the customer s obligation would not change in the event of theft or damage to the product;

§ the customer has economic substance;

§ the amount of returns can be reasonably estimated; and

§ the Company does not have significant obligations for future performance in order to bring about resale of the product by the customer.

The Company has historically offered short-term rights of return in certain sales arrangements. If the Company is able to estimate returns for these types of arrangements, revenue is recognized, net of an allowance for returns, and these arrangements are recorded in the consolidated financial statements. If the Company is unable to estimate returns for these types of arrangements, revenue is not recognized in the consolidated financial statements until the rights of return expire.

Revenue related to sales arrangements that include the right to use software stored on the Company s hardware is accounted for under FASB ASC Topic 985-605-05, *Software, Revenue Recognition*, *Hosting Arrangements,* or ASC

985-605-05, which requires that for software licenses and related implementation services to continue to fall under ASC 985-605-05, the customer must have the contractual right to take possession of the software without incurring a significant penalty and it must be feasible for the customer to either host the software themselves or through another third-party. If an arrangement is not deemed to be accounted for under ASC 985-605-05, the entire arrangement is accounted for as a service contract in accordance with ASC 985-605-25. In that instance, the entire arrangement would be recognized during the period that the hosting services are being performed.

From time to time, the Company offers future purchase discounts on its products and services as part of its sales arrangements. Pursuant to FASB ASC Topic 985-605-55, *Software, Revenue Recognition, Flowchart of Revenue Recognition on Software Arrangements*, or ASC 985-605-55, such discounts that are incremental to the range of discounts reflected in the pricing of the other elements of the arrangement, that are incremental to the range of discounts typically given in comparable transactions, and that are significant, are treated as an additional element of the contract to be deferred. Amounts deferred related to future purchase options are not recognized until either the customer exercises the discount offer or the offer expires.

RCM service revenue is derived from services fees, which include amounts charged for ongoing billing and other related services, and are generally billed to the customer as a percentage of total collections. The Company does not recognize revenue for services fees until these collections are made, as the services fees are not fixed or determinable until such time.

Revenue is divided into two categories, system sales and maintenance, EDI, RCM and other services. Revenue in the system sales category includes software license fees, third-party hardware and software, and implementation and training services related to purchase of the Company s software systems. Revenue in the maintenance, EDI, RCM and other services category includes maintenance, EDI, RCM services, follow on training and implementation services, annual third-party license fees, hosting services and other services revenue.

Cash and Cash Equivalents. Cash and cash equivalents generally consist of cash, money market funds and short-term U.S. Treasury securities with maturities of 90 days or less at the time of purchase. The money market fund in which the Company holds a portion of its cash invests in only investment grade money market instruments from a variety of industries, and therefore bears relatively low market risk. The average maturity of the investments owned by the money market fund is approximately two months.

Restricted Cash. Restricted cash consists of cash which is being held by HSI acting as agent for the disbursement of certain state social services programs. The Company records an offsetting Care Services liability (see also Note 3) when it initially receives such cash from the government social service programs and relieves both restricted cash and the Care Services liability when amounts are disbursed. HSI earns an administrative fee which is based on a percentage of funds disbursed on behalf of certain government social service programs.

Marketable Securities and ARS Put Option Rights. Marketable securities are recorded at fair value, based on quoted market rates or valuation analysis when appropriate.

Previously, the Company held investments in tax exempt municipal auction-rate securities (ARS), which were classified as either current or non-current marketable securities depending on the liquidity and timing of expected realization of such securities. The ARS were rated by one or more national rating agencies and had contractual terms of up to 30 years, but generally had interest rate reset dates that occurred every 7, 28 or 35 days. Despite the underlying long-term maturity of ARS, such securities were priced and subsequently traded as short-term investments because of the interest rate reset feature. If there were insufficient buyers, the auction is said to fail and the holders were unable to liquidate the investments through auction. A failed auction did not result in a default of the debt instrument. Under their respective terms, the securities continued to accrue interest and be auctioned until the auction succeeded, the issuer called the securities or the securities matured. In February 2008, the Company began to experience failed auctions on its ARS.

The Company s ARS were held by UBS Financial Services Inc. (UBS). On November 13, 2008, the Company entered into an Auction Rate Security Rights Agreement (the Rights Agreement) with UBS, whereby the Company accepted UBS s offer to purchase the Company s ARS investments at any time during the period of June 30, 2010 through July 2, 2012. As a result, the Company had obtained an asset, ARS put option rights, whereby the Company had a right to put the ARS back to UBS.

Prior to signing the Rights Agreement, the Company had asserted that it had the intent and ability to hold these securities until anticipated recovery and classified its ARS as held for sale securities. By accepting the Rights Agreement, the Company could no longer assert that it has the intent to hold the ARS until anticipated recovery and consequently elected to reclassify its investments in ARS as trading securities, as defined by FASB ASC Topic 320, *Investments Debt and Equity Securities,* or ASC 320, on the date of Company s acceptance of the Rights Agreement. As trading securities, the ARS were carried at fair value with changes recorded through earnings.

To determine the estimated fair values of the ARS, factors including credit quality, assumptions about the likelihood of redemption, observable market data such as yields or spreads of fixed rate municipal bonds and other trading instruments issued by the same or comparable issuers, were considered. The Company had valued the ARS as the approximate midpoint between various fair values, measured as the difference between the par value of the ARS and the fair value of the securities, discounted by the credit risk of the broker and other factors such as the Company s historical experience to sell ARS at par.

As the Company was permitted to put the ARS back to UBS at par value, the Company accounted for the ARS put option right as a separate asset that was measured at its fair value with changes recorded through earnings. The Company had valued the ARS put option right as the approximate midpoint between various fair values, measured as the difference between the par value of the ARS and the fair value of the securities, discounted by the credit risk of the broker and other factors such as the Company s historical experience to sell ARS at par.

On June 30, 2010, the earliest date allowable under the Rights Agreement, the Company exercised its ARS put option rights and put its ARS back to UBS. The ARS were sold and settled on July 1, 2010 at 100% of the $7,700 par value.

Allowance for Doubtful Accounts. The Company provides credit terms typically ranging from thirty days to less than twelve months for most system and maintenance contract sales and generally does not require collateral. The Company performs credit evaluations of its customers and maintains reserves for estimated credit losses. Reserves for potential credit losses are determined by establishing both specific and general reserves. Specific reserves are based on management s estimate of the probability of collection for certain troubled accounts. General reserves are established based on the Company s historical experience of bad debt expense and the aging of the Company s accounts receivable balances, net of deferred revenue and specifically reserved accounts. Accounts are written off as uncollectible only after the Company has expended extensive collection efforts.

Included in accounts receivable are amounts related to maintenance and services which were billed, but which had not yet been rendered as of the end of the period. Undelivered maintenance and services are included as a component of deferred revenue (see also Note 3).

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Software Development Costs. Development costs incurred in the research and development of new software products and enhancements to existing software products for external use are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional external software development costs are capitalized in accordance with FASB ASC Topic 985-20, *Software, Costs of Computer Software to be Sold, Leased or Marketed*, or ASC 985-20. Development costs associated with internal use software are expensed as incurred until certain capitalization criteria are met, as defined by FASB ASC Topic 350-40, *Intangibles Goodwill and Other Internal-Use Software*, or ASC 350-40, which defines which types of costs should be capitalized and provides guidance on determining whether software is for internal or external use.

Such capitalized costs are amortized on a straight-line basis over the estimated economic life of the related product, which is typically three years. The Company provides support services on the current and prior two versions of its software. Management performs an annual review of the estimated economic life and the recoverability of such capitalized software costs. If a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off.

Goodwill. Goodwill is related to NextGen and the HSI, PMP, NextGen IS, and Opus acquisitions, which closed on May 20, 2008, October 28, 2008, August 12, 2009, and February 10, 2010, respectively (see Notes 4 and 5). In accordance with FASB ASC Topic 350-20, *Intangibles Goodwill and Other, Goodwill*, or ASC 350-20, the Company tests goodwill for impairment annually at the end of its first fiscal quarter, referred to as the annual test date, and has determined that there was no impairment to its goodwill as of June 30, 2010. The Company will also test for impairment between annual test dates if an event occurs or circumstances change that would indicate the carrying amount may be impaired. Impairment testing for goodwill is performed at a reporting-unit level, which is defined as an operating segment or one level below and operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component constitutes a business for which discrete financial information is available and segment management regularly reviews the operating results of that component.

The Company has determined that NextGen, HSI, and PMP each qualify as a separate reporting unit while NextGen IS and Opus are aggregated as one reporting unit at which goodwill impairment testing is performed.

An impairment loss would generally be recognized when the carrying amount of the reporting unit s net assets exceeds the estimated fair value of the reporting unit. As of December 31, 2010, the Company has not identified any events or circumstances that would require an interim goodwill impairment test. See Note 5.

Intangible Assets. Intangible assets consist of capitalized software costs, customer relationships, trade names and certain intellectual property. Intangible assets related to customer relationships, trade names, and software technology arose in connection with the acquisition of HSI, PMP, NextGen IS, and Opus. These intangible assets were recorded at fair value and are stated net of accumulated amortization. Intangible assets are amortized over their remaining estimated useful lives, ranging from 3 to 9 years. The Company s amortization policy for intangible assets is based on the principles in FASB ASC Topic 350-30, *Intangibles Goodwill and Other, General Intangibles Other than Goodwill*, or ASC 350-30, which requires that the amortization of intangible assets reflect the pattern that the economic benefits of the intangible assets are consumed.

Income Taxes. The Company accounts for income taxes in accordance with FASB ASC Topic 740, *Income Taxes,* or ASC 740**.** Income taxes are provided based on current taxable income and the future tax consequences of temporary differences between the basis of assets and liabilities for financial and tax reporting. The deferred income tax assets and liabilities represent the future state and federal tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred income taxes are also recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. At each reporting period, management assesses the realizable value of deferred tax assets based on, among other things, estimates of future taxable income, and adjusts the related valuation allowance as necessary. Management makes a number of assumptions and estimates in determining the appropriate amount of expense to record for income taxes. These assumptions and estimates consider the taxing jurisdiction in which the Company operates as well as current tax regulations. Accruals are established for estimates of tax effects for certain transactions and future projected profitability of the Company s businesses based on management s interpretation of existing facts and circumstances.

Self-Insurance Liabilities. Effective January 1, 2010, the Company became self-insured with respect to healthcare claims, subject to stop-loss limits. The Company accrues for estimated self-insurance costs and uninsured exposures based on claims filed and an estimate of claims incurred but not reported as of each balance sheet date. However, it is possible that recorded accruals may not be adequate to cover the future payment of claims. Adjustments, if any, to estimated accruals resulting from ultimate claim payments will be reflected in earnings during the periods in which such adjustments are determined. Periodically, the Company reevaluates the adequacy of the accruals by comparing amounts accrued on the balance sheets for anticipated losses to an updated actuarial loss forecasts and third-party claim administrator loss estimates and makes adjustments to the accruals as needed. The self-insurance accrual is included in other current liabilities. If any of the factors that contribute to the overall cost of insurance claims were to change, the actual amount incurred for the self-insurance liabilities would be directly affected.

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Share-Based Compensation. FASB ASC Topic 718 *Compensation Stock Compensation,* or ASC 718, requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. Expected term is estimated using historical exercise experience. Volatility is estimated by using the weighted-average historical volatility of the Company s Common Stock, which approximates expected volatility. The risk free rate is the implied yield available on the U.S Treasury zero-coupon issues with remaining terms equal to the expected term. The expected dividend yield is the average dividend rate during a period equal to the expected term of the option. Those inputs are then entered into the Black Scholes model to determine the estimated fair value. The value of the portion of the award that is ultimately expected to vest is recognized ratably as expense over the requisite service period in the Company s consolidated statements of income.

Share-based compensation is adjusted on a quarterly basis for changes to estimated forfeitures based on a review of historical forfeiture activity. To the extent that actual forfeitures differ, or are expected to differ, from the estimate, share-based compensation expense is adjusted accordingly. The effect of the forfeiture adjustments for the three and nine months ended December 31, 2010 and 2009 was not significant.

The following table shows total share-based compensation expense included in the consolidated statements of income for the three and nine months ended December 31, 2010 and 2009.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
Costs and expenses:				
Cost of revenue	$ 70	$ 18	$ 207	$ 45
Research and development costs	41	26	113	63
Selling, general and administrative	738	85	2,393	1,340
Total share-based compensation	849	129	2,713	1,448
Amounts capitalized in software development costs		(1)	(2)	(26)
Amounts charged against earnings, before income tax benefit	$ 849	$ 128	$ 2,711	$ 1,422
Related income tax benefit	(304)	(48)	(967)	(526)
Decrease in net income	$ 545	$ 80	$ 1,744	$ 896

Recently Adopted Accounting Standards

In January 2010, the FASB issued Accounting Standards Update, or ASU, 2010-06, *Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements,* or ASU 2010-06, to require additional disclosures about recurring or nonrecurring fair value measurements, including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. The standard also clarifies existing disclosures about the level of disaggregation, valuation techniques and inputs to fair value measurements. The provisions of ASU 2010-06 are effective for interim and annual reporting periods beginning after December 15, 2009, except for the Level 3 reconciliation disclosures that are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted the provisions of ASU 2010-06 regarding

Level 1 and Level 2 fair value measurements during the quarter ended June 30, 2010. As the Company did not have any transfers between Level 1 and Level 2 fair value measurement, the adoption of this standard did not have a material effect on the Company s consolidated financial statements. The Company does not expect the future adoption of the provisions for Level 3 reconciliation to have a significant impact on its consolidated financial statements.

