

# QUALITY SYSTEMS, INC

## FORM 10-Q (Quarterly Report)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended December 31, 2016

or

**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**

*(State or other jurisdiction of incorporation or organization)*

**18111 Von Karman Avenue, Suite 800, Irvine, California**  
*(Address of principal executive offices)*

**95-2888568**

*(IRS Employer Identification No.)*

**92612**  
*(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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  No

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer  *(Do not check if a smaller reporting company)*

Small reporting company

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

The number of outstanding shares of the Registrant's common stock as of January 23, 2017 was 62,437,163 shares.

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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, 2016	March 31, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,994	\$ 27,176
Restricted cash and cash equivalents	4,647	5,320
Marketable securities	—	9,297
Accounts receivable, net	75,516	94,024
Inventory	252	555
Income taxes receivable	14,481	32,709
Prepaid expenses and other current assets	15,944	14,910
Total current assets	134,834	183,991
Equipment and improvements, net	26,097	25,790
Capitalized software costs, net	12,995	13,250
Deferred income taxes, net	9,780	8,198
Intangibles, net	74,722	91,675
Goodwill	185,888	188,837
Other assets	18,703	19,049
Total assets	\$ 463,019	\$ 530,790
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 5,223	\$ 11,126
Deferred revenue	49,763	57,935
Accrued compensation and related benefits	18,620	18,670
Income taxes payable	8	91
Other current liabilities	44,338	50,238
Total current liabilities	117,952	138,060
Deferred revenue, net of current	1,312	1,335
Deferred compensation	6,738	6,357
Line of credit	25,000	105,000
Other noncurrent liabilities	14,267	10,661
Total liabilities	165,269	261,413
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Common stock		
\$0.01 par value; authorized 100,000 shares; issued and outstanding 62,437 and 60,978 shares at December 31, 2016 and March 31, 2016, respectively	624	610
Additional paid-in capital	225,967	211,262
Accumulated other comprehensive loss	(653)	(481)
Retained earnings	71,812	57,986
Total shareholders' equity	297,750	269,377
Total liabilities and shareholders' equity	\$ 463,019	\$ 530,790

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

**QUALITY SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands, except per share data)  
(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
<b>Revenues:</b>				
Software license and hardware	\$ 16,995	\$ 16,150	\$ 48,966	\$ 52,026
Software related subscription services	22,546	11,705	63,911	36,388
Total software, hardware and related	39,541	27,855	112,877	88,414
Support and maintenance	39,924	39,519	116,905	125,408
Revenue cycle management and related services	20,048	21,594	62,037	62,630
Electronic data interchange and data services	21,790	20,643	65,527	61,413
Professional services	6,565	7,421	19,893	26,700
Total revenues	127,868	117,032	377,239	364,565
<b>Cost of revenue:</b>				
Software license and hardware	5,680	6,530	19,227	20,149
Software related subscription services	9,345	5,533	27,107	17,454
Total software, hardware and related	15,025	12,063	46,334	37,603
Support and maintenance	7,299	7,537	20,903	23,874
Revenue cycle management and related services	13,462	14,381	42,052	43,573
Electronic data interchange and data services	12,662	12,437	38,232	37,302
Professional services	5,904	7,367	19,643	24,008
Total cost of revenue	54,352	53,785	167,164	166,360
Gross profit	73,516	63,247	210,075	198,205
<b>Operating expenses:</b>				
Selling, general and administrative	37,542	39,395	120,913	115,962
Research and development costs, net	19,714	14,518	56,230	49,584
Amortization of acquired intangible assets	2,568	897	7,889	2,692
Restructuring costs	231	—	4,685	—
Total operating expenses	60,055	54,810	189,717	168,238
Income from operations	13,461	8,437	20,358	29,967
Interest income	—	60	9	406
Interest expense	(629)	(11)	(2,445)	(14)
Other expense, net	(4)	(43)	(146)	(147)
Income before provision for income taxes	12,828	8,443	17,776	30,212
Provision for income taxes	2,342	1,141	3,950	8,233
Net income	\$ 10,486	\$ 7,302	\$ 13,826	\$ 21,979
<b>Other comprehensive income:</b>				
Foreign currency translation, net of tax	(89)	(7)	(182)	(291)
Unrealized gain (loss) on marketable securities, net of tax	—	(29)	10	(34)
Comprehensive income	\$ 10,397	\$ 7,266	\$ 13,654	\$ 21,654
<b>Net income per share:</b>				
Basic	\$ 0.17	\$ 0.12	\$ 0.22	\$ 0.36
Diluted	\$ 0.17	\$ 0.12	\$ 0.22	\$ 0.36
<b>Weighted-average shares outstanding:</b>				
Basic	62,093	60,867	61,645	60,548
Diluted	62,093	61,279	61,900	61,190
Dividends declared per common share	\$ —	\$ 0.175	\$ —	\$ 0.525

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,	
	2016	2015
<b>Cash flows from operating activities:</b>		
Net income	\$ 13,826	\$ 21,979
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation	7,562	6,577
Amortization of capitalized software costs	6,626	7,428
Amortization of other intangibles	16,953	5,402
Amortization of debt issuance costs	807	—
Loss on disposal of equipment and improvements	452	158
Provision for bad debts	2,503	2,107
Provision for inventory obsolescence	369	118
Share-based compensation	5,177	2,328
Deferred income taxes	1,367	741
Change in fair value of contingent consideration	3,797	1,201
Loss on disposition of Hospital Solutions Division	—	1,366
<b>Changes in assets and liabilities:</b>		
Accounts receivable	16,005	11,313
Inventory	(66)	(160)
Accounts payable	(5,983)	6
Deferred revenue	(8,195)	(10,320)
Accrued compensation and related benefits	(50)	(7,706)
Income taxes	18,060	(18,395)
Deferred compensation	381	917
Other assets and liabilities	1,832	2,232
<b>Net cash provided by operating activities</b>	<b>81,423</b>	<b>27,292</b>
<b>Cash flows from investing activities:</b>		
Additions to capitalized software costs	(6,371)	(11,604)
Additions to equipment and improvements	(8,242)	(9,926)
Proceeds from sales and maturities of marketable securities	9,291	5,310
Purchases of marketable securities	—	(6,024)
HealthFusion working capital adjustment payment	(282)	—
<b>Net cash used in investing activities</b>	<b>(5,604)</b>	<b>(22,244)</b>
<b>Cash flows from financing activities:</b>		
Principal repayments on line of credit	(80,000)	—
Proceeds from issuance of shares under employee plans	999	732
Dividends paid	—	(32,125)
<b>Net cash used in financing activities</b>	<b>(79,001)</b>	<b>(31,393)</b>
<b>Net increase decrease in cash and cash equivalents</b>	<b>(3,182)</b>	<b>(26,345)</b>
Cash and cash equivalents at beginning of period	27,176	118,993
<b>Cash and cash equivalents at end of period</b>	<b>\$ 23,994</b>	<b>\$ 92,648</b>

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

	Nine Months Ended December 31,	
	2016	2015
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for income taxes	\$ 4,455	\$ 27,653
Cash refunds from income taxes	\$ 19,932	\$ 2,079
Cash paid for interest	\$ 1,670	\$ —
Common stock issued for Mirth share-based contingent consideration	\$ 9,273	\$ 9,273
<b>Non-cash investing and financing activities:</b>		
Tenant improvement allowance from landlord	\$ 3,094	\$ 1,324
Dividends declared but not paid	\$ —	\$ 10,726
Unpaid additions to equipment and improvements	\$ 80	\$ 226

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

**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 (collectively, the "Company"). Each of the terms "we," "us," or "our" as used herein refers collectively to the Company, unless otherwise stated. All intercompany accounts and transactions have been eliminated.

**Basis of Presentation.** The accompanying unaudited consolidated financial statements as of December 31, 2016 and for the three and nine months ended December 31, 2016 have been prepared in accordance with the requirements of Quarterly Report on Form 10-Q and Article 10 of the Securities and Exchange Commission 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 our Annual Report on Form 10-K for the fiscal year ended March 31, 2016. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments which are necessary for a fair statement 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.

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

**Significant Accounting Policies.** Effective July 1, 2016, we revised our reportable operating segments (see Note 14). There have been no other material changes to the significant accounting policies from those disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016.

**Share-Based Compensation.** The following table shows total share-based compensation expense included in the consolidated statements of comprehensive income for the three and nine months ended December 31, 2016 and 2015:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Costs and expenses:				
Cost of revenue	\$ 144	\$ 101	\$ 459	\$ 300
Research and development costs, net	273	67	690	280
Selling, general and administrative	1,584	575	4,028	1,748
Total share-based compensation	2,001	743	5,177	2,328
Income tax benefit	(718)	(225)	(1,825)	(701)
Decrease in net income	\$ 1,283	\$ 518	\$ 3,352	\$ 1,627

**Recent Accounting Standards.** Recent accounting pronouncements requiring implementation in future periods are discussed below or in the notes, where applicable.

In November 2016, the FASB issued Accounting Standards Update ("ASU") 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* ("ASU 2016-18"). ASU 2016-18 provides guidance on the classification of restricted cash and cash equivalents in the statement of cash flows. Although it does not provide a definition of restricted cash or restricted cash equivalents, it states that amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. ASU 2016-18 is effective for us in the first quarter of fiscal 2019, and we do not expect the adoption of this new standard to have a material impact on our consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory* ("ASU 2016-16"). ASU 2016-16 requires the recognition of current and deferred income taxes for intra-entity asset transfers when the transaction occurs. ASU 2016-16 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted. ASU 2016-16 is effective for us in the first quarter of fiscal 2019, and we are currently in the process of evaluating the potential impact of adoption of this updated authoritative guidance on our consolidated financial statements.



In August 2016, the FASB issued ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 is intended to add and clarify guidance on the classification of certain cash receipts and cash payments in the statement of cash flows to eliminate diversity in practice related to how such cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. ASU 2016-15 is effective for us in the first quarter of fiscal 2019, and we do not expect the adoption of this new standard to have a material impact on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* ("ASU 2016-09"). ASU 2016-09 simplifies the accounting for and reporting on share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The amendments in this update are to be applied differently upon adoption with certain amendments being applied prospectively, retrospectively and under a modified retrospective transition method. We expect to adopt ASU 2016-09 in the first quarter of fiscal 2018, and we do not expect the adoption of this new standard to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASU 2016-02"), which is intended to improve financial reporting about leasing transactions. The new guidance will require lessees to recognize on their balance sheets the assets and liabilities for the rights and obligations created by leases and to disclose key information about the leasing arrangements. ASU 2016-02 is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted. ASU 2016-02 is effective for us in the first quarter of fiscal 2020. We are currently in the process of evaluating the potential impact of adoption of this updated authoritative guidance on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Arrangement* ("ASU 2015-05"), which requires a customer to determine whether a cloud computing arrangement contains a software license that should be accounted for as internal-use software or as a service contract. ASU 2015-05 is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. Upon adoption, an entity has the option to apply the provisions of ASU 2015-05 either prospectively to all arrangements entered into or materially modified, or retrospectively. The adoption of this new standard did not have material impact on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"), which incorporates and expands upon certain principles that currently exist in U.S. auditing standards. ASU 2014-15 provides guidance regarding management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. The new standard requires management to perform interim and annual evaluations and sets forth principles for considering the mitigating effect of management's plans. The standard mandates certain disclosures when conditions give rise to substantial doubt about a company's ability to continue as a going concern within one year from the financial statement issuance date. ASU 2014-15 is effective for us commencing fiscal year ending March 31, 2017. The adoption of this new standard has not had, and is not expected to have, an impact on our consolidated financial statements.

In May 2014, the FASB, along with the International Accounting Standards Board, issued ASU 2014-09, *Revenue from Contracts with Customers* ("ASU 2014-09"), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. ASU 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies reporting using International Financial Reporting Standards and GAAP. The core principle of this updated guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard also requires additional disclosure about revenue and provides improved guidance for multiple element arrangements. In July 2015 decision, the FASB issued ASU 2015-14, *Deferral of Effective Date* ("ASU 2015-14") to delay the effective date by one year. In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606) –Principal versus Agent Consideration* ("ASU 2016-08"). In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing* ("ASU 2016-10"). In May 2016, the FASB issued ASU 2016-11, *Revenue from Contracts with Customers (Topic 606) and Derivatives and Hedging (Topic 815) – Rescission of SEC Guidance Because of ASU 2014-09 and 2014-16* ("ASU 2016-11") and ASU 2016-12, *Revenue from Contracts with Customers (Topic 606) –Narrow Scope Improvements and Practical Expedients* ("ASU 2016-12"). The new ASUs do not change the core principle of the guidance in Topic 606 (as amended by ASU 2014-09), but rather help to provide further interpretive clarifications on the new guidance in ASU 2014-09. ASU 2014-09, as amended by ASU 2015-14, is effective for us in the first quarter of fiscal 2019. Companies are permitted to adopt this new guidance following either a full retrospective or modified retrospective approach.

