

COMPUTER PROGRAMS & SYSTEMS INC  
Form 10-Q  
August 08, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended June 30, 2007.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 000-49796

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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

(Exact Name of Registrant as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of  
  
Incorporation or Organization)

**74-3032373**  
(I.R.S. Employer  
  
Identification No.)

**6600 Wall Street, Mobile, Alabama**  
(Address of Principal Executive Offices)

**(251) 639-8100**

**36695**  
(Zip Code)

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(Registrant's Telephone Number, Including Area Code)

N/A

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of August 3, 2007, there were 10,801,327 shares of the issuer's common stock outstanding.

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**(For the period ended June 30, 2007)**

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

	June 30, 2007 (Unaudited)	December 31, 2006
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 9,657,180	\$ 8,760,122
Investments	10,971,746	10,717,952
Accounts receivable, net of allowance for doubtful accounts of \$825,000 and \$814,000, respectively	14,250,349	14,095,791
Financing receivables, current portion	2,207,353	2,177,430
Inventories	1,515,843	1,668,119
Deferred tax assets	1,369,620	1,406,279
Prepaid income taxes	30,617	107,426
Prepaid expenses	294,514	319,533
Total current assets	40,297,222	39,252,652
Property and equipment		
Land	936,026	936,026
Maintenance equipment	4,715,084	4,446,419
Computer equipment	6,820,585	6,440,844
Office furniture and equipment	1,948,632	1,940,853
Automobiles	132,926	132,926
	14,553,253	13,897,068
Less accumulated depreciation	(8,687,848)	(7,641,868)
Net property and equipment	5,865,405	6,255,200
Financing receivables	2,433,308	2,396,764
Total assets	\$ 48,595,935	\$ 47,904,616
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,202,777	\$ 1,204,279
Deferred revenue	3,411,361	2,274,592
Accrued vacation	2,148,740	2,053,288
Other accrued liabilities	2,888,822	3,157,585
Total current liabilities	9,651,700	8,689,744
Deferred tax liabilities	539,000	508,382
Stockholders equity:		
Common stock, par value \$0.001 per share; 30,000,000 shares authorized; 10,797,904 and 10,756,381 shares issued and outstanding	10,798	10,756

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Additional paid-in capital	24,002,713	22,427,967
Accumulated other comprehensive income (loss)	273	(7,333)
Retained earnings	14,391,451	16,275,100
<b>Total stockholders' equity</b>	<b>38,405,235</b>	<b>38,706,490</b>
Total liabilities and stockholders' equity	\$ 48,595,935	\$ 47,904,616

See accompanying notes.

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
<b>Sales revenues:</b>				
System sales	\$ 10,265,862	\$ 13,212,070	\$ 18,582,469	\$ 27,731,119
Support and maintenance	12,367,782	11,426,796	24,908,123	22,597,106
Outsourcing	5,329,436	4,345,915	10,418,915	8,193,869
<b>Total sales revenues</b>	<b>27,963,080</b>	<b>28,984,781</b>	<b>53,909,507</b>	<b>58,522,094</b>
<b>Costs of sales:</b>				
System sales	7,765,596	8,521,092	14,945,403	17,276,525
Support and maintenance	5,006,426	5,040,841	10,062,925	9,948,400
Outsourcing	3,295,311	2,459,310	6,352,608	4,682,687
<b>Total costs of sales</b>	<b>16,067,333</b>	<b>16,021,243</b>	<b>31,360,936</b>	<b>31,907,612</b>
<b>Gross profit</b>	<b>11,895,747</b>	<b>12,963,538</b>	<b>22,548,571</b>	<b>26,614,482</b>
<b>Operating expenses:</b>				
Sales and marketing	2,306,268	2,132,828	4,382,331	4,341,624
General and administrative	4,764,994	4,410,076	9,657,047	9,392,085
<b>Total operating expenses</b>	<b>7,071,262</b>	<b>6,542,904</b>	<b>14,039,378</b>	<b>13,733,709</b>
<b>Operating income</b>	<b>4,824,485</b>	<b>6,420,634</b>	<b>8,509,193</b>	<b>12,880,773</b>
<b>Other income:</b>				
Interest income	272,473	264,048	549,108	520,758
<b>Total other income</b>	<b>272,473</b>	<b>264,048</b>	<b>549,108</b>	<b>520,758</b>
<b>Income before taxes</b>	<b>5,096,958</b>	<b>6,684,682</b>	<b>9,058,301</b>	<b>13,401,531</b>
<b>Income taxes</b>	<b>1,795,058</b>	<b>2,599,836</b>	<b>3,196,884</b>	<b>5,223,483</b>
<b>Net income</b>	<b>\$ 3,301,900</b>	<b>\$ 4,084,846</b>	<b>\$ 5,861,417</b>	<b>\$ 8,178,048</b>
<b>Net income per share basic</b>	<b>\$ 0.31</b>	<b>\$ 0.38</b>	<b>\$ 0.55</b>	<b>\$ 0.77</b>
<b>Net income per share diluted</b>	<b>\$ 0.31</b>	<b>\$ 0.38</b>	<b>\$ 0.55</b>	<b>\$ 0.76</b>
<b>Weighted average shares outstanding</b>				
Basic	10,682,876	10,637,288	10,673,495	10,632,933
Diluted	10,732,503	10,718,971	10,725,519	10,717,100
<b>Dividends declared per share</b>	<b>\$ 0.36</b>	<b>\$ 0.36</b>	<b>\$ 0.36</b>	<b>\$ 0.36</b>

