

# 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, 2017

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)*

**95-2888568**

*(IRS Employer Identification No.)*

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

**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," "smaller reporting company," and "emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2018 was 63,713,925 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, 2017	March 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,359	\$ 37,673
Restricted cash and cash equivalents	3,393	4,916
Accounts receivable, net	79,416	83,407
Inventory	154	158
Income taxes receivable	4,082	2,679
Prepaid expenses and other current assets	17,944	17,969
<b>Total current assets</b>	<b>128,348</b>	<b>146,802</b>
Equipment and improvements, net	27,137	27,426
Capitalized software costs, net	23,209	13,607
Deferred income taxes, net	7,197	11,265
Intangibles, net	80,663	69,213
Goodwill	216,530	185,898
Other assets	18,299	19,010
<b>Total assets</b>	<b>\$ 501,383</b>	<b>\$ 473,221</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,069	\$ 4,618
Deferred revenue	52,843	52,383
Accrued compensation and related benefits	21,898	24,513
Income taxes payable	—	405
Other current liabilities	30,153	46,775
<b>Total current liabilities</b>	<b>107,963</b>	<b>128,694</b>
Deferred revenue, net of current	853	1,394
Deferred compensation	6,473	6,629
Line of credit	39,000	15,000
Other noncurrent liabilities	16,354	16,461
<b>Total liabilities</b>	<b>170,643</b>	<b>168,178</b>
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Common stock		
\$0.01 par value; authorized 100,000 shares; issued and outstanding 63,712 and 62,455 shares at December 31, 2017 and March 31, 2017, respectively	637	625
Additional paid-in capital	240,584	228,549
Accumulated other comprehensive loss	(235)	(358)
Retained earnings (1)	89,754	76,227
<b>Total shareholders' equity</b>	<b>330,740</b>	<b>305,043</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 501,383</b>	<b>\$ 473,221</b>

(1) Includes cumulative-effect adjustment related to the adoption of ASU 2016-09, as defined in Note 1. See Note 1 for additional details.

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,	
	2017	2016	2017	2016
<b>Revenues:</b>				
Software license and hardware	\$ 13,131	\$ 16,995	\$ 40,198	\$ 48,966
Software related subscription services	24,690	22,546	73,584	63,911
Total software, hardware and related	37,821	39,541	113,782	112,877
Support and maintenance	40,362	39,924	123,171	116,905
Revenue cycle management and related services	21,922	20,048	64,327	62,037
Electronic data interchange and data services	23,136	21,790	69,446	65,527
Professional services	8,474	6,565	24,518	19,893
Total revenues	131,715	127,868	395,244	377,239
<b>Cost of revenue:</b>				
Software license and hardware	5,726	5,680	15,947	19,227
Software related subscription services	11,693	9,345	32,822	27,107
Total software, hardware and related	17,419	15,025	48,769	46,334
Support and maintenance	7,525	7,299	22,583	20,903
Revenue cycle management and related services	15,401	13,462	45,615	42,052
Electronic data interchange and data services	13,581	12,662	40,313	38,232
Professional services	7,708	5,904	22,278	19,643
Total cost of revenue	61,634	54,352	179,558	167,164
Gross profit	70,081	73,516	215,686	210,075
<b>Operating expenses:</b>				
Selling, general and administrative	43,563	37,542	127,517	120,913
Research and development costs, net	20,645	19,714	60,161	56,230
Amortization of acquired intangible assets	1,956	2,568	6,015	7,889
Restructuring costs	130	231	130	4,685
Total operating expenses	66,294	60,055	193,823	189,717
Income from operations	3,787	13,461	21,863	20,358
Interest income	15	-	36	9
Interest expense	(733)	(629)	(2,250)	(2,445)
Other expense, net	(41)	(4)	(48)	(146)
Income before provision for income taxes	3,028	12,828	19,601	17,776
Provision for income taxes	1,487	2,342	6,134	3,950
Net income	\$ 1,541	\$ 10,486	\$ 13,467	\$ 13,826
<b>Other comprehensive income:</b>				
Foreign currency translation, net of tax	222	(89)	123	(182)
Unrealized gain on marketable securities, net of tax	—	—	—	10
Comprehensive income	\$ 1,763	\$ 10,397	\$ 13,590	\$ 13,654
<b>Net income per share:</b>				
Basic	\$ 0.02	\$ 0.17	\$ 0.21	\$ 0.22
Diluted	\$ 0.02	\$ 0.17	\$ 0.21	\$ 0.22
<b>Weighted-average shares outstanding:</b>				
Basic	63,706	62,093	63,287	61,645
Diluted	63,708	62,093	63,296	61,900

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,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 13,467	\$ 13,826
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,017	7,562
Amortization of capitalized software costs	4,409	6,626
Amortization of other intangibles	17,350	16,953
Amortization of debt issuance costs	807	807
Provision for bad debts	5,084	2,503
Provision for inventory obsolescence	55	369
Share-based compensation	8,585	5,177
Deferred income taxes	3,110	1,367
Excess tax benefit from share-based compensation	328	—
Change in fair value of contingent consideration	—	3,797
Loss on disposal of equipment and improvements	150	452
Changes in assets and liabilities, net of amounts acquired:		
Accounts receivable	960	16,005
Inventory	(51)	(66)
Accounts payable	(2,442)	(5,983)
Deferred revenue	(709)	(8,195)
Accrued compensation and related benefits	(3,315)	(50)
Income taxes	(1,956)	18,060
Deferred compensation	(156)	381
Other assets and liabilities	3,082	1,832
Net cash provided by operating activities	<u>56,775</u>	<u>81,423</u>
Cash flows from investing activities:		
Additions to capitalized software costs	(13,647)	(6,371)
Additions to equipment and improvements	(7,606)	(8,242)
Proceeds from sales and maturities of marketable securities	—	9,291
Payments for acquisitions, net of cash acquired	(58,892)	—
HealthFusion working capital adjustment payment	—	(282)
Net cash used in investing activities	<u>(80,145)</u>	<u>(5,604)</u>
Cash flows from financing activities:		
Proceeds from line of credit	50,000	—
Repayments on line of credit	(26,000)	(80,000)
Payment of contingent consideration related to acquisitions	(18,817)	—
Proceeds from issuance of shares under employee plans	4,640	999
Payments for taxes related to net share settlement of equity awards	(767)	—
Net cash provided by (used in) financing activities	<u>9,056</u>	<u>(79,001)</u>
Net decrease in cash and cash equivalents	<u>(14,314)</u>	<u>(3,182)</u>
Cash and cash equivalents at beginning of period	37,673	27,176
Cash and cash equivalents at end of period	<u>\$ 23,359</u>	<u>\$ 23,994</u>

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

	<b>Nine Months Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for income taxes	\$ 5,786	\$ 4,455
Cash refunds from income taxes	1,084	19,932
Cash paid for interest	1,388	1,670
Common stock issued for Mirth share-based contingent consideration	-	9,273
<b>Non-cash investing and financing activities:</b>		
Tenant improvement allowance from landlord	\$ 1,442	\$ 3,094
Unpaid additions to equipment and improvements	138	80
<b>On April 14, 2017, we acquired Entrada in a transaction summarized as follows:</b>		
Fair value of net assets acquired	\$ 35,293	\$ —
Cash paid, net of cash acquired	\$ (33,856)	\$ —
Liabilities assumed	\$ 1,437	\$ —
<b>On August 16, 2017, we acquired EagleDream in a transaction summarized as follows:</b>		
Fair value of net assets acquired	\$ 27,895	\$ —
Cash paid, net of cash acquired	\$ (25,036)	\$ —
Liabilities assumed	\$ 2,859	\$ —

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.

**Business Segments.** We have determined that the Company operates in one segment as of June 30, 2017. We have made such determination by first identifying our Chief Executive Officer as our chief operating decision maker ("CODM") and considering the measures used by our CODM to allocate resources. Our CODM utilizes consolidated revenue and consolidated operating results to assess performance and make decisions about allocation of resources.

Previously, through the end of fiscal year 2017, we operated under two reportable segments, consisting of the Software and Related Solutions segment and the RCM and Related Services segment, which was consistent with the disaggregated financial information used and evaluated by our CODM to assess performance and make decisions about the allocation of resources. However, as part of our reorganization efforts that were substantially complete as of the end of fiscal year 2017, our internal organizational structure whereby certain functions that formerly existed within each individual operating segment has continued to evolve. Our former Chief Operating Officer was previously responsible for leading the operations of our former RCM and Related Services business while our former Chief Client Officer led our client success organization, consisting of the Software and Related Solutions business and other functions, such as sales and marketing. Upon the resignation of our former Chief Operating Officer in April 2017 and concurrent appointment of our former Chief Client Officer as Chief Operating Officer, our entire portfolio of software and services were aligned under our new Chief Operating Officer in an effort to provide our clients with an even more simplified experience and more effectively deliver a consolidated financial solution to our clients, rather than components of a solution. As a result of such changes in our internal organization structure, the CODM now operates the Company as a single functional organization. The CODM measures company-wide performance by reviewing consolidated revenue and operating results and evaluates the impact of allocating resources to overall profit and margins on a consolidated basis.

