QUALITY SYSTEMS INC
Form 10-Q
November 05, 2007

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

FORM 10-Q

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

For the quarterly period ended September 30, 2007

OR

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

Commission file number 0-13801

QUALITY SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

California	**95-2888568**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

18191 Von Karman Avenue, Irvine California 92612	
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant's telephone number, including area code: (949) 255-2600

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 twelve 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 ninety days. Yes x No o

Indicate by check mark whether the Registrant is a large accelerated filers, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12B-2 of the Exchange Act. (Check one): Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock as of the latest practicable date 27,356,965 shares of Common Stock, $0.01 par value, as of November 1, 2007.

PART I

CONSOLIDATED FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

QUALITY SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	September 30, 2007	March 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,920	$ 60,028
Marketable securities	46,000	—
Accounts receivable, net	68,374	63,945
Inventories, net	1,369	1,175
Net current deferred tax assets	3,912	3,443
Other current assets	3,937	4,507
Total current assets	150,512	133,098
Equipment and improvements, net	5,075	5,029
Capitalized software costs, net	8,005	6,982
Net deferred tax assets	1,539	1,180
Goodwill	1,840	1,840
Other assets	2,811	2,552
	$ 169,782	$ 150,681
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,814	$ 5,246
Deferred revenue	39,339	38,774
Accrued compensation and related benefits	6,002	6,521
Income taxes payable	1,080	315
Other current liabilities	7,428	5,626
Total current liabilities	57,663	56,482
Deferred revenue, net of current	597	674
Deferred compensation	2,517	2,279
	60,777	59,435
Commitments and contingencies		
Shareholders' equity:		
Common stock, $0.01 par value; authorized 50,000 shares; issued and outstanding 27,349 and 27,123 shares at September 30, 2007 and March 31, 2007, respectively	273	271
Additional paid-in capital	72,591	65,666
Retained earnings	36,141	25,309

		September 30, 2007		March 31, 2007
Total shareholders' equity		109,005		91,246
Total liabilities and shareholders' equity	$	169,782	$	150,681

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

QUALITY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF INCOME
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended		Six Months Ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Revenues:				
Software, hardware and supplies	$ 18,514	$ 16,737	$ 35,253	$ 31,766
Implementation and training services	3,182	2,848	6,430	5,802
System sales	21,696	19,585	41,683	37,568
Maintenance	13,442	9,639	26,001	19,038
Electronic data interchange services	5,406	4,066	10,430	8,043
Other services	4,602	4,169	9,064	8,884
Maintenance, EDI and Other services	23,450	17,874	45,495	35,965
Total revenue	45,146	37,459	87,178	73,533
Cost of revenue:				
Software, hardware and supplies	2,477	1,723	4,966	3,412
Implementation and training services	2,423	2,154	4,832	4,117
Total cost of system sales	4,900	3,877	9,798	7,529
Maintenance	3,033	2,792	6,159	5,929
Electronic data interchange services	3,742	2,926	7,251	5,706
Other services	3,100	2,238	6,109	4,126
Total cost of maintenance and other services	9,875	7,956	19,519	15,761
Total cost of revenue	14,775	11,833	29,317	23,290
Gross profit	30,371	25,626	57,861	50,243
Operating expenses:				
Selling, general and administrative	13,188	9,994	25,831	20,194
Research and development costs	2,688	2,591	5,488	4,909
Total operating expenses	15,876	12,585	31,319	25,103
Income from operations	14,495	13,041	26,542	25,140
Interest income	645	819	1,384	1,486
Income before provision for income taxes	15,140	13,860	27,926	26,626

	Three Months Ended		Six Months Ended	
Provision for income taxes	5,468	5,523	10,314	10,620
Net income	$ 9,672	$ 8,337	$ 17,612	$ 16,006
Net income per share:				
Basic	$ 0.35	$ 0.31	$ 0.65	$ 0.60
Diluted	$ 0.35	$ 0.30	$ 0.64	$ 0.59
Weighted average shares outstanding:				
Basic	27,287	26,802	27,211	26,758
Diluted	27,718	27,380	27,696	27,332
Dividends declared per common share	$ 0.25	$ —	$ 0.50	$ —

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

QUALITY SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	Six Months Ended	
	September 30, 2007	**September 30, 2006**
Cash flows from operating activities:		
Net income	$ 17,612	$ 16,006
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,139	862
Amortization of capitalized software costs	2,004	1,494
Provision for bad debts	220	411
Non-cash share-based compensation	2,035	1,738
Deferred income taxes	(828)	(87)
Tax benefit from exercise of stock options	1,421	1,586
Excess tax benefit from share-based compensation	(1,186)	(1,569)
Changes in assets and liabilities:		
Accounts receivable	(4,649)	(11,038)
Inventories	(194)	(295)
Income tax receivable	—	1,128
Other current assets	570	98
Other assets	(259)	(428)
Accounts payable	(1,432)	455
Deferred revenue	488	3,434
Accrued compensation and related benefits	(519)	(993)
Income taxes payable	765	—
Other current liabilities	1,802	2,749
Deferred compensation	238	246
Net cash provided by operating activities	19,227	15,797
Cash flows from investing activities:		
Additions to capitalized software costs	(3,027)	(2,175)
Additions to equipment and improvements	(1,185)	(1,315)
Purchases of marketable securities	(73,600)	—
Sales of marketable securities	27,600	—
Net cash used in investing activities	(50,212)	(3,490)
Cash flows from financing activities		
Dividends Paid	(6,780)	—
Excess tax benefit from share-based compensation	1,186	1,569
Proceeds from the exercise of stock options	3,471	3,599
Net cash (used in)/provided by financing activities	(2,123)	5,168
Net (decrease)/increase in cash and cash equivalents	(33,108)	17,475
Cash and cash equivalents at beginning of period	60,028	57,225

	Six Months Ended	
Cash and cash equivalents at end of period	$ 26,920	$ 74,700
Supplemental disclosures of cash flow information:		
Cash paid during the period for income taxes, net of refunds	$ 9,142	$ 8,017

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

QUALITY SYSTEMS, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements as of September 30, 2007 and for the six months ended September 30, 2007 and 2006, have been prepared in accordance with the requirements of Form 10-Q and Article 10 of Regulation S-X, and therefore do not include all information and footnotes which would be presented were such consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These consolidated financial statements should be read in conjunction with the audited consolidated financial statements presented in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2007. Amounts related to disclosures of March 31, 2007 balances within these interim consolidated financial statements were derived from the aforementioned Form 10-K. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments which are necessary for a fair presentation of the results of operations and cash flows for the periods presented. The results of operations for such interim periods are not necessarily indicative of results of operations to be expected for the full year.

References to dollar amounts in this financial statement section are in thousands, except share and per share data, unless otherwise specified.

2. Summary of Significant Accounting Policies

Principles of consolidation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant inter-company accounts and transactions have been eliminated.

Revenue recognition. The Company recognizes revenue pursuant to Statement of Position No. 97-2, "Software Revenue Recognition" (SOP 97-2), as amended by Statement of Position No. 98-9 "Modification of SOP 97-2, Software Revenue Recognition" (SOP 98-9). The Company generates revenue from the sale of licensing rights to its software products directly to end-users and value-added resellers (VARs). The Company also generates revenue from sales of hardware and third party software, implementation, training, EDI, post-contract support (maintenance) and other services performed for customers who license its products.

A typical system contract contains multiple elements of the above items. SOP 98-9 requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on vendor specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to either the price charged when the same element is sold separately (using a rolling average of stand alone transactions) or the price established by management having the relevant authority to do so, for an element not yet sold separately. VSOE calculations are updated and reviewed quarterly or annually depending on the nature of the product or service.

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

When evidence of fair value exists for the undelivered elements only, the residual method, provided for under SOP 98-9, is used. Under the residual method, the Company defers revenue related to the undelivered elements in a system sale based on VSOE of fair value of each of the undelivered elements, and allocates the remainder of the contract price net of all discounts to revenue recognized from the delivered elements. If VSOE of fair value of any undelivered element does not exist, all revenue is deferred until VSOE of fair value of the undelivered element is established or the element has been delivered.

The Company bills for the entire contract amount upon contract execution. Amounts billed in excess of the amounts contractually due are recorded in accounts receivable as advance billings. Amounts are contractually due when services are performed or in accordance with contractually specified payment dates. Provided the fees are fixed and determinable and collection is considered probable, revenue from licensing rights and sales of hardware and third party software is generally recognized upon shipment and transfer of title. In certain transactions where collections risk is high, the cash basis method is used to

4

recognize revenue. If the fee is not fixed or determinable, then the revenue recognized in each period (subject to application of other revenue recognition criteria) will be the lesser of the aggregate of amounts due and payable or the amount of the arrangement fee that would have been recognized if the fees were being recognized using the residual method. Fees which are considered fixed or determinable at the inception of the Company's arrangements must include the following characteristics:

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

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

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

Contract accounting is applied where services include significant software modification, development or customization. In such instances, the arrangement fee is accounted for in accordance with Statement of Position No. 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" (SOP 81-1). Pursuant to SOP 81-1, the Company uses the percentage of completion method provided all of the following conditions exist:

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

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

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

- reliable estimates of progress towards completion can be made.

The Company measures completion using labor input hours. Costs of providing services, including services accounted for in accordance with SOP 81-1, are expensed as incurred.