We have established a cross-functional team to assess the potential impact of the new revenue standard. Our assessment process consists of reviewing our current accounting policies and practices to identify potential differences that would result from applying the requirements of the new standard to our revenue contracts and identifying appropriate changes to our business processes, systems and controls to support revenue recognition and disclosure requirements under the new standard. Our initial assessment of the impact of the new revenue standard on our current business processes, systems and controls are expected to be completed during fiscal 2017. Additionally, we are currently evaluating the potential impact that the implementation of this new revenue

standard will have on our consolidated financial statements as well as selection of the method of adoption. We currently do not expect to implement this new standard prior to the required effective date.

We do not believe that any other recently issued, but not yet effective accounting standards, if adopted, would have a material impact on our consolidated financial statements.

## 2. Fair Value Measurements

The following tables set forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis at December 31, 2016 and March 31, 2016 :

	Balance at December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
<b>ASSETS</b>				
Cash and cash equivalents <sup>(1)</sup>	\$ 23,994	\$ 23,994	\$ —	\$ —
Restricted cash and cash equivalents	4,647	4,647	—	—
	<u>\$ 28,641</u>	<u>\$ 28,641</u>	<u>\$ —</u>	<u>\$ —</u>
<b>LIABILITIES</b>				
Contingent consideration related to acquisitions	\$ 18,367	\$ —	\$ 18,367	\$ —
	<u>\$ 18,367</u>	<u>\$ —</u>	<u>\$ 18,367</u>	<u>\$ —</u>
	Balance at March 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
<b>ASSETS</b>				
Cash and cash equivalents <sup>(1)</sup>	\$ 27,176	\$ 27,176	\$ —	\$ —
Restricted cash and cash equivalents	5,320	5,320	—	—
Marketable securities <sup>(2)</sup>	9,297	9,297	—	—
	<u>\$ 41,793</u>	<u>\$ 41,793</u>	<u>\$ —</u>	<u>\$ —</u>
<b>LIABILITIES</b>				
Contingent consideration related to acquisitions	\$ 23,843	\$ —	\$ —	\$ 23,843
	<u>\$ 23,843</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 23,843</u>

<sup>(1)</sup> Cash equivalents consist primarily of money market funds.

<sup>(2)</sup> Marketable securities consist of available-for-sale money market instruments and fixed-income securities, including certificates of deposit, corporate bonds and notes, and municipal securities.

The contingent consideration liability as of December 31, 2016 relates to the acquisition of HealthFusion (see Note 3). Prior to December 31, 2016, we had assessed the fair value of the contingent consideration liability on a recurring basis and any adjustments to fair value subsequent to the measurement period were reflected in the consolidated statements of comprehensive income. Key assumptions included discount rates and probability-adjusted achievement estimates of certain revenue targets that were not observable in the market. The categorization of the framework used to measure fair value of the contingent consideration liability was previously considered to be within the Level 3 valuation hierarchy due to the subjective nature of the unobservable inputs used. As of the end of the measurement period on December 31, 2016, the actual revenue achievement rate was utilized to compute the ending contingent consideration liability. Accordingly, the contingent consideration liability was transferred into the Level 2 valuation hierarchy because the fair value was determined based on other significant observable inputs.

The following table presents activity in our financial assets and liabilities measured at fair value using significant unobservable inputs (Level 3), as of and for the nine months ended December 31, 2016 :

	Total Liabilities
Balance at April 1, 2016	\$ 23,843
Settlement of contingent consideration related to Mirth	(9,273)
Fair value adjustments	3,797
Transfer of HealthFusion contingent consideration to Level 2	(18,367)
Balance at December 31, 2016	\$ —

During the nine months ended December 31, 2016 , we issued shares of common stock to settle \$9,273 in contingent consideration liabilities related to the acquisition of Mirth and recorded \$3,797 of fair value adjustments to contingent consideration liabilities, of which \$3,367 was related to HealthFusion and \$430 was related to Mirth. During the three months ended December 31, 2016 , we recorded a benefit of \$2,033 for fair value adjustments of contingent consideration liabilities related to HealthFusion. The fair value adjustments to contingent consideration liabilities are included as a component of selling, general and administrative expense in the consolidated statements of comprehensive income.

We believe that the fair value of other financial assets and liabilities, including accounts receivable, accounts payable, and line of credit, approximate their respective carrying values due to their nominal credit risk.

### **Non-Recurring Fair Value Measurements**

We have certain assets, including 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 to be within the Level 3 valuation hierarchy due to the subjective nature of the unobservable inputs used. During the nine months ended December 31, 2016 , we recorded certain adjustments to HealthFusion goodwill (see Note 3).

## **3. Business Combinations**

### **HealthFusion Acquisition**

On January 4, 2016, we completed our acquisition of HealthFusion Holdings, Inc. ("HealthFusion") pursuant to the Agreement and Plan of Merger (the "Merger Agreement"), dated October 30, 2015. HealthFusion provides Web-based, cloud computing software for physicians, medical billing service providers, and hospitals. Its flagship product, MediTouch®, is a fully-integrated, cloud-based software suite consisting of clearinghouse, practice management, electronic health records, and patient portals with rich functionality to enable mobility, workflow automation, and advanced reporting and analytics aimed primarily at small-to-mid-size physician practices. The acquisition of HealthFusion is part of our strategy to expand its client base and cloud-based solution capabilities in the ambulatory market. Over time, we plan to expand the HealthFusion platform to satisfy the needs of practices of increasing size and complexity.

The preliminary purchase price totals \$183,049 , which includes preliminary working capital and other customary adjustments and the fair value of contingent consideration related to an additional \$25,000 of cash in the form of an earnout, subject to HealthFusion achieving certain revenue targets through December 31, 2016. The initial estimated fair value of contingent consideration of \$16,700 was based on a Monte Carlo-based valuation model that considered, among other assumptions and inputs, our estimate of projected HealthFusion revenues. As of December 31, 2016 , the fair value of the contingent consideration was \$18,367 .

The acquisition was initially funded by a draw against the revolving credit agreement (see Note 7), a portion of which was subsequently repaid from existing cash on hand.

We accounted for the HealthFusion acquisition as a purchase business combination using the acquisition method of accounting. The preliminary purchase price was allocated to the tangible and intangible assets acquired and liabilities assumed based on their preliminary estimated fair values as of the acquisition date. The preliminary fair values of acquired assets and liabilities assumed represent management's estimate of fair value and are subject to change if additional information, such as changes to deferred taxes and/or working capital, becomes available. We expect to finalize the purchase price allocation as soon as practicable within the measurement period, but not later than one year following the acquisition date.

The preliminary estimated fair value of the acquired tangible and intangible assets and liabilities assumed were determined using multiple valuation approaches depending on the type of tangible or intangible asset acquired, including but not limited to the income approach, the excess earnings method and the relief from royalty method approach.

The preliminary amount of goodwill represents the excess of the preliminary purchase price over the preliminary net identifiable assets acquired and liabilities assumed. Goodwill primarily represents, among other factors, the value of synergies expected to be

realized and the assemblage of all assets that enable us to create new client relationships, neither of which qualify as separate amortizable intangible assets. Goodwill arising from the acquisition of HealthFusion was determined as the excess of the preliminary purchase price over the net acquisition date fair values of the acquired assets and the liabilities assumed, and is not deductible for tax purposes. HealthFusion operates under our Software and Related Solutions segment. During the nine months ended December 31, 2016, we recorded a \$2,949 adjustment to HealthFusion goodwill related to changes in deferred taxes based on the filing of final tax returns.

The total preliminary purchase price for the HealthFusion acquisition is summarized as follows:

Initial purchase price	\$	165,000
Contingent consideration		16,700
Preliminary working capital and other adjustments		1,349
Total preliminary purchase price	\$	<u>183,049</u>

January 4, 2016

Preliminary fair value of the net tangible assets acquired and liabilities assumed:		
Acquired cash and cash equivalents	\$	2,225
Accounts receivable, net		1,514
Prepaid expenses and other current assets		4,645
Equipment and improvements, net		767
Capitalized software costs, net		307
Other assets		700
Accounts payable		(1,085)
Accrued compensation and related benefits		(533)
Deferred revenue		(1,067)
Deferred income taxes, net		(9,078)
Other liabilities		(2,721)
Total preliminary net tangible assets acquired and liabilities assumed		<u>(4,326)</u>
Preliminary fair value of identifiable intangible assets acquired:		
Software technology		42,500
Customer relationships		28,500
Trade name		4,000
Goodwill		112,375
Total preliminary identifiable intangible assets acquired		<u>187,375</u>
Total preliminary purchase price	\$	<u>183,049</u>

#### 4. Goodwill

We test goodwill for impairment annually during our first fiscal quarter, referred to as the annual test date. We 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. We have not identified any events or circumstances as of December 31, 2016 that would require an interim goodwill impairment test. During the nine months ended December 31, 2016, we recorded certain adjustment to HealthFusion goodwill (see Note 3).

We do not amortize goodwill as it has been determined to have an indefinite useful life.

We have also determined that the change in reportable operating segments as a result of our ongoing reorganization efforts (see Note 14) did not have a significant impact on the amount of goodwill that is allocated to each reporting unit and each reportable operating segment. Goodwill by reportable operating segment consists of the following:

	December 31, 2016	March 31, 2016
Software and Related Solutions	\$ 153,598	\$ 156,547
RCM and Related Services	32,290	32,290
Total goodwill	<u>\$ 185,888</u>	<u>\$ 188,837</u>

## 5. Intangible Assets

Our definite-lived intangible assets, other than capitalized software development costs, are summarized as follows:

	December 31, 2016			
	Customer Relationships	Trade Name and Contracts	Software Technology	Total
Gross carrying amount	\$ 50,550	\$ 5,480	\$ 67,810	\$ 123,840
Accumulated amortization	(26,693)	(1,821)	(20,604)	(49,118)
Net intangible assets	\$ 23,857	\$ 3,659	\$ 47,206	\$ 74,722

  

	March 31, 2016			
	Customer Relationships	Trade Name and Contracts	Software Technology	Total
Gross carrying amount	\$ 50,550	\$ 7,368	\$ 67,810	\$ 125,728
Accumulated amortization	(19,618)	(2,895)	(11,540)	(34,053)
Net intangible assets	\$ 30,932	\$ 4,473	\$ 56,270	\$ 91,675

Amortization expense related to customer relationships and trade name and contracts recorded as operating expenses in the consolidated statements of comprehensive income was \$2,568 and \$898 for the three months ended December 31, 2016 and 2015, respectively. Amortization expense related to software technology recorded as cost of revenue was \$3,007 and \$903 for the three months ended December 31, 2016 and 2015, respectively.

Amortization expense related to customer relationships and trade name and contracts recorded as operating expenses in the consolidated statements of comprehensive income was \$7,889 and \$2,692 for the nine months ended December 31, 2016 and 2015, respectively. Amortization expense related to software technology recorded as cost of revenue was \$9,064 and \$2,710 for the nine months ended December 31, 2016 and 2015, respectively.

The following table summarizes the remaining estimated amortization of definite-lived intangible assets as of December 31, 2016:

	Amortization Expense Recorded As:		
	Operating Expense	Cost of Revenue	Total
For the year ended March 31,			
2017 (remaining three months)	2,527	2,963	5,490
2018	7,264	11,851	19,115
2019	4,852	11,851	16,703
2020	3,855	11,851	15,706
2021	3,006	7,968	10,974
2022 and beyond	6,012	722	6,734
Total	\$ 27,516	\$ 47,206	\$ 74,722

## 6. Capitalized Software Costs

Our capitalized software costs are summarized as follows:

	December 31, 2016	March 31, 2016
Gross carrying amount	\$ 103,070	\$ 96,699
Accumulated amortization	(90,075)	(83,449)
Net capitalized software costs	\$ 12,995	\$ 13,250

Amortization expense related to capitalized software costs was \$1,807 and \$2,499 for the three months ended December 31, 2016 and 2015, respectively, and is recorded as cost of revenue in the consolidated statements of comprehensive income. Amortization

expense related to capitalized software costs was \$6,626 and \$7,428 for the nine months ended December 31, 2016 and 2015, respectively.

The following table presents the remaining estimated amortization of capitalized software costs as of December 31, 2016. The estimated amortization is comprised of (i) amortization of released products and (ii) the expected amortization for products that are not yet available for sale based on their estimated economic lives and projected general release dates.