**Basis of Presentation.** The accompanying unaudited consolidated financial statements as of December 31, 2017 and for the three and nine months ended December 31, 2017 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, 2017. 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.** There have been no material changes to our significant accounting policies from those disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017.

**Share-Based Compensation.** The following table summarizes total share-based compensation expense included in the consolidated statements of comprehensive income for the three and nine months ended December 31, 2017 and 2016:

	<u>Three Months Ended December 31,</u>		<u>Nine Months Ended December 31,</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Costs and expenses:				
Cost of revenue	\$ 259	\$ 144	\$ 686	\$ 459
Research and development costs	557	273	1,431	690
Selling, general and administrative	2,637	1,584	6,468	4,028
Total share-based compensation	<u>3,453</u>	<u>2,001</u>	<u>8,585</u>	<u>5,177</u>
Income tax benefit	(1,080)	(718)	(2,940)	(1,825)
Decrease in net income	<u>\$ 2,373</u>	<u>\$ 1,283</u>	<u>\$ 5,645</u>	<u>\$ 3,352</u>

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

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting* ("ASU 2017-09"). ASU 2017-09 clarifies the changes to terms or conditions of a share-based payment award that require an entity to apply modification accounting. ASU 2017-09 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early application is permitted and prospective application is required. ASU 2017-09 is effective for us in the first quarter of fiscal 2019, and we currently do not expect the adoption of this new standard to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* ("ASU 2017-04"). ASU 2017-04 removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of Step two of the goodwill impairment test. Instead, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. ASU 2017-04 is effective prospectively for annual and interim periods beginning after December 15, 2019, and early adoption is permitted on goodwill impairment tests performed on testing dates after January 1, 2017. ASU 2017-04 is effective for us in the fourth quarter of fiscal 2020, and we currently do not expect the adoption of this new standard to have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* ("ASU 2017-01"). ASU 2017-01 clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted in two scenarios as identified in the new standard. ASU 2017-01 is effective for us in the first quarter of fiscal 2019, and we currently do not expect the adoption of this new standard to have a material impact on our consolidated financial statements.

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 adopted ASU 2016-09 in the first quarter of fiscal 2018. As permitted by ASU 2016-09, we have made an accounting policy election to account for forfeitures as they occur, which was adopted on a modified retrospective basis and resulted in a cumulative-effect adjustment of \$0.1 million to retained earnings and additional paid-in capital as of April 1, 2017. ASU 2016-09 also eliminates additional paid-in capital pools and requires excess tax benefits and tax deficiencies to be recorded in the income statement when the awards vest or are settled, which was adopted on a prospective basis. The requirements to recognize previously unrecognized excess tax benefits on a modified retrospective basis did not have an impact on our consolidated financial statements. Upon adoption of ASU 2016-09, excess tax benefits and tax deficiencies are recognized in the income statement, and the tax effects of exercised or vested awards are treated as discrete items in the period they occur. The provisions of ASU 2016-09 could have an

impact to our future income tax expense, including increased volatility in our effective tax rate on a quarter by quarter basis due to a number of factors, including fluctuations in the stock price and the timing of stock option exercises and vesting of restricted share awards. Additionally, ASU 2016-09 addresses presentation of excess tax benefits and deficiencies and employee taxes paid related to shares withheld for tax withholdings purposes on the statement of cash flows, including a requirement to present excess tax benefits and deficiencies as an operating activity in the same manner as other cash flows related to income taxes on the statement of cash flows, which will be adopted on a prospective basis, and presentation of employee taxes paid related to shares withheld for tax withholdings purposes as a financing activity, which is consistent with our current presentation and thus did not impact 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 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 completed our assessment of the potential impacts to our business processes, systems, and internal controls that could result from the implementation of the new revenue guidance. Based on our assessment, we currently believe that the impact on our consolidated financial statements could be material. We expect that revenue related to hardware, EDI, maintenance, and certain subscriptions would remain substantially unchanged, and we are the process of evaluating the impact of the new revenue guidance on our other revenue streams. Due to the complexity of our revenue recognition, a significant amount of work remains as we continue to evaluate all potential impacts of the new revenue guidance, and develop and implement the necessary changes to our current accounting systems, processes, and internal controls. Accordingly, our preliminary assessments are subject to change. We expect that the new revenue guidance will result in additional complexity to our revenue recognition, including the use of an increased amount of significant judgments and estimates, particularly as it relates to our RCM services revenue, as compared to our current revenue recognition. We preliminarily expect our RCM services revenue to decrease subsequent to the adoption of the new revenue guidance as a larger portion of our RCM fees is expected to be allocated to software and subscriptions revenue.

Additionally, certain incremental costs incurred to obtain contracts with customers, such as sales commissions, are within the scope of the new revenue guidance and are required to be capitalized and amortized to expense over the remaining performance periods of the contracts. Currently, our sales commission are capitalized and amortized to expense over the related period of revenue recognition. Although the amortization period of capitalized sales commissions may differ upon adoption of the new revenue guidance, we do not expect the adoption of this new revenue standard to have a material impact on our consolidated financial statements with respect to the capitalization and amortization of sales commissions.

We currently expect to implement the new revenue guidance when it becomes effective for us in the first quarter of fiscal 2019 utilizing the modified retrospective transition method. Under this transition method, prior period amounts will not be adjusted and the cumulative effect from prior periods of applying the new revenue guidance will be recognized in our consolidated balance sheets as of the date of adoption, including an adjustment to retained earnings.

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, 2017 and March 31, 2017:

	Balance At December 31, 2017	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 (1)	\$ 23,359	\$ 23,359	\$ —	\$ —
Restricted cash and cash equivalents	3,393	3,393	—	—
	<u>\$ 26,752</u>	<u>\$ 26,752</u>	<u>\$ —</u>	<u>\$ —</u>

	Balance At March 31, 2017	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 (1)	\$ 37,673	\$ 37,673	\$ —	\$ —
Restricted cash and cash equivalents	4,916	4,916	—	—
	<u>\$ 42,589</u>	<u>\$ 42,589</u>	<u>\$ —</u>	<u>\$ —</u>
<b>LIABILITIES</b>				
Contingent consideration related to acquisitions (2)	\$ 18,817	\$ —	\$ 18,817	\$ —
	<u>\$ 18,817</u>	<u>\$ —</u>	<u>\$ 18,817</u>	<u>\$ —</u>

(1) Cash equivalents consist primarily of money market funds.

(2) The contingent consideration liability as of March 31, 2017 relates to the acquisition of HealthFusion, which was settled during the quarter ended June 30, 2017. The measurement period of the contingent consideration liability ended on December 31, 2016, and thus the actual revenue achievement rate was utilized to compute the ending contingent consideration liability as of March 31, 2017. Accordingly, the contingent consideration liability was reflected under a Level 2 valuation hierarchy because the fair value was determined based on other significant observable inputs.

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 three and nine months ended December 31, 2017, no adjustments were recorded.

## 3. Business Combinations

### Entrada Acquisition

On April 14, 2017, we completed our acquisition of Entrada, Inc. ("Entrada") pursuant to the terms of the Agreement and Plan of Merger, dated April 11, 2017 (the "Agreement"). Based in Nashville, TN, Entrada is a leading provider of cloud-based solutions that are reshaping the way care is delivered by leveraging the power of mobile whenever and wherever care happens. Entrada's best-in-class mobile application integrates with multiple clinical platforms and all major electronic health record systems. Entrada enables organizations to maximize their existing technology investments while simultaneously enhancing physician and staff productivity. The acquisition of Entrada and its cloud-based, mobile application is part of our commitment to deliver systematic solutions that meet its clients' transforming work requirements to become increasingly nimble and mobile.

The preliminary purchase price totaled \$33,958, which included preliminary working capital and other customary adjustments. The acquisition was primarily funded by a draw against our revolving credit agreement (see Note 7).

We accounted for the Entrada 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.

In connection with the Entrada acquisition, we recorded \$15,400 of intangible assets related to customer relationships, trade names and software technology. We are amortizing the Entrada customer relationships over 10 years and trade names and software technology over 5 years. The weighted average amortization period for the total amount of intangible assets acquired is 6.1 years.

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 Entrada is not deductible for tax purposes and is allocated to our single reportable segment.