Recently Issued Accounting Standards

In September 2009, the FASB reached a consensus on ASU 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements*, or ASU 2009-13, and ASU 2009-14, *Software (Topic 985) Certain Revenue Arrangements That Include Software Elements,* or ASU 2009-14. ASU 2009-13 modifies the requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. ASU 2009-13 eliminates the requirement that all undelivered elements must have either: (a) VSOE or (b) third-party evidence, or TPE, before an entity can recognize the portion of an overall arrangement consideration that is attributable to items that already have been delivered. In the absence of VSOE or TPE of the standalone selling price for one or more delivered or undelivered elements in a multiple-element arrangement, entities will be required to estimate the selling prices of those elements. Overall arrangement consideration will be allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by VSOE or TPE or are based on the entity s estimated selling price. The residual method of allocating arrangement consideration has been eliminated. ASU 2009-14 modifies the software revenue recognition guidance to exclude from its scope tangible products that contain both software and non-software components that function together to deliver a product s essential functionality. Because the Company s software arrangements will continue to follow ASC 985-605, the elimination of the residual method under ASU 2009-14 does not apply to these software arrangements. These new updates are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company does not expect the future adoption of these ASUs to have a significant impact on its consolidated financial statements.

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2. Fair Value Measurements

The Company applies ASC 820 with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company s consolidated financial statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. As defined by ASC 820, 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 on the measurement date. The Company estimates fair value utilizing market data or assumptions that market participants would use in pricing the asset or liability in a current transaction, including assumptions about risk and the risks inherent in the inputs to the valuation technique. ASC 820 prioritizes the inputs used in measuring fair value into the following hierarchy (with Level 1 as the highest priority):

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

Level 2 Observable inputs other than those included in Level 1 (for example, quoted prices for similar assets in active markets or quoted prices for identical assets in inactive markets); and

Level 3 Unobservable inputs reflecting management s own assumptions about the inputs used in estimating the value of the asset.

Recurring Fair Value Measurements

The fair value hierarchy requires the use of observable market data when available. The financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The following tables sets forth by level within the fair value hierarchy the Company s financial assets and liabilities that were accounted for at fair value on a recurring basis at December 31, 2010 and March 31, 2010:

	Balance at December 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 118,221	$ 118,221	$	$
Restricted cash	2,956	2,956		
	$ 121,177	$ 121,177	$	$

	Balance at March 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 84,611	$ 84,611	$	$

Restricted cash	2,339	2,339		
Marketable securities (1)	7,158			7,158
ARS put option rights (2)	548			548
	$ 94,656	$ 86,950	$	$ 7,706

(1) Marketable securities consist of ARS.

(2) ARS put option rights are included in other current assets.

On June 30, 2010, the earliest date allowable under the Rights Agreement, the Company exercised its ARS put option rights and put its ARS back to UBS, resulting in a net loss of $6, which is included in other income for the nine months ended December 31, 2010. The ARS were sold and settled on July 1, 2010 at 100% of the $7,700 par value. The Company recorded interest of $83 from the ARS for the nine months ended December 31, 2010. The Company has no outstanding ARS or ARS put option rights at December 31, 2010.

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The following table presents activity in the Company s financial assets measured at fair value using significant unobservable inputs (Level 3), as defined by ASC 820, as of and for the nine months ended December 31, 2010:

Balance at March 31, 2010	$ 7,706
Transfer in/(out) of Level 3	
Proceeds from sale (at par)	(7,700)
Recognized loss	(6)
Balance at December 31, 2010	$

The Company s contingent consideration liability is accounted for at fair value on a recurring basis and is adjusted to fair value when the carrying value differs from fair value. The categorization of the framework used to measure fair value of the contingent consideration liability is considered Level 3 due to the subjective nature of the unobservable inputs used. During the nine months ended December 31, 2010, the Company recorded a fair value adjustment of $1,059 to the contingent consideration liability of which $886 was related to the acquisition of Opus and $173 was related to the acquisition of NextGen IS. The fair value measurement for the contingent consideration liability was estimated based on the probability of Opus and NextGen IS achieving certain revenue, EBITDA and strategic goal targets and business milestones.

Non-Recurring Fair Value Measurements

The Company has certain assets, including equipment and improvements, goodwill, and other intangible assets, which are measured at fair value on a non-recurring basis and are adjusted to fair value only if an impairment charge is recognized. The categorization of the framework used to measure fair value of the assets is considered Level 3 due to the subjective nature of the unobservable inputs used. During the nine months ended December 31, 2010, there were no adjustments to fair value of such assets.

Fair Value of Financial Instruments

The estimated fair value of financial instruments is determined using the best available market information and appropriate valuation methodologies. However, considerable judgment is necessary in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market exchange, or the value that ultimately will be realized upon maturity or disposition. The use of different market assumptions may have a material effect on the estimated fair value amounts. The Company s financial instruments, other than those presented in the disclosures above, include cash and cash equivalents, accounts receivables, accounts payable, and accrued liabilities. The carrying value of these assets and liabilities approximates fair value because of the short-term nature of these instruments.

3. Composition of Certain Financial Statement Captions

Accounts receivable include amounts related to maintenance and services that were billed but not yet rendered at each period end. Undelivered maintenance and services are included as a component of the deferred revenue balance.

	December 31, 2010	March 31, 2010
Accounts receivable, excluding undelivered software, maintenance and services	$ 89,039	$ 72,500
Undelivered software, maintenance and implementation services billed in advance, included in deferred revenue	40,542	39,447
Accounts receivable, gross	129,581	111,947
Allowance for doubtful accounts	(6,385)	(4,489)

Accounts receivable, net	$ 123,196	$ 107,458

Inventories are summarized as follows:

	December 31, 2010	March 31, 2010
Computer systems and components, net of reserve for obsolescence of $237	$ 1,931	$ 1,322
Miscellaneous parts and supplies	11	18
Inventories	$ 1,942	$ 1,340

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Equipment and improvements are summarized as follows:

	December 31, 2010	March 31, 2010
Computer and electronic test equipment	$ 22,041	$ 18,599
Furniture and fixtures	5,353	5,136
Leasehold improvements	3,720	1,969
	31,114	25,704
Accumulated depreciation and amortization	(20,174)	(17,272)
Equipment and improvements, net	$ 10,940	$ 8,432

Current and non-current deferred revenue are summarized as follows:

	December 31, 2010	March 31, 2010
Maintenance	$ 12,230	$ 13,242
Implementation services	47,458	38,137
Annual license services	9,067	8,214
Undelivered software and other	3,142	4,516
Deferred revenue	$ 71,897	$ 64,109
Deferred revenue, net of current	$ 870	$ 474

Accrued compensation and related benefits are summarized as follows:

	December 31, 2010	March 31, 2010
Payroll, bonus and commission	$ 4,223	$ 4,185
Vacation	5,099	4,766
Accrued compensation and related benefits	$ 9,322	$ 8,951

Other current liabilities are summarized as follows:

	December 31, 2010	March 31, 2010
Contingent consideration related to acquisition	$ 4,909	$ 5,275
Care services liabilities	2,955	2,336

Users Group Meeting (UGM) accrual	2,559	
Accrued EDI expense	2,330	2,000
Accrued royalties	1,149	926
Customer deposits	1,102	1,036
Professional services	756	391
Sales tax payable	646	506
Outside commission payable	549	468
Self insurance reserve	374	516
Deferred rent	298	641
Other accrued expenses	3,328	2,125
Other current liabilities	$ 20,955	$ 16,220

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4. Business Combinations

On February 10, 2010, the Company acquired Opus, a provider of clinical information systems to the small hospital inpatient market, and on August 12, 2009, the Company acquired NextGen IS, a provider of financial information systems to the small hospital inpatient market.

During the nine months ended December 31, 2010, the Company recorded a fair value adjustment of $1,059 to the contingent consideration liability of which $886 was related to the acquisition of Opus and $173 was related to the acquisition of NextGen IS. The fair value of the contingent consideration liability was estimated based on the probability of Opus and NextGen IS achieving certain revenue, EBITDA and strategic goal targets and business milestones.

The Company accounted for these acquisitions as a purchase business combination as defined in FASB ASC Topic 805, *Business Combinations*, or ASC 805. Under the acquisition method of accounting, the purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. The fair value of the assets acquired and liabilities assumed represent management s estimate of fair value. For additional disclosures regarding the Opus and NextGen IS acquisitions, refer to Note 5, Business Combinations, in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

5. Goodwill

In accordance with ASC 350-20, the Company does not amortize goodwill as the goodwill has been determined to have an indefinite useful life.

Goodwill consists of the following:

	December 31, 2010	March 31, 2010
NextGen Division		
Opus Healthcare Solutions, Inc.	$ 13,005	$ 13,005
NextGen Inpatient Solutions, LLC	1,020	1,020
NextGen Healthcare Information Systems, Inc.	1,840	1,840
Total NextGen Division goodwill	15,865	15,865
Practice Solutions Division		
Practice Management Partners, Inc.	19,485	19,485
Healthcare Strategic Initiatives	10,839	10,839
Total Practice Solutions Division goodwill	30,324	30,324
Total goodwill	$ 46,189	$ 46,189

6. Intangible Assets

The Company s intangible assets, other than capitalized software development costs, with determinable lives are summarized as follows:

	December 31, 2010			
	Customer Relationships	Trade Name	Software Technology	Total
Gross carrying amount	$ 10,206	$ 637	$ 12,119	$ 22,962
Accumulated amortization	(3,474)	(389)	(1,379)	(5,242)

Net intangible assets	$ 6,732	$ 248	$ 10,740	$ 17,720

	March 31, 2010			
	Customer Relationships	Trade Name	Software Technology	Total
Gross carrying amount	$ 10,206	$ 637	$ 12,119	$ 22,962
Accumulated amortization	(2,357)	(269)	(191)	(2,817)
Net intangible assets	$ 7,849	$ 368	$ 11,928	$ 20,145

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Activity related to the intangible assets for the nine months ended December 31, 2010 is as follows:

	Customer Relationships	Trade Name	Software Technology	Total
Balance as of April 1, 2010	$ 7,849	$ 368	$ 11,928	$ 20,145
Amortization (1)	(1,117)	(120)	(1,188)	(2,425)
Balance as of December 31, 2010	$ 6,732	$ 248	$ 10,740	$ 17,720

	Customer Relationships	Trade Name	Software Technology	Total
Balance as of April 1, 2009	$ 7,877	$ 526	$	$ 8,403
Acquisition	156		119	275
Amortization (1)	(968)	(119)	(14)	(1,101)
Balance as of December 31, 2009	$ 7,065	$ 407	$ 105	$ 7,577

(1) Amortization of the customer relationships and trade name intangible assets is included in operating expenses and amortization of the software technology intangible assets is included in cost of revenue for software, hardware and supplies.

The following table represents the remaining estimated amortization of intangible assets with determinable lives as of December 31, 2010:

For the year ended March 31,	
2011 (remaining three months)	$ 830
2012	3,320
2013	3,184
2014	3,055
2015 and beyond	7,331
Total	$ 17,720

7. Capitalized Software Costs

The Company s capitalized software development costs are summarized as follows:

	December 31, 2010	March 31, 2010
Gross carrying amount	$ 50,078	$ 41,429
Accumulated amortization	(35,147)	(29,883)

Net capitalized software costs	$ 14,931	$ 11,546

Activity related to net capitalized software costs for the nine months ended December 31, 2010 is as follows:

	Nine Months Ended December 31,	
	2010	2009
Beginning of the period	$ 11,546	$ 9,552
Capitalized	8,649	4,732
Amortization	(5,264)	(4,326)
End of the period	$ 14,931	$ 9,958

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The following table represents the remaining estimated amortization of capitalized software costs as of December 31, 2010:

For the year ended March 31,	
2011 (remaining three months)	$ 1,909
2012	6,547
2013	4,599
2014	1,876
Total	$ 14,931

8. Share-Based Awards

Employee Stock Option Plans

In September 1998, the Company s shareholders approved a stock option plan (the 1998 Plan) under which 4,000,000 shares of Common Stock were reserved for the issuance of options. The 1998 Plan provides that employees, directors and consultants of the Company may, at the discretion of the Board of Directors or a duly designated compensation committee, be granted options to purchase shares of Common Stock. The exercise price of each option granted was determined by the Board of Directors at the date of grant, and options under the 1998 Plan expire no later than ten years from the grant date. Options granted will generally become exercisable in accordance with the terms of the agreement pursuant to which they were granted. Certain option grants to directors became exercisable three months from the date of grant. Upon an acquisition of the Company by merger or asset sale, each outstanding option may be subject to accelerated vesting under certain circumstances. The 1998 Plan terminated on December 31, 2007. As of December 31, 2010, there were 267,953 outstanding options related to this Plan.

In October 2005, the Company s shareholders approved a stock option and incentive plan (the 2005 Plan) under which 2,400,000 shares of Common Stock were reserved for the issuance of awards, including stock options, incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock, unrestricted stock, restricted stock units, performance shares, performance units (including performance options) and other share-based awards. The 2005 Plan provides that employees, directors and consultants of the Company may, at the discretion of the Board of Directors or a duly designated compensation committee, be granted awards to acquire shares of Common Stock. The exercise price of each option award shall be determined by the Board of Directors at the date of grant in accordance with the terms of the 2005 Plan, and under the 2005 Plan awards expire no later than ten years from the grant date. Options granted will generally become exercisable in accordance with the terms of the agreement pursuant to which they were granted. Upon an acquisition of the Company by merger or asset sale, each outstanding option may be subject to accelerated vesting under certain circumstances. The 2005 Plan terminates on May 25, 2015, unless terminated earlier by the Board of Directors. As of December 31, 2010, there were 488,894 outstanding options and 1,786,624 shares available for future grant related to this Plan.