For the year ended March 31,	
2017 (remaining three months)	\$ 1,500
2018	5,300
2019	4,300
2020	1,895
Total	<u>\$ 12,995</u>

## 7. Line of Credit

On January 4, 2016, we entered into a \$250,000 revolving credit agreement ("Credit Agreement") with JP Morgan Chase Bank, N.A., as administrative agent, U.S. Bank National Association, as syndication agent, and certain other lenders. The Credit Agreement is secured by substantially all of our existing and future property and material domestic subsidiaries. The Credit Agreement provides a subfacility of up to \$10,000 for letters of credit and a subfacility of up to \$10,000 for swing-line loans. The Credit Agreement matures on January 4, 2021 and the full balance of the revolving loans and all other obligations under the agreement must be paid at that time. The revolving loans under the Credit Agreement will be available for letters of credit, working capital and general corporate purposes. We were in compliance with all covenants under the Credit Agreement as of December 31, 2016.

As of December 31, 2016, we had \$25,000 in outstanding loans and \$225,000 of unused credit under the Credit Agreement.

During the three months ended December 31, 2016, we recorded \$359 of interest expense and \$269 in amortization of deferred debt issuance costs related to the Credit Agreement. During the nine months ended December 31, 2016, we recorded \$1,631 of interest expense and \$807 in amortization of deferred debt issuance costs related to the Credit Agreement.

## 8. Composition of Certain Financial Statement Captions

Accounts receivable may include amounts invoiced for undelivered products and services at each period end. Undelivered products and services are included as a component of the deferred revenue balance on the accompanying consolidated balance sheets.

	December 31, 2016	March 31, 2016
Accounts receivable, gross	\$ 86,388	\$ 104,467
Sales return reserve	(8,623)	(7,541)
Allowance for doubtful accounts	(2,249)	(2,902)
Accounts receivable, net	<u>\$ 75,516</u>	<u>\$ 94,024</u>

Inventory is comprised of computer systems and components.

Prepaid expenses and other current assets are summarized as follows:

	December 31, 2016	March 31, 2016
Prepaid expenses	\$ 13,448	\$ 11,804
Other current assets	2,496	3,106
Prepaid expenses and other current assets	<u>\$ 15,944</u>	<u>\$ 14,910</u>

Equipment and improvements are summarized as follows:

	December 31, 2016	March 31, 2016
Computer equipment	\$ 21,483	\$ 32,213
Internal-use software	10,899	10,201
Furniture and fixtures	10,561	9,799
Leasehold improvements	16,538	13,408
Equipment and improvements, gross	59,481	65,621
Accumulated depreciation and amortization	(33,384)	(39,831)
Equipment and improvements, net	<u>\$ 26,097</u>	<u>\$ 25,790</u>

The current portion of deferred revenues are summarized as follows:

	December 31, 2016	March 31, 2016
Professional services	\$ 22,005	\$ 23,128
Software license, hardware and other	10,469	14,913
Support and maintenance	8,948	11,902
Software related subscription services	8,341	7,992
Deferred revenue	<u>\$ 49,763</u>	<u>\$ 57,935</u>

Accrued compensation and related benefits are summarized as follows:

	December 31, 2016	March 31, 2016
Payroll, bonus and commission	\$ 10,617	\$ 9,683
Vacation	8,003	8,987
Accrued compensation and related benefits	<u>\$ 18,620</u>	<u>\$ 18,670</u>

Other current and noncurrent liabilities are summarized as follows:

	December 31, 2016	March 31, 2016
Contingent consideration and other liabilities related to acquisitions	\$ 18,367	\$ 24,153
Care services liabilities	4,647	5,339
Customer credit balances and deposits	3,973	4,123
Accrued EDI expense	2,270	2,604
Accrued consulting and outside services	2,194	3,650
Accrued self insurance expense	1,898	1,862
Accrued outsourcing costs	1,613	1,604
Deferred rent	1,409	828
Accrued legal expense	758	864
Accrued royalties	740	2,341
Employee benefit plan withholdings	639	213
Sales tax payable	333	655
Other accrued expenses	5,497	2,002
Other current liabilities	<u>\$ 44,338</u>	<u>\$ 50,238</u>
Deferred rent	\$ 9,538	\$ 6,577
Uncertain tax position and related liabilities	4,729	4,084
Other noncurrent liabilities	<u>\$ 14,267</u>	<u>\$ 10,661</u>

## 9. Income Taxes

The provision for income taxes for the three months ended December 31, 2016 was \$2,342 and the provision for income taxes for the three months ended December 31, 2015 was \$1,141 . The effective tax rates were 18.3% and 13.5% for the three months ended December 31, 2016 and 2015 , respectively. The effective rate for the three months ended December 31, 2016 increased compared to the prior year period primarily due to the impact of lower qualifying production activity deductions in the current period, certain non-deductible acquisition-related costs, and a discrete valuation allowance, offset by federal and state research and development credit and other discrete adjustments.

The provision for income taxes for the nine months ended December 31, 2016 was \$3,950 and the provision for income taxes for the nine months ended December 31, 2015 was \$8,233 . The effective tax rates were 22.2% and 27.3% for the nine months ended December 31, 2016 and 2015 , respectively. The effective rate for the nine months ended December 31, 2016 decreased compared to the prior year period primarily due to favorable discrete adjustments for federal and state research and development credit, offset by non-deductible acquisition-related costs, lower qualifying production activity deductions in the current period, and other discrete adjustments.

The deferred tax assets and liabilities have been shown net in the accompanying consolidated balance sheets as noncurrent. We expect to receive the full benefit of the deferred tax assets recorded with the exception of certain state credits, state net operating loss carryforwards, and foreign accumulated minimum tax credits, for which we have recorded a valuation allowance.

### Uncertain tax positions

We had liabilities of \$4,729 and \$4,084 for unrecognized tax benefits related to various federal, state and local income tax matters as of December 31, 2016 and March 31, 2016 , respectively. If recognized, this amount would reduce our effective tax rate.

We are no longer subject to U.S. federal income tax examinations for tax years before 2013. With few exceptions, we are no longer subject to state income tax examinations for tax years before 2012. We do 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

The dual presentation of "basic" and "diluted" earnings per share is provided below. Share amounts below are in thousands.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
<b>Earnings per share — Basic:</b>				
Net income	\$ 10,486	\$ 7,302	\$ 13,826	\$ 21,979
Weighted-average shares outstanding — Basic	62,093	60,867	61,645	60,548
Net income per common share — Basic	\$ 0.17	\$ 0.12	\$ 0.22	\$ 0.36
<b>Earnings per share — Diluted:</b>				
Net income	\$ 10,486	\$ 7,302	\$ 13,826	\$ 21,979
Weighted-average shares outstanding	62,093	60,867	61,645	60,548
Effect of potentially dilutive securities	—	412	255	642
Weighted-average shares outstanding — Diluted	62,093	61,279	61,900	61,190
Net income per common share — Diluted	\$ 0.17	\$ 0.12	\$ 0.22	\$ 0.36

The computation of diluted net income per share does not include 3,054 and 3,015 options to acquire shares of common stock for the three and nine months ended December 31, 2016 , 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 1,839 and 1,789 options to acquire shares of common stock for the three and nine months ended December 31, 2015 , respectively, because their inclusion would have an anti-dilutive effect on net income per share.



## 11. Share-Based Awards

### Employee Stock Option and Incentive Plans

In October 2005, our shareholders approved a stock option and incentive plan (the "2005 Plan") under which 4,800,000 shares of common stock were reserved for the issuance of awards, including 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 our employees and directors may, at the discretion of the Board of Directors ("Board") or a duly designated compensation committee, be granted certain share-based awards. In the case of option awards granted under the 2005 Plan, the exercise price of each option is determined based on the date of grant and expire no later than 10 years from the date of grant. Awards granted pursuant to the 2005 Plan are subject to the vesting schedule or performance metrics set forth in the agreements pursuant to which they are granted. Upon a change of control of our Company, as such term is defined in the 2005 Plan, awards under the 2005 Plan will fully vest under certain circumstances. The 2005 Plan expired on May 25, 2015. As of December 31, 2016, there were 969,565 outstanding options and 567 outstanding shares of restricted stock awards under the 2005 Plan.

In August 2015, our shareholders approved a stock option and incentive plan (the "2015 Plan") under which 11,500,000 shares of common stock were reserved for the issuance of awards, including incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock awards and restricted stock unit awards, performance stock awards and other share-based awards. The 2015 Plan provides that our employees and directors may, at the discretion of the Board of Directors or a duly designated compensation committee, be granted certain share-based awards. In the case of option awards granted under the 2015 Plan, the exercise price of each option is determined based on the date of grant and expire no later than 10 years from the date of grant. Awards granted pursuant to the 2015 Plan are subject to the vesting schedule or performance metrics set forth in the agreements pursuant to which they are granted. Upon a change of control of our Company, as such term is defined in the 2015 Plan, awards under the 2015 Plan will fully vest under certain circumstances. As of December 31, 2016, there were 1,994,750 outstanding options, 933,165 outstanding shares of restricted stock awards, 123,082 outstanding shares of performance stock awards, and 8,079,983 shares available for future grant under the 2015 Plan.

The following table summarizes the stock option transactions during the nine months ended December 31, 2016:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, April 1, 2016	2,447,286	\$ 19.55	6.3	\$ 574
Granted	1,056,500	12.82	7.4	
Forfeited/Canceled	(539,471)	22.13	4.7	
Outstanding, December 31, 2016	2,964,315	\$ 16.68	6.4	\$ 377
Vested and expected to vest, September 30, 2016	2,652,038	\$ 16.93	6.3	\$ 329
Exercisable, December 31, 2016	586,120	\$ 25.05	3.9	\$ 11

We utilize the Black-Scholes valuation model for estimating the fair value of share-based compensation with the following assumptions:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Expected term	6.3 years	3.9 years	6.0 - 6.6 years	3.8 - 3.9 years
Expected volatility	37.1%	38.9%	36.9% - 37.4%	38.3% - 38.9%
Expected dividends	—%	5.3%	—%	4.1% - 5.3%
Risk-free rate	1.5%	1.3%	1.2% - 1.5%	1.3% - 1.6%

The weighted-average grant date fair value of stock options granted during the nine months ended December 31, 2016 and 2015 was \$4.92 and \$3.33 per share, respectively.

During the nine months ended December 31, 2016 , a total of 1,056,500 options to purchase shares of common stock were granted under the 2015 Plan at an exercise price equal to the market price of our common stock on the date of grant, as summarized below:

Option Grant Date	Number of Shares	Exercise Price	Vesting Terms <sup>(1)</sup>	Expiration
November 1, 2016	50,000	\$ 12.71	Four years	November 1, 2024
July 11, 2016	150,000	\$ 12.60	Four years	July 11, 2024
May 31, 2016	100,000	\$ 12.71	Five years	May 31, 2024
May 25, 2016	216,500	\$ 12.78	Four years	May 25, 2024
May 24, 2016	540,000	\$ 12.93	Four years	May 24, 2024
Fiscal year 2017 grants	<u>1,056,500</u>			

<sup>(1)</sup> Options vest in equal annual installments on each grant anniversary date commencing one year following the date of grant.

Non-vested stock option award activity during the nine months ended December 31, 2016 is summarized as follows:

	Non-Vested Number of Shares	Weighted- Average Grant-Date Fair Value per Share
Outstanding, April 1, 2016	1,859,750	\$ 4.67
Granted	1,056,500	4.92
Vested	(276,595)	4.30
Forfeited/Canceled	(261,460)	4.38
Outstanding, December 31, 2016	<u>2,378,195</u>	\$ 4.72

As of December 31, 2016 , \$8,662 of total unrecognized compensation costs related to stock options is expected to be recognized over a weighted-average period of 3.2 years. This amount does not include the cost of new options that may be granted in future periods or any changes in our forfeiture percentage. The total fair value of options vested during the nine months ended December 31, 2016 and 2015 was \$1,189 and \$1,564 , respectively.

Restricted stock awards activity during the nine months ended December 31, 2016 is summarized as follows:

	Number of Shares	Weighted- Average Grant-Date Fair Value per Share
Outstanding, April 1, 2016	191,247	\$ 14.44
Granted	857,456	12.81
Vested	(68,309)	14.29
Canceled	(46,662)	12.78
Outstanding, December 31, 2016	<u>933,732</u>	\$ 12.80

Share-based compensation expense related to restricted stock awards was \$1,054 and \$249 for the three months ended December 31, 2016 and 2015 , respectively. Share-based compensation expense related to restricted stock awards was \$2,571 and \$664 for the nine months ended December 31, 2016 and 2015 , respectively.