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

Individual product returns are estimated in accordance with Statement of Financial Accounting Standards No. 48, "Revenue Recognition When Right of Return Exists" (SFAS 48). The Company also ensures that the other criteria in SFAS 48 have been met prior to recognition of revenue:

- the price is fixed or determinable;

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

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

- the customer has economic substance;

- the amount of returns can be reasonably estimated; and

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

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

Revenue related to sales arrangements which include the right to use software stored on the Company's hardware are accounted for under the Emerging Issues Task Force Issue (EITF) No. 00-3 "Application of AICPA Statement of Position 97-2 to arrangements that include the right to use software stored on another entity's hardware". EITF No. 00-3 requires that for hosting related services to continue to fall under SOP No. 97-2, the customer must have the contractual right to take possession of the software without incurring a significant penalty and it must be feasible for the customer to either host the software themselves or through another third party. If an arrangement is not deemed to be accounted for under SOP 97-2, the entire arrangement is accounted for as a service contract in accordance with EITF Issue No. 00-21 "Revenue arrangements with multiple deliverables". In that instance, the entire arrangement would be recognized as the hosting services are being performed.

From time to time, the Company offers future purchase discounts on its products and services as part of its sales arrangements. Pursuant to AICPA TPA 5100.50, such discounts which are incremental to the range of discounts reflected in the pricing of the other elements of the arrangement, which are incremental to the range of discounts typically given in comparable transactions, and which are significant, are treated as an additional element of the contract to be deferred. Amounts deferred related to future purchase options are not recognized until either the customer exercises the discount offer or the offer expires.

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

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

Marketable Securities . As of September 30, 2007, the Company had short-term investments in tax exempt Auction Rate Securities (ARS) of approximately $46.0 million. The ARS are rated AAA or AA by one or more national rating agencies and have contractual terms of up to 30 years, but generally have interest rate reset dates that occur every 7, 28 or 35 days and despite the long-term nature of their stated contractual maturities, management has the ability to quickly liquidate these securities at ongoing auctions every 35 days or less. The investments in ARS are classified as available-for-sale on the Company's Consolidated Balance Sheets. The investments are recorded at cost which approximates fair market value due to their variable interest rates, which typically resets every 7, 28 or 35 days. As a result, no cumulative gross unrealized holding gains/losses from the investments have been realized. All income generated from these investments is recorded as interest income.

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

Included in accounts receivable are amounts related to maintenance and services which were billed, but which had not yet been rendered as of the end of the period. Undelivered maintenance and services are included on the accompanying Consolidated Balance Sheets as deferred revenue (see also Note 4).

Inventories . Inventories consist of hardware for specific customer orders and spare parts, and are valued at lower of cost (first-in, first-out) or market. Management provides a reserve to reduce inventory to its net realizable value.

Equipment and improvements. Equipment and improvements are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of equipment and improvements are provided over the estimated useful lives of the assets, or the related lease terms if shorter, by the straight-line method. Useful lives range as follows:

•	Computers and electronic test equipment	3-5 years
•	Furniture and fixtures	5-7 years
•	Leasehold improvements	lesser of lease term or estimated useful life of asset

Software development costs. Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional development costs are capitalized in accordance with Statement of Financial Accounting Standards No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed” (SFAS 86). Such capitalized costs are amortized on a straight line basis over the estimated economic life of the related product of three years. The Company provides support services on the current and prior two versions of its software. Management performs an annual review of the estimated economic life and the recoverability of such capitalized software costs. If a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable research and development activities, any remaining capitalized amounts are written off.

Income Taxes. Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consists of taxes currently due plus deferred taxes related to temporary differences between the basis of assets and liabilities for financial and tax reporting. The deferred income tax assets and liabilities represent the future state and federal tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred income taxes also are recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. Valuation allowances are established as a reduction of net deferred income tax assets if management determines that it is more likely than not that the deferred assets will not be realized.

Share-Based Compensation

Statement of Financial Accounting Standard No. 123R, “Share-Based Payment” (SFAS 123R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. Expected term is estimated using the simplified method which is equal to the midpoint between the vesting period and the contractual term. Volatility is estimated by using the weighted average historical volatility of our common stock, which approximates expected volatility. The risk free rate is the implied yield available on the U.S Treasury zero-coupon issues with remaining terms equal to the expected term. The expected dividend yield is the average dividend rate during a period equal to the expected term of the option. Those inputs are then entered into the Black Scholes model to determine the estimated fair value. The value of the portion of the award that is ultimately expected to vest is recognized ratably as expense over the requisite service period in the Company’s Consolidated Statements of Income.

The following table shows total stock-based employee compensation expense included in the Consolidated Statement of Income for the three and six month periods ended September 30, 2007 and 2006.

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Six Months Ended September 30, 2007	Six Months Ended September 30, 2006
Costs and expenses:				
Cost of revenue	$ 129	$ 124	$ 272	$ 241
Research and development	215	210	451	407
Selling, general and administrative	615	579	1,312	1,090
Total share-based compensation for the period	959	913	2,035	1,738
Amounts capitalized in software development costs	(9)	(9)	(21)	(23)
Amounts charged against earnings, before income tax benefit	$ 950	$ 904	$ 2,014	$ 1,715
Amount of related income tax benefit recognized in earnings	$ 252	$ 233	$ 537	$ 443

3. Recent Accounting Pronouncements

In February 2007, the Financial Standards Accounting Board (FASB) issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of SFAS No. 115", which applies to all entities with available-for-sale and trading securities. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, "Fair Value Measurements". The Company plans to adopt SFAS 159 effective April 1, 2008 and is in the process of determining the effect, if any, the adoption of SFAS 159 will have on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157), which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of this standard will have on its consolidated financial statements.

4. Composition of Certain Financial Statement Captions

Accounts receivable include amounts related to maintenance and services which were billed but not yet rendered as of the end of the period. Undelivered maintenance and services are included on the accompanying Consolidated Balance Sheets as part of the deferred revenue balance.

	September 30, 2007	March 31, 2007
Accounts receivable, excluding undelivered software, maintenance and services	$ 46,553	$ 42,574
Undelivered software, maintenance and implementation services billed in advance, included in deferred revenue	24,031	23,809
Accounts receivable, gross	70,584	66,383
Allowance for doubtful accounts	(2,210)	(2,438)
Accounts receivable, net	$ 68,374	$ 63,945

Inventories are summarized as follows:

	September 30, 2007	March 31, 2007
Computer systems and components, net of reserve for obsolescence of $324 for both periods	$ 1,335	$ 1,147
Miscellaneous parts and supplies	34	28
Inventories, net	$ 1,369	$ 1,175

Accrued compensation and related benefits are summarized as follows:

	September 30, 2007	March 31, 2007
Bonus	$ 3,563	$ 4,158
Vacation	2,439	2,363
Accrued compensation and related benefits	$ 6,002	$ 6,521

Short and long-term deferred revenue are summarized as follows:

	September 30, 2007	March 31, 2007
Maintenance	$ 8,854	$ 10,241
Implementation services	29,368	26,465
Undelivered software and other	1,714	2,742

	September 30, 2007	March 31, 2007
Deferred Revenue	$ 39,936	$ 39,448

Other current liabilities are summarized as follows:

	September 30, 2007	March 31, 2007
Customer deposits	$ 2,629	$ 703
Sales tax payable	959	805
Deferred rent	648	652
Accrued EDI expenses	694	613
Commission payable	408	767
Professional fees	301	425
Accrued royalties	179	463
Other accrued expenses	1,610	1,198
Other current liabilities	$ 7,428	$ 5,626

5. Intangible Assets – Goodwill

In accordance with Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” (SFAS 142), the Company does not amortize goodwill as the goodwill has been determined to have indefinite useful life. The balance of goodwill is related to the Company’s NextGen Healthcare Information Systems Division (NextGen or Division), which was acquired by virtue of two acquisitions completed in May of 1996 and 1997, respectively. In accordance with SFAS 142, the Company has compared the fair value of the NextGen Division with the carrying amount of assets associated with the Division and determined that none of the goodwill recorded as of June 30, 2007 (the annual assessment date) was impaired. Assessments are performed annually unless there is a triggering event which would require an earlier assessment. The fair value of NextGen was determined using a reasonable estimate of future cash flows of the Division and a risk adjusted discount rate to compute a net present value of future cash flows.

6. Intangible Assets – Capitalized Software Development Costs

The Company had the following amounts related to intangible assets with definite lives (in thousands):

	September 30, 2007	March 31, 2007
Gross carrying amount	$ 24,653	$ 21,626
Accumulated amortization	(16,648)	(14,644)
Net capitalized software development	$ 8,005	$ 6,982
Aggregate amortization expense during the six month and twelve month period	$ 2,004	$ 3,231

Activity related to net capitalized software costs for the six month period ended September 30, 2007 and 2006 is as follows:

	September 30, 2007	September 30, 2006
Beginning of the period	$ 6,982	$ 5,171
Capitalization	3,027	2,175
Amortization	(2,004)	(1,494)
End of the period	$ 8,005	$ 5,852

The following table represents the remaining estimated amortization of intangible assets with determinable lives as of September 30, 2007:

For the year ended March 31,	
2008	$ 2,106
2009	3,385
2010	2,132
2011	382
Total	$ 8,005

7. Employee Stock Option Plans

In September 1998, the Company's shareholders approved a stock option plan (the "1998 Plan") under which 4,000,000 shares of Common Stock were reserved for the issuance of options. The 1998 Plan provides that employees, directors and consultants of the Company, at the discretion of the Board of Directors or a duly designated compensation committee, be granted options to purchase shares of Common Stock. The exercise price of each option granted shall be determined by the Board of Directors at the date of grant, and options under the 1998 Plan expire no later than ten years from the grant date. Options granted will generally become exercisable in accordance with the terms of the agreement pursuant to which they were granted. Certain option grants to directors became exercisable three months from the date of grant. Upon an acquisition of the Company by merger or asset sale, each outstanding option may be subject to accelerated vesting under certain circumstances. The 1998 Plan terminates on December 31, 2007, unless sooner terminated by the Board. At September 30, 2007, 74,858 shares were available for future grant under the 1998 Plan. As of September 30, 2007, there were 1,345,815 outstanding options related to this Plan.