Activity of all stock option plans during the nine months ended December 31, 2010 is as follows:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, April 1, 2010	871,963	$43.15	4.5	$ 15,945
Granted	55,000	$58.29	7.5	
Exercised	(95,645)	$36.78	2.2	$ 3,160
Forfeited/Canceled	(74,471)	$55.01	6.1	

Outstanding, December 31, 2010	756,847	$43.90	4.0	$19,621
Vested and expected to vest, December 31, 2010	747,639	$43.82	4.0	$19,440
Exercisable, December 31, 2010	327,830	$35.62	2.3	$11,210

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The Company utilized the Black-Scholes valuation model for estimating the fair value of share-based compensation after the adoption of ASC 718 with the following assumptions:

	Nine Months Ended December 31, 2010	Nine Months Ended December 31, 2009
Expected life	4.2 years	4.4 years
Expected volatility	42.6% - 44.7%	45.9% - 48.7%
Expected dividends	1.9% - 2.2%	1.9% - 2.3%
Risk-free rate	1.5% - 2.1%	2.2% - 2.5%

The weighted-average grant date fair value of stock options granted during the nine months ended December 31, 2010 was $18.48 per share. The expected dividend yield is the average dividend rate during a period equal to the expected life of the option.

During the nine months ended December 31, 2010 and 2009, 55,000 and 168,425 options were granted, respectively, under the 2005 Plan. The Company issues new shares to satisfy option exercises. Based on historical experience of option cancellations, the Company has estimated an annualized forfeiture rate of 2.8% for employee options and 0.0% for director options. Forfeiture rates will be adjusted over the requisite service period when actual forfeitures differ, or are expected to differ, from the estimate.

On November 29, 2010, the Board of Directors granted a total of 10,000 options under the Company s 2005 Plan to a selected employee at an exercise price equal to the market price of the Company s Common Stock on the date of grant ($64.32 per share). The options vest in five equal annual installments beginning November 29, 2011 and expire on November 29, 2018.

On August 3, 2010, the Board of Directors granted a total of 5,000 options under the Company s 2005 Plan to a selected employee at an exercise price equal to the market price of the Company s Common Stock on the date of grant ($55.24 per share). The options vest in five equal annual installments beginning August 3, 2011 and expire on August 3, 2018.

On June 4, 2010, the Board of Directors granted a total of 25,000 options under the Company s 2005 Plan to selected employees at an exercise price equal to the market price of the Company s Common Stock on the date of grant ($56.29 per share). The options vest in five equal annual installments beginning June 4, 2011 and expire on June 4, 2018.

On June 2, 2010, the Board of Directors granted a total of 15,000 options under the Company s 2005 Plan to a selected employee at an exercise price equal to the market price of the Company s Common Stock on the date of grant ($58.62 per share). The options vest in five equal annual installments beginning June 2, 2011 and expire on June 2, 2018.

Performance-Based Awards

On May 26, 2010, the Board of Directors approved its fiscal 2011 equity incentive program for certain employees to be awarded options to purchase the Company s Common Stock. The maximum number of options available under the equity incentive program plan is 280,000, of which 115,000 are reserved for the Company s Named Executive Officers and 165,000 for non-executive employees of the Company. Under the program, executives are eligible to receive options based on meeting certain target increases in earnings per share performance and revenue growth during fiscal year 2011. Under the program, the non-executive employees are eligible to receive options based on satisfying certain management established criteria and recommendations of senior management. The options shall be issued pursuant to one of the Company s shareholder approved option plans, have an exercise price equal to the closing price of the Company s shares on the date of grant, a term of eight years, and vesting in five equal annual installments commencing one year following the date of grant.

Compensation expense associated with the performance based awards under the Company s 2011 incentive plan are initially based on the number of options expected to vest after assessing the probability that certain performance criteria will be met. Cumulative adjustments are recorded quarterly to reflect subsequent changes in the estimated outcome of performance-related conditions. The Company utilized the Black-Scholes option valuation model and recorded stock compensation expense related to the performance based awards of approximately $377 during the nine months ended December 31, 2010 using the following assumptions:

	Nine Months Ended December 31, 2010
Expected life	4.2 years
Expected volatility	42.5%
Expected dividends	1.7%
Risk-free rate	2.0%

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Non-vested stock option award activity, including employee stock options and performance-based awards, for the nine months ended December 31, 2010, is summarized as follows:

	Non-Vested Number of Shares	Weighted-Average Grant-Date Fair Value per Share
Outstanding, April 1, 2010	610,836	$15.26
Granted	55,000	$18.48
Vested	(162,348)	$12.18
Forfeited/Canceled	(74,471)	$18.82
Outstanding, December 31, 2010	429,017	$16.21

As of December 31, 2010, $5,256 of total unrecognized compensation costs related to stock options is expected to be recognized over a weighted-average period of 5.3 years. This amount does not include the cost of new options that may be granted in future periods or any changes in the Company s forfeiture percentage. The total fair value of options vested during the nine months ended December 31, 2010 and 2009 was $1,017 and $1,673, respectively.

Restricted Stock Units

On May 27, 2009, the Board of Directors approved its Outside Director Compensation Plan, whereby each non-employee Director is to be awarded shares of restricted stock units upon election or re-election to the Board. The restricted stock units are awarded under the 2005 Plan. Such restricted stock units vest in two equal, annual installments on the first and second anniversaries of the grant date and are nontransferable for one year following vesting. Upon each vesting of the award, one share of Common Stock shall be issued for each restricted stock unit. The weighted-average grant date fair value of $54.26 for the restricted stock units was estimated using the market price of its Common Stock on the date of grant. The fair value of these restricted stock units is amortized on a straight-line basis over the vesting period.

As of December 31, 2010, 17,146 restricted stock units were issued and approximately $324 of compensation expense was recorded under this Plan during the nine months ended December 31, 2010. Restricted stock units award activity for the nine months ended December 31, 2010, is summarized as follows:

	Number of Shares	Weighted-Average Grant-Date Fair Value per Share
Outstanding, April 1, 2010	8,000	$53.86
Granted	9,146	$54.62
Vested	(5,698)	$54.43
Outstanding, December 31, 2010	11,448	$54.18

As of December 31, 2010, $470 of total unrecognized compensation costs related to restricted stock units is expected to be recognized over a weighted-average period of 1.3 years. This amount does not include the cost of new restricted stock units that may be granted in future periods.

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9. Income Taxes

The provision for income taxes for the nine months ended December 31, 2010 was approximately $22,881 as compared to approximately $20,739 for the year ago period. The effective tax rates for the nine months ended December 31, 2010 and 2009 were 34.7% and 37.0%, respectively. The provision for income taxes for the nine months ended December 31, 2010 differs from the combined statutory rates primarily due to the impact of varying state income tax rates, tax-exempt interest income, and the qualified production activities deduction. The effective rate for the nine months ended December 31, 2010 decreased as compared to the prior year period primarily due to fluctuations in the state effective tax rate and increased benefits from the qualified production activities deduction. The effective rate also decreased as compared to the prior year period because of a discrete benefit of $1.0 million, resulting from a catch-up adjustment due to the extension of the federal research and development tax credit, which was retroactive to the initial expiration date of December 31, 2009.

Uncertain tax positions

As of December 31, 2010, the Company has provided a liability of $659 for unrecognized tax benefits related to various federal and state income tax matters. If recognized, $659 would impact the Company s effective tax rate. The reserve for the nine months ended December 31, 2010 increased from the year ago period by $602 due to the addition of prior year tax positions of acquired companies.

The Company s income tax returns filed for tax years 2007 through 2010 and 2006 through 2010 are subject to examination by the federal and state taxing authorities, respectively. The Company is currently not under examination by the Internal Revenue Service or any state income tax authority. The Company does not anticipate that total unrecognized tax benefits will significantly change due to the settlement of audits or the expiration of statute of limitations within the next twelve months.

10. Earnings Per Share

Basic net income per share is based upon the weighted-average shares of Common Stock outstanding. Diluted net income per share is based on the assumption that the Company s outstanding options are included in the calculation of diluted earnings per share, except when their effect would be anti-dilutive. Dilution is computed by applying the treasury stock method. Under this method, options are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase Common Stock at the average market price during the period. The following table reconciles the weighted-average shares outstanding for basic and diluted net income per share for the periods indicated (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
Net income	$ 17,531	$ 13,152	$ 43,053	$ 35,318
Basic net income per share:				
Weighted-average shares outstanding Basic	28,978	28,667	28,936	28,586
Basic net income per common share	$ 0.60	$ 0.46	$ 1.49	$ 1.24
Net income	$ 17,531	$ 13,152	$ 43,053	$ 35,318
Diluted net income per share:				
Weighted-average shares outstanding Basic	28,978	28,667	28,936	28,586
Effect of potentially dilutive securities	162	166	155	169

Weighted-average shares outstanding	Diluted	29,140	28,833	29,091	28,755
Diluted net income per common share		$ 0.60	$ 0.46	$ 1.48	$ 1.23

The computation of diluted net income per share does not include 277,000 and 263,000 options for the three and nine months ended December 31, 2010, respectively, because their inclusion would have an anti-dilutive effect on net income per share.

The computation of diluted net income per share does not include 168,000 options for both the three and nine months ended December 31, 2009, because their inclusion would have an anti-dilutive effect on net income per share.

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11. Operating Segment Information

The Company has prepared operating segment information in accordance with ASC 280 to report components that are evaluated regularly by its chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

As a result of certain organizational changes during fiscal year 2010, the composition of the Company s NextGen Division was revised to exclude the former NextGen Practice Solutions unit and the Company s RCM entities (HSI and PMP), both of which are now administered and aggregated in the Company s Practice Solutions Division. Following the reorganization, the Company operates three reportable operating segments (not including Corporate), comprised of the NextGen Division, the QSI Dental Division and the Practice Solutions Division.

Prior period segment results were revised to reflect this reorganization for the Company s NextGen Division and Practice Solution Division. The results of operations related to the HSI and PMP acquisitions are included in the Practice Solutions Division. The results of operations related to the Opus and NextGen IS acquisitions are included in the NextGen Division.

The QSI Dental Division, co-located with the Company s corporate headquarters in Irvine, California, currently focuses on developing, marketing and supporting software suites sold to dental and certain niche medical practices. In addition, the Division supports a number of medical clients that utilize the Division s UNIX® based medical practice management software product.

The NextGen Division, with headquarters in Horsham, Pennsylvania, and significant locations in Atlanta, Georgia and Austin, Texas, focuses principally on developing and marketing products and services for medical practices.

The Practice Solutions Division, with locations in St. Louis, Missouri and Hunt Valley, Maryland, focuses primarily on providing physician practices with RCM services, primarily billing and collection services for medical practices. This Division combines a Web-delivered SaaS model and the NextGen^{epm} software platform to execute its service offerings.

The three Divisions operate largely as stand-alone operations, with each Division maintaining its own distinct product lines, product platforms, development, implementation and support teams, sales staffing and branding. The three Divisions share the resources of the Company s corporate office which includes a variety of accounting and other administrative functions. Additionally, there are a small but growing number of clients who are simultaneously utilizing software or services from more than one of its three Divisions.

The accounting policies of the Company s operating segments are the same as those described in Note 1, Summary of Significant Accounting Policies, of our notes to consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q, except that the disaggregated financial results of the segments reflect allocation of certain functional expense categories consistent with the basis and manner in which Company management internally disaggregates financial information for the purpose of assisting in making internal operating decisions. Certain corporate overhead costs, such as executive and accounting department personnel-related expenses, are not allocated to the individual segments by management.

Operating segment data is as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
Revenue:				
QSI Dental Division	$ 4,321	$ 4,368	$ 14,319	$ 12,474
NextGen Division	75,055	59,365	205,643	168,122
Practice Solutions Division	12,495	11,229	36,293	32,702
Consolidated revenue	$ 91,871	$ 74,962	$ 256,255	$ 213,298

Operating income:				
QSI Dental Division	$ 797	$ 916	$ 3,355	$ 2,481
NextGen Division	30,533	23,774	77,267	63,413
Practice Solutions Division	1,294	765	2,758	2,302
Unallocated corporate expense	(6,843)	(4,707)	(17,749)	(12,513)
Consolidated operating income	$ 25,781	$ 20,748	$ 65,631	$ 55,683

Management evaluates performance based on stand-alone segment operating income. Because the Company does not evaluate performance based on return on assets at the operating segment level, assets are not tracked internally by segment. Therefore, segment asset information is not presented.

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All of the recorded goodwill at December 31, 2010 relates to the Company s NextGen Division and Practice Solutions Division. As a result of the reorganization discussed above, the goodwill relating to the fiscal year 2009 acquisitions of HSI and PMP is now recorded in the Practice Solutions Division. The goodwill relating to the acquisitions of Opus and NextGen IS is recorded in the NextGen Division.

12. Concentration of Credit Risk

The Company had cash deposits at U.S. banks and financial institutions which exceeded federally insured limits at December 31, 2010. The Company is exposed to credit loss for amounts in excess of insured limits in the event of non-performance by the institutions; however, the Company does not anticipate non-performance by these institutions.