See accompanying notes.

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

	<b>Common Shares</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Retained Earnings</b>	<b>Total Stockholders Equity</b>
Balance at December 31, 2006	10,756,381	10,756	\$ 22,427,967	\$ (7,333)	\$ 16,275,100	\$ 38,706,490
Net Income					5,861,417	5,861,417
Issuance of common stock	41,523	42	685,328			685,370
Unrealized gain on available for sale investments, net of tax of \$4,862				7,606		7,606
Share-based compensation			641,648			641,648
Dividends					(7,745,066)	(7,745,066)
Income tax benefit from stock option exercise			247,770			247,770
Balance at June 30, 2007	10,797,904	10,798	\$ 24,002,713	\$ 273	\$ 14,391,451	\$ 38,405,235

See accompanying notes.

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

	<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>Operating Activities</b>		
Net income	\$ 5,861,417	\$ 8,178,048
Adjustments to net income:		
Provision for bad debt	14,111	(73,292)
Deferred taxes	65,866	(423,910)
Share-based compensation	641,648	664,474
Income tax benefit from stock option exercises	(247,770)	(165,204)
Depreciation	1,045,980	992,518
Changes in operating assets and liabilities:		
Accounts receivable	(168,669)	(1,016,739)
Financing receivables	(66,467)	(558,591)
Inventories	152,276	165,043
Prepaid expenses	25,019	(88,700)
Accounts payable	(1,502)	(614,240)
Deferred revenue	1,136,769	(614,708)
Other liabilities	(173,311)	121,538
Income taxes payable	324,579	397,257
Net cash provided by operating activities	8,609,946	6,963,494
<b>Investing Activities</b>		
Purchases of property and equipment	(656,185)	(946,635)
Purchases of investments	(244,777)	(189,267)
Net cash used in investing activities	(900,962)	(1,135,902)
<b>Financing Activities</b>		
Proceeds from exercise of stock options	685,370	239,696
Income tax benefit from stock option exercises	247,770	165,204
Dividends paid	(7,745,066)	(7,739,034)
Net cash used in financing activities	(6,811,926)	(7,334,134)
Increase (decrease) in cash and cash equivalents	897,058	(1,506,542)
Cash and cash equivalents at beginning of period	8,760,122	11,669,690
Cash and cash equivalents at end of period	\$ 9,657,180	\$ 10,163,148
Cash paid for income taxes, net of refund	\$ 2,806,438	\$ 5,250,136
See accompanying notes.		



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**COMPUTER PROGRAMS AND SYSTEMS, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

**1. BASIS OF PRESENTATION**

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

Certain financial information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These unaudited condensed financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2006 and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2006.

**2. REVENUE RECOGNITION**

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

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

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

Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements*, issued by the United States Securities and Exchange Commission, as amended by SAB No. 104.