In October 2005, the Company's shareholders approved a stock option and incentive plan (the "2005 Plan") under which 2,400,000 shares of Common Stock have been reserved for the issuance of awards, including stock options, incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock, unrestricted stock, restricted stock units, performance shares, performance units (including performance options) and other share-based awards. The 2005 Plan provides that employees, directors and consultants of the Company, at the discretion of the Board of Directors or a duly designated compensation committee, be granted awards to purchase shares of Common Stock. The exercise price of each award granted shall be determined by the Board of Directors at the date of grant in accordance with the terms of the 2005 Plan, and under the 2005 Plan awards expire no later than ten years from the grant date. Options granted will generally become exercisable in accordance with the terms of the agreement pursuant to which they were granted. Upon an acquisition of the Company by merger or asset sale, each outstanding award may be subject to accelerated vesting under certain circumstances. The 2005 Plan terminates on May 25, 2015, unless sooner terminated by the Board. At September 30, 2007, 2,400,000 shares were available for future grant under the 2005 Plan. As of September 30, 2007, there were no outstanding options related to this Plan.

A summary of stock option transactions during the six months ended September 30, 2007 is as follows:

	Number of Shares	Weighted -Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding, April 1, 2007	1,461,950	$ 18.46	4.00	
Granted	159,500	$ 38.83	4.96	
Exercised	(226,385)	$ 15.33	3.13	$ 4,821
Forfeited/Canceled	(49,250)	$ 19.07	3.72	
Outstanding, September 30,2007	1,345,815	$ 21.38	3.70	$ 20,993
Exercisable, September 30,2007	479,779	$ 20.59	3.55	$ 7,730
Vested and expected to vest, September 30, 2007	1,334,643	$ 21.38	3.70	$ 20,822

The Company continues to utilize the Black-Scholes valuation model for estimating the fair value of stock-based compensation after the adoption of SFAS 123R. The following assumptions were utilized for options granted during the period:

	Six Months Ended September 30, 2007	Six Months Ended September 30, 2006
Expected life	3.75 years	3.75-4.75 years
Expected volatility	43.17% - 44.81%	48.3%-48.5%
Expected dividends	2.67% - 2.99%	2.36%
Risk-free rate	4.06% - 5.09%	4.60%-4.85%

During the six months ended September 30, 2007 and 2006, 159,500 and 75,000 options were granted, respectively, under the 1998 Stock Option Plan. The Company issues new shares to satisfy option exercises. Based on historical experience of option cancellations, the Company has estimated an annualized forfeiture rate of 1.2% for employee options and 0.0% for director options. Forfeiture rates will be adjusted over the requisite service period when actual forfeitures differ, or are expected to differ, from the estimate. The weighted average grant date fair value of stock options granted during the six months ended September 30, 2007 and 2006 was $12.86 per share and $14.33 per share, respectively.

On June 12, 2007, the Board of Directors granted a total of 159,500 options under a previously approved performance-based equity incentive program for selected employees based on fiscal year 2007 performance. These shares were issued under the Company’s 1998 Stock Option Plan at an exercise price equal to the market price of the Company’s common stock on the date of grant ($38.83 per share). The options vest in four equal annual installments beginning June 12, 2008 and expire on June 12, 2012.

On May 31, 2007, the Board of Directors approved a performance-based equity incentive program for employees to be awarded options to purchase the Company’s common stock based on meeting certain target increases in earnings per share performance and revenue growth during fiscal year 2008. Under the program, options may also be granted as an incentive to prospective employees to join the Company. If earned, the options shall be issued pursuant to one of the Company’s shareholder approved option plans, have an exercise price equal to the closing price of the Company’s shares on the date of grant, a term of five years, vesting in four equal installments commencing one year following the date of grant. The maximum number of options available under the performance-based equity incentive program plan is 310,000. Based on performance versus established plan targets, no share-based compensation expense was recorded for the six months ended September 30, 2007.

Non-vested stock option award activity, including awards for the six month period ended September 30, 2007, is summarized as follows:

	Non-vested Number of Shares		Weighted -Average Grant Date Fair Value per Share
Non-vested, April 1, 2007	941,300	$	7.89
Granted	159,500	$	12.86
Vested	(185,514)	$	6.10
Forfeited/Canceled	(49,250)	$	8.60
Non-vested, September 30, 2007	866,036	$	9.15

As of September 30, 2007, $5,938 of total unrecognized compensation costs related to stock options is expected to be recognized over a weighted average period of 3.78 years. This amount does not include the cost of new options that may be granted in future periods or any changes in the Company's forfeiture percentage. The total fair value of shares vested during the six months ended September 30, 2007 and 2006 was $1,132 and $872.

8. Income Taxes

The provision for income taxes for the six months ended September 30, 2007 was approximately $10,314 as compared to approximately $10,620 for the year ago period. The effective tax rates for the six months ended September 30, 2007 and 2006 were 36.9% and 39.9%, respectively. The provision for income taxes for the six months ended September 30, 2007 and 2006 differ from the combined statutory rates primarily due to increased deductions related to incentive stock option exercises, the impact of varying state income tax rates, research and development tax credits, and the qualified production activities deduction. The effective rate for the six months ended September 30, 2007 decreased from the prior year primarily from an increase in the statutory deduction for qualified production activities, deductions related to tax-exempt interest income, and increased deductions related to incentive stock option exercises.

For the six months ended September 30, 2007, the Company claimed research and development tax credits of $514 and $48 for federal and state purposes, respectively. The Company expects to capture this benefit on its tax returns.

On April 1, 2007, the Company adopted the provisions of Financial Standards Accounting Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes (FIN 48) an interpretation of FASB Statement No. 109 ("SFAS 109")." The adoption of the provisions of FIN 48 had no material effect on the consolidated financial statements. As a result, there was no cumulative effect related to adopting FIN 48. However, certain amounts have been reclassified in the statement of financial position in order to comply with the requirements of the statement.

At adoption, and as of September 30, 2007, the Company had $394 and $392, respectively, of unrecognized tax benefits, $89 of which would affect the Company's effective tax rate if recognized in the future.

The Company's continuing practice is to recognize interest and/or penalties related to income tax matters in general and administrative expenses. At adoption and as of September 30, 2007, the Company had $45 and $38, respectively, accrued for interest payable and no penalties were accrued.

The Company's income tax returns filed for tax years 2003 through 2006 and 2002 through 2006 are subject to examination by the federal and state taxing authorities, respectively.

The Company does not anticipate that total unrecognized tax benefits will significantly change due to the settlement of audits or the expiration of statute of limitations within the next twelve months.

9. Net Income Per Share

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
Net income	$ 9,672	$ 8,337	$ 17,612	$ 16,006
Basic net income per common share:				
Weighted average of common shares outstanding	27,287	26,802	27,211	26,758
Basic net income per common share	$ 0.35	$ 0.31	$ 0.65	$ 0.60

	Three Months Ended September 30,		Six Months Ended September 30,	
Net income	$ 9,672	$ 8,337	$ 17,612	$ 16,006
Diluted net income per common Share:				
Weighted average of common shares outstanding	27,287	26,802	27,211	26,758
Effect of potentially dilutive securities (options)	431	578	485	574
Weighted average of common shares outstanding-diluted	27,718	27,380	27,696	27,332
Diluted net income per common share	$ 0.35	$ 0.30	$ 0.64	$ 0.59

The computation of diluted net income per share does not include 245,000 and 75,000 options for the three and six months ended September 30, 2007 and 2006, respectively, because their inclusion would have an anti-dilutive effect on net income per share.

10. Operating Segment Information

The Company has prepared operating segment information in accordance with SFAS 131 “Disclosures About Segments of an Enterprise and Related Information” to report components that are evaluated regularly by its chief operating decision maker, or decision making group in deciding how to allocate resources and in assessing performance. Reportable operating segments include the NextGen Division and the QSI Division.

The two divisions operate largely as stand-alone operations, with each division maintaining its own distinct product lines, product platforms, development, implementation and support teams, sales staffing, and branding. The two divisions share the resources of the Company’s “corporate office” which includes a variety of accounting and other administrative functions. Additionally, there are a small number of clients who are simultaneously utilizing software from each of the Company’s two divisions.

The QSI Division, co-located with the Company’s Corporate Headquarters in Irvine, California, currently focuses on developing, marketing and supporting software suites sold to dental and certain niche medical practices. In addition, the division supports a number of medical clients that utilize the division’s UNIX[a] based medical practice management software product. The NextGen Division, with headquarters in Horsham, Pennsylvania, and a second significant location in Atlanta, Georgia, focuses principally on developing and marketing products and services for medical practices.

The accounting policies of the Company’s operating segments are the same as those described in Note 2 - Summary of Significant Accounting Policies, except that the disaggregated financial results of the segments reflect allocation of certain functional expense categories consistent with the basis and manner in which Company management internally disaggregates financial information for the purpose of assisting in making internal operating decisions. Certain corporate overhead costs, such as executive and accounting department personnel-related expenses, are not allocated to the individual segments by management. Management evaluates performance based on stand-alone segment operating income. Because the Company does not evaluate performance based on return on assets at the operating segment level, assets are not tracked internally by segment. Therefore, segment asset information is not presented.