13. Commitments, Guarantees and Contingencies

Commitments and Guarantees

Software license agreements in both the QSI and NextGen Divisions include a performance guarantee that the Company s software products will substantially operate as described in the applicable program documentation for a period of 365 days after delivery. To date, the Company has not incurred any significant costs associated with its performance guarantee or other related warranties and does not expect to incur significant warranty costs in the future. Therefore, no accrual has been made for potential costs associated with these warranties. Certain arrangements also include performance guarantees related to response time, availability for operational use, and other performance-related guarantees. Certain arrangements also include penalties in the form of maintenance credits should the performance of the software fail to meet the performance guarantees. To date, the Company has not incurred any significant costs associated with these warranties and does not expect to incur significant warranty costs in the future. Therefore, no accrual has been made for potential costs associated with these warranties.

The Company has historically offered short-term rights of return in certain sales arrangements. If the Company is able to estimate returns for these types of arrangements and all other criteria for revenue recognition have been met, revenue is recognized and these arrangements are recorded in the consolidated financial statements. If the Company is unable to estimate returns for these types of arrangements, revenue is not recognized in the consolidated financial statements until the rights of return expire, provided also, that all other criteria of revenue recognition have been met.

The Company s standard sales agreements in the NextGen Division contain an indemnification provision pursuant to which it shall indemnify, hold harmless, and reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with any United States patent, any copyright or other intellectual property infringement claim by any third-party with respect to its software. The QSI Dental Division arrangements occasionally utilize this type of language as well. As the Company has not incurred any significant costs to defend lawsuits or settle claims related to these indemnification agreements, the Company believes that its estimated exposure on these agreements is currently minimal. Accordingly, the Company has no liabilities recorded for these indemnification obligations.

The Company has entered into marketing assistance agreements with existing users of the Company s products which provide the opportunity for those users to earn commissions if they host specific site visits upon the Company s request for prospective customers that directly result in a purchase of the Company s software by the visiting prospects. Amounts earned by existing users under this program are treated as a selling expense in the period when earned.

Litigation

The Company has experienced legal claims by parties asserting that it has infringed their intellectual property rights. The Company believes that these claims are without merit and intends to defend against them vigorously; however, the Company could incur substantial costs and diversion of management resources defending any infringement claim even if it is ultimately successful in the defense of such matter. Litigation is inherently uncertain and always difficult to predict. The Company refers you to the discussion of infringement and litigation risks in the Item 1A. Risk Factors section of the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

14. Subsequent Events

On January 26, 2011, the Board of Directors approved a quarterly cash dividend of $0.35 per share on the Company s outstanding shares of Common Stock, payable to shareholders of record as of March 17, 2011 with an expected distribution date on or about April 5, 2011.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for the historical information contained herein, the matters discussed in this management s discussion and analysis of financial condition and results of operations, or MD&A, including discussions of our product development plans, business strategies and market factors influencing our results, may include forward-looking statements that involve certain risks and uncertainties. Actual results may differ from those anticipated by us as a result of various factors, both foreseen and unforeseen, including, but not limited to, our ability to continue to develop new products and increase systems sales in markets characterized by rapid technological evolution, consolidation, and competition from larger, better-capitalized competitors. Many other economic, competitive, governmental and technological factors could affect our ability to achieve our goals, and interested persons are urged to review any risks that may be described in Item 1A. Risk Factors as set forth herein and other risk factors appearing in our most recent filing on our Annual Report on Form 10-K for the fiscal year ended March 31, 2010, as supplemented by additional risk factors, if any, in our interim filings on our Quarterly Report on Form 10-Q, as well as in our other public disclosures and filings with the Securities and Exchange Commission.

This MD&A is provided as a supplement to the consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q in order to enhance your understanding of our results of operations and financial condition and should be read in conjunction with, and is qualified in its entirety by, the consolidated financial statements and related notes thereto included elsewhere in this Quarterly Report on Form 10-Q. Historical results of operations, percentage margin fluctuations and any trends that may be inferred from the discussion below are not necessarily indicative of the operating results for any future period.

Our MD&A is organized as follows:

Management Overview. This section provides a general description of our Company and operating segments, a discussion as to how we derive our revenue, background information on certain trends and developments affecting our Company, a summary of our acquisition transactions and a discussion on management s strategy for driving revenue growth.

Critical Accounting Policies and Estimates. This section discusses those accounting policies that are considered important to the evaluation and reporting of our financial condition and results of operations, and whose application requires us to exercise subjective or complex judgments in making estimates and assumptions. In addition, all of our significant accounting policies, including our critical accounting policies, are summarized in Note 1, Summary of Significant Accounting Policies, of our notes to consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Company Overview. This section provides a more detailed description of our Company, operating segments, products and services offered.

Overview of Results of Operations and Results of Operations by Operating Divisions. These sections provide our analysis and outlook for the significant line items on our consolidated statements of income, as well as other information that we deem meaningful to understand our results of operations on both a consolidated basis and an operating division basis.

Liquidity and Capital Resources. This section provides an analysis of our liquidity and cash flows.

New Accounting Pronouncements. This section provides a summary of the most recent authoritative accounting standards and guidance that have either been recently adopted by our Company or may be adopted in the future.

Management Overview

Quality Systems, Inc., including its wholly-owned subsidiaries, is comprised of the QSI Dental Division; the NextGen Division, which consists of NextGen Healthcare Information Systems, Inc. (NextGen), NextGen Inpatient Solutions, LLC (NextGen IS f/k/a Sphere) and Opus Healthcare Solutions, Inc. (Opus); and the Practice Solutions Division, which consists of Lackland Acquisition II, LLC dba Healthcare Strategic Initiatives (HSI) and Practice Management Partners, Inc. (PMP) (collectively, the Company , we , our , or us). The Company develops and markets healthcare information systems that automate certain aspects of medical and dental practices, networks of practices such as physician hospital organizations (PHOs) and management service organizations (MSOs), ambulatory care centers, community health centers, Federal Qualified Health Centers, and medical and dental schools. The Company also provides revenue cycle management (RCM) services through the Practice Solutions Division.

The turbulence in the worldwide economy has impacted almost all industries. While healthcare is not immune to economic cycles, we believe it is more resilient than most segments of the economy. The impact of the current economic conditions on our existing and prospective clients has been mixed. We continue to see organizations that are doing fairly well operationally; however, some organizations with a large dependency on Medicaid populations are being impacted by the challenging financial condition of the many state governments in whose jurisdictions they conduct business. A positive factor for U.S. healthcare is the fact that the Obama Administration is pursuing broad healthcare reform aimed at improving issues surrounding healthcare. The American Recovery and Reinvestment Act (ARRA), which became law on February 17, 2009, includes more than $20 billion to help healthcare organizations modernize operations through the acquisition of health care information technology. The Certification Commission for Health Information Technology (CCHIT), a non-profit organization recognized by the Office of the National Coordinator for Health Information Technology as an approved Authorized Testing and Certification Body, announced that our EHR solution was certified as a Complete EHR and 2011/2012 compliant during the quarter ended September 30, 2010, which comes off the heels of the Stage 1 Meaningful Use definition criteria under the ARRA that was announced in July 2010. With the lifting of the many Meaningful Use definition uncertainties, which has impacted software revenue, we believe we are well positioned to aid physicians and hospitals with their EHR decisions as they prepare to make incentive-based purchases.

On May 20, 2008, we acquired HSI, a full-service healthcare RCM company. HSI operates under the umbrella of the Company s Practice Solutions Division. Founded in 1996, HSI provides RCM services to providers including health systems, hospitals, and physicians in private practice with an in-house team of more than 200 employees, including specialists in medical billing, coding and compliance, payor credentialing, and information technology.

On October 28, 2008, we acquired PMP, a full-service healthcare RCM company. This acquisition is also part of our growth strategy for our Practice Solutions Division. Similar to HSI, PMP operates under the umbrella of the Company s Practice Solutions Division. Founded in 2001, PMP provides physician billing and technology management services to healthcare providers, primarily in the Mid-Atlantic region.

On August 12, 2009, we acquired NextGen IS, a provider of financial information systems to the small hospital inpatient market. This acquisition, along with our acquisition of Opus, is part of our strategy to expand into the small hospital market and to add new customers by taking advantage of cross-selling opportunities between the ambulatory and inpatient markets.

On February 10, 2010, we acquired Opus, a provider of clinical information systems to the small hospital inpatient market. Founded in 1987 and headquartered in Austin, Texas, Opus delivers Web-based clinical solutions to hospital systems and integrated health networks nationwide. This acquisition complements and will be integrated with the assets and operations of NextGen IS. Both companies are established developers of software and services for the inpatient market and will operate under the Company s NextGen Division.

Our strategy is, at present, to focus on providing software and services to medical and dental practices. The key elements of this strategy are to continue development and enhancement of select software solutions in target markets, to continue investments in our infrastructure including but not limited to product development, sales, marketing, implementation, and support, to continue efforts to make infrastructure investments within an overall context of maintaining reasonable expense discipline, to add new customers through maintaining and expanding sales, marketing and product development activities, and to expand our relationship with existing customers through delivery of add-on and complementary products and services and continuing our gold-standard commitment of service in support of our customers.

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Critical Accounting Policies and Estimates

The discussion and analysis of our consolidated financial statements and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate estimates (including but not limited to those related to revenue recognition, uncollectible accounts receivable, software development cost, intangible assets and self-insurance accruals) for reasonableness. We base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that may not be readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We describe our significant accounting policies in Note 2, Summary of Significant Accounting Policies, of our notes to consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2010. We discuss our critical accounting policies and estimates in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, in our Annual Report on Form 10-K for the fiscal year ended March 31, 2010. There have been no material changes in our significant accounting policies or critical accounting policies and estimates since the end of fiscal year 2010.

Company Overview

The Company is comprised of the QSI Dental Division, the NextGen Division, and the Practice Solutions Division. Operationally, HSI and PMP comprise the Practice Solutions Division, while Opus and NextGen IS operate under the NextGen Division. We primarily derive revenue by developing and marketing healthcare information systems that automate certain aspects of medical and dental practices, networks of practices such as PHOs and MSOs, ambulatory care centers, community health centers, and medical and dental schools along with comprehensive systems implementation, maintenance and support and add on complementary services such as RCM and electronic data interchange (EDI). Our systems and services provide our clients with the ability to redesign patient care and other workflow processes while improving productivity through facilitation of managed access to patient information. Utilizing our proprietary software in combination with third-party hardware and software solutions, our products enable the integration of a variety of administrative and clinical information operations.

Quality Systems, Inc., a California corporation formed in 1974, was founded with an early focus on providing information systems to dental group practices. In the mid-1980 s, we capitalized on the increasing focus on medical cost containment and further expanded our information processing systems to serve the medical market. In the mid-1990 s, we made two acquisitions that accelerated our penetration of the medical market. These two acquisitions formed the basis for the NextGen Division. Today, we serve the medical and dental markets through our NextGen Division and QSI Dental Division.

Historically, the Company has operated principally through two operating divisions: QSI Dental Division and NextGen Division. Through our acquisitions of HSI and PMP in 2008, we continued to strengthen our RCM service offerings. During fiscal year 2010, as a result of certain organizational changes, the composition of the Company s NextGen Division was revised to exclude the former NextGen Practice Solutions unit and the Company s RCM entities (HSI and PMP), both of which are now administered and aggregated in the Company s Practice Solutions Division. Following the reorganization, the Company now operates three reportable operating segments (not including Corporate), comprised of the NextGen Division, the QSI Dental Division and the Practice Solutions Division. Accordingly, our results for the three and nine months ended December 31, 2009 have been re-casted to reflect this change.

The following table breaks down our reported segment revenue and segment revenue growth by Division for the three and nine months ended December 31, 2010 and 2009:

	Segment Revenue Breakdown		Segment Revenue Growth	
	Three Months Ended December 31,	Nine Months Ended December 31,	Three Months Ended December 31,	Nine Months Ended December 31,

	2010	2009	2010	2009	2010	2009	2010	2009
QSI Dental Division	4.7%	5.8%	5.6%	5.8%	(1.1)%	10.1%	14.8%	2.7%
NextGen Division	81.7%	79.2%	80.2%	78.9%	26.4%	(3.5)%	22.3%	0.4%
Practice Solutions Division	13.6%	15.0%	14.2%	15.3%	11.3%	N/A	11.0%	N/A
Consolidated	100.0%	100.0%	100.0%	100.0%	22.6%	14.5%	20.1%	18.7%

The QSI Dental Division, co-located with our corporate headquarters in Irvine, California, currently focuses on developing, marketing and supporting software suites sold to dental and certain niche medical practices. In addition, the Division supports a number of medical clients that utilize the Division s UNIX®-based medical practice management software product and its Software as a Service, or SaaS model, based NextDDS financial and clinical software.

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The QSI Dental Division s practice management software suite utilizes a UNIX® operating system. Its Clinical Product Suite (CPS) utilizes a Windows NT® operating system and can be fully integrated with the practice management software from each of our Divisions. CPS incorporates a wide range of clinical tools including, but not limited to, periodontal charting and digital imaging of X-ray and inter-oral camera images as part of the electronic patient record. The Division develops, markets, and manages our EDI/connectivity applications. Our QSInet Application Service Provider (ASP) offering is also developed and marketed by the QSI Dental Division.

In July 2009, we licensed source code that allows us to deliver hosted, Web-based SaaS model practice management and clinical software solutions to the dental industry. This new software solution (NextDDS) is being marketed primarily to the multi-location dental group practice market in which the Division has historically been a dominant player. NextDDS brings the QSI Dental Division to the forefront of the emergence of Internet-based applications and cloud computing and represents a significant growth opportunity for the Division to sell both to its existing customer base as well as new customers.