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

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

The Company's revenue is generated from three sources:

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

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

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the provision of outsourcing services, which includes electronic billing, statement processing, payroll processing and business office outsourcing.

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

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

The Company accounts for ASP contracts in accordance with the EITF 00-3, *Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware*. EITF 00-3 states that the software element of ASP services is covered by SOP 97-2 only if the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party related to the vendor to host the software. Each ASP contract includes a system purchase and buyout clause, and this clause specifies the total amount of the system buyout.

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In addition, a clause is included which states that should the system be bought out by the customer, the customer would be required to enter into a general support agreement (for post contract support services) for the remainder of the original ASP term. Accordingly, the Company has concluded that ASP customers do not have the right to take possession of the system without significant penalty (i.e. the purchase price of the system), and thus ASP revenue of the Company does not fall within the scope of SOP 97-2. In accordance with SAB No. 104, revenue is recognized when the services are performed.

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

**3. DETAILS ON BALANCE SHEET AMOUNTS**

Other accrued liabilities are comprised of the following:

	June 30, 2007	December 31, 2006
Accrued salaries and benefits	\$ 2,060,316	\$ 2,275,743
Accrued commissions	210,812	389,597
Accrued self-insurance reserves	430,400	440,100
Other	187,294	52,145
	\$ 2,888,822	\$ 3,157,585

**4. INVESTMENTS**

The Company accounts for investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Accordingly, investments are classified as available-for-sale securities and are reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of shareholder's equity. The Company's management determines the appropriate classifications of investments in fixed maturity securities at the time of acquisition and re-evaluates the classifications at each balance sheet date. The Company's investments in fixed maturity securities are classified as available-for-sale.

Investments are comprised of the following at June 30, 2007:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short term investments	\$ 679,704	\$ 2,142	\$	\$ 681,846
Obligations of U.S. Treasury, U.S. government corporation and agencies	5,409,929	17,055	20,185	5,406,799
Mortgaged backed securities	360,545		4,900	355,645
Municipal obligations	1,000,000			1,000,000
Corporate bonds	3,521,114	16,407	10,065	3,527,456
	\$ 10,971,292	\$ 35,604	\$ 35,150	\$ 10,971,746

Shown below are the amortized cost and estimated fair value of securities with fixed maturities at June 30, 2007, by contract maturity date. Actual maturities may differ from contractual maturities because issuers of certain securities retain early call or prepayment rights.

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	<b>Amortized Cost</b>	<b>Fair Value</b>
Due in 2007	\$ 1,710,983	\$ 1,720,736
Due in 2008	2,817,746	2,824,760
Due in 2009	4,402,314	4,388,759
Due thereafter	1,360,545	1,355,645
	<b>\$ 10,291,588</b>	<b>\$ 10,289,900</b>

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Investments are comprised of the following at December 31, 2006:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short term investments	\$ 218,763	\$	\$	\$ 218,763
Obligations of U.S. Treasury, U.S. government corporation and agencies	5,019,979	21,591	25,092	5,016,478
Mortgaged backed securities	385,384		7,282	378,102
Municipal obligations	600,000			600,000
Corporate bonds	4,505,868	14,890	16,149	4,504,609
	\$ 10,729,994	\$ 36,481	\$ 48,523	\$ 10,717,952

**5. NET INCOME PER SHARE**

The Company presents both basic and diluted earnings per share (EPS) amounts. Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted EPS amounts are based upon the weighted average number of common and common equivalent shares outstanding during the period presented. The Company uses the treasury stock method to calculate the impact of outstanding stock options and unvested restricted stock grants. Potentially dilutive shares are derived from outstanding stock options and unvested restricted stock grants that have an exercise price less than the weighted average market price of our common stock. Any options or restricted stock grants with an exercise price greater than the weighted average market price of our common stock are considered antidilutive and are excluded from the computation of diluted earnings per share. The difference between basic and diluted EPS is attributable to stock options. For the three month periods ended June 30, 2007 and 2006, these dilutive shares were 49,627 and 81,683, respectively. For the six month periods ended June 30, 2007 and 2006, these dilutive shares were 52,024 and 84,167, respectively. The number of unvested restricted stock grants considered antidilutive and thus excluded from the year to date dilutive earnings per share computation at June 30, 2007 were 111,009.