Operating segment data for the six month periods ended September 30, 2007 and 2006 is as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2007	2006	2007	2006
Revenue:				
QSI Division	$ 4,006	$ 3,972	$ 7,988	$ 7,862
NextGen Division	41,140	33,487	79,190	65,671
Consolidated revenue	$ 45,146	$ 37,459	$ 87,178	$ 73,533
Operating income(loss):				
QSI Division	$ 1,290	$ 1,245	$ 2,346	$ 2,158
NextGen Division	15,698	14,055	29,601	27,449
Unallocated corporate expenses	(2,493)	(2,259)	(5,405)	(4,467)
Consolidated operating income	$ 14,495	$ 13,041	$ 26,542	$ 25,140

[a] UNIX is a registered trademark of the AT&T Corporation.

13

11. Concentration of Credit Risk

The Company had cash deposits at U.S. banks and financial institutions which exceeded federally insured limits at September 30, 2007. The Company is exposed to credit loss for amounts in excess of insured limits in the event of non-performance by the institutions; however, the Company does not anticipate non-performance by these institutions.

12. Commitments, Guarantees and Contingencies

Commitments and Guarantees

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

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

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

From time to time, the Company offers future purchase discounts on its products and services as part of its sales arrangements. Discounts which are incremental to the range of discounts reflected in the pricing of the other elements of the arrangement, which are incremental to the range of discounts typically given in comparable transactions, and which are significant, are treated as an additional element of the contract to be deferred. Amounts deferred related to future purchase options are not recognized until either the customer exercises the discount offer or the offer expires.

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

Gain Contingency

On September 26, 2007, Gregory Flynn, Executive Vice President and General Manager of the Company’s QSI Division passed away. Mr. Flynn participated in the Company’s deferred compensation plan which is funded through the purchase of a life insurance policy with the Company named as beneficiary. As a result of Mr. Flynn’s passing, the Company expects to record an additional future compensation expense of approximately $0.2 million which will be offset by expected net insurance proceeds of approximately $0.9 million. The compensation expense and the insurance proceeds are contingent on the Company's submission of an insurance claim and the ultimate acceptance of such claim and realization of the insurance proceeds. Both the expense and the insurance proceeds will not be recorded until the insurance proceeds are realized or realizable. As of September 30, 2007, no insurance proceeds have been realized; therefore, no expense or gain relating to this event has been recorded in this period.

13. Subsequent Event

On October 25, 2007, the Board of Directors approved a regular quarterly dividend of twenty-five cents ($0.25) per share payable on its outstanding shares of common stock. The cash dividend record date is December 14, 2007 and the cash dividend is expected to be distributed to shareholders on or about January 7, 2008.

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

Except for the historical information contained herein, the matters discussed in this quarterly report may include forward-looking statements that involve certain risks and uncertainties. Actual results may differ from those anticipated by us as a result of various factors, both foreseen and unforeseen, including, but not limited to, our ability to continue to develop new products and increase systems sales in markets characterized by rapid technological evolution, consolidation, and competition from larger, better capitalized competitors. Many other economic, competitive, governmental and technological factors could impact our ability to achieve our goals, and interested persons are urged to review any new risks which may be described in "Risk Factors" set forth herein and other risk factors appearing in our most recent filing on Form 10-K, as supplemented by additional risk factors, if any, in our interim filings on Form 10-Q, as well as in our other public disclosures and filings with the Securities and Exchange Commission.

The following discussion 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 profit fluctuations and any trends that may be inferred from the discussion below are not necessarily indicative of the operating results for any future period.

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

We believe revenue recognition, the allowance for doubtful accounts, capitalized software costs, share-based compensation and income taxes are among the most critical accounting policies and estimates that impact our consolidated financial statements. We believe that our significant accounting policies, as described in Note 2 of our Condensed Notes to Consolidated Financial Statements, "Summary of Significant Accounting Policies", should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Revenue Recognition . We currently recognize revenue pursuant to SOP 97-2, as amended by SOP 98-9. We generate revenue from the sale of licensing rights to use our software products sold directly to end-users and value-added resellers (VARs). We also generate revenue from sales of hardware and third party software, and implementation, training, software customization, EDI, post-contract support ("maintenance") and other services performed for customers who license our products.

A typical system contract contains multiple elements of the above items. SOP 97-2, as amended, requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of those elements. The fair value of an element must be based on vendor specific objective evidence (VSOE). We limit our assessment of VSOE for each element to either the price charged when the same element is sold separately (using a rolling average of stand alone transactions) or the price established by management having the relevant authority to do so, for an element not yet sold separately. VSOE calculations are updated and reviewed at the end of each quarter or annually depending on the nature of the product or service.

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

When evidence of fair value exists for the undelivered elements only, the residual method, provided for under SOP 98-9, is used. Under the residual method, we defer revenue related to the undelivered elements in a system sale based on VSOE of fair value of each of the undelivered elements, and allocate the remainder of the contract price net of all discounts to revenue recognized from the delivered elements. Undelivered elements of a system sale may include implementation and training services, hardware and third party software, maintenance, future purchase discounts, or other services. If VSOE of fair value of any undelivered element does not exist, all revenue is deferred until VSOE of fair value of the undelivered element is established or the element has been delivered.

We bill for the entire contract amount upon contract execution. Amounts billed in excess of the amounts contractually due are recorded in accounts receivable as advance billings. Amounts are contractually due when services are performed or in accordance with contractually specified payment dates. Provided the fees are fixed and determinable and collection is considered probable, revenue from licensing rights and sales of hardware and third party software is generally recognized upon shipment and transfer of title. In certain transactions whose collections risk is high, the cash basis method is used to recognize revenue. If the fee is not fixed or determinable, then the revenue recognized in each period (subject to application of other revenue recognition criteria) will be the lesser of the aggregate of amounts due and payable or the amount of the arrangement fee that would have been recognized if the fees were being recognized using the residual method. Fees which are considered fixed or determinable at the inception of our arrangements must include the following characteristics:

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

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

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

Contract accounting is applied where services include significant software modification, development or customization. In such instances, the arrangement fee is accounted for in accordance with Statement of Position No. 81-1 “Accounting for Performance of Construction-Type and Certain Production-Type Contracts” (SOP 81-1).

Pursuant to SOP 81-1, we use the percentage of completion method provided all of the following conditions exist:

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

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

- We can be expected to perform our contractual obligations; and

- Reliable estimates of progress towards completion can be made.

We measure completion using labor input hours. Costs of providing services, including services accounted for in accordance with SOP 81-1, are expensed as incurred.

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

Product returns are estimated in accordance with Statement of Financial Accounting Standards No. 48, “Revenue Recognition When Right of Return Exists” (SFAS 48). The Company also ensures that the other criteria in SFAS 48 have been met prior to recognition of revenue:

- The price is fixed or determinable;

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

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

17

- The customer has economic substance;
- The amount of returns can be reasonably estimated; and
- We do not have significant obligations for future performance in order to bring about resale of the product by the customer.

We have historically offered short-term rights of return of less than 30 days in certain sales arrangements. If we are able to estimate returns for these types of arrangements, 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 our consolidated financial statements until the rights of return expire.

Revenue related to sales arrangements which include the right to use software stored on the Company's hardware are accounted for under the Emerging Issues Task Force Issue No. 00-3 "Application of AICPA Statement of Position 97-2 to arrangements that include the right to use software stored on another Entity's hardware". EITF No. 00-3 requires that for hosting related services to continue to fall under SOP No. 97-2, the customer must have the contractual right to take possession of the software without incurring a significant penalty and it must be feasible for the customer to either host the software themselves or through another third party. If an arrangement is not deemed to be accounted for under SOP 97-2, the entire arrangement is accounted for as a service contract in accordance with EITF Issue No. 00-21 "Revenue arrangements with multiple deliverables". In that instance, the entire arrangement would be recognized as the hosting services are being performed.

From time to time, we offer future purchase discounts on our products and services as part of our sales arrangements. Pursuant to AICPA TPA 5100.51, discounts which are incremental to the range of discounts reflected in the pricing of the other elements of the arrangement, which are incremental to the range of discounts typically given in comparable transactions, and which are significant, are treated as an additional element of the contract to be deferred. Amounts deferred related to future purchase options are not recognized until either the customer exercises the discount offer or the offer expires.

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

Allowance for Doubtful Accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We perform credit evaluations of our customers and maintain reserves for estimated credit losses. Reserves for potential credit losses are determined by establishing both specific and general reserves. Specific reserves are based on management's estimate of the probability of collection for certain troubled accounts. General reserves are established based on our historical experience of bad debt expense and the aging of our accounts receivable balances net of deferred revenue and specifically reserved accounts. If the financial condition of our customers were to deteriorate resulting in an impairment of their ability to make payments, additional allowances would be required.

Software Development Costs. Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established with the completion of a working model of the enhancement or product, any additional development costs are capitalized in accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed" (SFAS 86). Such capitalized costs are amortized on a straight line basis over the estimated economic life of the related product, which is generally three years. We perform an annual review of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off.

Share-Based Compensation. On April 1, 2006, we adopted Statement of Financial Accounting Standard No. 123R, "Share-Based Payment" (SFAS 123R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. SFAS 123R supersedes our previous accounting under Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25). SFAS 123R requires us to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. We use the simplified method for estimating expected term equal to the midpoint between the vesting period and the contractual term. Prior to using the simplified method, we estimated the expected term of an option. We estimate volatility by using the weighted average historical volatility of our common stock, which we believe approximates expected volatility. The risk free rate is the implied yield available on the U.S Treasury zero-coupon issues with remaining terms equal to the expected term. The expected dividend yield is the average dividend rate during a period equal to the expected term of the option. Those inputs are then entered into the Black Scholes model to determine the estimated fair value. The value of the portion of the award that is expected to vest is recognized as expense over the requisite service period in our consolidated statement of income.