The weighted-average grant date fair value for the restricted stock awards was estimated using the market price of the common stock on the date of grant. The fair value of the restricted stock awards is amortized on a straight-line basis over the vesting period, which is generally two years.

As of December 31, 2016 , \$9,930 of total unrecognized compensation costs related to restricted stock awards is expected to be recognized over a weighted-average period of 2.2 years. This amount does not include the cost of new restricted stock awards that may be granted in future periods.

On December 29, 2016, the Compensation Committee of the Board granted 123,082 performance stock awards to certain executive officers. The performance stock awards vest in four equal increments on each of the first four anniversaries of the grant date, subject in each case to the executive officer's continued service and achievement of certain Company performance goals, including strong Company stock price performance. Share-based compensation expense related to the performance stock awards was not significant for the three and nine months ended December 31, 2016 .

### **Employee Share Purchase Plan**

On August 11, 2014, our shareholders approved an Employee Share Purchase Plan (the "Purchase Plan") under which 4,000,000 shares of common stock were reserved for future grant. The Purchase Plan allows eligible employees to purchase shares through payroll deductions of up to 15% of total base salary at a price equal to 90% of the lower of the fair market values of the shares as of the beginning or the end of the corresponding offering period. Any shares purchased under the Purchase Plan are subject to a six-month holding period. Employees are limited to purchasing no more than 1,500 shares on any single purchase date and no more than \$25,000 in total fair market value of shares during any one calendar year. As of December 31, 2016, we have issued 209,876 shares under the Purchase Plan and 3,790,124 shares are available for future issuance.

Share-based compensation expense recorded for the employee share purchase plan was \$70 and \$70 for the three months ended December 31, 2016 and 2015, respectively. Share-based compensation expense recorded for the employee share purchase plan was \$277 and \$216 for the nine months ended December 31, 2016 and 2015, respectively.

### **12. Concentration of Credit Risk**

We had cash deposits at U.S. banks and financial institutions which exceeded federally insured limits at December 31, 2016. We are exposed to credit loss for amounts in excess of insured limits in the event of non-performance by the institutions; however, we do not anticipate non-performance by these institutions.

### **13. Commitments, Guarantees and Contingencies**

#### ***Commitments and Guarantees***

Our software license agreements include a performance guarantee that our software products will substantially operate as described in the applicable program documentation for a period of 365 days after delivery. To date, we have not incurred any significant costs associated with our performance guarantee or other related warranties and do 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, we have not incurred any significant costs associated with these warranties and do not expect to incur significant warranty costs in the future. Therefore, no accrual has been made for potential costs associated with these warranties.

We have historically offered short-term rights of return in certain sales arrangements. If we are 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 we are 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.

Our standard sales agreements contain an indemnification provision pursuant to which we 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 our software. As we have not incurred any significant costs to defend lawsuits or settle claims related to these indemnification agreements, we believe that our estimated exposure on these agreements is currently minimal. Accordingly, we have no liabilities recorded for these indemnification obligations.

#### ***Hussein Litigation***

On October 7, 2013, a complaint was filed against our Company and certain of our officers and directors in the Superior Court of the State of California for the County of Orange, captioned Ahmed D. Hussein v. Sheldon Razin, Steven Plochocki, Quality Systems, Inc. and Does 1-10, inclusive, No. 30-2013-00679600-CU-NP-CJC, by Ahmed Hussein, a former director and significant shareholder of our Company. We filed a demurrer to the complaint, which the Court granted on April 10, 2014. An amended complaint was filed on April 25, 2014. The amended complaint generally alleges fraud and deceit, constructive fraud, negligent misrepresentation and breach of fiduciary duty in connection with statements made to our shareholders regarding our financial condition and projected future performance. The amended complaint seeks actual damages, exemplary and punitive damages and costs. We filed a demurrer to the amended complaint. On July 29, 2014, the Court sustained the demurrer with respect to the breach of fiduciary duty claim, and overruled the demurrer with respect to the fraud and deceit claims. On August 28, 2014, we filed an answer and also filed a cross-complaint against the plaintiff, alleging that the plaintiff breached fiduciary duties owed to the Company, Mr. Razin and Mr. Plochocki. Mr. Razin and Mr. Plochocki have dismissed their claims against Hussein, leaving QSI as the sole plaintiff in the cross-complaint. On June 26, 2015, we filed a motion for summary judgment, which the Court granted on September 16, 2015, dismissing all claims against us. On September 23, 2015, the plaintiff filed an application for reconsideration of the Court's summary judgment order, which the Court denied. On October 28, 2015, the plaintiff filed a motion for summary judgment, seeking to dismiss our cross-complaint, which the Court denied on March 3, 2016. On May 9, 2016, the plaintiff filed a motion for summary adjudication, seeking to again dismiss our cross-complaint, which the Court denied on August 5, 2016. On August 5, 2016, the plaintiff filed a motion for judgment on the pleadings, seeking to again

dismiss our cross-complaint, which the Court denied on September 2, 2016. Trial is set for April 10, 2017 on QSI's cross-complaint. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this claim.

#### ***Federal Securities Class Action***

On November 19, 2013, a putative class action complaint was filed on behalf of the shareholders of our Company other than the defendants against us and certain of our officers and directors in the United States District Court for the Central District of California by one of our shareholders. After the Court appointed lead plaintiffs and lead counsel for this action, and recaptioned the action *In re Quality Systems, Inc. Securities Litigation*, No. 8L13-cv-01818-CJC(JPRx), lead plaintiffs filed an amended complaint on April 7, 2014. The amended complaint, which is substantially similar to the litigation described above under the caption "*Hussein Litigation*," generally alleges that statements made to our shareholders regarding our financial condition and projected future performance were false and misleading in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that the individual defendants are liable for such statements because they are controlling persons under Section 20(a) of the Exchange Act. The complaint seeks compensatory damages, court costs and attorneys' fees. We filed a motion to dismiss the amended complaint on June 20, 2014, which the Court granted on October 20, 2014, dismissing the complaint with prejudice. Plaintiffs filed a motion for reconsideration of the Court's order, which the Court denied on January 5, 2015. On January 30, 2015, Plaintiffs filed a notice of appeal to the United States Court of Appeals for the Ninth Circuit, captioned *In re Quality Systems, Inc. Securities Litigation*, No. 15-55173. Plaintiffs filed their opening brief and we answered. Oral argument was held on December 5, 2016. The Court's decision remains pending. We believe that the plaintiffs' claims are without merit and continue to defend against them vigorously. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this claim.

#### ***Shareholder Derivative Litigation***

On January 24, 2014, a complaint was filed against our Company and certain of our officers and current and former directors in the United States District Court for the Central District of California, captioned *Timothy J. Foss, derivatively on behalf of himself and all others similarly situated, vs. Craig A. Barbarosh, George H. Bristol, James C. Malone, Peter M. Neupert, Morris Panner, D. Russell Pflueger, Steven T. Plochocki, Sheldon Razin, Lance E. Rosenzweig and Quality Systems, Inc.*, No. SACV14-00110-DOC-JPPx, by Timothy J. Foss, a shareholder of ours. The complaint arises from the same allegations described above under the captions "*Hussein Litigation*" and "*Federal Securities Class Action*" and generally alleges breach of fiduciary duties, abuse of control and gross mismanagement by our directors, in addition to unjust enrichment and insider selling by individual directors. The complaint seeks compensatory damages, restitution and disgorgement of all profits, court costs, attorneys' fees and implementation of enhanced corporate governance procedures. The parties have agreed to stay this litigation until the United States Court of Appeals for the Ninth Circuit issues a ruling on the pending appeal described above under the caption "*Federal Securities Class Action*". We believe that the plaintiff's claims are without merit and intend to defend against them vigorously. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this claim.

#### **14. Operating Segment Information**

Effective July 1, 2016, we revised our reportable operating segments. As part of our ongoing reorganization efforts, we refined the measurement of our segment data to better reflect our current internal organizational structure whereby certain functions that formerly existed within each individual operating segment have changed. Our operating segments now consist of the Software and Related Solutions segment and the RCM and Related Services segment, which is consistent with the disaggregated financial information used and evaluated by our chief operating decision maker (consisting of our Chief Executive Officer) to assess performance and make decisions about the allocation of resources. Revenue and gross profit are the key measures of segment profitability used by our chief operating decision maker to measure segment operating performance and to make key business decisions. The revenues and gross profit of each segment are derived from distinct product and services within each segment. The Software and Related Solutions segment aggregates the revenues and gross profit of our software-related products and services, including software license and hardware, software-related subscription services, support and maintenance, EDI and data services, and certain professional services, such as implementation, training, and consulting. The RCM and Related Services segment aggregates the revenues and gross profit of our RCM services and certain related ancillary service offerings.

Certain functional roles that do not engage in revenue generating activities, such as product solutions and strategy, research and development, and certain corporate general and administrative functions, including finance, human resources, marketing, and legal, are considered to be shared-services and are not controlled by segment-level leadership. Although the segments may derive direct benefits as a result of such shared-services functions, our chief operating decision maker evaluates performance based upon stand-alone segment revenues and gross profit. Accordingly, the shared-services functions are not considered separate operating segments, and the related operating expenses are not included within our operating segments disclosure. Additionally, total assets are managed at a consolidated level and thus are also not included within our operating segments disclosure. Accounting policies for each of our operating segments are the same as those applied to our consolidated financial statements.

Operating segment data for the three and nine months ended December 31, 2016 and 2015 is summarized in the table below. Prior period data has been retroactively reclassified to present all segment information on a comparable basis. The change in reportable segments has no impact to consolidated revenues and consolidated cost of revenue, nor does it affect our presentation of revenue and cost of revenue on the consolidated statements of comprehensive income.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
<b>Revenue:</b>				
Software and Related Solutions	\$ 106,958	\$ 93,927	\$ 312,854	\$ 291,783
RCM and Related Services	20,910	22,486	64,385	65,313
Hospital Solutions <sup>(1)</sup>	—	619	—	7,469
<b>Consolidated revenue</b>	<b>\$ 127,868</b>	<b>\$ 117,032</b>	<b>\$ 377,239</b>	<b>\$ 364,565</b>
<b>Gross profit (loss):</b>				
Software and Related Solutions	\$ 71,252	\$ 58,949	\$ 204,414	\$ 184,982
RCM and Related Services	7,077	7,769	21,337	20,792
Hospital Solutions <sup>(1)</sup>	—	(69)	—	2,569
Unallocated cost of revenue <sup>(2)</sup>	(4,813)	(3,402)	(15,676)	(10,138)
<b>Consolidated gross profit</b>	<b>\$ 73,516</b>	<b>\$ 63,247</b>	<b>\$ 210,075</b>	<b>\$ 198,205</b>

<sup>(1)</sup> The former Hospital Solutions Division was divested in October 2015 and therefore, does not represent a distinct operating segment. Historical amounts for Hospital Solutions have not been revised.

<sup>(2)</sup> Consists of amortization of acquired software technology and amortization of capitalized software costs not allocated to the operating segments for the purposes of measuring performance.

## 15. Restructuring Plan

In fiscal year 2016, we initiated a three-phase plan intended to better position our organization for future success. We implemented a series of actions with the objective of achieving greater synergies and further integration of our products and services in support of our business strategies, and enabling a more efficient, integrated and client-centered delivery of the holistic solutions that we believe is required by our ambulatory care clients. We also transformed our management team with the appointment of a new chief executive officer, chief financial officer, chief technology officer, chief strategy officer, and chief client officer. In the first phase, we redesigned the organization to more effectively support the execution of our strategy. Under phase two of our reorganization, we will continue to build our infrastructure and enhance our healthcare information technology capabilities to drive future revenue growth. The third phase of the plan will consist of developing and marketing the services and solutions that we believe will accelerate revenue growth.

The overall plan also includes a multi-year initiative, called NextGen 2.0, to merge our business units into a more streamlined, functional-based organization structure and to realign our organizational structure by consolidating the sales, marketing, information services, and software development responsibilities into single, company-wide roles in order to achieve greater efficiency. As a result, our reportable segments have changed and may change again due to such changes in the organization of our business.

The first phase was completed in April 2016, when we announced a corporate restructuring plan, which was approved by our Board of Directors. During the three and nine months ended December 31, 2016, we recorded \$231 and \$4,685, respectively, of restructuring costs within operating expenses in our consolidated statements of comprehensive income. The restructuring costs consist primarily of payroll-related costs, such as severance, outplacement costs, and continuing healthcare coverage, associated with the involuntary separation of employees pursuant to a one-time benefit arrangement, which were accrued when it was probable that the benefits will be paid and the amount were reasonably estimable. The remaining restructuring liability as of December 31, 2016 was not significant. The restructuring plan is expected to be complete by the end of fiscal 2017.