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

Initial purchase price	\$	34,000
Preliminary working capital and other adjustments		(42)
Total preliminary purchase price	\$	<u>33,958</u>

	<u>April 14, 2017</u>	
Preliminary fair value of the net tangible assets acquired and liabilities assumed:		
Acquired cash and cash equivalents	\$	102
Accounts receivable, net		1,835
Prepaid expense and other current assets		145
Equipment and improvements, net		134
Capitalized software costs, net		364
Deferred income taxes, net		1,041
Accounts payable		(639)
Accrued compensation and related benefits		(120)
Deferred revenues		(234)
Other liabilities		(444)
Total preliminary net tangible assets acquired and liabilities assumed		<u>2,184</u>
Preliminary fair value of identifiable intangible assets acquired:		
Goodwill		16,374
Software technology		10,500
Customer relationships		3,300
Trade name		1,600
Total preliminary identifiable intangible assets acquired		<u>31,774</u>
Total preliminary purchase price	\$	<u>33,958</u>

The pro forma effects of the Entrada acquisition would not have been material to the Company's results of operations and are therefore not presented.

#### **EagleDream Health Acquisition**

On August 16, 2017, we completed the acquisition of EagleDream Health, Inc. ("EagleDream") pursuant to the Agreement and Plan of Merger (the "Merger Agreement"), dated July 31, 2017. Headquartered in Rochester, NY, EagleDream is a cloud-based analytics company that drives meaningful insight across clinical, financial and administrative data to optimize practice performance.

The preliminary purchase price totaled \$25,609, which included preliminary working capital and other customary adjustments. The acquisition was partially funded by a draw against our revolving credit agreement (see Note 7).

We accounted for the EagleDream 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.

In connection with the EagleDream acquisition, we recorded \$13,400 of intangible assets related to customer relationships and software technology. We are amortizing the EagleDream customer relationships over 8 years and software technology over 5 years. The weighted average amortization period for the total amount of intangible assets acquired is 5.1 years.

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 EagleDream is not deductible for tax purposes and is allocated to our single reportable segment.

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

Initial purchase price	\$	26,000
Preliminary working capital and other adjustments		(391)
<b>Total preliminary purchase price</b>	<b>\$</b>	<b>25,609</b>
<b>August 16, 2017</b>		
Preliminary fair value of the net tangible assets acquired and liabilities assumed:		
Acquired cash and cash equivalents	\$	573
Accounts receivable, net		217
Prepaid expense and other current assets		20
Accounts payable		(115)
Accrued compensation and related benefits		(271)
Deferred revenues		(394)
Deferred income taxes, net		(1,957)
Other liabilities		(122)
<b>Total preliminary net tangible assets acquired and liabilities assumed</b>		<b>(2,049)</b>
Preliminary fair value of identifiable intangible assets acquired:		
Goodwill		14,258
Software technology		12,800
Customer relationships		600
<b>Total preliminary identifiable intangible assets acquired</b>		<b>27,658</b>
<b>Total preliminary purchase price</b>	<b>\$</b>	<b>25,609</b>

The pro forma effects of the EagleDream acquisition would not have been material to the Company's results of operations and are therefore not presented.

#### 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, 2017 that would require an interim goodwill impairment test.

We do not amortize goodwill as it has been determined to have an indefinite useful life. The carrying amount of goodwill as of December 31, 2017 was \$216,530, which reflects the acquisitions of Entrada and EagleDream (see Note 3). The carrying amount of goodwill as of March 31, 2017 was \$185,898.

## 5. Intangible Assets

Our definite-lived intangible assets, other than capitalized software development costs, are summarized as follows, and reflects the acquisitions of Entrada and EagleDream (see Note 3):

	December 31, 2017			
	Customer Relationships	Trade Name and Contracts	Software Technology	Total
Gross carrying amount	\$ 54,450	\$ 7,080	\$ 91,110	\$ 152,640
Accumulated amortization	(33,955)	(3,118)	(34,904)	(71,977)
Net intangible assets	\$ 20,495	\$ 3,962	\$ 56,206	\$ 80,663

	March 31, 2017			
	Customer Relationships	Trade Name and Contracts	Software Technology	Total
Gross carrying amount	\$ 50,550	\$ 5,480	\$ 67,810	\$ 123,840
Accumulated amortization	(28,972)	(2,088)	(23,567)	(54,627)
Net intangible assets	\$ 21,578	\$ 3,392	\$ 44,243	\$ 69,213

Amortization expense related to customer relationships and trade name and contracts recorded as operating expenses in the consolidated statements of comprehensive income was \$1,956 and \$2,568 for the three months ended December 31, 2017 and 2016, respectively. Amortization expense related to software technology recorded as cost of revenue was \$4,127 and \$3,007 for the three months ended December 31, 2017 and 2016, respectively.

Amortization expense related to customer relationships and trade name and contracts was \$6,015 and \$7,889 for the nine months ended December 31, 2017 and 2016, respectively. Amortization expense related to software technology was \$11,335 and \$9,064 for the nine months ended December 31, 2017 and 2016, respectively.

The following table summarizes the remaining estimated amortization of definite-lived intangible assets as of December 31, 2017:

	Amortization Expense Recorded As:		
	Operating Expense	Cost of Revenue	Total
For the year ended March 31, 2018 (remaining three months)	\$ 1,922	\$ 4,128	\$ 6,050
2019	5,577	16,511	22,088
2020	4,580	16,511	21,091
2021	3,731	12,628	16,359
2022	2,593	4,840	7,433
2023 and beyond	6,054	1,588	7,642
Total	\$ 24,457	\$ 56,206	\$ 80,663

## 6. Capitalized Software Costs

Our capitalized software costs are summarized as follows:

	December 31, 2017	March 31, 2017
Gross carrying amount	\$ 115,202	\$ 104,948
Accumulated amortization	(91,993)	(91,341)
Net capitalized software costs	\$ 23,209	\$ 13,607

Amortization expense related to capitalized software costs was \$1,838 and \$1,807 for the three months ended December 31, 2017 and 2016, respectively, and is recorded as cost of revenue in the consolidated statements of comprehensive income.

Amortization expense related to capitalized software costs was \$4,409 and \$6,626 for the nine months ended December 31, 2017 and 2016, respectively.

The following table presents the remaining estimated amortization of capitalized software costs as of December 31, 2017. 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.

<b>For the year ended March 31,</b>	
2018 (remaining three months)	\$ 2,500
2019	10,500
2020	6,100
2021	3,500
2022	609
Total	<u>\$ 23,209</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, 2017.

As of December 31, 2017, we had \$39,000 in outstanding loans and \$211,000 of unused credit under the Credit Agreement. As of March 31, 2017, we had \$15,000 in outstanding loans under the Credit Agreement.

Interest expense related to the Credit Agreement was \$463 and \$359 for the three months ended December 31, 2017 and 2016, respectively. Amortization of deferred debt issuance costs was \$269 for both the three months ended December 31, 2017 and 2016.

Interest expense related to the Credit Agreement was \$1,390 and \$1,631 for the nine months ended December 31, 2017 and 2016, respectively. Amortization of deferred debt issuance costs was \$807 for both the nine months ended December 31, 2017 and 2016, respectively.

## 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.

	<u>December 31, 2017</u>	<u>March 31, 2017</u>
Accounts receivable, gross	\$ 88,437	\$ 93,377
Sales return reserve	(5,580)	(7,213)
Allowance for doubtful accounts	(3,441)	(2,757)
Accounts receivable, net	<u>\$ 79,416</u>	<u>\$ 83,407</u>

Inventory is comprised of computer systems and components.

Prepaid expenses and other current assets are summarized as follows:

	<u>December 31, 2017</u>	<u>March 31, 2017</u>
Prepaid expenses	\$ 16,409	\$ 14,884
Other current assets	1,535	3,085
Prepaid expenses and other current assets	<u>\$ 17,944</u>	<u>\$ 17,969</u>

Equipment and improvements are summarized as follows:

	December 31, 2017	March 31, 2017
Computer equipment	\$ 26,886	\$ 22,014
Internal-use software	14,359	13,053
Furniture and fixtures	11,448	10,472
Leasehold improvements	16,231	16,360
Equipment and improvements, gross	68,924	61,899
Accumulated depreciation and amortization	(41,787)	(34,473)
Equipment and improvements, net	<u>\$ 27,137</u>	<u>\$ 27,426</u>

The current portion of deferred revenues are summarized as follows:

	December 31, 2017	March 31, 2017
Professional services	\$ 21,887	\$ 21,889
Software license, hardware and other	12,251	12,680
Support and maintenance	9,436	9,691
Software related subscription services	9,269	8,123
Deferred revenue	<u>\$ 52,843</u>	<u>\$ 52,383</u>

Accrued compensation and related benefits are summarized as follows:

	December 31, 2017	March 31, 2017
Payroll, bonus and commission	\$ 13,198	\$ 15,836
Vacation	8,700	8,677
Accrued compensation and related benefits	<u>\$ 21,898</u>	<u>\$ 24,513</u>

Other current and noncurrent liabilities are summarized as follows:

	December 31, 2017	March 31, 2017
Customer credit balances and deposits	\$ 4,406	\$ 4,124
Care services liabilities	3,393	4,957
Accrued self insurance expense	2,880	1,697
Accrued consulting and outside services	2,384	2,496
Deferred rent and lease obligations	2,228	2,427
Accrued EDI expense	2,025	2,490
Accrued royalties	1,891	2,033
Accrued outsourcing costs	1,853	1,588
Accrued legal expense	1,560	853
Accrued hosting costs	973	401
Employee benefit plan withholdings	655	739
Sales tax payable	601	448
Contingent consideration and other liabilities related to acquisitions	—	18,817
Other accrued expenses	5,304	3,705
Other current liabilities	<u>\$ 30,153</u>	<u>\$ 46,775</u>
Deferred rent and lease obligations	\$ 11,116	\$ 11,402
Uncertain tax positions	4,890	4,762
Other liabilities	348	297
Other noncurrent liabilities	<u>\$ 16,354</u>	<u>\$ 16,461</u>

## 9. Income Taxes

The provision for income taxes in the three months ended December 31, 2017 and 2016 was \$1,487 and \$2,342, respectively. The effective tax rates were 49.1% and 18.3% for the three months ended December 31, 2017 and 2016, respectively. The provision for income taxes for the nine months ended December 31, 2017 and 2016 was \$6,134 and \$3,950, respectively. The effective tax rates were 31.3% and 22.2% for the nine months ended December 31, 2017 and 2016, respectively. The increase in the effective tax rate for the three and nine months ended December 31, 2017 compared to the prior year periods was primarily due to a one-time

reevaluation of deferred and foreign transition taxes, which was a result of new tax reform legislation enacted on December 22, 2017, as described further below. This increase in the effective tax rate was offset by a favorable benefit due to an increase in the research and development credit claimed on our recently filed tax return.

The deferred tax assets and liabilities are presented 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 \$4,890 and \$4,762 for unrecognized tax benefits related to various federal, state and local income tax matters as of December 31, 2017 and March 31, 2017, respectively. If recognized, this amount would reduce our effective tax rate.

We are no longer subject to United States federal income tax examinations for tax years before fiscal year ended 2014. With a few exceptions, we are no longer subject to state or local income tax examinations for tax years before fiscal year ended 2013. We do not anticipate the total unrecognized tax benefits to significantly change due to the settlement of audits or the expiration of statute of limitations within the next twelve months.

#### **United States Tax Reform**

On December 22, 2017, the President of the United States signed and enacted into law H.R. 1 (the "Tax Reform"). This new tax legislation, effective for tax years beginning on or after January 1, 2018, except for certain provisions, resulted in significant changes to existing United States tax law, including various provisions that will impact our Company. Below is a summary of the provisions of the Tax Reform that we believe will be most impactful to our Company.

We are subject to the provisions of FASB Accounting Standards Codification 740-10, *Income Taxes*, which requires that the effect on deferred tax assets and liabilities of a change in tax rates be recognized in the period the tax rate change was enacted. The Tax Reform reduces the federal corporate tax rate from 35% to 21% effective January 1, 2018, and thus we have revised our estimated annual effective tax rate to reflect the change in the federal statutory rate by using a blended rate of 31.5% for the annual period ended March 31, 2018. As a result of the enacted reduction in the federal corporate income tax rate, we recorded a one-time, non-cash increase to income tax expense for the three and nine months ended December 31, 2017 related to the remeasurement of certain deferred tax assets and liabilities. The resulting \$3,095 decrease in net deferred tax assets was reasonably estimated and based on the tax rates at which they are expected to reverse in the future. We are currently in the process of analyzing certain aspects of the Tax Reform and continue to refine our calculations, which include, but are not limited to, computing the full year remeasurement of net deferred tax assets.

The Tax Reform also required a one-time transition tax based on total post-1986 foreign cumulative earnings and profits previously deferred from United States federal taxation, which was reasonably estimated at December 31, 2017 and recorded as a one-time income tax expense of \$1,354 in the current period. This liability is expected to be paid with our annual tax returns for the fiscal year ended March 31, 2018. We will continue to analyze the calculation of cumulative foreign earnings and finalize the amounts held in cash or other specified assets.

We have recorded the provisional impacts of the Tax Reform at December 31, 2017 based on our most reasonable estimates, as noted above. The Tax Reform legislation includes various other provisions with effective dates for the Company beginning April 1, 2018 and beyond. For other changes that impact business related income, exclusions, deductions and credits with effective dates for our fiscal year beginning April 1, 2018, we will continue to account for those items based on our existing accounting under ASC 740, *Income Taxes*, and the provisions of the tax laws that were in effect immediately prior to the enactment of the Tax Reform. We will continue to analyze the provisions of the Tax Reform to fully assess the impact on our consolidated financial statements and expect to provide additional details in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

## 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,	
	2017	2016	2017	2016
<b>Earnings per share — Basic:</b>				
Net income	\$ 1,541	\$ 10,486	\$ 13,467	\$ 13,826
Weighted-average shares outstanding — Basic	63,706	62,093	63,287	61,645
Net income per common share — Basic	<u>\$ 0.02</u>	<u>\$ 0.17</u>	<u>\$ 0.21</u>	<u>\$ 0.22</u>
<b>Earnings per share — Diluted:</b>				
Net income	\$ 1,541	\$ 10,486	\$ 13,467	\$ 13,826
Weighted-average shares outstanding	63,706	62,093	63,287	61,645
Effect of potentially dilutive securities	2	-	9	255
Weighted-average shares outstanding — Diluted	63,708	62,093	63,296	61,900
Net income per common share — Diluted	<u>\$ 0.02</u>	<u>\$ 0.17</u>	<u>\$ 0.21</u>	<u>\$ 0.22</u>

The computation of diluted net income per share does not include 3,228 and 2,785 options to acquire shares of common stock for the three and nine months ended December 31, 2017, 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 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.

## 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, 2017, there were 689,260 outstanding options 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. In August 2017, our shareholders approved an amendment to our 2015 Equity Incentive Plan, (the “Amended 2015 Plan”), to, among other items, increase the number of shares of common stock reserved for issuance thereunder by 6,000,000. The Amended 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 Amended 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 Amended 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 Amended 2015 Plan, awards under the Amended 2015 Plan will fully vest under certain circumstances. As of December 31, 2017, there were 3,134,375 outstanding options, 1,601,580 outstanding shares of restricted stock awards, 86,187 outstanding shares of performance stock awards, and 9,269,858 shares available for future grant under the Amended 2015 Plan.

The following table summarizes the stock option transactions during the nine months ended December 31, 2017:

	Number of Shares	Weighted- Average Exercise Price per Share	Weighted- Average Remaining Contractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, April 1, 2017	2,885,415	\$ 15.41	6.2	\$ 3,150
Granted	1,479,000	14.56	7.8	
Exercised	(216,405)	16.62	6.0	\$ 119
Forfeited/Canceled	(324,375)	17.93	4.7	
Outstanding, December 31, 2017	<u>3,823,635</u>	\$ 15.73	6.3	\$ 733
Vested and expected to vest, December 31, 2017	<u>3,401,964</u>	\$ 15.90	6.3	\$ 654
Exercisable, December 31, 2017	<u>923,480</u>	\$ 19.96	4.4	\$ 190

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,	
	2017	2016	2017	2016
Expected term	5.6 - 6.1 years	6.3 years	5.6 - 6.1 years	6.0 - 6.6 years
Expected volatility	37.0% - 37.5%	37.1%	37.0% - 37.7%	36.9% - 37.4%
Expected dividends	0.0%	0.0%	0.0%	0.0%
Risk-free rate	2.1% - 2.2%	1.5%	1.9% - 2.2%	1.2% - 1.5%

The weighted-average grant date fair value of stock options granted during the nine months ended December 31, 2017 and 2016 was \$5.59 and \$4.92 per share, respectively.

During the nine months ended December 31, 2017, a total of 1,479,000 options to purchase shares of common stock were granted under the Amended 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 (1)	Expiration
June 13, 2017	249,000	\$ 16.37	Four Years	June 13, 2025
May 24, 2017	60,000	\$ 14.57	Four Years	May 24, 2025
August 4, 2017	25,000	\$ 16.13	Four Years	August 4, 2025
October 31, 2017	915,000	\$ 14.07	Four Years	October 31, 2025
December 4, 2017	230,000	\$ 14.38	Four Years	December 4, 2025
Fiscal year 2018 grants	<u>1,479,000</u>			

(1) 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, 2017 is summarized as follows:

	Number of Shares	Weighted- Average Grant-Date Fair Value per Share
Outstanding, April 1, 2017	2,073,295	\$ 5.09
Granted	1,479,000	5.59
Vested	(442,690)	4.86
Forfeited/Canceled	(209,450)	4.57
Outstanding, December 31, 2017	<u>2,900,155</u>	\$ 5.16

As of December 31, 2017, \$12,861 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, 2017 and 2016 was \$2,154 and \$1,189, respectively.