**6. INCOME TAXES**

The Company accounts for income taxes using the liability method in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*. Deferred income taxes arise from the temporary differences in the recognition of income and expenses for tax purposes. Deferred tax assets and liabilities are comprised of the following:

	June 30, 2007	December 31, 2006
Deferred tax assets:		
Accounts receivable	\$ 321,662	\$ 317,352
Accrued vacation	838,009	800,782
Stock compensation	485,245	516,811
Other comprehensive income	3,297	4,707
Other accrued liabilities	206,652	283,438
<b>Total deferred tax assets</b>	<b>\$ 1,854,865</b>	<b>\$ 1,923,090</b>
Deferred tax liabilities:		
Deferred compensation	\$	\$ 8,294
Depreciation	1,024,245	1,016,900

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Total deferred tax liabilities	\$ 1,024,245	\$ 1,025,194
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Significant components of the Company's income tax provision for the six months ended June 30 are as follows:

	2007	2006
Current provision:		
Federal	\$ 2,546,263	\$ 4,651,010
State	584,755	996,384
Deferred provision:		
Federal	59,110	(380,533)
State	6,756	(43,378)
<b>Total income tax provision</b>	<b>\$ 3,196,884</b>	<b>\$ 5,223,483</b>

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

	2007	2006
Income taxes at U. S. Federal statutory rate	\$ 3,170,405	\$ 4,690,536
State income tax, net of federal tax effect	421,697	604,171
Other	(395,218)	(71,224)
<b>Total income tax provision</b>	<b>\$ 3,196,884</b>	<b>\$ 5,223,483</b>

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 requires a company to determine whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. If the more-likely-than-not threshold is met, a company must measure the tax position to determine the amount to recognize in the financial statements. The application of income tax law is inherently complex. Laws and regulation in this area are voluminous and are often ambiguous. As such, we are required to make many subjective assumptions and judgments regarding our income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in the balance sheets and statements of income.

At the adoption date of January 1, 2007, we had no unrecognized tax benefits which would affect our effective tax rate if recognized. At June 30, 2007, we have no unrecognized tax benefits.

The Company classifies interest and penalties arising from the underpayment of income taxes in the statement of income under general and administrative expenses. As of June 30, 2007, we have no accrued interest or penalties related to uncertain tax positions. The tax year 2006 federal return remains open to examination and the tax years 2003-2006 remain open to examination by other taxing jurisdictions to which we are subject.

**7. STOCK BASED COMPENSATION**

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (Revised 2004), *Share Based Payment* (SFAS No. 123R). SFAS No. 123R establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date based on the fair value of the award, and is recognized as an expense over the employee's requisite service period. The Company previously applied Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations and provided pro forma disclosures of SFAS No. 123, *Accounting for Stock Based Compensation*. The Company elected to adopt the modified prospective application method as provided by SFAS No. 123R, and, accordingly, prior periods are not restated for the effects of SFAS No. 123R. The Company recorded compensation costs as the requisite service rendered for the unvested portion of previously issued awards that remain outstanding at the initial date of adoption and any awards issued, modified,

repurchased, or cancelled after the effective date of SFAS No. 123R.



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The following table shows total stock-based compensation expense for the three and six months ended June 30, 2007 and 2006, included in the Condensed Statement of Income:

	Three Months Ended		Six Months Ended	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
Costs of sales	\$ 116,793	\$ 152,736	\$ 269,529	\$ 282,087
Operating expenses	179,288	236,772	372,119	382,387
Pre-tax stock-based compensation expense	296,081	389,508	641,648	664,474
Less: income tax effect	117,248	151,480	254,093	259,012
Net stock-based compensation expense	\$ 178,833	\$ 238,028	\$ 387,555	\$ 405,462

**2002 Stock Option Plan**

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

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

Under the methodology of SFAS No. 123, the fair value of the Company's stock options was estimated at the date of grant using the Black-Scholes option pricing model. The multiple option approach was used, with assumptions for expected option life of 5 years and 44% expected volatility for the market price of the Company's stock in 2002. An estimated dividend yield of 3% was used. The risk-free rate of return was determined to be 2.79% in 2002. No options have been granted in 2007.