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

### CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q ("Report") and certain information incorporated herein by reference contain forward-looking statements within the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. All statements included or incorporated by reference in this Report, other than statements that are purely historical, are forward-looking statements. Words such as "anticipate," "expect," "intend," "plan," "believe," "seek," "estimate," "will," "should," "would," "could," "may," and similar expressions also identify forward-looking statements. These forward-looking statements include, without limitation, discussions of our product development plans, business strategies, future operations, financial condition and prospects, developments in and the impacts of government regulation and legislation, including, without limitation, The American Recovery and Reinvestment Act, the Patient Protection and Affordable Care Act, and the Medicare Access and CHIP Reauthorization Act of 2015, and market factors influencing our results. Our expectations, beliefs, objectives, intentions and strategies regarding our future results are not guarantees of future performance and are subject to risks and uncertainties, both foreseen and unforeseen, that could cause actual results to differ materially from results contemplated in our forward-looking statements. These risks and uncertainties include, but are 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 Annual Report on Form 10-K for the fiscal year ended March 31, 2016 ("Annual Report"), as supplemented by additional risk factors, if any, in our interim filings on our Quarterly Reports on Form 10-Q, as well as in our other public disclosures and filings with the Securities and Exchange Commission ("SEC"). Because of these risk factors, as well as other variables affecting our financial condition and results of operations, past financial performance may not be a reliable indicator of future performance and historical trends should not be used to anticipate results or trends in future periods. We assume no obligation to update any forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of the filing of this Report.

This management's discussion and analysis of financial condition and results of operations ("MD&A") is provided as a supplement to the consolidated financial statements and notes thereto included elsewhere in this Report 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 Report. 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.

### Company Overview

Quality Systems, Inc., primarily through its NextGen Healthcare subsidiary, provides technology-based solutions and services to the ambulatory care market in the United States. Our solutions provide our clients with the ability to redesign patient care and other workflow processes while improving productivity through the facilitation of managed access to patient information. We help promote healthy communities by empowering physician practice success and enriching the patient care experience while lowering the cost of healthcare.

We primarily derive revenue by developing and marketing software and services that automate certain aspects of practice management ("PM") and electronic health records ("EHR") for medical and dental practices. Our software can be licensed on a perpetual, on-premise basis, hosted in a private cloud or, in certain instances, as a software-as-a-service ("SaaS") solution. We market and sell our solutions through a dedicated sales force and to a much lesser extent, through resellers. Our clients include single and small practice physicians, networks of practices such as physician hospital organizations ("PHOs"), management service organizations ("MSOs"), accountable care organizations ("ACOs"), ambulatory care centers, community health centers and medical and dental schools. We also provide implementation, training, support and maintenance for software and complementary services such as revenue cycle management ("RCM") and electronic data interchange ("EDI").

We have a history of developing new and enhanced technologies. Over the course of a number of years, we have also made strategic acquisitions to complement and enhance our product portfolio in the ambulatory care, RCM, and hospital markets.

Quality Systems, Inc. was incorporated in California in 1974. Our principal offices are located at 18111 Von Karman Ave., Suite 800, Irvine, California, 92612. Our websites are located at [www.nextgen.com](http://www.nextgen.com) and [www.qsii.com](http://www.qsii.com). We operate on a fiscal year ending on March 31.

### Trends and Events in Our Business

We believe that the following trends and events as described below have contributed to our consolidated results of operations and may continue to impact our future results.

We believe healthcare is more heavily influenced by regulatory and national health projects than by the cycles of our economy. The healthcare industry has been significantly impacted by the Obama Administration's broad healthcare reform efforts, including the Health Information Technology for Economic and Clinical Health portion of the American Recovery and Reinvestment Act of 2009 ("HITECH Act") and the Patient Protection and Affordable Care Act ("ACA") that provided significant incentives to health care organizations for "Meaningful Use" adoption and interoperable electronic health record solutions.

We also believe that healthcare reform, including the repeal of the sustainable growth rate ("SGR") formula as part of the Medicare Access and CHIP Reauthorization Act of 2015 ("MACRA"), and a movement towards a value-based, pay-for-performance model and quality initiative efforts will stimulate demand for robust electronic health record solutions as well as new health information technology solutions from bundled billing capabilities to patient engagement and population health management. We believe MACRA may be the most important of the three regulations for our market because it permanently changes how ambulatory healthcare providers are reimbursed by Medicare. It offers certainty and a timeline for the market's move away from volume-based, fee-for-service models to value-based payment models that reward the delivery of lower cost, high quality care.

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 market for physician based electronic health records software is becoming increasingly saturated while physician group practices are rapidly being consolidated by hospitals, insurance payers and other entities. Hospital software providers are leveraging their position with their hospital clients to gain market share with hospital owned physician practices. Insurance providers and large physician groups are also consolidating physician offices creating additional opportunity for ambulatory software providers like us. Our strategy is to focus on addressing the growing needs of accountable care organizations around interoperability, patient engagements, population health, and data analytics.

We believe that our core strength lies in the central role our software products and services play in the delivery of healthcare by the primary physician in an ambulatory setting. We intend to remain at the forefront of upcoming new regulatory requirements and meaningful use requirements for stimulus payments. We intend to continue the development and enhancement of our software solutions to support healthcare reform, such as the recently enacted MACRA, which promotes the transition from fee-for-service to value-based, pay-for-performance and patient-centric and quality initiatives such as accountable care organizations. Key elements of our future software development will be to expand our interoperability capabilities enhancing the competitiveness of our software offerings, make our products more intuitive and easy to use, and to enhance the capability of our MediTouch® Platform to allow us to deliver our software over the cloud to larger ambulatory care practices.

In addition to the activities described above, mergers and acquisitions have been important to our development. In September 2013 we acquired Mirth Corporation ("Mirth"), a global leader in health information technology that helps clients achieve interoperability. In April 2015, we acquired Gennius, Inc. ("Gennius"), a population health analytics company which we believe enhances and leverages our acquisition of Mirth by broadening our business intelligence capabilities in the growing population health and value based care areas. In January 2016, we completed the acquisition of HealthFusion Holdings, Inc. ("HealthFusion"), a cloud-based healthcare information technology ("HCIT") company providing electronic health record ("EHR") and practice management ("PM") software primarily to the one-to-ten physician size market. We entered into a revolving credit agreement to fund the transaction. We believe the acquisition provided us with access to a market we were not in and provides us with technology that will accelerate our transition to the cloud.

We continue to evaluate the organizational structure of our company with the objective of achieving greater synergies and further integration of our products and services, in support of our business strategies. In fiscal 2016, we initiated a three-phase plan to better position our organization for future success. In the first phase, we redesigned the organization to more effectively support the execution of our strategy. We also transformed our management team with the appointment of a new chief executive officer, chief financial officer, chief technology officer, chief strategy officer, and chief client officer. This first phase was completed in April 2016, when we announced a corporate restructuring plan intended to enable a more efficient, integrated and client-centered delivery of the holistic solutions that we believe is required by our ambulatory care clients. The restructuring plan includes merging our business units into a more streamlined, functional-based organization structure. We are now beginning phase two of our reorganization, which includes building and enhancing the capabilities that will drive future revenue growth. The third phase of the plan will consist of developing and marketing the services and solutions that we believe will accelerate revenue growth.

We have made and intend to continue making substantial investments in our infrastructure while continuing our strong commitment of service in support of our client satisfaction programs and maintaining reasonable expense discipline. Such investments include but are not limited to maintaining and expanding sales, marketing and product development activities to improve patient care and reduce healthcare costs, providing industry-leading, integrated clinical and administrative healthcare data systems, services, and expertise to clinical, medical, technology, and healthcare business professionals. We also strive to add new clients and expand our relationship with existing clients through delivery of add-on and complementary products and services. We believe that the client base that uses our software on a daily basis is a strategic asset, and we intend to leverage this strategic asset by expanding our product and service offerings towards this client base.

Led by our vision and mission, we are resetting our strategy and structure to deliver value to our clients. To achieve lower-cost, increased structural capability, our new management team is building an aligned, client-focused organization, supported by a recurring revenue stream and a large and diverse existing client base.

## Our Strategy

We strive to be the trusted partner for clients of all size, integrating services, software and analytics into a consolidated solution. As a healthcare information technology and services company, we plan to continue investing in our current capabilities as well as building and/or acquiring new capabilities as we guide our clients from fee-for-service to fee-for-value payer reimbursement models. With approximately 90,000 providers using our solutions, we are enabling care and believe we can truly transform the delivery of care through the following strategic priorities:

- **Focus on the ambulatory client segment.** In October 2015, we sold our Hospital Solutions Division to focus on our core ambulatory clients. Further, a recent operational reorganization better allows us to serve the needs of our ambulatory clients through a simpler, more nimble, and focused organization. We believe it is essential to protect, build and sell new capabilities within our ambulatory platform. We are focused on our core by increasing quality and the serviceability of our solutions. We intend to continue to enhance the capabilities of our NextGen Ambulatory flagship product.
- **Cloud transition.** Through our acquisition of HealthFusion in January 2016, we acquired a highly scalable, pure cloud-based and mobile-enabled platform that operates under the tradename MediTouch®. We intend to expand the capability of this platform to serve the requirements of larger ambulatory practices. When combined with our Mirth-branded products, we can offer our clients a full suite of cloud-based solutions that better enable our clients to focus on care delivery.
- **Solutions selling.** We believe there is significant opportunity to extend the solutions we offer existing and new clients through value added services such as RCM, EDI, interoperability solutions and professional services. This will evolve our relationships from being a seller of products and services to delivering a consistent solution suite and experience for our clients.
- **Population health software and services.** We are migrating into applications, analytics and services that we believe will enable our clients to be successful in managing the health of patient populations. We are establishing strong development partners within our core client base, participating in shared-risk contracts, and working together to determine population health solutions.
- **More effective use of capital.** From cessation of the dividend, leveraging our balance sheet for future opportunities, to managing our cost structure, we are transforming our capital strategy. Our recent reorganization was formulated to result in a more efficient, integrated and streamlined organization.

## 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 ("GAAP"). The preparation of these consolidated financial statements requires us to make estimates and judgments that affect our reported amounts of assets, liabilities, revenue and expenses, and related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends, and other factors we believe to be reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. On a regular basis, we review the accounting policies and update our assumptions, estimates, and judgments, as needed, to ensure that our consolidated financial statements are presented fairly and in accordance with GAAP. Actual results could differ materially from our estimates under different assumptions or conditions. To the extent that there are material differences between our estimates and actual results, our financial condition or results of operations will be affected.

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. We discuss our critical accounting policies and estimates in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," of our Annual Report. There have been no material changes in our significant accounting policies or critical accounting policies and estimates since the fiscal year ended March 31, 2016 .



## Results of Operations

The following table sets forth the percentage of revenue represented by each item in our consolidated statements of comprehensive income for the three and nine months ended December 31, 2016 and 2015 (certain percentages below may not sum due to rounding):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
<b>Revenues:</b>				
Software license and hardware	13.3%	13.8%	13.0%	14.3%
Software related subscription services	17.6	10.0	16.9	10.0
Total software, hardware and related	30.9	23.8	29.9	24.3
Support and maintenance	31.2	33.8	31.0	34.4
Revenue cycle management and related services	15.7	18.5	16.4	17.2
Electronic data interchange and data services	17.0	17.6	17.4	16.8
Professional services	5.1	6.3	5.3	7.3
Total revenues	100.0	100.0	100.0	100.0
<b>Cost of revenue:</b>				
Software license and hardware	4.4	5.6	5.1	5.5
Software related subscription services	7.3	4.7	7.2	4.8
Total software, hardware and related	11.8	10.3	12.3	10.3
Support and maintenance	5.7	6.4	5.5	6.5
Revenue cycle management and related services	10.5	12.3	11.1	12.0
Electronic data interchange and data services	9.9	10.6	10.1	10.2
Professional services	4.6	6.3	5.2	6.6
Total cost of revenue	42.5	46.0	44.3	45.6
Gross profit	57.5	54.0	55.7	54.4
<b>Operating expenses:</b>				
Selling, general and administrative	29.4	33.7	32.1	31.8
Research and development costs, net	15.4	12.4	14.9	13.6
Amortization of acquired intangible assets	2.0	0.8	2.1	0.7
Restructuring costs	0.2	—	1.2	—
Total operating expenses	47.0	46.8	50.3	46.1
Income from operations	10.5	7.2	5.4	8.2
Interest income	—	0.1	—	0.1
Interest expense	(0.5)	—	(0.6)	—
Other expense, net	—	—	—	—
Income before provision for income taxes	10.0	7.2	4.7	8.3
Provision for income taxes	1.8	1.0	1.0	2.3
Net income	8.2%	6.2%	3.7%	6.0%

## Revenues

The following table presents our consolidated revenues for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
<b>Revenues:</b>				
Software license and hardware	\$ 16,995	\$ 16,150	\$ 48,966	\$ 52,026
Software related subscription services	22,546	11,705	63,911	36,388
Total software, hardware and related	39,541	27,855	112,877	88,414
Support and maintenance	39,924	39,519	116,905	125,408
Revenue cycle management and related services	20,048	21,594	62,037	62,630
Electronic data interchange and data services	21,790	20,643	65,527	61,413
Professional services	6,565	7,421	19,893	26,700
Total revenues	\$ 127,868	\$ 117,032	\$ 377,239	\$ 364,565

We generate revenue from sales of licensing rights and subscriptions to our software products, hardware and third party software products, support and maintenance services, revenue cycle management and related services ("RCM"), electronic data interchange and data services ("EDI"), and professional services, such as implementation, training, and consulting performed for clients who use our products.