Research and Development Tax Credits. Management’s treatment of research and development tax credits represented a significant estimate which affected the effective income tax rate for the Company for the six months ended September 30, 2007. Research and development credits taken by the Company involve certain assumptions and judgments regarding qualified expenses under Internal Revenue Code Section 41. These credits are subject to examination by the federal and state taxing authorities.

For the six months ended September 30, 2007, the Company claimed research and development tax credits of $514 and $48 for federal and state purposes, respectively. The Company expects to capture this benefit on its tax returns.

Qualified Production Activities Deduction. Management’s treatment of this deduction represented an estimate that affected the effective income tax rate for the Company for the six months ended September 30, 2007. The deduction taken by the Company involved certain assumptions and judgments regarding the allocation of indirect expenses as prescribed under Internal Revenue Code Section 199.

Company Overview

Quality Systems Inc., comprised of the QSI Division (QSI Division) and a wholly owned subsidiary, NextGen Healthcare Information Systems, Inc. (NextGen Division) (collectively, the Company, we, our, or us) develops and markets healthcare information systems that automate certain aspects of medical and dental practices, networks of practices such as physician hospital organizations (PHO’s) and management service organizations (MSO’s), ambulatory care centers, community health centers, and medical and dental schools.

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

The two divisions operate largely as stand-alone operations with each division maintaining its own distinct product lines, product platforms, development, implementation and support teams, sales staffing, and branding. The two divisions share the resources of the “corporate office” which includes a variety of accounting and other administrative functions. Additionally, there are a small number of clients who are simultaneously utilizing software from each of our two divisions.

The QSI Division, co-located with our corporate headquarters in Irvine, California, currently focuses on developing, marketing and supporting software suites sold to dental and certain niche medical practices. In addition, the Division supports a number of medical clients that utilize the Division’s UNIX[1] based medical practice management software product.

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

---

[1] UNIX is a registered trademark of the AT&T Corporation.

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

In addition, both divisions develop and market software that automates the patient record. Adoption of this software, commonly referred to as clinical software, is in its relatively early stages. Therefore, we are typically competing to replace paper-based patient record alternatives as opposed to replacing previously purchased systems.

Electronic Data Interchange (EDI)/connectivity products are intended to automate a number of manual, often paper-based or telephony intensive communications between patients and/or providers and/or payors. Two of the more common EDI services are forwarding insurance claims electronically from providers to payors and assisting practices with issuing statements to patients. Most practices utilize at least some of these services from us or one of our competitors. Other EDI/connectivity services are used more sporadically by client practices. We typically compete to displace incumbent vendors for claims and statements accounts, and attempt to increase usage of other elements in our EDI/connectivity product line. In general, EDI services are only sold to those accounts utilizing software from one of our divisions.

The QSI Division's practice management software suite utilizes a UNIX operating system. Its Clinical Product Suite (CPS) utilizes a Windows NT[2] operating system and can be fully integrated with the practice management software from each division. CPS incorporates a wide range of clinical tools including, but not limited to, periodontal charting and digital imaging of X-ray and inter-oral camera images as part of the electronic patient record. The Division develops, markets, and manages our EDI/connectivity applications. The QSInet Application Service Provider (ASP/Internet) offering is also developed and marketed by this Division.

Our NextGen Division develops and sells proprietary electronic medical records software and practice management systems under the NextGen®[3] product name. Major product categories of the NextGen suite include Electronic Medical Records (NextGen^{emr}), Enterprise Practice Management (NextGen^{epm}), Enterprise Appointment Scheduling (NextGen^{eas}), Enterprise Master Patient Index (NextGen^{epi}), NextGen Image Control System (NextGen^{ics}), Managed Care Server (NextGen^{mcs}), Electronic Data Interchange, System Interfaces, Internet Operability (NextGen^{web}), a Patient-centric and Provider-centric Web Portal solution (NextMD[4].com), NextGen Express, a version of NextGen^{emr} designed for small practices and NextGen Community Health Solution (NextGen^{chs}). Beginning in the fiscal year ended March 31, 2008, the NextGen Division began offering optional NextGen Hosting Solutions to new and existing customers. NextGen products utilize Microsoft Windows technology and can operate in a client-server environment as well as via private intranet, the Internet, or in an ASP environment.

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

Inclusive of divisional EDI revenue, the NextGen Division accounted for approximately 91.1% of our revenue for the second quarter of fiscal 2008 compared to 89.4% in the second quarter of fiscal 2007. The QSI Division accounted for 8.9% and 10.6% of revenue in the second quarter of fiscal 2008 and 2007, respectively. The NextGen Division's year over year revenue grew at 22.9% and 31.2% in the second quarter of fiscal 2008 and 2007, respectively, while the QSI Division's year over year revenue remained relatively consistent in the second quarter of fiscal 2008 and 2007, respectively.

In addition to the aforementioned software solutions which we offer through our two divisions, each division offers comprehensive hardware and software installation services, maintenance and support services, and system training services.

---

[2] Windows NT is registered trademarks of the Microsoft Corporation.

[3] NextGen is a registered trademark of NextGen Healthcare Information Systems, Inc.

[4] NextMD is a registered trademark of NextGen Healthcare Information Systems, Inc.

Results of Operations

Overview of results

- Consolidated revenue grew 18.6% in the six months ended September 30, 2007 versus 2006 and 29.1% in the six months ended September 30, 2006 versus 2005.

- Consolidated income from operations grew 5.6% in the six months ended September 30, 2007 versus 2006 and grew 48.4% in the six months ended September 30, 2006 versus 2005. For the six months ended September 30, 2007, operating income was impacted by a shift in the revenue mix with increased hardware and maintenance revenue resulting in a decline in our gross profit margin, and headcount additions which resulted in higher selling, general and administrative expenses as a percentage of revenue.

- We have benefited and hope to continue to benefit from the increased demands on healthcare providers for greater efficiency and lower costs, as well as increased adoption rates for electronic medical records and other technology in the healthcare arena.

NextGen Division

- Our NextGen Division's revenue grew 20.6% in the six months ended September 30, 2007 versus 2006 and 33.7% in the six months ended September 30, 2006 versus 2005. Divisional operating income (excluding unallocated corporate expenses) grew 7.8% in the six months ended September 30, 2007 versus 2006 and 47.9% in the six months ended September 30, 2006 versus 2005. For the six months ended September 30, 2007, operating income was impacted by a shift in the revenue mix with increased hardware and maintenance revenue resulting in a decline in our gross profit margin, and headcount additions which resulted in higher selling, general and administrative expenses as a percentage of revenue.

- During the six months ended September 30, 2007, we added staffing resources to most of our client-facing departments, and intend to continue doing so during the remainder of fiscal year 2008.

- Our goals include continuing to further enhance our existing products, developing new products for targeted markets, continuing to add new customers, selling additional software and services to existing customers and expanding penetration of connectivity services to new and existing customers.

QSI Division

- Our QSI Division revenue grew 1.6% in the six months ended September 30, 2007 versus 2006 and grew 1.5% in the six months ended September 30, 2006 versus 2005. The Division experienced a 8.0% increase in operating income (excluding unallocated corporate expenses) in the six months ended September 30, 2007 versus 2006 as compared to a 4.5% decrease in operating income in the six months ended September 30, 2006 versus 2005.

- Our goals for the QSI Division include maximizing profit performance given the constraints represented by a weak purchasing environment in the dental group practice market.

The following table sets forth for the periods indicated the percentage of revenues represented by each item in our Consolidated Statements of Income (unaudited).

(Unaudited)	**Three Months Ended September 30,**		**Six Months Ended September 30,**	
	2007	**2006**	**2007**	**2006**
Revenues:				
Software, hardware and supplies	41.0%	44.7%	40.4%	43.2%
Implementation and training services	7.1	7.6	7.4	7.9
System sales	48.1	52.3	47.8	51.1
Maintenance	29.8	25.7	29.8	25.9
Electronic data interchange services	12.0	10.9	12.0	10.9
Other services	10.2	11.1	10.4	12.1
Maintenance, EDI and other services	51.9*	47.7	52.2	48.9
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Software, hardware and supplies	5.5	4.6	5.7	4.6
Implementation and training services	5.4	5.8	5.5	5.6
Total cost of system sales	10.9	10.4	11.2	10.2
Maintenance	6.7	7.3	7.1	7.5
Electronic data interchange services	8.3	7.8	8.3	7.8
Other services	6.9	6.1	7.0	6.2
Total cost of maintenance, EDI and other services	21.9	21.2	22.4	21.5
Total cost of revenue	32.7*	31.6	33.6	31.7
Gross profit	67.3	68.4	66.4	68.3
Selling, general and administrative	29.2	26.7	29.6	27.4
Research and development	6.0	6.9	6.3	6.7
Income from operations	32.1	34.8	30.5	34.2
Interest income	1.4	2.2	1.6	2.0
Income before provision for income taxes	33.5	37.0	32.0*	36.2

(Unaudited)	Three Months Ended September 30,		Six Months Ended September 30,	
Provision for income taxes	12.1	14.7	11.8	14.4
Net income	21.4%	22.3%	20.2%	21.8%

* does not add due to rounding

For the Three-Month Periods Ended September 30, 2007 versus 2006

Net Income. The Company's net income for the three months ended September 30, 2007 was $9.7 million or $0.35 per share on a basic and $0.35 per share on a fully diluted basis. In comparison, we earned $8.3 million or $0.31 per share on a basic and $0.30 per share on a fully diluted basis for the three months ended September 30, 2006. The increase in net income for the three months ended September 30, 2007 was a result of the following:

- a 20.5% increase in consolidated revenue;
- a 22.9% increase in NextGen Division revenue which accounted for 91.1% of consolidated revenue;
- a reduction in the effective tax rate in the quarter ended September 30, 2007 to 36.1% versus 39.8% in the prior year period driven primarily by an increase in the statutory deduction for qualified production activities, deductions related to tax-exempt interest income, and deductions related to incentive stock option exercises;

The above positive factors were offset by:

- increased hardware and maintenance revenue resulting in the gross profit margin declining to 67.3% in the three months ended September 30, 2007 versus 68.4% in the prior year period; and
- an increase in the selling, general and administrative expenses to 29.2% of revenue in the three months ended September 30, 2007 versus 26.7% of revenue in the prior year period, primarily due to headcount additions.