A summary of stock option activity under the plan during the six month periods ended June 30, 2007 and 2006 is as follows:

	June 30, 2007		June 30, 2006	
	Shares	Exercise Price	Shares	Exercise Price
Outstanding at beginning of year	222,597	\$ 16.50	251,519	\$ 16.50
Granted				
Exercised	(41,523)	16.50	(14,527)	16.50
Forfeited	(9,991)	16.50	(5,629)	16.50
Outstanding at end of period	171,083	\$ 16.50	231,363	\$ 16.50
Exercisable at end of period	171,083	\$ 16.50	40,909	\$ 16.50
Shares available for future grants under the plan as end of period		495,355		482,542
Weighted-average grant date fair value		\$		\$
Weighted-average remaining contractual life		2.0		3.0

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Aggregate intrinsic value outstanding options	\$ 2,477,282
Aggregate intrinsic value exercisable options	\$ 2,477,282

The aggregate intrinsic value in the above table represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last trading date of the second quarter of 2007 and the exercise price, multiplied by the number of options.) The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

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The aggregate intrinsic value of options exercised during the quarters ended June 30, 2007 and June 30, 2006 was \$621,213 and \$91,427 respectively.

As of June 30, 2007, there was no unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the existing stock option plan.

**2005 Restricted Stock Plan**

On January 27, 2006, the Compensation Committee of the Board of Directors approved the grant of 116,498 shares of restricted stock, effective January 30, 2006, to certain executive officers of the Company under the 2005 Restricted Stock Plan. The grant date fair value was \$42.91 per share. The restricted stock vests in five equal annual installments commencing on the first anniversary of the date of grant. On May 17, 2006, the Compensation Committee of the Board of Directors approved the grant of 17,810 shares of restricted stock to Michael Jones, the newly named Chief Operating Officer of the Company. The grant date fair value was \$42.11 per share. The restricted stock vests in five equal annual installments commencing January 30, 2007, and each January 30 thereafter.

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested stock outstanding at beginning of year	111,009	\$ 42.79
Granted		
Vested	(22,202)	42.81
Forfeited		
Nonvested stock outstanding at end of period	88,807	\$ 42.79

As of June 30, 2007, there was \$3,399,972 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2005 Restricted Stock Plan. This cost is expected to be recognized over a weighted-average period of 3.6 years.

**8. COMPREHENSIVE INCOME**

Statement of Financial Accounting Standards No. 130 *Reporting Comprehensive Income*, requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with accounting principles generally accepted in the United States of America. Total comprehensive income for the three and six months ended June 30, 2007 and 2006 are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net income as reported	\$ 3,301,900	\$ 4,084,846	\$ 5,861,417	\$ 8,178,048
Other comprehensive income:				
Unrealized gain (loss) on investments, net of taxes	(10,948)	(2,709)	7,606	(13,053)
Total comprehensive income	\$ 3,290,952	\$ 4,082,137	\$ 5,869,023	\$ 8,164,995

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

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

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

overall business and economic conditions affecting the healthcare industry;

saturation of our target market and hospital consolidations;

changes in customer purchasing priorities and demand for information technology systems;

competition with companies that have greater financial, technical and marketing resources than we have;

failure to develop new technology and products in response to market demands;

fluctuations in quarterly financial performance due to, among other factors, timing of customer installations;

failure of our products to function properly resulting in claims for medical losses;

government regulation of our products and customers, including changes in healthcare policy affecting Medicare reimbursement rates; and

interruptions in our power supply and/or telecommunications capabilities.

Additional information concerning these and other factors which could cause differences between forward-looking statements and future actual results is discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission.

### **Overview**

We are a healthcare information technology company that designs, develops, markets, installs and supports computerized information technology systems to meet the unique demands of small and midsize hospitals. Our target market includes acute care community hospitals with 300 or fewer beds and small specialty hospitals. We are a single-source vendor providing comprehensive software and hardware products, complemented by data conversion, complete installation and extensive support. Our fully integrated, enterprise-wide system automates the management of clinical and financial data across the primary functional areas of a hospital. In addition, we provide services that enable our customers to outsource certain data-related business processes which we can perform more efficiently. We believe our products and services enhance hospital performance in the critical areas of clinical care, revenue cycle management, cost control and regulatory compliance. From our initial hospital installation in 1981, we have grown to serve more than 600 hospital customers across 46 states and the District of Columbia. In

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the three months ended June 30, 2007, we generated revenues of \$28.0 million from the sale of our products and services.