Restricted stock awards activity during the nine months ended December 31, 2017 is summarized as follows:

<b>Restricted Stock</b>	<b>Number of Shares</b>	<b>Weighted- Average Grant-Date Fair Value per Share</b>
Outstanding, April 1, 2017	902,948	\$ 12.92
Granted	1,140,374	15.50
Vested	(344,659)	12.66
Canceled	(97,083)	14.10
Outstanding, December 31, 2017	1,601,580	\$ 14.82

Share-based compensation expense related to restricted stock awards was \$2,333 and \$1,054 for the three months ended December 31, 2017 and 2016, respectively. Share-based compensation expense related to restricted stock awards was \$6,079 and \$2,571 for the nine months ended December 31, 2017 and 2016, 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 between one to three years.

As of December 31, 2017, \$19,034 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, of which 86,187 shares are currently outstanding. 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 \$77 and \$227 for the three and nine months ended December 31, 2017, respectively.

#### **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, 2017, we have issued 315,368 shares under the Purchase Plan and 3,684,632 shares are available for future issuance.

Share-based compensation expense recorded for the employee share purchase plan was \$88 and \$70 for the three months ended December 31, 2017 and 2016, respectively. Share-based compensation expense recorded for the employee share purchase plan was \$265 and \$277 for the nine months ended December 31, 2017 and 2016, respectively.

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

We had cash deposits at United States banks and financial institutions which exceeded federally insured limits at December 31, 2017. 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

The following table summarizes our significant contractual obligations at December 31, 2017 and the effect that such obligations are expected to have on our liquidity and cash in future periods:

Contractual Obligations	For the year ended March 31,						
	Total	2018 (remaining three months)	2019	2020	2021	2022	2023 and beyond
Operating lease obligations	\$ 60,114	\$ 2,219	\$ 9,321	\$ 9,013	\$ 8,998	\$ 8,726	\$ 21,837
Remaining lease obligations for vacated properties (1)	4,659	547	1,413	794	816	551	538
Line of credit obligations (Note 7)	39,000	-	-	-	39,000	-	-
Purchase commitments (2)	32,322	312	3,840	5,297	7,073	7,900	7,900
<b>Total</b>	<b>\$ 136,095</b>	<b>\$ 3,078</b>	<b>\$ 14,574</b>	<b>\$ 15,104</b>	<b>\$ 55,887</b>	<b>\$ 17,177</b>	<b>\$ 30,275</b>

(1) Remaining lease obligations for vacated properties relates to remaining lease obligations at certain locations, including Austin, Solana Beach, Costa Mesa, and a portion of Horsham, that we have vacated and are actively marketing the locations for sublease as part of our reorganization efforts. Total obligations have not been reduced by projected sublease rentals or by minimum sublease rentals of \$1,258 due in future periods under non-cancelable subleases.

(2) Purchase commitments relates to payments due under certain non-cancelable agreements to purchase goods and services.

The deferred compensation liability as of December 31, 2017 was \$6,473, 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, 2017 was \$4,890, which is not included in the table above as the timing of expected payments is not determinable.

#### 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 Hussein, alleging that he 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 with respect to Hussein's claims, which the Court granted on September 16, 2015, dismissing all of Hussein's claims against us. On September 23, 2015, Hussein filed an application for reconsideration of the Court's summary judgment order, which the Court denied. Hussein filed a renewed application for reconsideration of the Court's summary judgment order on August 3, 2017. The Court again denied Hussein's application.

On October 28, 2015, May 9, 2016, and August 5, 2016, Hussein filed a motion for summary judgment, motion for summary adjudication, and motion for judgment on the pleadings, respectively, seeking to dismiss our cross-complaint. The Court denied each motion. Trial on our cross-complaint began June 12, 2017. On July 26, 2017, the Court issued a statement of decision granting Hussein's motion for judgment on our cross-complaint.

Final judgment over Hussein's claims and our cross-claims was entered on January 9, 2018. Hussein has noticed his appeal of the order granting summary judgment over his claims, and we are evaluating a potential cross-appeal. 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. 8:13-cv-01818-CJC-JPR, 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. On July 28, 2017, the Ninth Circuit issued a decision reversing and remanding the District Court's order on our motion to dismiss. On September 5, 2017, we filed a petition for rehearing en banc, which was denied on September 29, 2017. After the Ninth Circuit issued its mandate, the District Court reopened the case. The parties have begun discovery. We believe that the plaintiffs' claims are without merit and continue to defend against them vigorously, including by evaluating potential challenges to the Ninth Circuit decision. 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 purported 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 matter was stayed pending the Ninth Circuit's decision in the appeal described above under the caption, "Federal Securities Class Action." This stay now has been lifted and, pursuant to a stipulated briefing schedule, Defendants' motion to dismiss is due February 2, 2018.

On September 28, 2017, a complaint was filed against our Company and certain of our current and former officers and directors in the United States District Court for the Central District of California, captioned *Kusumam Koshy, derivatively on behalf of Quality Systems Inc. vs. Craig Barbarosh, George H. Bristol, James C. Malone, Peter M. Neupert, Morris Panner, D. Russell Pflueger, Steven T. Plochocki, Sheldon Razin, Lance E. Rosenzweig, Paul A. Holt, and Quality Systems, Inc.*, No. 8:17-cv-01694, by Kusumam Koshy, a purported shareholder of ours. The complaint alleges breach of fiduciary duties and abuse of control, as well as unjust enrichment and insider selling by individual directors arising out of the allegations described above under the captions "Hussein Litigation" and "Federal Securities Class Action," QSI's adoption of revised indemnification agreements, and the

resignation of certain officers of the Company. The complaint seeks restitution and disgorgement, court costs and attorneys' fees, and enhanced corporate governance reforms and internal control procedures. On January 12, 2018, Defendants filed a motion to dismiss the derivative complaint.

We believe that the plaintiffs' 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.

#### **Other Regulatory Matters**

In April 2017, we received a request for documents and information from the United States Attorney's Office for the District of Vermont pursuant to a Civil Investigative Demand ("CID"). The CID relates to an investigation concerning the certification we obtained for our software under the United States Department of Health and Human Services' Electronic Health Record Incentive Program. We have provided documents and information in response to that CID. On December 11, 2017, we received a subpoena from the United States Department of Justice in connection with the same matter seeking among other things records relating to (a) data used to determine objectives and measures under the Meaningful Use (MU) and the Physician Quality Reporting System (PQRS) programs, (b) EHR software code used in certifying the 2014 EHR software, and information, and (c) payments provided for the referral of EHR business.

Given the highly-regulated nature of our industry, we may, from time to time, be subject to subpoenas, requests for information, or investigations from various government agencies. It is our practice to respond to such matters in a cooperative, thorough and timely manner. We continue to respond to this CID and subpoena and intend to cooperate fully with the government. Requests and investigations of this nature may lead to the assertion of claims or the commencement of legal proceedings against us, as well as other material liabilities. In addition, our responses to these requests require time and effort, which can result in additional cost to us. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this matter.

#### **14. Restructuring Plan**

In fiscal year 2016, as part of our reorganization efforts, we recorded \$7,078 of restructuring costs within operating expenses in our consolidated statements of net income and comprehensive income. The restructuring plan was substantially complete by the end of fiscal 2017. The restructuring costs consisted 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 would be paid and the amounts were reasonably estimable. Also included in restructuring costs were certain facilities-related costs associated with accruals for the remaining lease obligations at certain locations, including Solana Beach, Costa Mesa, and a portion of Horsham with contractual lease terms ending between January 2018 and September 2023. We have vacated each of the locations or portions thereof and are actively marketing the locations for sublease. We estimated the remaining lease obligations at fair value as of the cease-use date for each location based on the future contractual lease obligations, reduced by projected sublease rentals that could be reasonably obtained for the locations after a period of marketing, and adjusted for the effect of deferred rents that have been recognized under the lease. The effect of discounting future cash flows using a credit-adjusted risk free rate was not significant. Sublease income and commencement dates were estimated based on data available from rental activity in the local markets. Significant judgment was required to estimate the remaining lease obligations at fair value and actual results could vary from the estimates, resulting in potential future adjustments to amounts previously recorded. As of December 31, 2017, the remaining lease obligation, net of estimated projected sublease rentals, was \$1,363.

## 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, uncertainties related to the future impact of United States tax reform, 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, 2017 ("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., known to our clients as NextGen Healthcare, provides software, services and analytics solutions to the ambulatory care market. We are a healthcare information technology and services company that delivers the foundational capabilities to organizations that want to promote healthy communities. Our technology provides a customizable platform that empowers physician practice success, enriches the patient care experience and lowers 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 ambulatory care practices. In addition, our software and services facilitate interoperability. Our software can be licensed and delivered on-premise or in the cloud as software-as-a-service ("SaaS"). Our services include maintenance and support, professional services, and complementary services such as managed cloud services, revenue cycle management ("RCM") and electronic data interchange ("EDI"). We market and sell our solutions through a dedicated sales force and to a much lesser extent, through resellers. Our clients span the entire ambulatory market from large multi-specialty to small single specialty practices and include networks of practices such as physician hospital organizations ("PHOs"), management service organizations ("MSOs"), accountable care organizations ("ACOs"), ambulatory care centers and community health centers.