The NextGen Division, with headquarters in Horsham, Pennsylvania, and significant locations in Atlanta, Georgia and Austin, Texas, provides integrated clinical, financial and connectivity solutions for ambulatory, inpatient and dental provider organizations.

The NextGen Division develops and sells proprietary electronic health records software and practice management systems under the NextGen product name. Major product categories of the NextGen suite include electronic health records (NextGen EHR), an enterprise practice management system (NextGen Practice Management), an image control system (NextGen Document Management), electronic data interchange (NextGen EDI), System Interfaces, community health information exchange (NextGen HIE), and a patient-centric and provider-centric Web portal solution (NextGen Patient Portal). The NextGen Division also offers optional NextGen Hosting Solutions to new and existing customers. NextGen products utilize Microsoft Windows technology and can operate in a client-server environment as well as via private intranet, the Internet, or in an ASP environment.

The Practice Solutions Division, with locations in St. Louis, Missouri and Hunt Valley, Maryland, focuses primarily on providing physician practices with RCM services, primarily billing and collection services for medical practices. This Division combines a Web-delivered SaaS model and the NextGen^{epm} software platform to execute its service offerings. We intend to transition our customer base onto the NextGen platform. The Practice Solutions Division provides technology solutions and consulting services to cover the full spectrum of providers revenue cycle needs from patient access to claims denials.

The Divisions operate largely as stand-alone operations, with each Division maintaining its own distinct product lines, product platforms, development, implementation and support teams, sales staffing and branding. The three Divisions share the resources of our corporate office, which includes a variety of accounting and other administrative functions. Additionally, there are a small but growing number of clients who are simultaneously utilizing software or services from more than one of our three Divisions.

The QSI Dental and NextGen Divisions develop and market practice management software that is designed to automate and streamline a number of the administrative functions required for operating a medical or dental practice. Examples of practice management software functions include scheduling and billing capabilities. It is important to note that in both the medical and dental environments, practice management software systems have already been implemented by the vast majority of practices. Therefore, we actively compete for the replacement market.

With the acquisition of NextGen IS in 2009, the NextGen Division entered the market for financial information systems for small hospitals. Therefore, since 2009, the NextGen Division has also been developing and marketing an equivalent practice management software product for the small hospital market, which performs administrative functions required for operating a small hospital.

In addition, the QSI Dental and NextGen Divisions develop and market software that automate patient records in both a practice and hospital setting. Therefore, we are typically competing to replace paper-based patient record alternatives as opposed to replacing previously purchased systems.

We make available EDI capabilities and connectivity services to our customers. The EDI/connectivity capabilities encompass direct interfaces between our products and external third-party systems, as well as transaction-based services. EDI products are intended to automate a number of manual, often paper-based or telephony-intensive communications between patients and/or providers and/or payors. Two of the more common EDI services are forwarding insurance claims electronically from providers to payors and assisting practices with issuing statements to patients. Most client practices utilize at least some of these services from us or one of our competitors. Other EDI/connectivity services are used more sporadically by client practices. We typically compete to displace incumbent vendors for claims and statements accounts and attempt to increase usage of other elements in our EDI/connectivity product line. In general, EDI services are only sold to those accounts utilizing software from either the QSI Dental or NextGen Divisions.

We continue to pursue product and service enhancement initiatives within each Division. The majority of such expenditures are currently targeted to the NextGen Division product line and client base.

Overview of Our Results

§ Consolidated revenue increased 20.1% and income from operations grew by 17.9% in the nine months ended December 31, 2010 versus the same period in 2009. For the nine months ended December 31, 2010, revenue was positively impacted by growth in recurring revenue, including maintenance, EDI and RCM revenue, which grew 24.1%, 17.1% and 21.7%, respectively and accounted for 56.5% of total consolidated revenue during the nine months ended December 31, 2010. In the same period a year ago, recurring revenue represented 55.6% of total consolidated revenue. Revenue was also positively impacted by growth in sales of systems at our NextGen Division, which, inclusive of inpatient systems sales, increased 17.8% to $83.1 million in the nine months ended December 31, 2010.

§ The increase in income from operations was negatively impacted by: (a) amortization of the software technology intangible asset related to the Opus acquisition that is included in cost of sales, (b) higher selling, general and administrative expenses, which was primarily a result of increased headcount expenses and selling-related expenses at the NextGen Division, (c) business integration expenses at the Practice Solution Division, (d) additional expenses related to a fair value adjustment to the contingent consideration liability related to the acquisitions of Opus and NextGen IS, and (e) higher corporate-related expenses and increased research and development costs.

§ The effective tax rate for the nine months ended December 31, 2010 is 34.7% as a result of a discrete benefit of $1.0 million, resulting from a catch-up adjustment due to the extension of the federal research and development tax credit, which was retroactive to the initial expiration date of December 31, 2009.

§ We have benefited and hope to continue to benefit from the increased demands on healthcare providers for greater efficiency and lower costs, financial incentives from the ARRA to physicians who adopt electronic health records, as well as increased adoption rates for electronic health records and other technology in the healthcare arena.

§ While we expect to benefit from the increasing demands for greater efficiency as well as government support for increased adoption of electronic health records, the current economic environment, combined with unpredictability of the federal government s plans to promote increased adoption of electronic medical records, makes the near term achievement of such benefits and, ultimately, their impact on system sales, uncertain.

NextGen Division

§ NextGen Division revenue increased 22.3% in the nine months ended December 31, 2010 and divisional operating income (excluding unallocated corporate expenses) increased 21.9% as compared to the prior year period. Organic revenue (excluding Opus) growth in the NextGen Division was 14.9% for the nine months ended December 31, 2010. The acquisition of Opus in fiscal year 2010 added approximately $11.2 million in revenue for the nine months ended December 31, 2010 as compared to the same period a year ago.

§ Recurring revenue, consisting of maintenance and EDI revenue, increased 24.5% to $101.9 million from $81.9 million in the same period a year ago and accounted for 49.6% of total NextGen Division revenue during the nine months ended December 31, 2010. In the same period a year ago, recurring revenue represented 48.7% of total divisional revenue.

§ During the nine months ended December 31, 2010, we added staffing resources and increased our investment in research and development in anticipation of growth from the ARRA. Our goals include taking maximum advantage of benefits related to the ARRA and continuing to further enhance our existing products, including continued efforts to maintain our status as a qualified vendor under the ARRA, integrating our inpatient and ambulatory software products, developing new products for targeted markets, continuing to add new customers, selling additional software and services to existing customers, expanding penetration of connectivity and other services to new and existing customers, and capitalizing on growth and cross selling opportunities within the Practice Solutions Division and the recently acquired acute care software product lines.

§ The NextGen Division s growth is attributed to a strong brand name and reputation within a growing marketplace for electronic health records and investments in sales and marketing activities, including a revamped NextGen.com Web site, new NextGen logo, new marketing campaigns, trade show attendance, and other expanded advertising and marketing expenditures. We have also benefited from winning numerous industry awards for the NextGen Division s flagship NextGen^{ehr} and NextGen^{epm} software products and more recently in 2010 for its NextGen HIE product. Further, the increasing acceptance of electronic records technology in the healthcare industry continues to provide growth opportunities.

QSI Dental Division

§ QSI Dental Division revenue increased 14.8% in the nine months ended December 31, 2010 and divisional operating income (excluding unallocated corporate expenses) increased 35.2% as compared to the prior year period.

§ An increase of 60.4% in system sales revenue during the nine months ended December 31, 2010 as compared to the prior year period was the chief contributor to the operating income results. The QSI Dental Division has benefited from system sales to Federally Qualified Healthcare Centers (FQHC), which are typically sold jointly with the NextGen Division. The Company is well-positioned to sell to the FQHC market as these entities typically provide both medical and dental services at the same location.

§ In July 2009, we licensed source code that allows us to deliver hosted, Web-based SaaS practice management and clinical software solutions to the dental industry. This new software solution (NextDDS) is being be marketed primarily to the multi-location dental group practice market in which the QSI Dental Division has historically been a dominant player. NextDDS brings the QSI Dental Division to the forefront of the emergence of Internet-based applications and cloud computing and represents a significant growth opportunity for us to sell both to our existing customer base as well as new customers.

§ Our goal for the QSI Dental Division is to maximize profit performance given the constraints represented by a relatively weak purchasing environment in the dental group practice market while taking advantage of opportunities with the new NextDDS product. The QSI Dental Division also intends to leverage the NextGen Division s sales force to sell its dental electronic medical records software to practices that provide both medical and dental services such as Federal Qualified Health Centers, which are receiving grants as part of the ARRA.

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Practice Solutions Division

§ Practice Solutions Division revenue increased 11.1% in the nine months ended December 31, 2010 and divisional operating income (excluding unallocated corporate expenses) increased 17.8% as compared to the prior year period. The Practice Solutions Division benefited from organic growth achieved through cross selling RCM services to existing NextGen Division customers and well as new customers added during the nine months ended December 31, 2010.

§ Operating income as a percentage of revenue increased to approximately 7.6% of revenue in the nine months ended December 31, 2010 versus 7.2% of revenue in the prior year period primarily as a result of higher RCM revenue compared to the prior year period, offset by increased costs related to transitioning to the NextGen platform including training of staff and initial set up and other costs related to achieving higher production volumes as well as integration expenses related to consolidating the operations of the two entities (HSI and PMP) that make up the Practice Solutions Division.

The following table sets forth for the periods indicated the percentage of net revenue represented by each item in our consolidated statements of income (certain percentages below may not sum due to rounding):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
(Unaudited)				
Revenues:				
Software, hardware and supplies	32.3%	32.5%	29.2%	30.5%
Implementation and training services	4.6	4.4	5.1	4.8
System sales	36.9	36.9	34.3	35.2
Maintenance	30.4	29.5	31.6	30.6
Electronic data interchange services	11.3	11.9	11.8	12.1
Revenue cycle management and related services	12.5	12.8	13.1	12.9
Other services	8.9	8.9	9.2	9.2
Maintenance, EDI, RCM and other services	63.1	63.1	65.7	64.8
Total revenues	100.0	100.0	100.0	100.0
Cost of revenue:				
Software, hardware and supplies	6.2	3.7	6.5	4.3
Implementation and training services	4.0	3.9	4.0	4.3
Total cost of system sales	10.2	7.6	10.4	8.6
Maintenance	3.7	4.5	3.9	4.5
Electronic data interchange services	7.5	8.7	8.0	8.7
	9.5	9.5	9.8	9.6

Revenue cycle management and related services				
Other services	4.3	7.4	4.7	7.2
Total cost of maintenance, EDI, RCM and other services	25.0	30.1	26.4	30.1
Total cost of revenue	35.2	37.8	36.8	38.7
Gross profit	64.8	62.2	63.2	61.3
Operating expenses:				
Selling, general and administrative	30.4	28.8	30.8	28.9
Research and development costs	5.8	5.3	6.3	5.8
Amortization of acquired intangible assets	0.5	0.5	0.5	0.5
Total operating expenses	36.7	34.6	37.6	35.2
Income from operations	28.1	27.7	25.6	26.1
Interest income	0.1	0.1	0.1	0.1
Other income, net	0.0	0.2	0.0	0.1
Income before provision for income taxes	28.1	28.0	25.7	26.3
Provision for income taxes	9.0	10.4	8.9	9.7
Net income	19.1%	17.5%	16.8%	16.6%

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Comparison of the Three Months Ended December 31, 2010 and December 31, 2009

Net Income. The Company s net income for the three months ended December 31, 2010 was $17.5 million, or $0.60 per share on a basic and fully diluted basis. In comparison, we earned $13.2 million, or $0.46 per share on a basic and fully diluted basis for the three months ended December 31, 2009. The increase in net income for the three months ended December 31, 2010 was primarily attributed to the following:

- a 22.6% increase in consolidated revenue, including an increase of $15.6 million in revenue from our NextGen Division and an increase of $1.3 million in revenue from our Practice Solutions Division;
- a 26.4% increase in NextGen Division revenue, which accounted for 81.7% of consolidated revenue;
- an increase of recurring revenue, including RCM, maintenance, and EDI revenue, offset by an increase in selling, general and administrative expenses as a percentage of revenue related to higher selling, general and corporate expenses, increased commissions expense, and a fair value adjustment to the contingent consideration liability related to the acquisitions of Opus and NextGen IS; and
- a decrease of the effective tax rate to 32.1% for the three months ended December 31, 2010 as a result of a discrete benefit of $1.0 million, resulting from a catch-up adjustment due to the extension of the federal research and development tax credit, which was retroactive to the initial expiration date of December 31, 2009.

Revenue. Revenue for the three months ended December 31, 2010 increased 22.6% to $91.9 million from $75.0 million for the three months ended December 31, 2009. NextGen Division revenue increased 26.4% to $75.1 million from $59.4 million in the three months ended December 31, 2009, while QSI Dental Division revenue decreased by 1.1% during that same period to $4.3 million from $4.4 million and Practice Solutions Division revenue increased 11.3% during that same period to $12.5 million from $11.2 million.

System Sales. Revenue earned from Company-wide sales of systems for the three months ended December 31, 2010 increased 22.7% to $33.9 million from $27.7 million in the prior year period.

Our increase in revenue from sales of systems was principally the result of a 25.1% increase in category revenue at our NextGen Division, whose sales in this category grew to $32.7 million during the three months ended December 31, 2010 from $26.1 million during the same prior year period. This increase was driven by higher sales of software to both new and existing clients, as well as increases in hardware and third-party software and implementation and training services revenue.