### **Results of Operations**

#### **Three Months Ended June 30, 2007 Compared with Three Months Ended June 30, 2006**

*Revenues.* Total revenues decreased by 3.5%, or \$1.0 million, to \$28.0 million for the three months ended June 30, 2007, from \$29.0 million for the three months ended June 30, 2006.

System sales revenues decreased by 22.3%, or \$2.9 million, to \$10.3 million for the three months ended June 30, 2007, from \$13.2 million for the three months ended June 30, 2006. This decrease was primarily due to a decrease in the sale of information systems to new customers.

Support and maintenance revenues increased by 8.2%, or \$0.9 million, to \$12.3 million for the three months ended June 30, 2007, from \$11.4 million for the three months ended June 30, 2006. This increase was attributable to an increase in recurring revenues as a result of a larger customer base and increased sales of add-on business to existing customers.

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Outsourcing revenues increased by 22.6%, or \$1.0 million, to \$5.3 million for the three months ended June 30, 2007, from \$4.3 million for the three months ended June 30, 2006. We experienced an increase in outsourcing revenues as a result of continued growth in existing customer demand for electronic billing and business office outsourcing services. We were providing full business office outsourcing services to twenty-three customers at June 30, 2007 compared to twelve customers at June 30, 2006.

*Costs of Sales.* Total costs of sales remained constant at \$16.0 million for the three months ended June 30, 2007 and 2006. As a percentage of total revenues, costs of sales increased to 57.5% for the three months ended June 30, 2007 from 55.3% for the three months ended June 30, 2006.

Cost of system sales decreased by 8.9%, or \$0.8 million, to \$7.7 million for the three months ended June 30, 2007, from \$8.5 million for the three months ended June 30, 2006. Cost of equipment decreased \$0.5 million as a result of a decrease in equipment sales which resulted from a decrease in new system sales. Travel related expenses decreased \$0.3 million. The gross margin on system sales decreased to 24.4% for the three months ended June 30, 2007, from 35.5% for the three months ended June 30, 2006. The decrease in the sale of systems to new customers coupled with a high percentage of fixed expenses included in cost of sales resulted in the decreased gross margin percentage.

Cost of support and maintenance remained constant at \$5.0 million for the three months ended June 30, 2007 and 2006. The gross margin on support and maintenance revenues increased to 59.5% for the three months ended June 30, 2007, compared to 55.9% for the three months ended June 30, 2006. The increase in gross margin was primarily due to the addition of new customers and increased sales of add-on business to our existing customer base with a proportionately smaller increase in support personnel.

Our costs associated with outsourcing services increased by 34.0%, or \$0.8 million, to \$3.3 million for the three months ended June 30, 2007, from \$2.5 million for the three months ended June 30, 2006. This increase was caused primarily by an increase of \$0.6 million in payroll related expenses as a result of an increase in the number of employees needed to support our growing business office outsourcing operations and electronic billing operations. Postage expense also increased \$0.2 million as a result of increased volume in our statement outsourcing business as well as an increase in postal rates during the quarter.

*Sales and Marketing Expenses.* Sales and marketing expenses increased by 8.1%, or \$0.2 million, to \$2.3 million for the three months ended June 30, 2007, from \$2.1 million for the three months ended June 30, 2006. Commissions decreased \$0.1 million as a result of the decrease in system sales during the quarter. This was offset by an increase in payroll related expense of \$0.1 million as a result of additional sales and marketing personnel added throughout 2006.

*General and Administrative Expenses.* General and administrative expenses increased 8.0%, or \$0.4 million, to \$4.8 million for the three months ended June 30, 2007, from \$4.4 million for the three months ended June 30, 2006. Employee group insurance increased \$0.2 million as a result of unfavorable claims experience during the quarter. Legal and accounting fees increased \$0.1 million and other operating expenses also increased \$0.1 million.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses increased to 25.2% for the three months ended June 30, 2007 from 22.6% for three months ended June 30, 2006.