Revenue. Revenue for the three months ended September 30, 2007 increased 20.5% to $45.1 million from $37.5 million for the three months ended September 30, 2006. NextGen Division revenue increased 22.9% from $33.5 million in the three months ended September 30, 2006 to approximately $41.1 million in the three months ended September 30, 2007, while QSI Division revenue increased by 1.0% during the three months ended September 30, 2007 over the prior year period.

We divide revenue into two categories, "system sales" and "maintenance, EDI and other services". Revenue in the system sales category includes software license fees, third party hardware and software, and implementation and training services related to purchase of the Company's software systems. The majority of the revenue in the system sales category is related to the sale of software. Revenue in the maintenance, EDI and other services category includes, maintenance, EDI, follow on training and implementation services, annual third party license fees and other revenue. Maintenance revenue includes amounts initially deferred in conjunction with new customer arrangements and subsequently amortized and billings to existing customers.

System Sales. Revenue earned from company-wide sales of systems for the three months ended September 30, 2007, increased 10.8% to $21.7 million from $19.6 million in the prior year period.

Our increase in revenue from sales of systems was principally the result of an 11.1% increase in category revenue at our NextGen Division. Divisional sales in this category grew from $18.9 million during the three months ended September 30, 2006 to $21.0 million during the three months ended September 30, 2007. This increase was driven by higher sales of NextGen^{emr} and NextGen^{epm} software to both new and existing clients, as well as increases in sales of hardware, third party software and supplies and implementation and training services.

The following table breaks down our reported system sales into software, hardware, third party software, supplies, and implementation and training services components by division:

	Software	Hardware, Third Party Software and Supplies	Implementation and Training Services	Total System Sales
Three months ended September 30, 2007				
QSI Division	$ 217	$ 258	$ 225	$ 700
NextGen Division	16,713	1,326	2,957	20,996
Consolidated	$ 16,930	$ 1,584	$ 3,182	$ 21,696
Three months ended September 30, 2006				
QSI Division	$ 237	$ 271	$ 173	$ 681
NextGen Division	15,702	527	2,675	18,904
Consolidated	$ 15,939	$ 798	$ 2,848	$ 19,585

NextGen Division software revenue increased 6.4% between the three months ended September 30, 2007 and the prior year period. The Division's software revenue accounted for 79.6% of divisional system sales revenue during the three months ended September 30, 2007. As of September 30, 2006, divisional software revenue as a percentage of divisional system sales revenue was 83.1%. Sales of additional licenses to existing customers was $7.1 million during the three months ended September 30, 2007 down from $8.5 million in the prior year period. The sale of licenses to existing customers can fluctuate significantly from quarter to quarter and year to year. We do not consider the comparative decrease as an item of operational significance.

Software license revenue growth continues to be an area of primary emphasis for the NextGen Division.

During the three months ended September 30, 2007, 6.3% of NextGen's system sales revenue was represented by hardware and third party software compared to 2.8% in the prior year period. During the three months ended September 30, 2007, there was a shift in the revenue mix with increased revenue coming from hardware revenue. The number of customers who purchase hardware and third party software and the dollar amount of hardware and third party software revenue fluctuates each quarter depending on the needs of customers. The

inclusion of hardware and third party software in the Division's sales arrangements is typically at the request of the customer and is not a priority focus for us.

Implementation and training revenue related to system sales at the NextGen Division increased 10.5% in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. The amount of implementation and training services revenue in any given quarter is dependent on several factors, including timing of customer implementations, the availability of qualified staff, and the mix of services being rendered. The number of implementation and training staff increased during the three months ended September 30, 2007 versus 2006 in order to accommodate the increased amount of implementation services sold in conjunction with increased software sales. In order to achieve growth in this area, additional staffing increases and additional training facilities are anticipated, though actual future increases in revenue and staff will depend upon the availability of qualified staff, business mix and conditions, and our ability to retain current staff members.

The NextGen Division's growth has come in part from investments in sales and marketing activities including hiring additional sales representatives, trade show attendance, and advertising expenditures. We have also benefited from winning numerous industry awards for the NextGen Division's flagship NextGen^{emr} and NextGen^{epm} software products and the apparent increasing acceptance of electronic medical records technology in the healthcare industry.

For the QSI Division, total system sales remained relatively unchanged in the three months ended September 30, 2007 versus September 30, 2006. We do not presently foresee any material changes in the business environment for the Division with respect to the weak purchasing environment in the dental group practice market that has existed for the past several years.

Maintenance, EDI and Other Services. For the three months ended September 30, 2007, Company-wide revenue from maintenance, EDI and other services grew 31.2% to $23.5 million from $17.9 million in the prior year period. The increase in this category resulted from an increase in maintenance, EDI and other services revenue from the NextGen Division's client base. Total NextGen Division maintenance revenue for the three months ended September 30, 2007 grew 47.6% to $11.6 million from $7.9 million in the prior year period, while EDI revenue grew 43.6% to $4.2 million compared to $2.9 million during the prior year period. Other services revenue for the three months ended September 30, 2007 grew 14.1% to $4.3 million from $3.8 million in the prior year period. QSI Division maintenance revenue increased 3.2% in the three months ended September 30, 2007 as compared to the prior year period while QSI divisional EDI revenue increased by 5.0% in the three months ended September 30, 2007 as compared to the prior year period.

The following table details revenue included in the EDI, maintenance, and other category for the three month periods ended September 30, 2007 and 2006:

	Maintenance	EDI	Other	Total
Three months ended September 30, 2007				
QSI Division	$ 1,824	$ 1,179	$ 303	$ 3,306
NextGen Division	11,618	4,227	4,299	20,144
Consolidated	$ 13,442	$ 5,406	$ 4,602	$ 23,450
Three months ended September 30, 2006				
QSI Division	$ 1,767	$ 1,123	$ 401	$ 3,291
NextGen Division	7,872	2,943	3,768	14,583
Consolidated	$ 9,639	$ 4,066	$ 4,169	$ 17,874

The growth in maintenance revenue for the NextGen Division has come from new customers that have been added each quarter, existing customers who have purchased additional licenses, and our relative success in retaining existing maintenance customers. NextGen's EDI revenue growth has come from new customers and from further penetration of the Division's existing customer base. We intend to continue to promote maintenance and EDI services to both new and existing customers.

The following table provides the number of billing sites which were receiving maintenance services as of the last business day of the quarters ended September 30, 2007 and 2006 respectively, as well as the number of billing sites receiving EDI services during the last month of each respective period at each division of the Company. The table presents summary information only and includes billing entities added and removed for any reason. Note also that a single client may include one or multiple billing sites, and changes in billing protocols for certain clients can cause period to period changes in the number of billing sites.

	NextGen		QSI		Consolidated	
	Maintenance	**EDI**	**Maintenance**	**EDI**	**Maintenance**	**EDI**
September 30, 2006	903	649	262	183	1,165	832
Billing sites added	185	286	7	25	192	311
Billing sites removed	(53)	(45)	(12)	(30)	(65)	(75)
September 30, 2007	1,035	890	257	178	1,292	1,068

Cost of Revenue. Cost of revenue for the three months ended September 30, 2007 increased 24.9% to $14.8 million from $11.8 million in the quarter ended September 30, 2006 and the cost of revenue as a percentage of revenue increased to 32.7% from 31.6% due to the fact that the rate of growth in cost of revenue grew faster than the aggregate revenue growth rate for the Company.

The increase in our consolidated cost of revenue as a percentage of revenue between the three months ended September 30, 2007 and the three months ended September 30, 2006 is primarily attributable to an increase in the level of hardware and third party software as well as an increase in other expense as a percentage of revenue in the NextGen Division. Other expense, which consists of outside service costs, amortization of software development costs and other costs, increased to 17.8% of total revenue during the three months ended September 30, 2007 from 16.2% of total revenue during the three months ended September 30, 2006.

The following table details the individual components of cost of revenue and gross profit as a percentage of total revenue for our Company and our two divisions.

	Hardware, Third Party Software	**Payroll and related Benefits**	**Other**	**Total Cost of Revenue**	**Gross Profit**
Three months ended September 30, 2007					
QSI Division	4.0%	18.6%	19.3%	41.9%	58.1%
NextGen Division	3.2	11.0	17.6	31.8	68.2
Consolidated	3.3%	11.7%	17.8%	32.7%	67.3%
Three months ended September 30, 2006					
QSI Division	8.0%	17.5%	21.6%	47.1%	52.9%
NextGen Division	2.1	12.1	15.5	29.7	70.3
Consolidated	2.8%	12.6%	16.2%	31.6%	68.4%

During the three months ended September 30, 2007, hardware and third party software constituted a larger portion of consolidated cost of revenue compared to the prior year period. The number of customers who purchase hardware and third party software and the dollar amount of hardware and third party software purchased fluctuates each quarter depending on the needs of the customers and is not a priority focus for us.