The following table breaks down our reported system sales into software, hardware, third-party software, supplies, and implementation and training services components on a consolidated and divisional basis (in thousands):

	Software	Hardware, Third Party Software and Supplies	Implementation and Training Services	Total System Sales
Three Months Ended December 31, 2010				
QSI Dental Division	$ 380	$ 347	$ 262	$ 989
NextGen Division	25,953	2,881	3,863	32,697
Practice Solutions Division	102	12	137	251
Consolidated	$ 26,435	$ 3,240	$ 4,262	$ 33,937
Three Months Ended December 31, 2009				
QSI Dental Division	$ 477	$ 404	$ 193	$ 1,074

NextGen Division	22,206	843	3,087	26,136
Practice Solutions Division	416		33	449
Consolidated	$ 23,099	$ 1,247	$ 3,313	$ 27,659

NextGen Division software license revenue increased 16.9% in the three months ended December 31, 2010 versus the same period last year. The Division s software revenue accounted for 79.4% of divisional system sales revenue during the three months ended December 31, 2010, compared to 85.0% during the same period a year ago. The September 2010 announcement that NextGen^{ehr} became CCHIT® certified along with the finalization of the Stage 1 Meaningful Use definition criteria under the ARRA in July 2010 positively impacted the growth in software license revenue during the three months ended December 31, 2010. Software license revenue continues to be an area of primary emphasis for the NextGen Division. The Opus acquisition, which closed in February 2010, contributed approximately $1.9 million to the NextGen Division s software license revenue during the three months ended December 31, 2010.

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During the three months ended December 31, 2010, 8.8% of the NextGen Division s system sales revenue was represented by hardware and third-party software compared to 3.2% during same period a year ago. The increase in hardware and third-party software was a result of previously backordered hardware that was shipped during the three months ended December 31, 2010. The number of customers who purchase hardware and third-party software and the dollar amount of hardware and third-party software revenue fluctuates each quarter depending on the needs of customers. The inclusion of hardware and third-party software in the Division s sales arrangements is typically at the request of our customers.

Implementation and training revenue related to system sales at the NextGen Division increased 25.1% in the three months ended December 31, 2010 compared the prior year period. The amount of implementation and training services revenue is dependent on several factors, including timing of customer implementations, the availability of qualified staff, and the mix of services being rendered. The number of implementation and training staff increased during the three months ended December 31, 2010 versus the same period in 2009 in order to accommodate the increased amount of implementation services sold in conjunction with increased software sales. In order to achieve growth in this area, additional staffing increases and additional training facilities are anticipated, though actual future increases in revenue and staff will depend upon the availability of qualified staff, business mix and conditions, and our ability to retain current staff members.

For the QSI Dental Division, total system sales decreased $0.1 million, or 7.9%, to $1.0 million in the three months ended December 31, 2010 as compared to $1.1 million the prior year period. In addition, the Division began selling the SaaS based NextDDS product during fiscal year 2010.

For the Practice Solutions Division, total system sales decreased by 44.1% in the three months ended December 31, 2010 as compared to the prior year period. Systems sales revenue within the Practice Solutions Division is composed of sales to existing RCM customers only and can fluctuate given the size of the current customer base of the Practice Solutions Division.

Maintenance, EDI, RCM and Other Services. For the three months ended December 31, 2010, Company-wide revenue from maintenance, EDI, RCM and other services grew 22.5% to $57.9 million from $47.3 million in the prior year period. The increase in this category resulted primarily from an increase in maintenance, EDI and other services revenue from the NextGen Division and RCM revenue from the Practice Solutions Division. Total NextGen Division maintenance revenue for the three months ended December 31, 2010 grew 28.6% to $26.1 million from $20.3 million in the same prior year period while EDI revenue grew 20.0% to $9.1 million compared to $7.6 million during the same prior year period. Other services revenue for the NextGen Division for the three months ended December 31, 2010, which consists primarily of third-party annual software license renewals, follow-on training hours, consulting services and hosting services, increased 33.9% to $7.1 million from $5.3 million in the same prior year period, primarily due to increases in third-party annual software licenses, consulting services and hosting services revenue. QSI Dental Division maintenance, EDI and other revenue remained consistent at $3.3 million in the three months ended December 31, 2010 as compared to the three months ended December 31, 2009. For the three months ended December 31, 2010, RCM revenue grew $1.9 million to $11.5 million compared to $9.6 million in the prior year period.

The following table details maintenance, EDI, RCM, and other services revenue by category on a consolidated and divisional basis for the three months ended December 31, 2010 and 2009 (in thousands):

	Maintenance	EDI	RCM	Other	Total
Three Months Ended December 31, 2010					
QSI Dental Division	$ 1,805	$ 1,214	$	$ 313	$ 3,332
NextGen Division	26,063	9,146		7,149	42,358
Practice Solutions Division	40		11,496	708	12,244
Consolidated	$ 27,908	$ 10,360	$ 11,496	$ 8,170	$ 57,934

Three Months Ended December 31, 2009					
QSI Dental Division	$ 1,821	$ 1,274	$	$ 198	$ 3,293
NextGen Division	20,266	7,623		5,340	33,229
Practice Solutions Division	52		9,602	1,127	10,781
Consolidated	$ 22,139	$ 8,897	$ 9,602	$ 6,665	$ 47,303

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Maintenance revenue for the NextGen Division increased by $5.8 million for the three months ended December 31, 2010 as compared to the same prior year period. The growth in maintenance revenue is a result of a $2.9 million increase in net additional licenses from new customers and existing customers, $2.0 million in maintenance revenue related to the Opus acquisition, and approximately $0.9 million related to a recent price increase that became effective during the quarter ended September 30, 2010.

The NextGen Division s EDI revenue growth has come from new customers and from further penetration of the Division s existing customer base. The growth in RCM revenue has come from new customers that have been acquired from cross selling opportunities with the NextGen Division customer base. We intend to continue to promote maintenance, EDI and RCM services to both new and existing customers.

Cost of Revenue. Cost of revenue for the three months ended December 31, 2010 increased 14.2% to $32.3 million from $28.3 million in the three months ended December 31, 2009 and the cost of revenue as a percentage of revenue decreased to 35.2% from 37.8% due to the fact that the rate of growth in cost of revenue grew slower than the aggregate revenue growth rate for the Company.

The following table details revenue and cost of revenue on a consolidated and divisional basis for the three months ended December 31, 2010 and 2009 (in thousands):

	Three Months Ended December 31,			
	2010	%	2009	%
QSI Dental Division				
Revenue	$ 4,321	100.0%	$ 4,368	100.0%
Cost of revenue	2,097	48.5%	1,883	43.1%
Gross profit	$ 2,224	51.5%	$ 2,485	56.9%
NextGen Division				
Revenue	$ 75,055	100.0%	$ 59,365	100.0%
Cost of revenue	21,229	28.3%	18,659	31.4%
Gross profit	$ 53,826	71.7%	$ 40,706	68.6%
Practice Solutions Division				
Revenue	$ 12,495	100.0%	$ 11,229	100.0%
Cost of revenue	9,003	72.1%	7,767	69.2%
Gross profit	$ 3,492	27.9%	$ 3,462	30.8%
Consolidated				
Revenue	$ 91,871	100.0%	$ 74,962	100.0%
Cost of revenue	32,329	35.2%	28,309	37.8%
Gross profit	$ 59,542	64.8%	$ 46,653	62.2%

Gross profit margins at the QSI Dental Division for the three months ended December 31, 2010 decreased to 51.5% from 56.9% for the three months ended December 31, 2009 primarily as a result of a higher percentage of payroll and related benefits due to headcount additions in the three months ended December 31, 2010 as compared to the same period a year ago. Gross profit margins at the NextGen Division for the three months ended December 31, 2010 increased to 71.7% compared to 68.6% for the three months ended December 31, 2009 due to strong software sales and an increase in maintenance revenue, which yields higher margin than other services, along with improvements in EDI margins. Gross margin in the Practice Solutions Division decreased to 27.9% for the three months ended December 31, 2010 as compared to 30.8% in the prior year period because of a higher percentage of payroll and related benefits in the three months ended December 31, 2010 as compared to the same period a year ago.

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The following table details the individual components of cost of revenue and gross profit as a percentage of total revenue on a consolidated and divisional basis for the three months ended December 31, 2010 and 2009:

	Hardware, Third Party Software	Payroll and Related Benefits	EDI	Other	Total Cost of Revenue	Gross Profit
Three Months Ended December 31, 2010						
QSI Dental Division	7.0%	20.7%	12.8%	8.0%	48.5%	51.5%
NextGen Division	3.5%	11.3%	6.4%	7.1%	28.3%	71.7%
Practice Solutions Division	0.1%	43.8%	1.8%	26.4%	72.1%	27.9%
Consolidated	3.2%	16.2%	6.1%	9.7%	35.2%	64.8%
Three Months Ended December 31, 2009						
QSI Dental Division	8.4%	13.1%	15.2%	6.4%	43.1%	56.9%
NextGen Division	1.4%	14.5%	7.3%	8.2%	31.4%	68.6%
Practice Solutions Division	0.6%	41.9%	5.3%	21.4%	69.2%	30.8%
Consolidated	1.7%	17.2%	8.7%	10.2%	37.8%	62.2%

During the three months ended December 31, 2010, hardware and third-party software constituted a higher portion of cost of revenue compared to the prior year period in the NextGen Division. The number of customers who purchase hardware and third-party software and the dollar amount of hardware and third-party software purchased fluctuates each quarter depending on the needs of our customers.

Our payroll and benefits expense associated with delivering our products and services decreased to 16.2% of consolidated revenue in the three months ended December 31, 2010 compared to 17.2% during the same period last year. The absolute level of consolidated payroll and benefit expenses grew from $13.9 million in the three months ended December 31, 2009 to $14.8 million in the three months ended December 31, 2010, an increase of 6.8%, or approximately $0.9 million. Of the $0.9 million increase, approximately $0.8 million of the increase is related to the Practice Solutions Division. RCM is a service business, which inherently has higher percentage of payroll costs as a percentage of revenue. For the NextGen Division, a decrease of approximately $0.2 million was related to decreased headcount and payroll and benefits expense associated with delivering products and services. Payroll and benefits expense associated with delivering products and services in the QSI Dental Division increased $0.3 million from $0.6 million in the three months ended December 31, 2009 to $0.9 million in the three months ended December 31, 2010 primarily due to headcount additions.

Other expense, which primarily consists of third-party annual license and hosting costs, decreased to 9.7% of total revenue during the three months ended December 31, 2010 as compared to 10.2% for the same period a year ago. Contributing to this decline was better profit margins achieved in our consulting, hosting, and annual licenses revenues that are included in other services.

As a result of the foregoing events and activities, the gross profit percentage for the Company increased to 64.8% for the three months ended December 31, 2010 versus 62.2% for the prior year period.

We anticipate continued additions to headcount in all three Divisions in areas related to delivering products and services in future periods, but due to the uncertainties in the timing of our sales arrangements, our sales mix, the acquisition and training of qualified personnel, and other issues, we cannot accurately predict if related headcount expense as a percentage of revenue will increase or decrease in the future.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended December 31, 2010 increased 29.6% to $28.0 million as compared to $21.6 million for the prior year period. The increase in these expenses resulted primarily from:

- $5.6 million increase in salaries and related benefit expenses primarily as a result of headcount additions;

- $1.4 million increase in sales commissions primarily related to the NextGen Division;

- $1.1 million increase related to a fair value adjustment to the contingent consideration liability related to the acquisitions of Opus and NextGen IS; offset by

- $0.8 million decrease in advertising, tradeshows, and travel related expenses; and

- $0.9 million net decrease in other selling and administrative expenses.

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Share-based compensation expense was approximately $0.7 million and $0.1 million for the three months ended December 31, 2010 and 2009, respectively, and is included in the aforementioned amounts. Selling, general and administrative expenses as a percentage of revenue increased from 28.8% in the three months ended December 31, 2009 to 30.4% in the three months ended December 31, 2010.

We do not anticipate significant increases in expenditures for trade shows, advertising and the employment of additional sales and administrative staff at the NextGen Division until additional revenue growth is achieved. We anticipate future increases in corporate expenditures being made in a wide range of areas including professional services and investment in a companywide enterprise resource planning (ERP) system. While we expect selling, general and administrative expenses to increase on an absolute basis, we cannot accurately predict the impact these additional expenditures will have on selling, general and administrative expenses as a percentage of revenue.

Research and Development Costs. Research and development costs for the three months ended December 31, 2010 and 2009 were $5.4 million and $4.0 million, respectively. The increases in research and development expenses were due in part to increased investment in the NextGen Division product line. The Opus acquisition added $0.3 million in research and development expenses during the three month period ended December 31, 2010. Additions to capitalized software costs offset increases in research and development costs. For the three months ended December 31, 2010, $2.9 million was added to capitalized software costs while $1.8 million was capitalized during the three months ended December 31, 2009 as we continue to enhance our software to meet the Meaningful Use definitions under the ARRA. Research and development costs as a percentage of revenue increased to 5.8% in the three months ended December 31, 2010 from 5.3% for the same period in 2009. Research and development expenses are expected to continue at or above current dollar levels. Share-based compensation expense included in research and development costs was not material in the three months ended December 31, 2010 and 2009.

Interest and Other Income. Interest and other income for the three months ended December 31, 2010 and 2009 were $0.1 million and $0.2 million, respectively. Interest and other income consist primarily of dividends and interest earned on our investments.