*Net Income.* Net income for the three months ended June 30, 2007 decreased by 19.2%, or \$0.8 million, to \$3.3 million, or \$0.31 per diluted share, as compared with net income of \$4.1 million, or \$0.38 per diluted share, for the three months ended June 30, 2006. Net income represented 11.9% of revenue for the three months ended June 30, 2007, as compared to 14.1% of revenue for the three months ended June 30, 2006.

## **Six Months Ended June 30, 2007 Compared with Six Months Ended June 30, 2006**

*Revenues.* Total revenues decreased by 7.9%, or \$4.6 million, to \$53.9 million for the six months ended June 30, 2007, from \$58.5 million for the six months ended June 30, 2006.

System sales revenues decreased by 33.0%, or \$9.1 million, to \$18.6 million for the six months ended June 30, 2007, from \$27.7 million for the six months ended June 30, 2006. This decrease was primarily due to a decrease in the sale of information systems to new customers.

Support and maintenance revenues increased by 10.2%, or \$2.3 million, to \$24.9 million for the six months ended June 30, 2007, from \$22.6 million for the six months ended June 30, 2006. This increase was attributable to an increase in recurring revenues as a result of a larger customer base.

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Outsourcing revenues increased by 27.2%, or \$2.2 million, to \$10.4 million for the six months ended June 30, 2007, from \$8.2 million for the six months ended June 30, 2006. We experienced an increase in outsourcing revenues as a result of continued growth in customer demand for electronic billing, statement processing, and business office outsourcing services.

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*Costs of Sales.* Total costs of sales decreased by 1.7%, or \$0.5 million, to \$31.4 million for the six months ended June 30, 2007, from \$31.9 million for the six months ended June 30, 2006. As a percentage of total revenues, costs of sales increased to 58.2% for the six months ended June 30, 2007 from 54.5% for the six months ended June 30, 2006.

Cost of system sales decreased by 13.5%, or \$2.3 million, to \$14.9 million for the six months ended June 30, 2007, from \$17.2 million for the six months ended June 30, 2006. Payroll related expenses increased \$0.5 million as a result of salary increases and an increase in the number of employees. Cost of equipment decreased \$1.9 million as a result of a decrease in equipment sales. Travel related expenses decreased \$0.8 million due to a decrease in the number of new system installations. The gross margin on system sales decreased to 19.6% for the six months ended June 30, 2007, from 37.7% for the six months ended June 30, 2006. The decrease in the sale of systems to new customers coupled with a high percentage of fixed expenses included in cost of sales resulted in the decreased gross margin percentage.

Cost of support and maintenance increased by 1.2%, or \$0.1 million, to \$10.0 million for the six months ended June 30, 2007, from \$9.9 million for the six months ended June 30, 2006. This increase was caused primarily by an increase in payroll related expenses as a result of salary increases and an increase in the number of employees. The gross margin on support and maintenance revenues increased to 59.6% for the six months ended June 30, 2007, compared to 56.0% for the six months ended June 30, 2006.

Our costs associated with outsourcing services increased by 35.7%, or \$1.7 million, to \$6.4 million for the six months ended June 30, 2007, from \$4.7 million for the six months ended June 30, 2006. This increase was caused primarily by an increase of \$1.2 million in payroll related expenses as a result of an increase in the number of employees needed to support our growing business office outsourcing operations and electronic billing operations. Postage expense related to our statement outsourcing business also increased \$0.4 million due to an increase in volume and an increase in postal rates.

*Sales and Marketing Expenses.* Sales and marketing expenses increased by 0.9%, or \$0.1 million, to \$4.4 million for the six months ended June 30, 2007, from \$4.3 million for the six months ended June 30, 2006. The increase was attributable to an increase in travel expense of \$0.1 million.

*General and Administrative Expenses.* General and administrative expenses increased 2.8%, or \$0.3 million, to \$9.7 million for the six months ended June 30, 2007, from \$9.4 million for the six months ended June 30, 2006. Employee group insurance increased \$0.2 million as a result of unfavorable claims experience.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses increased to 26.0% for the six months ended June 30, 2007, from 23.5% for the six months ended June 30, 2006.