Our payroll and benefits expense associated with delivering our products and services decreased to 11.7% of consolidated revenue in the three months ended September 30, 2007 compared to 12.6% during the three months ended September 30, 2006. The absolute level of consolidated payroll and benefit expenses grew from $4.7 million in the three months ended September 30, 2006 to $5.3 million in the three months ended September 30, 2007, an increase of 13% or approximately $0.6 million. The increase was due primarily to additions to related headcount, payroll and benefits expense associated with delivering products and services in the NextGen Division where such expenses increased to $4.5 million in the three months ended September 30, 2007 from $4.0 million in the three months ended September 30, 2006. Payroll and benefits expense associated with delivering products and services in the QSI Division during the three months ended September 30, 2007 and 2006 remained relatively unchanged at approximately $0.7 million. The adoption of SFAS 123R added approximately $0.1 million in compensation expense to cost of revenue for both the three months ended September 30, 2007 and 2006, respectively.

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

We do not currently intend to make any significant additions to related headcount at the QSI Division.

As a result of the foregoing events and activities, the gross profit percentage for the Company and our NextGen division decreased for the three month period ended September 30, 2007 versus the prior year period.

The following table details revenue and cost of revenue on a consolidated and divisional basis for the three month periods ended September 30, 2007 and 2006:

	Three months ended September 30,		Three months ended September 30,	
	2007	%	2006	%
QSI Division Revenue	$ 4,006	100.0%	$ 3,972	100.0%
Cost of revenue	1,680	41.9	1,871	47.1
Gross profit	$ 2,326	58.1%	$ 2,101	52.9%
NextGen Division Revenue	$ 41,140	100.0%	$ 33,487	100.0%
Cost of revenue	13,095	31.8	9,962	29.7
Gross profit	$ 28,045	68.2%	$ 23,525	70.3%
Consolidated Revenue	$ 45,146	100.0%	$ 37,459	100.0%
Cost of revenue	14,775	32.7	11,833	31.6
Gross profit	$ 30,371	67.3%	$ 25,626	68.4%

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the three months ended September 30, 2007 increased 32.0% to $13.2 million as compared to $10.0 million for the three months ended September 30, 2006. The increase in these expenses resulted from a $1.2 million increase in compensation expense in the NextGen Division, $0.6 million in selling related expenses in the NextGen Division, $0.7 million in other general and administrative expenses in the NextGen Division and a $0.7 million increase in corporate related expenses. The adoption of SFAS 123R added approximately $0.6 million in compensation expense to selling, general and administrative expenses for both the three months ended September 30, 2007 and 2006, respectively, and is included in the aforementioned amounts. Selling, general and administrative expenses as a percentage of revenue increased from 26.7% in the three months ended September 30, 2006 to 29.2% in the three months ended September 30, 2007, due in part to the fact that the rate of growth in revenue was slower than the selling, general and administrative expense growth rate for the Company.

We anticipate increased expenditures for trade shows, advertising and the employment of additional sales and administrative staff at the NextGen Division. We also anticipate future increases in corporate expenditures being made in a wide range of areas. While we expect selling, general and administrative expenses to increase on an absolute basis, we cannot accurately predict the impact these additional expenditures will have on selling, general, and administrative expenses as a percentage of revenue.

Research and Development Costs. Research and development costs for the three months ended September 30, 2007 and 2006 were $2.7 million and $2.6 million, respectively. The increases in research and development expenses were due in part to increased investment in the NextGen product line. Additionally, the adoption of SFAS 123R added approximately $0.2 million in compensation expense to research and development costs for both the three months ended September 30, 2007 and 2006, respectively. Additions to capitalized software costs offset research and development costs. For the three months ended September 30, 2007, $1.6 million was added to capitalized software costs while $1.1 million was capitalized during the three months ended September 30, 2006. Research and development costs as a percentage of revenue decreased to 6.0% during the three months ended September 30, 2007 from 6.9% for the same period in 2006. Research and development expenses are expected to continue at or above current dollar levels.

Interest Income. Interest income for the three months ended September 30, 2007 decreased to $0.6 million compared to $0.8 million in the three months ended September 30, 2006. Interest income in the three months ended September 30, 2007 decreased primarily due to a greater proportion of funds invested in tax favored auction rate securities which offer lower interest rates but higher after-tax yields compared to money market or short term U.S. Treasuries as well as comparatively lower amounts of funds available for investment during the three months ended September 30, 2007 due to the regular quarterly dividend program adopted by our Board of Directors commencing with conclusion of our first fiscal quarter of 2008 (June 30, 2007) and continuing each fiscal quarter thereafter.

Our investment policy is determined by our Board of Directors. We currently maintain our cash in very liquid short term assets including money market funds and auction rate securities with maturities or interest reset dates of less than 90 days. Our Board of Directors continues to review alternate uses for our cash including, but not limited to payment of a special dividend, initiation of a stock buy back program, an expansion of our investment policy to include investments with maturities of greater than 90 days, or other items. Additionally, it is possible that we will utilize some or all of our cash to fund an acquisition or other similar business activity. Any or all of these programs could significantly impact our investment income in future periods.

Provision for Income Taxes. The provision for income taxes for the three months ended September 30, 2007 was approximately $5,468 as compared to approximately $5,523 for the prior year period. The effective tax rates for the three months ended September 30, 2007 and 2006 were 36.1% and 39.9%, respectively. The provision for income taxes for the three months ended September 30, 2007 and 2006 differ from the combined statutory rates primarily due to the impact of varying state income tax rates, research and development tax credits, and the qualified production activities deduction. In addition, the effective rate for the three months ended September 30, 2007 decreased from the prior year primarily from the increase in the statutory deduction for qualified production activities, a new deduction for tax-exempt interest income, and increased deductions related to incentive stock option exercises.

For the Six-Month Periods Ended September 30, 2007 versus 2006

Net Income. The Company's net income for the six months ended September 30, 2007 was $17.6 million or $0.65 per share on a basic and $0.64 per share on a fully diluted basis. In comparison, we earned $16.0 million or $0.60 per share on a basic and $0.59 per share on a fully diluted basis in the six months ended September 30, 2006. The increase in net income for the six months ended September 30, 2007, was achieved primarily through the following:

- a 18.6% increase in consolidated revenue; and
- a 20.6% increase in NextGen Division revenue which accounted for 90.8% of consolidated revenue.

Revenue. Revenue for the six months ended September 30, 2007 increased 18.6% to $87.2 million from $73.5 million for the six months ended September 30, 2006. NextGen Division revenue increased 20.6% from $65.7 million during the six month ended September 30, 2006 to $79.2 million during the six months ended September 30, 2007, while QSI Division revenue increased slightly to $8.0 million during the six month ended September 30, 2007 from $7.9 million during the six months ended September 30, 2006.

We divide revenue into two categories, "system sales" and "maintenance, EDI and other services". Revenue in the system sales category includes software license fees, third party hardware and software, and implementation and training services related to purchase of the Company's software systems. The majority of the revenue in the system sales category is related to the sale of software. Revenue in the maintenance, EDI and other services category includes, maintenance, EDI, follow on training and implementation services, annual third party license fees and other revenue.

System Sales. Company-wide sales of systems for the six months ended September 30, 2007 increased 11.0% to $41.7 million from $37.6 million in the same prior year period.

Our increase in revenue from sales of systems was principally the result of an 11.5% increase in category revenue at our NextGen Division whose systems sales grew from $36.3 million to $40.5 million during the six months ended September 30, 2007. This increase

27

was driven primarily by higher sales of NextGen^{emr} and NextGen^{epm} software to both new and existing clients, as well as increases in the sale of hardware, third party software, and supplies.

Category revenue in the QSI Division decreased slightly on a year over year basis during the six months ended September 30, 2007.

The following table breaks down our reported systems sales into software, hardware and third party software and supplies, and implementation and training services components by division:

	Software	Hardware, Third Party Software and Supplies	Implementation and Training Services	Total System Sales
Six months ended September 30, 2007				
QSI Division	$ 315	$ 336	$ 540	$ 1,191
NextGen Division	32,245	2,357	5,890	40,492
Consolidated	$ 32,560	$ 2,693	$ 6,430	$ 41,683
Six months ended September 30, 2006				
QSI Division	$ 275	$ 670	$ 295	$ 1,240
NextGen Division	29,646	1,175	5,507	36,328
Consolidated	$ 29,921	$ 1,845	$ 5,802	$ 37,568

NextGen Division software revenue increased 8.8% between the six months ended September 30, 2007 and the six months ended September 30, 2006. The Division's software revenue accounted for 79.6% of divisional systems sales revenue during the six months ending September 30, 2007, a decrease from 81.6% in the six months ended September 30, 2006.

Software license revenue growth continues to be an area of primary emphasis for the NextGen Division.

During the six months ended September 30, 2007, 5.8% of NextGen's system sales revenue was represented by hardware and third party software compared to 3.2% in the prior year period. During the six months ended September 30, 2007, there was an increase in the proportion of revenue coming from hardware sales. The number of customers who purchase hardware and third party software and the dollar amount of hardware and third party software revenue fluctuates each quarter depending on the needs of customers. The inclusion of hardware and third party software in the Division's sales arrangements is typically at the request of the customer and is not a priority focus for us.