Consolidated revenue for the three months ended December 31, 2016 increased \$10.8 million compared to the prior year period, which was driven primarily by subscription sales of the MediTouch® cloud-based system acquired from HealthFusion in January 2016 and lower level of sales credits and related reserves, which were partially offset by lower RCM revenue due to lower net new bookings.

Consolidated revenue for the nine months ended December 31, 2016 increased \$12.7 million compared to the prior year period as a result of \$27.5 million higher subscriptions related mostly to sales of the MediTouch® cloud-based system, partially offset by lower software license and hardware revenue, lower professional services revenue, and lower support and maintenance revenue. The decline in software license and hardware revenue was mostly caused by a shift in market dynamics toward cloud-based solutions and away from perpetual license arrangements, which has also resulted in lower demand for our professional services, including implementation, training, and consulting services. The decline in support and maintenance is due primarily to the disposition of the former Hospital Solutions Division in October 2015 and net attrition in products sold with accompanying maintenance.

RCM revenue decreased \$1.5 million and \$0.6 million for the three and nine months ended December 31, 2016 and 2015, respectively, due to lower net new bookings. EDI revenue increased \$1.1 million and \$4.1 million for the three and nine months ended December 31, 2016 and 2015, respectively, due to addition of new clients and further penetration of our existing client base.

Recurring service revenue, consisting of software related subscription services, support and maintenance, RCM, and EDI, represented 81.6% and 79.9% of total revenue for the three months ended December 31, 2016 and 2015, respectively. For the nine months ended December 31, 2016 and 2015, recurring service revenue represented 81.7% and 78.4%, respectively, of total revenue.

We expect to benefit from the growth of a replacement market driven by an expected consolidation of electronic health records vendors. We also anticipate the creation of new opportunities in connection with the evolution of healthcare from a fee-for-services reimbursement model to a pay-for-performance model around the management of patient populations. Our acquisitions of Gennius and Mirth provided us with new products and services around population health, collaborative care management, interoperability and enterprise analytics to address these market dynamics. While it remains difficult to assess the relative impact or the timing of positive and negative trends affecting the aforementioned market opportunities, we believe we are well positioned to remain a leader in serving the evolving market needs for healthcare information technology.

## Gross Profit

The following table presents our consolidated cost of revenue and gross profit for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Total cost of revenue	\$ 54,352	\$ 53,785	\$ 167,164	\$ 166,360
Gross profit	73,516	63,247	210,075	198,205
Gross margin %	57.5%	54.0%	55.7%	54.4%

Cost of revenue consists primarily of compensation expense, including share-based compensation, for personnel that deliver our products and services. Cost of revenue also includes amortization of capitalized software costs and acquired technology, third party consultant and outsourcing costs, costs associated with our EDI business partners and clearinghouses, hosting service costs, third party software costs and royalties, and other costs directly associated with delivering our products and services. Refer to Note 5, "Intangible Assets" and Note 6, "Capitalized Software Costs" of our notes to consolidated financial statements included elsewhere in this Report for additional information on current period amortization of capitalized software costs and acquired technology and an estimate of future expected amortization.

Share-based compensation expense included in cost of revenue was \$0.1 million and \$0.1 million for the three months ended December 31, 2016 and 2015, respectively, and is included in the amounts in the table above. Share-based compensation expense included in cost of revenue was \$0.5 million and \$0.3 million for the nine months ended December 31, 2016 and 2015, respectively, and is included in the amounts in the table above.

Gross profit for the three months ended December 31, 2016 increased \$10.3 million compared to the prior year period due primarily to higher revenues as discussed above and a lower level of sales credits and related reserves, which were offset by a \$0.6 million increase in cost of revenue. Cost of revenue increased due to amortization of the software technology intangible asset acquired from HealthFusion, partially offset by lower amortization of previously capitalized software development costs and lower payroll costs associated with delivering support and maintenance and professional services. The gross margin percentage increased to 57.5% for the three months ended December 31, 2016 compared to 54.0% in the prior year period.

Gross profit for the nine months ended December 31, 2016 increased \$11.9 million compared to the prior year period due also to higher revenues as discussed above, offset by a \$0.8 million increase in cost of revenue. Cost of revenue increased due to amortization of the software technology intangible asset acquired from HealthFusion, partially offset by lower payroll costs associated with delivering support and maintenance and professional services. The gross margin percentage increased to 55.7% for the nine months ended December 31, 2016 compared to 54.4% in the prior year period.

## Selling, General and Administrative Expense

The following table presents our consolidated selling, general and administrative expense for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Selling, general and administrative	\$ 37,542	\$ 39,395	\$ 120,913	\$ 115,962
Selling, general and administrative, as a percentage of revenue	29.4%	33.7%	32.1%	31.8%

Selling, general and administrative expense consist of compensation expense, including share-based compensation, for management and administrative personnel, selling and marketing expense, facilities costs, depreciation, professional service fees, including legal and accounting services, acquisition and transaction-related costs, and other general corporate and administrative expenses.

Share-based compensation expense included in selling, general and administrative expenses was \$1.6 million and \$0.6 million for the three months ended December 31, 2016 and 2015, respectively, and is included in the amounts in the table above. Share-based compensation expense included in selling, general and administrative expenses was \$4.0 million and \$1.7 million for the nine months ended December 31, 2016 and 2015, respectively, and is included in the amounts in the table above.

Selling, general and administrative expenses decreased \$1.9 million for the three months ended December 31, 2016 compared to the prior year period primarily because we incurred \$3.7 million of acquisition-related costs related to the acquisition of HealthFusion in the prior year period, a \$1.8 million loss on the disposition of the former Hospital Solutions Division in the prior year period, and recorded a current period benefit of \$2.0 million related to fair value adjustments of the HealthFusion contingent

consideration, which were partially offset by higher legal expense related shareholder litigation and additional selling, general and administrative expense associated with the acquisition of HealthFusion.

Selling, general and administrative expenses increased \$5.0 million for the nine months ended December 31, 2016 compared to the prior year period primarily due to \$3.4 million of fair value adjustments of the HealthFusion contingent consideration recorded in the current period, higher legal expense related shareholder litigation, and additional selling, general and administrative expense associated with the acquisition of HealthFusion, partially offset by lower payroll costs associated with the corporate restructuring plan (refer to Note 15, "Restructuring Plan" of our notes to consolidated financial statements included elsewhere in this Report for additional information) and the disposition of the Hospital Solutions Division in October 2015.

### Research and Development Costs, net

The following table presents our consolidated net research and development costs, capitalized software costs, and gross expenditures prior to capitalization, for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Gross expenditures	\$ 20,766	\$ 19,435	\$ 62,601	\$ 61,188
Capitalized software costs	(1,052)	(4,917)	(6,371)	(11,604)
Research and development costs, net	\$ 19,714	\$ 14,518	\$ 56,230	\$ 49,584

Research and development costs, as a percentage of revenue	15.4%	12.4%	14.9%	13.6%
Capitalized software costs as a percentage of gross expenditures	5.1%	25.3%	10.2%	19.0%

Gross research and development expenditures, including costs expensed and costs capitalized, consist of compensation expense, including share-based compensation, for research and development personnel, certain third-party consultant fees, software maintenance costs, and other costs related to new product development and enhancement to our existing products. We intend to continue to invest heavily in research and development expenses as we continue to bring additional functionality and features to the medical community and develop a new integrated inpatient and outpatient, web-based software platform.

The capitalization of software development costs results in a reduction to our reported net research and development costs. Our software capitalization rate, or capitalized software costs as a percentage of gross expenditures, has varied historically and may continue to vary based on the nature and status of specific projects and initiatives in progress. Although changes in software capitalization rates have no impact on our overall cash flows, it results in fluctuations in the amount of software development costs being expensed up front and the amount of net research and development costs reported in our consolidated statement of comprehensive income.

Share-based compensation expense included in research and development costs was \$0.3 million and \$0.1 million for the three months ended December 31, 2016 and 2015, respectively, and is included in the amounts in the table above. Share-based compensation expense included in research and development costs was \$0.7 million and \$0.3 million for the nine months ended December 31, 2016 and 2015, respectively, and is included in the amounts in the table above.

Net research and development costs for the three months ended December 31, 2016 increased \$5.2 million compared to the prior year period primarily as a result of a \$3.9 million decline in capitalized software costs and a \$1.3 million increase in our gross expenditures. Net research and development costs for the nine months ended December 31, 2016 increased \$6.6 million compared to the prior year period primarily as a result of a \$5.2 million decline in capitalized software costs and a \$1.4 million increase in our gross expenditures. The acquisition of HealthFusion contributed \$1.2 million and \$2.8 million of net research and development costs for the three and nine months ended December 31, 2016, respectively. Such increase was partially offset by lower gross expenditures from the discontinuation of the NextGen Now development project during the fourth quarter of fiscal 2016 and lower personnel costs associated with the restructuring plan.

The reduction in capitalized software costs for the three and nine months ended December 31, 2016 is due to a decline in the rate of the software capitalization compared to the prior year periods, which reflects differences in the nature and status of our projects and initiatives during a given period that affects the amount of development costs that may be capitalized, the discontinuation of the NextGen Now development project, and the recent releases of the next major version of our core software products.

## Amortization of Acquired Intangible Assets

The following table presents our amortization of acquired intangible assets for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Amortization of acquired intangible assets	\$ 2,568	\$ 897	\$ 7,889	\$ 2,692

Amortization of acquired intangible assets included in operating expense consist of the amortization related to our customer relationships, trade name, and contracts intangible assets acquired as part of our business combinations. Refer to Note 5, "Intangible Assets" of our notes to consolidated financial statements included elsewhere in this Report for an estimate of future expected amortization.

Amortization of acquired intangible assets for the three and nine months ended December 31, 2016 increased \$1.7 million and \$5.2 million , respectively, compared to the prior year periods due to additional amortization of the customer relationships and trade name intangible assets related to the acquisition of HealthFusion. Refer to Note 5, "Business Combinations" of our notes to consolidated financial statements included elsewhere in this Report for additional information.

## Restructuring Costs

During the three and nine months ended December 31, 2016 , we recorded \$0.2 million and \$4.7 million , respectively, of restructuring costs within operating expenses in our consolidated statements of comprehensive income. The restructuring costs resulted from a restructuring plan that we announced in April 2016, and such costs consist primarily of payroll-related costs, such as severance, outplacement costs, and continuing healthcare coverage, associated with the involuntary separation of employees pursuant to a one-time benefit arrangement. The remaining restructuring liability as of December 31, 2016 was not significant. The restructuring plan is expected to be complete by the end of fiscal 2017.

The restructuring is part of a three-phase plan initiated in fiscal year 2016 that was intended to better position our organization for future success. In the first phase, we restructured the organization to more effectively support the execution of our strategy. We believe that the restructuring will reduce our costs and improve our financial performance. As we begin phase two of our reorganization, we will continue to build our infrastructure and enhance our healthcare information technology capabilities to drive future revenue growth. The third phase of the plan will consist of developing and marketing the services and solutions that we believe will accelerate revenue growth.

The overall plan also includes a multi-year initiative, called NextGen 2.0, to merge our business units into a more streamlined, functional-based organization structure and to realign our organizational structure by consolidating the sales, marketing, information services, and software development responsibilities into single, company-wide roles in order to achieve greater efficiency.

Refer to Note 15, "Restructuring Plan" of our notes to consolidated financial statements included elsewhere in this Report for additional information.