*Net Income.* Net income for the six months ended June 30, 2007 decreased by 28.3%, or \$2.3 million, to \$5.9 million, or \$0.55 per diluted share, as compared with net income of \$8.2 million, or \$0.76 per diluted share, for the six months ended June 30, 2006. Net income represented 10.9% of revenue for the six months ended June 30, 2007, as compared to 14.0% of revenue for the six months ended June 30, 2006.

## **Liquidity and Capital Resources**

At June 30, 2007, we had cash and cash equivalents of \$9.7 million, compared with \$10.1 million at June 30, 2006. Net cash provided by operating activities for the six months ended June 30, 2007 was \$8.6 million, compared to \$7.0 million for the six months ended June 30, 2006. The increase was primarily due to an increase in customer deposits, offset by a decrease in net income.

Net cash used in investing activities totaled \$0.9 million for the six months ended June 30, 2007, compared to \$1.1 million for the six months ended June 30, 2006. We used cash for the purchase of \$0.7 million of property and equipment and investments of \$0.2 million.

Net cash used in financing activities totaled \$6.8 million for the six months ended June 30, 2007, compared to \$7.3 million for the six months ended June 30, 2006. We declared and paid dividends of \$7.7 million during the first six months of 2007. During the six months ended June 30, 2007, we received proceeds from the exercise of stock options including the related tax benefit of \$0.9 million.

We currently do not have a bank line of credit or other credit facility in place. Our future capital requirements will depend upon a number of factors, including the rate of growth of our sales, cash collections from our customers and our future investments in fixed assets. We believe that our available cash and cash equivalents and anticipated cash generated from operations will be sufficient to meet our operating requirements for at least the next 12 months.

## **Off-Balance Sheet Arrangements**



We are not currently a party to any material off-balance sheet arrangement as defined in Item 303 of Regulation S-K.

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### **Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

We currently do not use derivative financial instruments. Cash and cash equivalents consist of highly liquid financial instruments, primarily cash, money market funds and short term U.S. Government obligations, purchased with an original maturity of three months or less. Interest income on our income statement is included in Other Income.

As of June 30, 2007, the Company had no borrowings and is, therefore, not subject to interest rate risks related to debt instruments.

### **Item 4. Controls and Procedures**

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

## **PART II**

### **OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

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

### **Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem immaterial also may materially adversely affect our business, financial condition and/or operating results.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Not applicable.

### **Item 3. Defaults Upon Senior Securities.**

Not applicable.

**Table of Contents****Item 4. Submission of Matters to a Vote of Security Holders.**

The Company held its Annual Meeting of Stockholders on May 10, 2007. At the meeting, the stockholders voted to elect three Class II directors to serve a three-year term and to ratify the appointment of Grant Thornton LLP as the Company's independent registered public accounting firm for 2007. The results of the stockholder voting on these matters are summarized as follows:

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

<b>Name of Nominee</b>	<b>For</b>	<b>Withheld</b>
M. Kenny Muscat	7,017,746	2,695,943
J. Boyd Douglas	7,077,114	2,636,575
Charles P. Huffman	9,006,624	707,065

**Proposal 2 Ratification of Appointment of Independent Auditors:**

<b>For</b>	<b>Against</b>	<b>Abstentions</b>
9,683,816	7,940	21,931

Following the 2007 Annual Meeting, John Morrissey, Ernest F. Ladd, III, David A. Dye and Hal L. Daugherty continue to serve as Class III directors with terms expiring at the 2008 Annual Meeting, and William R. Seifert II, W. Austin Mulherin, III and John C. Johnson continue to serve as Class I directors with terms expiring at the 2009 Annual Meeting.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

- 3.1 Certificate of Incorporation (filed as Exhibit 3.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 3.2 Bylaws (filed as Exhibit 3.6 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURE**

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

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

Date: August 8, 2007

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

Date: August 8, 2007

By: /s/ M. Stephen Walker  
M. Stephen Walker  
Vice President - Finance and Chief Financial Officer

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**Exhibit Index**

<b>No.</b>	<b>Exhibit</b>
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