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.

We have a history of enhancing our solutions through both organic and inorganic activities. Over the last few years, we have entered into strategic transactions to complement and enhance our product portfolio in the ambulatory care market. In October 2015, we divested our former Hospital Solutions division. In January 2016, we acquired HealthFusion Holdings, Inc. ("HealthFusion"), in April 2017, we acquired Entrada, Inc. ("Entrada"), and in August 2017, we acquired EagleDream Health, Inc. ("EagleDream").

We have and intend to continue investments in our infrastructure, including but 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 while continuing our strong commitment of service in support of our client satisfaction programs. These investments in our infrastructure will continue while maintaining reasonable expense discipline. We strive to add new clients and expand our relationship with existing clients through delivery of add-on and complementary products and services and believe that our client base that is using our software on a daily basis is a strategic asset. 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 a lower-cost, increased capability structure, our new management team is building what we believe is 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 sizes, integrating services and software into a consolidated solution that enables an efficient and effective caregiver and patient experience while driving positive financial outcomes. 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 through an evolving healthcare marketplace that is transitioning from fee-for-service to fee-for-value 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 former 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 client segment. 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. At the same time, we intend to expand the capability of the highly scalable, pure cloud-based and mobile-enabled MediTouch® platform.

- **Platform as a service.** With the introduction of our API 2.0 framework and our continued leverage of the Mirth interoperability platform, we will continue our evolution to plug and play extensibility and information sharing that allows our customers to innovate and deploy high-fidelity extensions to our core applications without the costs, risks (security, performance, etc.) or complexity commonly associated with direct binding. We have also introduced platform-enabled automation capabilities to empower our clients to drive cost out of their processes while supporting their needs to implement the highly personalized workflows that are required to support value based care. Our acquisition of Entrada and its cloud-based, mobile application in April 2017 demonstrates our commitment to innovation that becomes essential for practitioners by improving their clinical productivity with documentation support services that seamlessly integrate into their electronic health record. We believe there is significant opportunity to extend the solutions we offer existing and new clients through value-added services such as RCM and EDI.
- **Population health software and services.** We are migrating into applications, analytics and services that will enable our clients to proactively manage the health of patient populations. We are establishing strong development partnerships with our most innovative customers who are actively participating in shared-risk contracts, and working together with them to create progressive population health capabilities. We support extraordinary information sharing capabilities vital to managing patient populations through our interoperability offerings.

### **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, 2017.

## 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, 2017 and 2016 (certain percentages below may not sum due to rounding):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
<b>Revenues:</b>				
Software license and hardware	10.0%	13.3%	10.2%	13.0%
Software related subscription services	18.7	17.6	18.6	16.9
Total software, hardware and related	28.7	30.9	28.8	29.9
Support and maintenance	30.6	31.2	31.2	31.0
Revenue cycle management and related services	16.6	15.7	16.3	16.4
Electronic data interchange and data services	17.6	17.0	17.6	17.4
Professional services	6.4	5.1	6.2	5.3
Total revenues	100.0	100.0	100.0	100.0
<b>Cost of revenue:</b>				
Software license and hardware	4.3	4.4	4.0	5.1
Software related subscription services	8.9	7.3	8.3	7.2
Total software, hardware and related	13.2	11.8	12.3	12.3
Support and maintenance	5.7	5.7	5.7	5.5
Revenue cycle management and related services	11.7	10.5	11.5	11.1
Electronic data interchange and data services	10.3	9.9	10.2	10.1
Professional services	5.9	4.6	5.6	5.2
Total cost of revenue	46.8	42.5	45.4	44.3
Gross profit	53.2	57.5	54.6	55.7
<b>Operating expenses:</b>				
Selling, general and administrative	33.1	29.4	32.3	32.1
Research and development costs, net	15.7	15.4	15.2	14.9
Amortization of acquired intangible assets	1.5	2.0	1.5	2.1
Restructuring costs	0.1	0.2	0.0	1.2
Total operating expenses	50.3	47.0	49.0	50.3
Income from operations	2.9	10.5	5.5	5.4
Interest income	0.0	0.0	0.0	0.0
Interest expense	(0.6)	(0.5)	(0.6)	(0.6)
Other expense, net	0.0	0.0	0.0	0.0
Income before provision for income taxes	2.3	10.0	5.0	4.7
Provision for income taxes	1.1	1.8	1.6	1.0
Net income	1.2%	8.2%	3.4%	3.7%

## Revenues

The following table presents our consolidated revenues for the three and nine months ended December 31, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Revenues:				
Software license and hardware	\$ 13,131	\$ 16,995	\$ 40,198	\$ 48,966
Software related subscription services	24,690	22,546	73,584	63,911
Total software, hardware and related	37,821	39,541	113,782	112,877
Support and maintenance	40,362	39,924	123,171	116,905
Revenue cycle management and related services	21,922	20,048	64,327	62,037
Electronic data interchange and data services	23,136	21,790	69,446	65,527
Professional services	8,474	6,565	24,518	19,893
Total revenues	\$ 131,715	\$ 127,868	\$ 395,244	\$ 377,239

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, 2017 increased \$3.8 million compared to the prior year primarily due to higher sales of software related subscription services, RCM services, and EDI services, partially offset by lower software license and hardware revenue. Software related subscription services increased \$2.1 million from sales of our cloud-based Entrada platform acquired in April 2017, incremental sales from our acquisition of EagleDream Health in August 2017, and higher sales of our MediTouch® cloud-based subscriptions. Professional services revenue increased \$1.9 million, which was mostly associated with transcription and editing services from our acquisition of Entrada, offset by lower sales of professional services due to lower client demand for our core software products and related implementation, training, and consulting services. RCM services revenue increased \$1.9 million from the addition of new clients and organic growth achieved through cross selling and ramping up of RCM services provided to our existing clients. EDI revenue increased \$1.3 million, which was primarily related to higher EDI services sold with our MediTouch® cloud-based solutions, addition of new clients, and further penetration of our existing client base. The \$0.4 million increase in support and maintenance is primarily due to lower sales credits in the current year period and the impact of our annual price increases, partially offset by client attrition. Software license and hardware declined \$3.9 million, which mainly reflects the increasingly saturated end-market for electronic health records software and our transition to a recurring subscription-based model.

Consolidated revenue for the nine months ended December 31, 2017 increased \$18.0 million compared to the prior year primarily due to higher sales of software related subscription services, RCM services, and EDI services, partially offset by lower software license and hardware revenue. Software related subscription services increased \$9.7 million from sales of our cloud-based Entrada platform acquired in April 2017, and higher sales of our MediTouch® cloud-based subscriptions, Mirth interoperability solutions, patient portal, and QSIDental Web offerings as we continue to expand our client base. The \$6.3 million increase in support and maintenance is primarily due to lower sales credits in the current year, addition of new customers, and the impact of our annual price increases. The \$4.6 million increase in professional services is mostly associated with transcription and editing services from our acquisition of Entrada, offset by lower sales of professional services due to lower client demand for our core software products and related implementation, training, and consulting services. EDI revenue increased \$3.9 million, which was primarily related to higher EDI services sold with our MediTouch® cloud-based solutions, addition of new clients, and further penetration of our existing client base. RCM services revenue increased \$2.3 million from the addition of new clients and organic growth achieved through cross selling and ramping up of RCM services provided to our existing clients, offset by customer attrition. The \$8.8 million decline in software license and hardware reflects the increasingly saturated end-market for electronic health records software and our transition to a recurring subscription-based model.

Recurring service revenue, consisting of software related subscription services, support and maintenance, RCM, and EDI, represented 84% and 82% of total revenue for the three months ended December 31, 2017 and 2016, respectively. For the nine months ended December 31, 2017 and 2016, recurring service revenue, represented 84% and 82%, respectively, of total revenue.

Our goals 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. We continue to expand our client base and cloud-based solution capabilities in the ambulatory market to meet the needs of practices of increasing size and complexity, and focus our strategy on accountable care organizations around interoperability, patient engagements, population health and collaborative care management, and enterprise analytics. Our software and service offerings offer clients a full suite of cloud-based solutions that better enable our clients to focus on care delivery. 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 also believe that a significant opportunity exists to continue cross selling RCM services to our existing clients as the portion of existing 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.

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. 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.

### Gross Profit

The following table presents our consolidated cost of revenue and gross profit for the three and nine months ended December 31, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Total cost of revenue	\$ 61,634	\$ 54,352	\$ 179,558	\$ 167,164
Gross profit	70,081	73,516	215,686	210,075
Gross margin %	53.2%	57.5%	54.6%	55.7%

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 \$0.3 million and \$0.1 million for the three months ended December 31, 2017 and 2016, and is included in the amounts in the table above. Share-based compensation expense included in cost of revenue was \$0.7 million and \$0.5 million for the nine months ended December 31, 2017 and 2016, and is included in the amounts in the table above.