## Interest and Other Income and Expense

The following table presents our interest expense for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Interest income	\$ —	\$ 60	\$ 9	\$ 406
Interest expense	(629)	(11)	(2,445)	(14)
Other expense, net	(4)	(43)	(146)	(147)

Interest income relates primarily to our marketable securities. Interest expense relates to our revolving credit agreement that was entered into in January 2016 and the related amortization of deferred debt issuance costs. Refer to Note 7, "Line of Credit" of our notes to consolidated financial statements included elsewhere in this Report for additional information. Other expense and income relates primarily to net realized gains and losses on our marketable securities.

Interest expense for the three and nine months ended December 31, 2016 increased \$0.6 million and \$2.4 million , respectively, compared to the prior year. The increase is primarily related to the interest expense associated with our revolving credit agreement

and the amortization of deferred debt issuance costs. As of December 31, 2016, we had \$25.0 million in outstanding loans under the revolving credit agreement.

All other fluctuations in interest and other income and expense are not deemed significant.

### Provision for Income Taxes

The following table presents our provision for income taxes for the three and nine months ended December 31, 2016 and 2015 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Provision for income taxes	\$ 2,342	\$ 1,141	\$ 3,950	\$ 8,233
Effective tax rate	18.3%	13.5%	22.2%	27.3%

The effective rate for the three months ended December 31, 2016 increased compared to the prior year period primarily due to the impact of lower qualifying production activity deductions in the current period, certain non-deductible acquisition-related costs, and a discrete valuation allowance, offset by federal and state research and development credit and other discrete adjustments.

The effective rate for the nine months ended December 31, 2016 decreased compared to the prior year period primarily due to favorable discrete adjustments for federal and state research and development credit, offset by non-deductible acquisition-related costs, lower qualifying production activity deductions in the current period, and other discrete adjustments.

### Net Income

The following table presents our net income (in thousands) and net income per share and for the three and nine months ended December 31, 2016 and 2015 :

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
Net income	\$ 10,486	\$ 7,302	\$ 13,826	\$ 21,979
Net income per share:				
Basic	\$ 0.17	\$ 0.12	\$ 0.22	\$ 0.36
Diluted	\$ 0.17	\$ 0.12	\$ 0.22	\$ 0.36

As a result of the foregoing changes in revenue and expense, net income for the three and nine months ended December 31, 2016 decreased \$3.2 million and \$8.2 million, respectively, compared to the prior year period.

### Operating Segment Information

Effective July 1, 2016, we revised our reportable operating segments. As part of our ongoing reorganization efforts, we refined the measurement of our segment data to better reflect our current internal organizational structure whereby certain functions that formerly existed within each individual operating segment have changed. Our operating segments now consist of the Software and Related Solutions segment and the RCM and Related Services segment, which is consistent with the disaggregated financial information used and evaluated by our chief operating decision maker (consisting of our Chief Executive Officer) to assess performance and make decisions about the allocation of resources. Revenue and gross profit are the key measures of segment profitability used by our chief operating decision maker to measure segment operating performance and to make key business decisions. The revenues and gross profit of each segment are derived from distinct product and services within each segment. The Software and Related Solutions segment aggregates the revenues and gross profit of our software-related products and services, including software license and hardware, software-related subscription services, support and maintenance, EDI and data services, and certain professional services, such as implementation, training, and consulting. The RCM and Related Services segment aggregates the revenues and gross profit of our RCM services and certain related ancillary service offerings.

Operating segment data for the three and nine months ended December 31, 2016 and 2015 is summarized in the table below. Prior period data has been retroactively reclassified to present all segment information on a comparable basis. The change in reportable segments has no impact to consolidated revenues and consolidated cost of revenue, nor does it affect our presentation of revenue and cost of revenue on the consolidated statements of comprehensive income.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2016	2015	2016	2015
<b>Revenue:</b>				
Software and Related Solutions	\$ 106,958	\$ 93,927	\$ 312,854	\$ 291,783
RCM and Related Services	20,910	22,486	64,385	65,313
Hospital Solutions <sup>(1)</sup>	—	619	—	7,469
<b>Consolidated revenue</b>	<b>\$ 127,868</b>	<b>\$ 117,032</b>	<b>\$ 377,239</b>	<b>\$ 364,565</b>
<b>Gross profit:</b>				
Software and Related Solutions	\$ 71,252	\$ 58,949	\$ 204,414	\$ 184,982
RCM and Related Services	7,077	7,769	21,337	20,792
Hospital Solutions <sup>(1)</sup>	—	(69)	—	2,569
Unallocated cost of revenue <sup>(2)</sup>	(4,813)	(3,402)	(15,676)	(10,138)
<b>Consolidated gross profit</b>	<b>\$ 73,516</b>	<b>\$ 63,247</b>	<b>\$ 210,075</b>	<b>\$ 198,205</b>

<sup>(1)</sup> The former Hospital Solutions Division was divested in October 2015 and therefore, does not represent a distinct operating segment. Historical amounts for Hospital Solutions have not been revised.

<sup>(2)</sup> Consists of amortization of acquired software technology and amortization of capitalized software costs not allocated to the operating segments for the purposes of measuring performance.

#### **Software and Related Solutions**

Software and Related Solutions revenue for the three months ended December 31, 2016 increased \$13.0 million and gross profit increased \$12.3 million compared to the prior year period. Software and Related Solutions revenue for the nine months ended December 31, 2016 increased \$21.1 million and gross profit increased \$19.4 million compared to the prior year period.

The increase in revenues for the three months ended December 31, 2016 was driven by an increase in our software related subscription services attributed mostly to the acquisition of HealthFusion in January 2016 and an increase in EDI revenue from the addition of new clients and further penetration of our existing client base, which were partially offset by a decline in professional services revenue, resulting from a recent decline in demand for our core software products and related services.

The increase in revenues for the nine months ended December 31, 2016 was also driven by an increase in our software related subscription services attributed mostly to the acquisition of HealthFusion in January 2016 and an increase in EDI revenue from the addition of new clients and further penetration of our existing client base, which were partially offset by a decline in software license and hardware and professional services revenue, resulting from a shift in market dynamics toward cloud-based solutions and away from perpetual license arrangements, resulting in lower client demand for our core software products and related support and maintenance, implementation, training, and consulting services.

The increase in gross profit for the three and nine months ended December 31, 2016 is due primarily to the aforementioned increases in revenue, which were offset by an increase in cost of revenue. Cost of revenue increased due to amortization of the software technology intangible asset acquired from HealthFusion, partially offset by lower amortization of previously capitalized software development costs and lower payroll costs associated with delivering support and maintenance and professional services. Gross profit for the three months ended December 31, 2016 was also positively impacted due to a lower level of sales credits and related reserves compared to the prior year period.

Our goals for Software and Related Solutions include further enhancement of our existing products, including expansion of our software and service offerings that support pay-for-performance initiatives around accountable care organizations, bringing greater ease of use and intuitiveness to our software products, enhancing our managed cloud and hosting services to lower our clients' total cost of ownership, expanding our interoperability and enterprise analytics capabilities, and further development and enhancements of our portfolio of specialty focused templates within our electronic health records software. We intend to remain at the forefront of upcoming new regulatory requirements, including meaningful use requirements for stimulus payments and recent healthcare reform that is driving the transition towards pay-for-performance, value-based reimbursement models. We believe that the expanded requirements for continued eligibility for incentive payments under meaningful use rules will result in an expanded

replacement market for electronic health records software. We also intend to continue selling additional software and services to existing clients, expanding penetration of connectivity and other services to new and existing clients, and capitalizing on growth and cross selling opportunities within RCM and Related Services. Our acquisition of HealthFusion will allow us expand our client base and cloud-based solution capabilities in the ambulatory market and meet the needs of practices of increasing size and complexity. Our acquisitions of Mirth and Gennius improve our competitiveness in the markets and provide new clients and expanded markets for Software and Related Solutions and also support our strategy to focus on accountable care organizations around interoperability, patient engagements, population health and collaborative care management, and enterprise analytics. We believe we are well-positioned within the evolving healthcare market to deliver products and services that address the growing importance of quality collaborative care and shift from fee-for-service to value-based, pay-for-performance care.

We believe that our operating results are attributed to a strong brand name and reputation within the marketplace for healthcare information technology software and services and investments in sales and marketing activities, including new marketing campaigns, Internet advertising investments, tradeshow attendance and other expanded advertising and marketing expenditures.

### **RCM and Related Services**

RCM and Related Services revenue for the three months ended December 31, 2016 decreased \$1.6 million compared to the prior period due to lower net new bookings. Gross profit for the three months ended December 31, 2016 decreased \$0.7 million due to the decline in revenues, partially offset by a reduction in employee-related costs.

RCM and Related Services revenue for the nine months ended December 31, 2016 decreased \$0.9 million compared to the prior year period due to lower net new bookings. Gross profit for the nine months ended December 31, 2016 increased \$0.5 million due to lower employee related costs, partially offset by a decline in revenue.

We believe that a significant opportunity exists to continue cross selling RCM services to our existing clients. The portion of existing NextGen clients who are using RCM services is approximately 10%. We are actively pursuing efforts to achieve faster growth from expanded efforts to leverage our existing sales force towards selling RCM services. We also believe that ongoing increases in the complexity of medical billing and collections processes, including the migration to value-based reimbursement models, will create additional opportunities for RCM and Related Services.

### **Liquidity and Capital Resources**

The following table presents selected financial statistics and information for the nine months ended December 31, 2016 and 2015 (in thousands):

	Nine Months Ended December 31,	
	2016	2015
Cash and cash equivalents and marketable securities	\$ 23,994	\$ 104,813
Unused portion of revolving credit agreement(1)	225,000	—
<b>Total liquidity</b>	<b>\$ 248,994</b>	<b>\$ 104,813</b>
<b>Net income</b>	<b>\$ 13,826</b>	<b>\$ 21,979</b>
<b>Net cash provided by operating activities</b>	<b>\$ 81,423</b>	<b>\$ 27,292</b>

(1) As of December 31, 2016, we had our outstanding loans of \$25.0 million under our \$250.0 million revolving credit agreement.

Our principal sources of liquidity are our cash generated from operations, driven mostly by our net income and working capital management, our cash and cash equivalents, and the Credit Agreement.

### **Cash and Cash Equivalents**

As of December 31, 2016, our cash and cash equivalents balance of \$24.0 million reflects a \$12.5 million decrease compared to \$36.5 million of cash, cash equivalents and marketable securities as of March 31, 2016. This decrease primarily reflects \$80.0 million of principal repayments on our revolving line of credit, partially offset by an increase in cash provided by operating activities as discussed further below, and payment of dividends in the prior year period.

In January 2016, we entered into a \$250.0 million revolving credit agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A., as administrative agent, U.S. Bank National Association, as syndication agent, and certain other lenders. Our outstanding loans under the Credit Agreement was \$25.0 million as of December 31, 2016.



We may continue to use a portion of our funds as well as available financing from the Credit Agreement for future acquisitions or other similar business activities, although the specific timing and amount of funds to be used is not currently determinable. Our principal sources of liquidity are our cash and cash equivalents, the Credit Agreement, as well as our cash generated from operations. We intend to expend some of our available 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.

Our investment policy is determined by our Board of Directors. Excess cash, if any, may be invested in very liquid short term assets including tax exempt and taxable money market funds, certificates of deposit and short term municipal bonds with average maturities of 365 days or less at the time of purchase. Our Board of Directors continues to review alternate uses for our cash including an expansion of our investment policy and other items. Any or all of these programs could significantly impact our investment income in future periods.

We believe that our cash and cash equivalents and marketable securities on hand at December 31, 2016, together with our cash flows from operations and liquidity provided by the Credit Agreement, will be sufficient to meet our working capital and capital expenditure requirements for the next twelve months.

### **Cash Flows from Operating Activities**

The following table summarizes our consolidated statements of cash flows for the nine months ended December 31, 2016 and 2015 (in thousands):

	Nine Months Ended December 31,	
	2016	2015
Net income	\$ 13,826	\$ 21,979
Non-cash expenses	45,613	27,426
Cash from net income, as adjusted	\$ 59,439	\$ 49,405
Change in deferred revenue	\$ (8,195)	\$ (10,320)
Change in accounts receivable	16,005	11,313
Change in other assets and liabilities	14,174	(23,106)
Net cash provided by operating activities	<u>\$ 81,423</u>	<u>\$ 27,292</u>

For the nine months ended December 31, 2016, cash provided by operating activities increased \$54.1 million compared to the prior year period. The increase is primarily due to a \$36.5 million increase in cash flows from changes in income taxes, \$10.0 million higher net income, as adjusted for non-cash expenses, and a \$6.8 million increase from changes in accounts receivable and deferred revenue. Non-cash expenses increased to \$45.6 million for the nine months ended December 31, 2016 compared to \$27.4 million in the prior year primarily due to higher amortization of intangibles associated with the acquisition of HealthFusion and changes in the fair value of contingent consideration liabilities.