Our investment policy is determined by our Board of Directors. We currently maintain our cash in very liquid short term assets including tax exempt and taxable money market funds and short-term U.S. Treasury securities with maturities of 90 days or less at the time of purchase. Our Board of Directors continues to review alternate uses for our cash including, but not limited to, payment of a special dividend, initiation of a stock buyback program, an expansion of our investment policy to include investments with longer maturities of greater than 90 days, and other items. Additionally, it is possible that we will utilize some or all of our cash to fund acquisitions or other similar business activities. Any or all of these programs could significantly impact our investment income in future periods.

Provision for Income Taxes. The provision for income taxes for the three months ended December 31, 2010 was approximately $8.3 million as compared to approximately $7.8 million for the corresponding period a year ago. The effective tax rates were 32.1% and 37.2% for the three months ended December 31, 2010 and 2009, respectively. The effective rate for the three months ended December 31, 2010 decreased as compared to the prior year period primarily due to fluctuations in the state effective tax rate and increased benefits from the qualified production activities deduction. The effective rate also decreased as compared to the prior year period because of a discrete benefit of $1.0 million, resulting from a catch-up adjustment due to the federal research and development tax credit, which was retroactive to the initial expiration date of December 31, 2009.

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Comparison of the Nine Months Ended December 31, 2010 and December 31, 2009

Net Income. The Company s net income for the nine months ended December 31, 2010 was $43.1 million, or $1.49 per share on a basic and $1.48 on a fully diluted basis. In comparison, we earned $35.3 million, or $1.24 per share on a basic and $1.23 per share on a fully diluted basis for the nine months ended December 31, 2009. The increase in net income for the nine months ended December 31, 2010 was primarily attributed to the following:

a 20.1% increase in consolidated revenue, including an increase of $37.5 million in revenue from our NextGen Division, an increase of $1.8 million from our QSI Dental Division, and an increase of $3.6 million in revenue from our Practice Solutions Division;

the acquisition of Opus in February 2010, which added approximately $11.2 million in revenue for the nine months ended December 31, 2010 as compared to the same period a year ago;

a 22.3% increase in NextGen Division revenue, which accounted for 80.2% of consolidated revenue;

an increase of recurring revenue, including RCM, maintenance, and EDI revenue, which accounted for 56.5% of total consolidated revenue during the nine months ended December 31, 2010 as compared to 55.6% of total consolidated revenue in the same period a year ago;

offset by an increase in selling, general and administrative expenses and research and development costs.

Revenue. Revenue for the nine months ended December 31, 2010 increased 20.1% to $256.3 million from $213.3 million for the nine months ended December 31, 2009. NextGen Division revenue increased 22.3% to $205.6 million from $168.1 million in the nine months ended December 31, 2009, while QSI Dental Division revenue increased 14.8% during that same period to $14.3 million from $12.5 million and Practice Solutions Division revenue increased 11.0% during that same period to $36.3 million from $32.7 million.

System Sales. Revenue earned from Company-wide sales of systems for the nine months ended December 31, 2010 increased 17.0% to $87.9 million from $75.1 million in the prior year period.

Our increase in revenue from sales of systems was principally the result of a 17.8% increase in category revenue at our NextGen Division, whose sales in this category increased from $70.5 million during the nine months ended December 31, 2009 to $83.1 million during the nine months ended December 31, 2010. This increase was driven by higher sales of software to both new and existing clients, as well as increases in hardware and third-party software and implementation and training services revenue.

The following table breaks down our reported system sales into software, hardware, third-party software, supplies, and implementation and training services components on a consolidated and Divisional basis (in thousands):

	Software	Hardware, Third Party Software and Supplies	Implementation and Training Services	Total System Sales
Nine Months Ended December 31, 2010				
QSI Dental Division	$ 1,819	$ 1,618	$ 769	$ 4,206
NextGen Division	63,134	7,916	12,022	83,072
Practice Solutions Division	300	19	278	597
Consolidated	$ 65,253	$ 9,553	$ 13,069	$ 87,875
Nine Months Ended December 31, 2009				

QSI Dental Division	$ 1,216	$ 861	$ 547	$ 2,624
NextGen Division	56,937	4,217	9,390	70,544
Practice Solutions Division	1,747		213	1,960
Consolidated	$ 59,900	$ 5,078	$ 10,150	$ 75,128

NextGen Division software license revenue increased 10.9% in the nine months ended December 31, 2010 versus the same period last year. The Division s software revenue accounted for 76.0% of divisional system sales revenue during the nine months ended December 31, 2010, compared to 80.7% during the same period a year ago. The September 2010 announcement that NextGen^ehr became CCHIT® certified along with the finalization of the Stage 1 Meaningful Use definition criteria under the ARRA in July 2010 positively impacted the growth in software license revenue during the three months ended December 31, 2010. Software license revenue continues to be an area of primary emphasis for the NextGen Division. The Opus acquisition, which closed in February 2010, contributed approximately $3.6 million to the NextGen Division s software license revenue during the nine months ended December 31, 2010.

During the nine months ended December 31, 2010, 9.5% of the NextGen Division s system sales revenue was represented by hardware and third-party software compared to 6.0% during same period a year ago. The increase in hardware and third party software was a result of previously backordered hardware from fiscal year 2010 that was shipped during the quarter ended June 30, 2010. The number of customers who purchase hardware and third-party software and the dollar amount of hardware and third-party software revenue fluctuates each quarter depending on the needs of customers. The inclusion of hardware and third-party software in the Division s sales arrangements is typically at the request of our customers.

Implementation and training revenue related to system sales at the NextGen Division increased 28.0% in the nine months ended December 31, 2010 compared the prior year period. The amount of implementation and training services revenue is dependent on several factors, including timing of customer implementations, the availability of qualified staff, and the mix of services being rendered. The number of implementation and training staff increased during the nine months ended December 31, 2010 versus the same period in 2009 in order to accommodate the increased amount of implementation services sold in conjunction with increased software sales.

For the QSI Dental Division, total system sales increased $1.6 million, or 60.3%, to $4.2 million in the nine months ended December 31, 2010 as compared to $2.6 million the prior year period. Systems sales in the QSI Dental Division were positively impacted by greater joint sales of dental and medical software to FQHC. In addition, the Division began selling the SaaS based NextDDS product during fiscal year 2010.

For the Practice Solutions Division, total system sales decreased by 69.5% in the nine months ended December 31, 2010 as compared to the prior year period. System sales was negatively impacted by $1.7 million of software license sales in the nine months ended December 31, 2009 as compared to $0.3 million of software sales recorded in the nine months ended December 31, 2010. Systems sales revenue within the Practice Solutions Division is composed of sales to existing RCM customers only and can fluctuate given the size of the current customer base of the Practice Solutions Division.

Maintenance, EDI, RCM and Other Services. For the nine months ended December 31, 2010, Company-wide revenue from maintenance, EDI, RCM and other services grew 21.9% to $168.4 million from $138.2 million in the prior year period. The increase in this category resulted primarily from an increase in maintenance, EDI and other services revenue from the NextGen Division and RCM revenue from the Practice Solutions Division. Total NextGen Division maintenance revenue for the nine months ended December 31, 2010 grew 26.1% to $75.4 million from $59.8 million in the same prior year period while EDI revenue grew 20.1% to $26.5 million compared to $22.1 million during the same prior year period. Other services revenue for the NextGen Division for the nine months ended December 31, 2010, which consists primarily of third-party annual software license renewals, follow-on training hours, consulting services and hosting services, increased 31.7% to $20.6 million from $15.7 million in the same prior year period, primarily due to increases in third-party annual software licenses and hosting services revenue. QSI Dental Division maintenance, EDI and other revenue increased 2.7% to $10.1 million in the nine months ended December 31, 2010 as compared to $9.9 million in the nine months ended December 31, 2009. For the nine months ended December 31, 2010, RCM revenue grew $5.9 million to $33.4 million compared to $27.5 million in the prior year period.

The following table details maintenance, EDI, RCM, and other services revenue by category on a consolidated and Divisional basis for the nine months ended December 31, 2010 and 2009 (in thousands):

	Maintenance	EDI	RCM	Other	Total
Nine Months Ended December 31, 2010					
QSI Dental Division	$ 5,463	$ 3,729	$	$ 921	$ 10,113
NextGen Division	75,392	26,537		20,642	122,571
Practice Solutions Division	118		33,443	2,135	35,696
Consolidated	$ 80,973	$ 30,266	$ 33,443	$ 23,698	$ 168,380
Nine Months Ended December 31, 2009					
QSI Dental Division	$ 5,388	$ 3,765	$	$ 697	$ 9,850
NextGen Division	59,809	22,090		15,678	97,577
Practice Solutions Division	57		27,482	3,204	30,743

Consolidated	$ 65,254	$ 25,855	$ 27,482	$ 19,579	$ 138,170

Maintenance revenue for the NextGen Division increased by $15.6 million for the nine months ended December 31, 2010 as compared to the same prior year period. The growth in maintenance revenue is a result of a $7.8 million increase in net additional licenses from new customers and existing customers, $5.9 million in maintenance revenue related to the Opus acquisition, and approximately $1.9 million related to a recent price increase that became effective during the quarter ended September 30, 2010.

The NextGen Division s EDI revenue growth has come from new customers and from further penetration of the Division s existing customer base. The growth in RCM revenue has come from new customers that have been acquired from cross selling opportunities with the NextGen Division customer base. We intend to continue to promote maintenance, EDI and RCM services to both new and existing customers.

Cost of Revenue. Cost of revenue for the nine months ended December 31, 2010 increased 14.3% to $94.3 million from $82.5 million in the nine months ended December 31, 2009 and the cost of revenue as a percentage of revenue decreased to 36.8% from 38.7% due to the fact that the rate of growth in cost of revenue grew slower than the aggregate revenue growth rate for the Company.

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The following table details revenue and cost of revenue on a consolidated and divisional basis for the nine months ended December 31, 2010 and 2009 (in thousands):

	Nine Months Ended December 31,			
	2010	%	2009	%
QSI Dental Division				
Revenue	$ 14,319	100.0%	$ 12,474	100.0%
Cost of revenue	6,744	47.1%	5,492	44.0%
Gross profit	$ 7,575	52.9%	$ 6,982	56.0%
NextGen Division				
Revenue	$ 205,643	100.0%	$ 168,122	100.0%
Cost of revenue	61,696	30.0%	54,536	32.4%
Gross profit	$ 143,947	70.0%	$ 113,586	67.6%
Practice Solutions Division				
Revenue	$ 36,293	100.0%	$ 32,702	100.0%
Cost of revenue	25,876	71.3%	22,481	68.7%
Gross profit	$ 10,417	28.7%	$ 10,221	31.3%
Consolidated				
Revenue	$ 256,255	100.0%	$ 213,298	100.0%
Cost of revenue	94,316	36.8%	82,509	38.7%
Gross profit	$ 161,939	63.2%	$ 130,789	61.3%

Gross profit margins at the QSI Dental Division for the nine months ended December 31, 2010 decreased to 52.9% from 56.0% for the nine months ended December 31, 2009 primarily as a result of a higher percentage hardware and third-party software expense and higher costs for payroll and related benefits due to headcount additions in the nine months ended December 31, 2010 as compared to the same period a year ago. Gross profit margins at the NextGen Division for the nine months ended December 31, 2010 increased to 70.0% compared to 67.6% for the nine months ended December 31, 2009 primarily due to strong software sales and an increase in maintenance revenue, which yields higher margin than other services, along with improvements in EDI margins. Gross margin in the Practice Solutions Division decreased to 28.7% for the nine months ended December 31, 2010 as compared to 31.3% in the prior year period because the prior year period gross margin was positively impacted by $1.7 million of software license sales as compared to $0.3 million of software sales recorded in the nine months ended December 31, 2010.
The following table details the individual components of cost of revenue and gross profit as a percentage of total revenue on a consolidated and divisional basis for the nine months ended December 31, 2010 and 2009:

	Hardware, Third Party Software	Payroll and Related Benefits	EDI	Other	Total Cost of Revenue	Gross Profit
Nine Months Ended December 31, 2010						
QSI Dental Division	8.9%	17.8%	12.8%	7.6%	47.1%	52.9%
NextGen Division	3.5%	12.1%	7.7%	6.7%	30.0%	70.0%
Practice Solutions Division	0.0%	43.8%	0.6%	26.9%	71.3%	28.7%
Consolidated	3.3%	16.9%	7.0%	9.6%	36.8%	63.2%
Nine Months Ended December 31, 2009						
QSI Dental Division	8.0%	14.0%	16.7%	5.3%	44.0%	56.0%
NextGen Division	2.9%	13.4%	9.5%	6.6%	32.4%	67.6%
Practice Solutions Division	0.3%	43.6%	1.8%	23.0%	68.7%	31.3%
Consolidated	2.8%	18.0%	8.7%	9.2%	38.7%	61.3%

During the nine months ended December 31, 2010, hardware and third-party software constituted a higher portion of cost of revenue compared to the prior year period in the NextGen Division. The number of customers who purchase hardware and third-party software and the dollar amount of hardware and third-party software purchased fluctuates each quarter depending on the needs of our customers.

Our payroll and benefits expense associated with delivering our products and services decreased to 16.9% of consolidated revenue in the nine months ended December 31, 2010 compared to 18.0% during the same period last year. The absolute level of consolidated payroll and benefit expenses grew from $38.4 million in the nine months ended December 31, 2009 to $43.4 million in the nine months ended December 31, 2010, an increase of 12.9%, or approximately $5.0 million. Of the $5.0 million increase, approximately $1.7 million of the increase is related to the Practice Solutions Division. RCM is a service business, which inherently has higher percentage of payroll costs as a percentage of revenue. For the NextGen Division, an increase of approximately $2.5 million was related to increased headcount and payroll and benefits expense associated with delivering products and services. Payroll and benefits expense associated with delivering products and services in the QSI Dental Division increased $0.8 million from $1.8 million in the nine months ended December 31, 2009 to $2.6 million in the nine months ended December 31, 2010 primarily due to headcount additions.