Gross profit for the three months ended December 31, 2017 decreased \$3.4 million compared to the prior year period due primarily to a \$7.3 million increase in cost of revenue, offset by the \$3.8 million higher revenues as discussed above. The increase in cost of revenue compared to the prior year period is the result of higher costs associated with the acquisitions of Entrada in April 2017 and EagleDream Health in August 2017, higher amortization of the software technology intangible assets associated with the two recent acquisitions, and higher personnel costs associated with delivering support and maintenance and RCM services, partially offset by lower amortization of previously capitalized software development cost, which result in a decline in our gross margin to approximately 53% in the current quarter compared to 58% in the prior year quarter.

Gross profit for the nine months ended December 31, 2017 increased \$5.6 million compared to the prior year period due primarily to \$18.0 million higher revenues as discussed above, offset by a \$12.4 million increase in cost of revenue. The increase in cost of revenue is the result of higher costs associated with the acquisitions of Entrada in April 2017 and EagleDream Health in August 2017, higher amortization of the software technology intangible assets associated with the two recent acquisitions, and higher personnel costs associated with delivering our RCM services. Gross margin decreased to approximately 55% in the nine months ended December 31, 2017 compared to 56% in the prior year nine months.

## 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, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Selling, general and administrative	\$ 43,563	\$ 37,542	\$ 127,517	\$ 120,913
Selling, general and administrative, as a percentage of revenue	33.1%	29.4%	32.3%	32.1%

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, consulting, 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 \$2.6 million and \$1.6 million for the three months ended December 31, 2017 and 2016, respectively, and is included in the amounts in the table above. Share-based compensation expense included in selling, general and administrative expenses was \$6.5 million and \$4.0 million for the nine months ended December 31, 2017 and 2016, respectively, and is included in the amounts above. The increase in share-based compensation for the three and nine months ended December 31, 2017 compared to the same prior year periods is due to increased utilization of share-based awards to incentivize our executives and employees. Refer to Note 11, "Share-Based Awards" of our notes to consolidated financial statements included elsewhere in this Report for additional information of our share-based awards and related incentive plans.

Selling, general and administrative expenses increased \$6.0 million for the three months ended December 31, 2017 compared to the prior year as a result of a \$2.0 million benefit recorded in the prior year period related to fair value adjustments of the HealthFusion contingent consideration, higher incremental costs associated with our acquisitions of Entrada in April 2017 EagleDream Health in August 2017, increases in bad debt expense associated with our continued efforts to resolve aged customer receivable balances, and higher legal expense.

Selling, general and administrative expenses increased \$6.6 million for the nine months ended December 31, 2017 compared to the prior year primarily due to higher incremental costs associated with our acquisitions of Entrada in April 2017 EagleDream Health in August 2017, increases in bad debt expense associated with our continued efforts to resolve aged customer receivable balances, and higher consulting costs associated with our assessment and implementation of the new revenue standard (ASC 606, *Revenue From Contracts With Customers*), including implementation of a new accounting system module, and higher legal expense, offset by \$3.4 million of fair value adjustments related to the HealthFusion contingent consideration recorded in the prior year period.

## 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, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Gross expenditures	\$ 24,668	\$ 20,766	\$ 73,808	\$ 62,601
Capitalized software costs	(4,023)	(1,052)	(13,647)	(6,371)
Research and development costs, net	\$ 20,645	\$ 19,714	\$ 60,161	\$ 56,230
Research and development costs, as a percentage of revenue	15.7%	15.4%	15.2%	14.9%
Capitalized software costs as a percentage of gross expenditures	16.3%	5.1%	18.5%	10.2%

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 net income and comprehensive income.

Share-based compensation expense included in research and development costs was \$0.6 million and \$0.3 million for the three months ended December 31, 2017 and 2016, respectively, and is included in the amounts in the table above. Share-based compensation expense included in research and development costs was \$1.4 million and \$0.7 million for the nine months ended December 31, 2017 and 2016, respectively, and is included in the amounts above.

Net research and development costs for the three months ended December 31, 2017 increased \$0.9 million compared to the prior year period, which is due to a \$3.9 million increase in our gross expenditures, offset by \$3.0 million higher capitalization of software costs. Net research and development costs for the nine months ended December 31, 2017 increased \$3.9 million compared to the prior year, which is due to a \$11.2 million increase in our gross expenditures, offset by \$7.3 million higher capitalization of software costs. The increase in both gross expenditures and capitalization of software costs are related to the development of the next major versions of our core software products and enhancements to our existing products, for which we incurred a higher level of personnel and third party development costs. Additionally, the acquisition of Entrada in April 2017 and an increase in our research and development headcount contributed to the increases in gross expenditures. Our software capitalization rate fluctuates due to differences in the nature and status of our projects and initiatives during a given year, which affects the amount of development costs that may be capitalized.

### Amortization of Acquired Intangible Assets

The following table presents our amortization of acquired intangible assets for the three and nine months ended December 31, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Amortization of acquired intangible assets	\$ 1,956	\$ 2,568	\$ 6,015	\$ 7,889

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, 2017 declined \$0.6 million and \$1.9 million, respectively, compared to prior year period due to certain acquired intangible assets being fully amortized during the year, partially offset by the incremental amortization associate with intangible assets acquired from Entrada and EagleDream.

### 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 restructuring plan was substantially complete by the end of fiscal 2017. During the three and nine months ended December 31, 2017, we recorded \$0.1 million of restructuring costs related to adjustments of our estimated remaining lease obligations. Refer to Note 14, "Restructuring Plan" of our notes to consolidated financial statements included elsewhere in this Report for additional details.

### Interest and Other Income and Expense

The following table presents our interest expense for the three and nine months ended December 31, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Interest income	\$ 15	\$ -	\$ 36	\$ 9
Interest expense	(733)	(629)	(2,250)	(2,445)
Other expense, net	(41)	(4)	(48)	(146)

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.

The fluctuations in our interest expense is caused by changes in outstanding balances under our revolving credit agreement in the current year compared to prior year. As of December 31, 2017, we had \$39.0 million in outstanding balances under the revolving credit agreement, compared to an outstanding balance of \$15.0 million as of March 31, 2017 and \$25.0 million as of December 31, 2016. 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, 2017 and 2016 (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Provision for income taxes	\$ 1,487	\$ 2,342	\$ 6,134	\$ 3,950
Effective tax rate	49.1%	18.3%	31.3%	22.2%

The effective tax rates for the three and nine months ended December 31, 2017 compared to the prior year periods increased primarily due to a one-time revaluation of deferred and foreign transition taxes, which was a result of new tax reform legislation enacted on December 22, 2017. The increase in the effective tax rates was offset by a favorable benefit due to an increase in the research and development credit claimed on our recently filed tax return.

We continue to fully assess the impact of the new tax reform legislation, that was enacted December 22, 2017, on our future taxes and on our consolidated financial statements. We have recorded the provisional impacts of the new tax reform legislation as of December 31, 2017 based on our most reasonable estimates. Our estimated impacts of the new tax reform legislation are based on our current knowledge, interpretation, and assumptions, and the recognized impacts could be materially different from current estimates based on our actual results in the fourth quarter of fiscal 2018, actions taken by the Company, the issuance of further guidance, and our further analysis of the new tax reform legislation. Refer to Note 9, "Income Taxes" of our notes to consolidated financial statements included elsewhere in this Report for more information.

### 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, 2017 and 2016:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2017	2016	2017	2016
Net income	\$ 1,541	\$ 10,486	\$ 13,467	\$ 13,826
Net income per share:				
Basic	\$ 0.02	\$ 0.17	\$ 0.21	\$ 0.22
Diluted	\$ 0.02	\$ 0.17	\$ 0.21	\$ 0.22

As a result of the foregoing changes in revenue and expense, net income for the three and nine months ended December 31, 2017 decreased \$8.9 million and decreased \$0.4 million, respectively, compared to the prior year periods.

## Liquidity and Capital Resources

The following table presents selected financial statistics and information for the nine months ended December 31, 2017 and 2016 (in thousands):

	Nine Months Ended December 31,	
	2017	2016
Cash and cash equivalents	\$ 23,359	\$ 23,994
Unused portion of revolving credit agreement (1)	211,000	225,000
Total liquidity	\$ 234,359	\$ 248,994
Net income	\$ 13,467	\$ 13,826
Net cash provided by operating activities	\$ 56,775	\$ 81,423

(1) As of December 31, 2017, we had outstanding loans of \$39.0 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 our revolving credit agreement.

### Cash and Cash Equivalents

As of December 31, 2017, our cash and cash equivalents balance of \$23.4 million reflects an \$14.3 million decrease compared to \$37.7 million as of March 31, 2017. This decrease primarily reflects \$58.9 million of net cash paid for the acquisitions of Entrada and EagleDream, which were partially funded by \$50.0 million of additional borrowings under our revolving credit agreement, \$26.0 million of principal repayments, and payment of \$18.8 million to settle the contingent consideration liability related to the acquisition of HealthFusion, offset by \$56.8 million of cash from operations. Our outstanding loans under our revolving credit agreement was \$39.0 million as of December 31, 2017.