### **Cash Flows from Investing Activities**

Net cash used in investing activities for the nine months ended December 31, 2016 was \$5.6 million compared with \$22.2 million in the prior year period. The \$16.6 million decrease in net cash used in investing activities is primarily due to \$9.3 million of cash proceeds from the sales of marketable securities in the nine months ended December 31, 2016 compared to \$0.7 million of net purchases in the prior year period, a \$5.2 million decrease in additions to capitalized software, and a \$1.7 million decrease in additions to equipment and improvements.

### **Cash Flows from Financing Activities**

Net cash used in financing activities for the nine months ended December 31, 2016 was \$79.0 million compared with \$31.4 million in the prior year period. The increase in cash used in financing activities relates to \$80.0 million of principal repayments on our revolving line of credit in the current year period, partially offset by \$32.1 million in dividends paid to shareholders during the prior year period.

### **Contractual Obligations**

The following table summarizes our significant contractual obligations at December 31, 2016 and the effect that such obligations are expected to have on our liquidity and cash in future periods (in thousands):

Contractual Obligations	Total	For the year ended March 31,					
		2017 (remaining three months)	2018	2019	2020	2021	2022 and beyond
Operating lease obligations <sup>(1)</sup>	\$ 71,136	\$ 2,816	\$ 10,980	\$ 10,116	\$ 9,222	\$ 9,226	\$ 28,776
Line of credit obligations	25,000	—	—	—	—	25,000	—
Contingent consideration and other acquisition related liabilities	18,567	18,567	—	—	—	—	—
Total	\$ 114,703	\$ 21,383	\$ 10,980	\$ 10,116	\$ 9,222	\$ 34,226	\$ 28,776

<sup>(1)</sup> Operating lease obligations have not been reduced by minimum sublease rentals of \$1.9 million due in future periods under our non-cancelable subleases.

The deferred compensation liability as of December 31, 2016 was \$6.7 million , which is not included in the table above as the timing of future benefit payments to employees is not determinable.

The uncertain tax position liability as of December 31, 2016 was \$4.7 million , which is not included in the table above as the timing of expected payments is not determinable.

### **New Accounting Pronouncements**

Refer to Note 1, "Summary of Significant Accounting Policies" of our notes to consolidated financial statements included elsewhere in this Report for a discussion of new accounting standards.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

As of December 31, 2016, we were subject to minimal market risk on our cash and cash equivalents as we maintained our balances in very liquid funds with maturities of 90 days or less at the time of purchase.

As of December 31, 2016, we had \$25.0 million in outstanding loans under our revolving credit agreement. The revolving loans under the agreement bear interest at our option of either, (a) a base rate based on the highest of (i) the rate of interest per annum publicly announced from time to time by JPMorgan Chase Bank, N.A., as its prime rate, (ii) the greater of (A) the federal funds effective rate and (B) the overnight bank funding rate (as determined by the Federal Reserve Bank of New York) plus 0.50% and (iii) the one-month British Bankers Association London Interbank Offered Rate ("LIBOR") plus 1.00% plus an applicable margin based on our leverage ratio from time to time, ranging from 0.50% to 1.50%, or (b) a LIBOR-based rate (subject to a floor of 0.00%) plus an applicable margin based on our leverage ratio from time to time, ranging from 1.50% to 2.50%. Accordingly, we are exposed to interest rate risk, primarily changes in LIBOR, due to our loans under the revolving credit agreement. A one hundred basis point (1.00%) change in the interest rate on our outstanding loans as of December 31, 2016 would result in a corresponding change in our annual interest expense of approximately \$0.3 million. Refer to Note 7, "Line of Credit" of our notes to consolidated financial statements included elsewhere in this Report for additional information.

As of December 31, 2016, we had international operations that exposed us to the risk of fluctuations in foreign currency exchange rates against the U.S. dollar. However, the impact of foreign currency fluctuations has not been material to our financial position or operating results.

### **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 our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Security Exchange Act of 1934, as amended, the "Exchange Act") as of December 31, 2016, the end of the period covered by this Quarterly Report on Form 10-Q (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 our disclosure controls and procedures are designed, and are effective, to give reasonable assurance that the information required to be disclosed by us in reports that we file 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. They have also concluded that our 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 our 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, 2016, 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.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

#### ***Hussein Litigation***

On October 7, 2013, a complaint was filed against our Company and certain of our officers and directors in the Superior Court of the State of California for the County of Orange, captioned Ahmed D. Hussein v. Sheldon Razin, Steven Plochocki, Quality Systems, Inc. and Does 1-10, inclusive, No. 30-2013-00679600-CU-NP-CJC, by Ahmed Hussein, a former director and significant shareholder of our Company. We filed a demurrer to the complaint, which the Court granted on April 10, 2014. An amended complaint was filed on April 25, 2014. The amended complaint generally alleges fraud and deceit, constructive fraud, negligent misrepresentation and breach of fiduciary duty in connection with statements made to our shareholders regarding our financial condition and projected future performance. The amended complaint seeks actual damages, exemplary and punitive damages and costs. We filed a demurrer to the amended complaint. On July 29, 2014, the Court sustained the demurrer with respect to the breach of fiduciary duty claim, and overruled the demurrer with respect to the fraud and deceit claims. On August 28, 2014, we filed an answer and also filed a cross-complaint against the plaintiff, alleging that the plaintiff breached fiduciary duties owed to the Company, Mr. Razin and Mr. Plochocki. Mr. Razin and Mr. Plochocki have dismissed their claims against Hussein, leaving QSI as the sole plaintiff in the cross-complaint. On June 26, 2015, we filed a motion for summary judgment, which the Court granted on September 16, 2015, dismissing all claims against us. On September 23, 2015, the plaintiff filed an application for reconsideration of the Court's summary judgment order, which the Court denied. On October 28, 2015, the plaintiff filed a motion for summary judgment, seeking to dismiss our cross-complaint, which the Court denied on March 3, 2016. On May 9, 2016, the plaintiff filed a motion for summary adjudication, seeking to again dismiss our cross-complaint, which the Court denied on August 5, 2016. On August 5, 2016, the plaintiff filed a motion for judgment on the pleadings, seeking to again dismiss our cross-complaint, which the Court denied on September 2, 2016. Trial is set for April 10, 2017 on QSI's cross-complaint. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this claim.

#### ***Federal Securities Class Action***

On November 19, 2013, a putative class action complaint was filed on behalf of the shareholders of our Company other than the defendants against us and certain of our officers and directors in the United States District Court for the Central District of California by one of our shareholders. After the Court appointed lead plaintiffs and lead counsel for this action, and recaptioned the action In re Quality Systems, Inc. Securities Litigation, No. 8L13-cv-01818-CJC(JPRx), lead plaintiffs filed an amended complaint on April 7, 2014. The amended complaint, which is substantially similar to the litigation described above under the caption "Hussein Litigation," generally alleges that statements made to our shareholders regarding our financial condition and projected future performance were false and misleading in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that the individual defendants are liable for such statements because they are controlling persons under Section 20(a) of the Exchange Act. The complaint seeks compensatory damages, court costs and attorneys' fees. We filed a motion to dismiss the amended complaint on June 20, 2014, which the Court granted on October 20, 2014, dismissing the complaint with prejudice. Plaintiffs filed a motion for reconsideration of the Court's order, which the Court denied on January 5, 2015. On January 30, 2015, Plaintiffs filed a notice of appeal to the United States Court of Appeals for the Ninth Circuit, captioned In re Quality Systems, Inc. Securities Litigation, No. 15-55173. Plaintiffs filed their opening brief and we answered. Oral argument was held on December 5, 2016. The Court's decision remains pending. We believe that the plaintiffs' claims are without merit and continue to defend against them vigorously. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this claim.

#### ***Shareholder Derivative Litigation***

On January 24, 2014, a complaint was filed against our Company and certain of our officers and current and former directors in the United States District Court for the Central District of California, captioned Timothy J. Foss, derivatively on behalf of himself and all others similarly situated, vs. Craig A. Barbarosh, George H. Bristol, James C. Malone, Peter M. Neupert, Morris Panner, D. Russell Pflueger, Steven T. Plochocki, Sheldon Razin, Lance E. Rosenzweig and Quality Systems, Inc., No. SACV14-00110-DOC-JPPx, by Timothy J. Foss, a shareholder of ours. The complaint arises from the same allegations described above under the captions "Hussein Litigation" and "Federal Securities Class Action" and generally alleges breach of fiduciary duties, abuse of control and gross mismanagement by our directors, in addition to unjust enrichment and insider selling by individual directors. The complaint seeks compensatory damages, restitution and disgorgement of all profits, court costs, attorneys' fees and implementation of enhanced corporate governance procedures. The parties have agreed to stay this litigation until the United States Court of Appeals for the Ninth Circuit issues a ruling on the pending appeal described above under the caption "Federal Securities Class Action". We believe that the plaintiff's claims are without merit and intend to defend against them vigorously. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this claim.

In addition to the above, we have experienced legal claims by customers regarding product and contract disputes and from time to time, claims by other third parties asserting that we have infringed their intellectual property rights. We believe that these claims, including those filed by Mr. Hussein, the Deerfield Beach Police Pension Fund and the shareholder derivative action, are without merit and intend to defend against them vigorously; however, we could incur substantial costs and diversion of management resources even if we are ultimately successful in the defense of such claims. 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.

**ITEM 1A. RISK FACTORS.**

Our business is subject to many risks and uncertainties, which may materially and adversely affect our future business, prospects, financial condition and results of operations. These risk factors are disclosed in "Item 1A. Risk Factors" in our Annual Report.

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

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not Applicable

**ITEM 5. OTHER INFORMATION.**

None.

**ITEM 6. EXHIBITS.**

<b>Exhibit Number</b>	<b>Exhibit Description</b>	<b>Filed Herewith</b>
10.1*	Form of Change of Control Severance Agreement, entered into with the Company's named executive officers effective December 27, 2016.	
10.2*	Form of Performance Stock Award Grant Notice and Performance/Restricted Stock Award Agreement for 2015 Equity Incentive Plan, entered into with the Company's named executive officers effective December 29, 2016.	
10.3*	Form of Restricted Stock Award Grant Notice and Performance/Restricted Stock Award Agreement for 2015 Equity Incentive Plan, entered into with the Company's named executive officers effective December 29, 2016.	
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.	X
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.	X
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.	X
101.INS**	XBRL Instance	
101.SCH**	XBRL Taxonomy Extension Schema	
101.CAL**	XBRL Taxonomy Extension Calculation	
101.DEF**	XBRL Taxonomy Extension Definition	
101.LAB**	XBRL Taxonomy Extension Label	
101.PRE**	XBRL Taxonomy Extension Presentation	
*	This exhibit is a management contract or a compensatory plan or arrangement, which were filed as Exhibits to the Company's Current Report on Form 8-K filed January 3, 2017.	
**	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.	

**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.

Date: January 25, 2017

By: QUALITY SYSTEMS, INC.  
/s/ John R. Frantz  
John R. Frantz  
Chief Executive Officer (Principal Executive Officer)

Date: January 25, 2017

By: /s/ James R. Arnold  
James R. Arnold  
Chief Financial Officer (Principal Financial Officer)

Date: January 25, 2017

By: /s/ John K. Stumpf  
John K. Stumpf  
Principal Accounting Officer

**EXHIBIT 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**

I, John R. Frantz, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Quality Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 25, 2017

By: /s/ John R. Frantz

\_\_\_\_\_  
John R. Frantz

Chief Executive Officer

(Principal Executive Officer)



**EXHIBIT 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**

I, James R. Arnold, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Quality Systems, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 25, 2017

By: /s/ James R. Arnold

James R. Arnold

Chief Financial Officer

(Principal Financial Officer)

**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**

In connection with the Quarterly Report on Form 10-Q of Quality Systems, Inc. (the "Company") for the quarterly period ended December 31, 2016 (the "Report"), the undersigned hereby certify in their capacities as Chief Executive Officer and Chief Financial Officer of the Company, respectively, pursuant to 18 U.S.C. section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: January 25, 2017

By: /s/ John R. Frantz

John R. Frantz  
Chief Executive Officer  
(Principal Executive Officer)

Date: January 25, 2017

By: /s/ James R. Arnold

James R. Arnold  
Chief Financial Officer  
(Principal Financial Officer)

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.