Other expense, which primarily consists of third-party annual license and hosting costs, increased to 9.6% of total revenue during the nine months ended December 31, 2010 as compared to 9.2% for the same period a year ago. Contributing to this decline was better profit margins achieved in our consulting, hosting, and annual licenses revenues that are included in other services.

As a result of the foregoing events and activities, the gross profit percentage for the Company increased to 63.2% for the nine months ended December 31, 2010 versus 61.3% the prior year period.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the nine months ended December 31, 2010 increased 28.0% to $79.0 million as compared to $61.7 million for the prior year period. The increase in these expenses resulted primarily from:

- $12.8 million increase in salaries and related benefit expenses primarily as a result of headcount additions;
- $4.0 million increase due to selling and administrative expenses from Opus, which was acquired in February 2010;
- $2.0 million increase in sales commissions primarily related to the NextGen Division;
- $1.1 million increase related to a fair value adjustment to the contingent consideration liability related to the acquisitions of Opus and NextGen IS; offset by
- $1.9 million decrease in advertising, tradeshows, and travel related expenses; and
- $0.7 million net decrease in other selling and administrative expenses.

Share-based compensation expense was approximately $2.4 million and $1.3 million for the nine months ended December 31, 2010 and 2009, respectively, and is included in the aforementioned amounts. Selling, general and administrative expenses as a percentage of revenue increased from 28.9% in the nine months ended December 31, 2009 to 30.8% in the nine months ended December 31, 2010.

Research and Development Costs. Research and development costs for the nine months ended December 31, 2010 and 2009 were $16.0 million and $12.3 million, respectively. The increases in research and development expenses were due in part to increased investment in the NextGen Division product line. The Opus acquisition added $1.1 million in research and development expenses during the nine month period ended December 31, 2010. Additions to capitalized software costs offset increases in research and development costs. For the nine months ended December 31, 2010, $8.6 million was added to capitalized software costs while $4.7 million was capitalized during the nine months ended December 31, 2009 as we continue to enhance our software to meet the Meaningful Use definitions under the ARRA. Research and development costs as a percentage of revenue increased to 6.3% in the nine months ended December 31, 2010 from 5.8% for the same period in 2009. Research and development expenses are expected to continue at or above current dollar levels. Share-based compensation expense included in research and development costs was not material in the nine months ended December 31, 2010 and 2009.

Interest and Other Income. Interest and other income for the nine months ended December 31, 2010 and 2009 were $0.3 million and $0.4 million, respectively. Interest and other income consist primarily of dividends and interest earned on our investments.

Provision for Income Taxes. The provision for income taxes for the nine months ended December 31, 2010 was approximately $22.9 million as compared to approximately $20.7 million for the corresponding period a year ago. The effective tax rates were 34.7% and 37.0% for the nine months ended December 31, 2010 and 2009, respectively. The effective rate for the nine months ended December 31, 2010 decreased as compared to the prior year period primarily due to fluctuations in the state effective tax rate and increased benefits from the qualified production activities deduction. The effective rate also decreased as compared to the prior year period because of a discrete benefit of $1.0 million, resulting from a catch-up adjustment due to the federal research and development tax credit, which was retroactive to the initial expiration date of December 31, 2009.

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Liquidity and Capital Resources

The following table presents selected financial statistics and information for the nine months ended December 31, 2010 and 2009 (dollar amounts in thousands):

	Nine Months Ended December 31,	
	2010	2009
Cash and cash equivalents	$ 118,221	$ 79,111
Net increase in cash and cash equivalents	$ 33,610	$ 8,931
Net income	$ 43,053	$ 35,318
Net cash provided by operating activities	$ 60,305	$ 39,820
Number of days of sales outstanding	122	124

Cash Flows from Operating Activities

Cash provided by operations has historically been our primary source of cash and has primarily been driven by our net income plus adjustments to add back non-cash expenses, including depreciation, amortization of intangibles and capitalized software costs, provisions for bad debts and inventory obsolescence, share-based compensation and deferred taxes.

The following table summarizes our consolidated statements of cash flows for the nine months ended December 31, 2010 and 2009 (in thousands):

	Nine Months Ended December 31,	
	2010	2009
Net income	$ 43,053	$ 35,318
Non-cash expenses	15,925	10,514
Change in deferred revenue	8,184	7,996
Change in accounts receivable	(18,639)	(14,186)
Change in other assets and liabilities	11,782	178
Net cash provided by operating activities	$ 60,305	$ 39,820

Net Income. As referenced in the above table, net income makes up the majority of our cash generated from operations for the nine months ended December 31, 2010 and 2009. The NextGen Division s contribution to net income has increased each year due to that Division s operating income increasing more quickly than our Company as a whole.

Non-Cash Expenses. Non-cash expenses include depreciation, amortization of intangibles and capitalized software costs, provisions for bad debts, share-based compensation and deferred taxes. Total non-cash expenses were $15.9 million and $10.5 million for the nine months ended December 31, 2010 and 2009, respectively. The $5.4 million increase in non-cash expenses for the nine months ended December 31, 2010 as compared to the prior year period is primarily related to an increase of approximately $0.5 million in depreciation, $0.9 million of amortization of capitalized software costs, $1.3 million of amortization of other intangibles, $0.1 million in bad debt expense, $1.3 million in share-based compensation and $1.3 million in deferred income tax benefit.

Deferred Revenue. Cash from operations benefited from increases in deferred revenue. Deferred revenue increased by approximately $8.2 million for the nine months ended December 31, 2010 versus an increase of $8.0 million in the prior year period, resulting in a $0.2 million increase to cash from operations as compared to the prior year period.

Accounts Receivable. Accounts receivable grew by approximately $18.6 million and $14.2 million for the nine months ended December 31, 2010 and 2009, respectively. The increase in accounts receivable is due to the following factors:

§ NextGen Division revenue grew 22.3% and 19.9% on a year-over-year basis, in the nine months ended December 31, 2010 and 2009, respectively;

§ Turnover of accounts receivable is generally slower in the NextGen Division due to the fact that the systems sales related revenue have longer payment terms, generally up to one year, which historically have accounted for a major portion of NextGen Division sales; and

§ We experienced an increase in the volume of undelivered services billed in advance by the NextGen Division, which were unpaid as of the end of each period and included in accounts receivable. This resulted in an increase in both deferred revenue and accounts receivable of approximately $7.2 million for the nine months ended December 31, 2010.

The turnover of accounts receivable measured in terms of days sales outstanding (DSO) decreased from 124 days to 122 days during the nine months ended December 31, 2010 as compared the same prior year period. The decrease in DSO is primarily due to the factors mentioned above, offset by an increase in recurring revenue, such as maintenance, EDI and RCM revenue, which has a faster turnover of accounts receivable compared to system sales.

If amounts included in both accounts receivable and deferred revenue were netted, the turnover of accounts receivable expressed as DSO would be 82 days as of December 31, 2010 and 83 days as of December 31, 2009. Provided turnover of accounts receivable, deferred revenue, and profitability remain consistent for the nine months ended December 31, 2010, we anticipate being able to continue to generate cash from operations during fiscal 2011 primarily from our net income.

Other Assets and Liabilities. Cash from operations benefited from increases in other liabilities and decreases in other assets. Other assets decreased by a total of $1.6 million while other liabilities grew a total of $10.2 million during the nine months ended December 31, 2010. The increase in other liabilities consisted of a $1.1 million increase in contingent consideration related to the Opus and NextGen IS acquisitions, $2.2 million increase in accounts payable, and $6.9 million increase in all other liabilities.

Cash Flows from Investing Activities

Net cash used in investing activities for the nine months ended December 31, 2010 and 2009 was $4.6 million and $11.7 million, respectively. The decrease of net cash used in investing activities during the nine months ended December 31, 2010 as compared to the prior year period is primarily due to proceeds of $7.7 million received from the sale of our ARS investments, which was offset by net cash used of $3.7 million for the additions of equipment and improvements and capitalized software. In addition, during the nine months ended December 31, 2009, $2.7 million was paid for contingent consideration related to the acquisition of PMP and $0.3 million was paid for the acquisition of NextGen IS.

Cash Flows from Financing Activities

Net cash used in financing activities for the nine months ended December 31, 2010 and 2009 was $22.0 million and $19.2 million, respectively. During the nine months ended December 31, 2010, we received proceeds of $3.5 million from the exercise of stock options and paid $26.0 million in dividends to shareholders as compared to proceeds of $5.3 million from the exercise of stock options and payment of $25.7 million in dividends to shareholders during the same period in the prior year. We recorded a reduction in our tax benefit from share-based compensation of $0.5 million and $1.2 million during the nine months ended December 31, 2010 and 2009, respectively, related to excess tax deductions received from stock option exercises. The benefit was recorded as additional paid in capital.

Cash and Cash Equivalents and Marketable Securities

At December 31, 2010, we had cash and cash equivalents of $118.2 million. We intend to expend some of these funds for the development of products complementary to our existing product line as well as new versions of certain of our products. These developments are intended to take advantage of more powerful technologies and to increase the integration of our products.

In January 2007, our Board of Directors adopted a policy whereby we intend to pay a regular quarterly dividend of $0.25 per share on our outstanding Common Stock, subject to further Board review and approval and establishment of record and distribution dates by our Board of Directors prior to the declaration of each such quarterly dividend. Our Board of Directors increased the quarterly dividend to $0.30 per share in August 2008 and to $0.35 per share in January 2011. We anticipate that future quarterly dividends, if and when declared by our Board of Directors pursuant to this policy, would likely be distributable on or about the fifth day of each of the months of October, January, April and July.

On January 26, 2011, the Board of Directors approved a quarterly cash dividend of $0.35 per share on the Company s outstanding shares of Common Stock, payable to shareholders of record as of March 17, 2011 with an expected distribution date on or about April 5, 2011.

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Our Board of Directors declared the following dividends during the periods presented:

Declaration Date	Record Date	Payment Date	Per Share Dividend
Fiscal year 2011			
May 26, 2010	June 17, 2010	July 6, 2010	$0.30
July 28, 2010	September 17, 2010	October 5, 2010	0.30
October 25, 2010	December 17, 2010	January 5, 2011	0.30
Fiscal year 2010			
May 27, 2009	June 12, 2009	July 6, 2009	$0.30
July 23, 2009	September 25, 2009	October 5, 2009	0.30
October 28, 2009	December 23, 2009	January 5, 2010	0.30
January 27, 2010	March 23, 2010	April 5, 2010	0.30

Management believes that its cash and cash equivalents on hand at December 31, 2010, together with its marketable securities and cash flows from operations, if any, will be sufficient to meet its working capital and capital expenditure requirements as well as any dividends to be paid in the ordinary course of business for the remainder of fiscal year 2011.

The Company has recently committed to implementing an ERP system to upgrade its business information systems. We believe the ERP will greatly enhance and streamline our operational processes and provide a common technology platform to support future growth opportunities. We anticipate capital expenditures will increase in fiscal 2012 and will be funded from cash on hand and cash flows from operations.

Contractual Obligations

The following table summarizes our significant contractual obligations, all of which relate to operating leases, at December 31, 2010 and the effect that such obligations are expected to have on our liquidity and cash in future periods:

Year ended March 31,	
2011 (remaining three months)	$ 1,202
2012	5,137
2013	5,450
2014	5,738
2015 and beyond	10,465
	$ 27,992

New Accounting Pronouncements

Refer to Note 1, Summary of Significant Accounting Policies, of our notes to consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q for a discussion of new accounting standards.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We currently maintain our cash in very liquid short term assets including tax exempt and taxable money market funds and short-term U.S. Treasury securities with maturities of 90 days or less at the time of purchase.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively) have evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Security Exchange Act of 1934, as amended) as of December 31, 2010, the end of the period covered by the Quarterly Report (the Evaluation Date). They have concluded that, as of the Evaluation Date, these disclosure controls and procedures were effective to ensure that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities and would be disclosed on a timely basis. The Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information required to be disclosed by the Company in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission (SEC). They have also concluded that the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that are filed or submitted under the Exchange Act are accumulated and communicated to the Company s management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the quarter ended December 31, 2010, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company s management, including its Chief Executive Officer and Chief Financial Officer, has concluded that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at that reasonable assurance level. However, the Company s management can provide no assurance that our disclosure controls and procedures or our internal control over financial reporting can prevent all errors and all fraud under all circumstances. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been or will be detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We have experienced legal claims by parties asserting that we have infringed their intellectual property rights. We believe that these claims are without merit and intend to defend against them vigorously; however, we could incur substantial costs and diversion of management resources defending any infringement claim, even if we are ultimately successful in the defense of such matter. Litigation is inherently uncertain and always difficult to predict. We refer you to the discussion of infringement and litigation risks in our Item 1A. Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed in Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	Description
31.1*	Certification of Principal Executive Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Principal Financial Officer Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of 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.INS **	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.LAB**	XBRL Taxonomy Extension Label
101.PRE**	XBRL Taxonomy Extension Presentation

* Filed herewith.

** XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities and Exchange Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is not subject to liability under these section.

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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.

QUALITY SYSTEMS, INC.

Date: February 1, 2011	By: /s/ Steven T. Plochocki Steven T. Plochocki Chief Executive Officer (Principal Executive Officer)
Date: February 1, 2011	By: /s/ Paul A. Holt Paul A. Holt Chief Financial Officer (Principal Accounting Officer)

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