We may continue to use a portion of our funds as well as available financing from our revolving 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. 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 on hand at December 31, 2017, together with our cash flows from operations and liquidity provided by our revolving 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, 2017 and 2016 (in thousands):

	Nine Months Ended December 31,	
	2017	2016
Net income	\$ 13,467	\$ 13,826
Non-cash expenses	47,895	45,613
Cash from net income, as adjusted	\$ 61,362	\$ 59,439
Change in deferred revenue	(709)	(8,195)
Change in accounts receivable	960	16,005
Change in other assets and liabilities	(4,838)	14,174
Net cash provided by operating activities	\$ 56,775	\$ 81,423

For the nine months ended December 31, 2017, cash provided by operating activities decreased \$24.6 million compared to the prior year period, of which \$15.0 million of the decrease was driven by a decline in accounts receivable in the prior year period related to

improved collections and aggressive working capital management and \$20.0 million of the decrease was due to changes in income taxes payable and receivable, offset by \$7.5 million from lower deferred revenue in the prior year period caused by lower system sales and a shift in market dynamics toward cloud-based solutions. Net income for the nine months ended December 31, 2017 decreased \$0.4 million compared to the prior year period, as described in the "Net Income" section above. Non-cash expenses for the nine months ended December 31, 2017 increased \$2.3 million compared to the prior year period primarily due to higher share-based compensation expense and higher bad debt expense, offset by a decrease in amortization of previously capitalized software costs and lower fair value adjustments related to the HealthFusion contingent consideration that were recorded in the prior year period.

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

Net cash used in investing activities for the nine months ended December 31, 2017 was \$80.1 million compared with \$5.6 million of cash used in investing activities in the prior year period. The increase in net cash used in investing activities is primarily due to \$58.9 million net cash paid for the acquisitions of Entrada and EagleDream, \$9.3 million lower proceeds from sales of marketable securities, and \$7.3 million increase in additions to capitalized software costs associated with the development of new products and enhancement of existing products, offset by \$0.6 million fewer additions to equipment and improvements.

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

Net cash provided by financing activities for the nine months ended December 31, 2017 was \$9.1 million compared with \$79.0 million cash used by financing activities in the prior year period. The increase in cash provided in financing activities relates to \$24.0 million of net cash provided by our revolving credit agreement, including \$50.0 million of additional borrowings and \$26.0 million of principal repayments, compared to the prior year period repayment of \$80.0 million on our line of credit. Additionally, in the nine months ended December 31, 2017 we received \$4.6 million in proceeds from the issuance of shares under employee stock plans. The increase in cash provided by financing activities was partially offset by \$18.8 million paid to settle the contingent consideration liability related to the acquisition of HealthFusion in the nine months ended December 31, 2017.

### **Contractual Obligations**

The following table summarizes our significant contractual obligations at December 31, 2017 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,					2023 and beyond
		2018 (remaining three months)	2019	2020	2021	2022	
Operating lease obligations	\$ 60,114	\$ 2,219	\$ 9,321	\$ 9,013	\$ 8,998	\$ 8,726	\$ 21,837
Remaining lease obligations for vacated properties (1)	4,659	547	1,413	794	816	551	538
Line of credit obligations (Note 7)	39,000	-	-	-	39,000	-	-
Purchase commitments (2)	32,322	312	3,840	5,297	7,073	7,900	7,900
<b>Total</b>	<b>\$ 136,095</b>	<b>\$ 3,078</b>	<b>\$ 14,574</b>	<b>\$ 15,104</b>	<b>\$ 55,887</b>	<b>\$ 17,177</b>	<b>\$ 30,275</b>

- (1) Remaining lease obligations for vacated properties relates to remaining lease obligations at certain locations, including Austin, Solana Beach, Costa Mesa, and a portion of Horsham, that we have vacated and are actively marketing the locations for sublease as part of our reorganization efforts. Total obligations have not been reduced by projected sublease rentals or by minimum sublease rentals of \$1.3 million due in future periods under non-cancelable subleases.
- (2) Purchase commitments relates to payments due under certain non-cancelable agreements to purchase goods and services.

The deferred compensation liability as of December 31, 2017 was \$6.5 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, 2017 was \$4.9 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, 2017, 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, 2017, we had \$39.0 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, 2017 would result in a corresponding change in our annual interest expense of approximately \$0.4 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, 2017, we had international operations that exposed us to the risk of fluctuations in foreign currency exchange rates against the United States 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, 2017, 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, 2017, 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 Hussein, 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 with respect to Hussein's claims, which the Court granted on September 16, 2015, dismissing all of Hussein's claims against us. On September 23, 2015, Hussein filed an application for reconsideration of the Court's summary judgment order, which the Court denied. Hussein filed a renewed application for reconsideration of the Court's summary judgment order on August 3, 2017. The Court again denied Hussein's application.

On October 28, 2015, May 9, 2016, and August 5, 2016, Hussein filed a motion for summary judgment, motion for summary adjudication, and motion for judgment on the pleadings, respectively, seeking to dismiss our cross-complaint. The Court denied each motion. Trial on our cross-complaint began June 12, 2017. On July 26, 2017, the Court issued a statement of decision granting Hussein's motion for judgment on our cross-complaint. Final judgment over Hussein's claims and our cross-claims was entered on January 9, 2018. Hussein has noticed his appeal of the order granting summary judgment over his claims, and we are evaluating a potential cross-appeal. 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. 8:13-cv-01818-CJC-JPR, 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. On July 28, 2017, the Ninth Circuit issued a decision reversing and remanding the District Court's order on our motion to dismiss. On September 5, 2017, we filed a petition for rehearing en banc, which was denied on September 29, 2017. After the Ninth Circuit issued its mandate, the District Court reopened the case. The parties have begun discovery. We believe that the plaintiffs' claims are without merit and continue to defend against them vigorously, including by evaluating potential challenges to the Ninth Circuit decision. 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 matter was stayed pending the Ninth Circuit's decision in the appeal described

above under the caption, "Federal Securities Class Action." This stay now has been lifted and, pursuant to a stipulated briefing schedule, Defendants' motion to dismiss is due February 2, 2018.

On September 28, 2017, a complaint was filed against our Company and certain of our current and former officers and directors in the United States District Court for the Central District of California, captioned Kusumam Koshy, derivatively on behalf of Quality Systems Inc. vs. Craig Barbarosh, George H. Bristol, James C. Malone, Peter M. Neupert, Morris Panner, D. Russell Pflueger, Steven T. Plochocki, Sheldon Razin, Lance E. Rosenzweig, Paul A. Holt, and Quality Systems, Inc., No. 8:17-cv-01694, by Kusumam Koshy, a purported shareholder of ours. The complaint alleges breach of fiduciary duties and abuse of control, as well as unjust enrichment and insider selling by individual directors arising out of the allegations described above under the captions "Hussein Litigation" and "Federal Securities Class Action," QSI's adoption of revised indemnification agreements, and the resignation of certain officers of the Company. The complaint seeks restitution and disgorgement, court costs and attorneys' fees, and enhanced corporate governance reforms and internal control procedures. On January 12, 2018, Defendants filed a motion to dismiss the derivative complaint.

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.

#### **Other Regulatory Matters**

In April 2017, we received a request for documents and information from the United States Attorney's Office for the District of Vermont pursuant to a Civil Investigative Demand ("CID"). The CID relates to an investigation concerning the certification we obtained for our software under the United States Department of Health and Human Services' Electronic Health Record Incentive Program. We have provided documents and information in response to that CID. On December 11, 2017, we received a subpoena from the United States Department of Justice in connection with the same matter seeking among other things records relating to (a) data used to determine objectives and measures under the Meaningful Use (MU) and the Physician Quality Reporting System (PQRS) programs, (b) EHR software code used in certifying the 2014 EHR software, and information, and (c) payments provided for the referral of EHR business.

Given the highly-regulated nature of our industry, we may, from time to time, be subject to subpoenas, requests for information, or investigations from various government agencies. It is our practice to respond to such matters in a cooperative, thorough and timely manner. We continue to respond to this CID and subpoena and intend to cooperate fully with the government. Requests and investigations of this nature may lead to the assertion of claims or the commencement of legal proceedings against us, as well as other material liabilities. In addition, our responses to these requests require time and effort, which can result in additional cost to us. At this time, we are unable to estimate the probability or the amount of liability, if any, related to this matter.

#### **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>
31.1	<a href="#">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.</a>	X
31.2	<a href="#">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.</a>	X
32.1	<a href="#">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.</a>	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	

\*\* 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 sections.

**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, 2018

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

Date: January 25, 2018

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

**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, 2018

By: /s/ John R. Frantz

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

**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, 2018

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, 2017 (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, 2018

By: /s/ John R. Frantz

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

Date: January 25, 2018

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.