Implementation and training revenue at the NextGen Division increased 7.0% from the six months ended September 30, 2007 compared to the six months ended September 30, 2006 while implementation and training revenue related to system sales decreased its share of category revenue from 15.2% in the six months ended September 30, 2006 to 14.5% in the six months ended September 30, 2007. The growth in implementation and training revenue is the result of increases in the amount of implementation and training services rendered to our customers. The number of implementation and training staff increased during the course of the six months ended September 30, 2007 versus 2006 in order to accommodate the increases in implementation services sold in conjunction with increased software sales. In order to achieve continued increasing revenue in this area, additional staffing increases are anticipated, though actual future increases will depend upon the availability of qualified staff, business conditions, and our ability to retain current staff members.

The NextGen Division's growth has come in part from investments in sales and marketing activities including hiring additional sales representatives, trade show attendance, and advertising expenditures. We have also benefited from winning numerous industry awards for the NextGen Division's flagship NextGen^{emr} and NextGen^{epm} software products, as well as the apparent increasing acceptance of electronic medical records technology in the healthcare industry.

Maintenance, EDI and Other Services. For the six months ended September 30, 2007, Company-wide revenue from maintenance, EDI and other services grew 26.5% to $45.5 million from $36.0 million during the same period last year. The increase in this category resulted principally from an increase in maintenance and EDI revenues from the NextGen Division's client base. Total NextGen Division maintenance revenue for the six months ended September 30, 2007 grew 44.3% to $22.4 million from $15.5 million in the period a year ago, while EDI revenue grew 42.6% to $8.1 million compared to $5.7 million during the same period. QSI Division maintenance, EDI and other revenue increased 2.6% over the year ago period.

The following table details revenue included in Maintenance, EDI and other services for the six month periods ended September 30, 2007 and 2006:

	Maintenance	EDI	Other	Total
Six months ended September 30, 2007				
QSI Division	$ 3,576	$ 2,294	$ 927	$ 6,797
NextGen Division	22,425	8,136	8,137	38,698
Consolidated	$ 26,001	$ 10,430	$ 9,064	$ 45,495
Six months ended September 30, 2006				
QSI Division	$ 3,495	$ 2,336	$ 791	$ 6,622
NextGen Division	15,543	5,707	8,093	29,343
Consolidated	$ 19,038	$ 8,043	$ 8,884	$ 35,965

The growth in overall maintenance revenue has come from new customers that have been added each quarter, additional software purchases by existing customers, as well as our relative success in retaining existing maintenance customers. NextGen EDI revenue growth has come from new customers and from further penetration of the Division's existing customer base. We intend to continue to promote maintenance and EDI services to both new and existing customers.

The following table provides the number of billing sites which were receiving maintenance services as of the last business day of the quarters ended September 30, 2007 and 2006 respectively, as well as the number of billing sites receiving EDI services during the last month of each respective period at each division of the Company. The table presents summary information only and includes billing entities added and removed for any reason. Note also that a single client may include one or multiple billing sites, and changes in billing arrangements with certain clients can cause period to period changes in the number of billing sites.

	NextGen		QSI		Consolidated	
	Maintenance	EDI	Maintenance	EDI	Maintenance	EDI
September 30, 2006	903	649	262	183	1,165	832
Billing sites added	185	286	7	25	192	311
Billing sites removed	(53)	(45)	(12)	(30)	(65)	(75)
September 30, 2007	1,035	890	257	178	1,292	1,068

Cost of Revenue. The cost of revenue for the six months ended September 30, 2007 increased 25.9% to $29.3 million from $23.3 million, while the cost of revenue as a percentage of net revenue increased to 33.6% from 31.7% during the same period a year ago.

The increase in our consolidated cost of revenue as a percentage of revenue between the six months ended September 30, 2007 and the six months ended September 30, 2006 is primarily attributable to an increase in the level of hardware and third party software included in the period's transactions as well as an increase in maintenance revenue. Additionally, other expense, which consists of outside service costs, amortization of software development costs and other costs, increased to 18.0% of revenue during the six months ended September 30, 2007 from 16.1% of revenue during the six months ended September 30, 2006.

The following table details the individual components of cost of revenue and gross profit as a percentage of total revenue for our Company and our two divisions:

	Hardware, Third Party Software	Payroll and related Benefits	Other	Total Cost of Revenue	Gross Profit
Six months ended September 30, 2007					
QSI Division	6.2%	18.7%	19.6%	44.5%	55.5%
NextGen Division	3.5	11.2	17.8	32.5	67.5
Consolidated	3.7%	11.9%	18.0%	33.6%	66.4%
Six months ended September 30, 2006					
QSI Division	7.0%	18.3%	21.8%	47.1%	52.9%
NextGen Division	2.4	12.1	15.3	29.8	70.2
Consolidated	2.9%	12.7%	16.1%	31.7%	68.3%

During the six months ended September 30, 2007, the cost of hardware and third party software constituted 3.7% of consolidated revenue compared to 2.9% in the same year ago period. The number of customers who purchase hardware and third party software and the dollar amount of hardware and third party software purchased fluctuates each quarter depending on the needs of the customers and is not a priority focus for us.

Our payroll and benefits expense associated with delivering our products and services decreased to 11.9% of consolidated revenue in the six months ended September 30, 2007 compared to 12.7% in the six months ended September 30, 2006. The absolute level of consolidated payroll and benefit expenses grew from $9.4 million in the six months ended September 30, 2006 to $10.4 million in the six months ended September 30, 2007, an increase of 11%. This increase was due primarily to additions to headcount, payroll and benefits expense associated with delivering products and services in the NextGen Division, where divisional expenses increased from $7.9 million in the six months ended September 30, 2006 compared to $8.9 million in the six months ended September 30, 2007, an increase of 13%. The NextGen Division's payroll and benefits expense associated with delivering products and services as a percentage of divisional revenue in the six months ended September 30, 2007 decreased to 11.2% compared to 12.1% in the prior year period, as revenue grew at a faster rate than the increase in payroll and benefits expenses. Headcount expense as a percentage of revenue for the six month period ended September 30, 2007 at the QSI Division increased compared to the prior year at 18.7% versus 18.3% in the prior year period. The adoption of SFAS 123R added approximately $0.3 million and $0.2 million of compensation expense to cost of revenue in the six months ended September 30, 2007 and 2006, respectively.

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

We do not currently intend to make any significant additions to related headcount at the QSI Division.

Should the NextGen Division continue to represent an increasing share of our revenue and should NextGen continue to show higher gross profit percentages compared to the QSI Division, our gross profit percentages and trends should more closely match those of the NextGen Division.

As a result of the foregoing events and activities, our gross profit percentage for the Company and our NextGen operating Division decreased for the six month period ended September 30, 2007 versus the prior year period.

The following table details revenue and cost of revenue on a consolidated and divisional basis for the six month periods ended September 30, 2007 and 2006:

	Six months ended September 30,		Six months ended September 30,	
	2007	%	2006	%
QSI Division Revenue	$ 7,988	100.0%	$ 7,862	100.0%
Cost of revenue	3,556	44.5	3,700	47.1
Gross profit	$ 4,432	55.5%	$ 4,162	52.9%
NextGen Division Revenue	$ 79,190	100.0%	$ 65,671	100.0%
Cost of revenue	25,761	32.5	19,590	29.8
Gross profit	$ 53,429	67.5%	$ 46,081	70.2%
Consolidated Revenue	$ 87,178	100.0%	$ 73,533	100.0%
Cost of revenue	29,317	33.6	23,290	31.7
Gross profit	$ 57,861	66.4%	$ 50,243	68.3%

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the six months ended September 30, 2007 increased 27.9% to $25.8 million as compared to $20.2 million for the six months ended September 30, 2006. The increase in the amount of such expenses resulted primarily from increases of $3.1 million in salaries, commissions, and related benefits in the NextGen Division, $1.0 million in selling related expenses in the NextGen Division, $0.8 million in other selling and general expenses in the NextGen Division and $0.7 million in increased corporate related expenses. The increase in corporate expenses was primarily composed of salaries and related benefits. The adoption of SFAS 123R added $1.3 million and $1.1 million of compensation expense to selling, general and administrative expenses for the six months ended September 30, 2007 and 2006, respectively and is included in the aforementioned amounts. Selling, general and administrative expenses as a percentage of revenue increased from 27.4% in the six months ended September 30, 2006 to 29.6% in the six months ended September 30, 2007 due in to the fact that the rate of growth in selling, general and administrative expense was faster than the revenue growth rate for the Company.

We anticipate increased expenditures for trade shows, advertising and the employment of additional sales and administrative staff at the NextGen Division. We also anticipate future increases in corporate expenditures being made in areas including but not limited to staffing and professional services. While we expect selling, general and administrative expenses to increase on an absolute basis, we cannot accurately predict the impact these additional expenditures will have on selling, general, and administrative expenses as a percentage of revenue.

Research and Development Costs. Research and development costs for the six months ended September 30, 2007 and 2006 were $5.5 million and $4.9 million, respectively. The increases in research and development expenses were primarily due to increased investment in the NextGen product line. Additions to capitalized software costs offset research and development costs. For the six months ended September 30, 2007, $3.0 million was added to capitalized software costs while $2.2 million was capitalized during the six months ended September 30, 2006. The adoption of SFAS 123R added $0.5 million and $0.4 million of compensation expense to research and development costs for the six months ended September 30, 2007 and 2006, respectively. Research and development costs as a percentage of net revenue decreased to 6.3% from 6.7% due to the fact that higher amounts were added to capitalized software costs in the six months ended September 30, 2007 over the prior year period and the growth in revenue exceeded the growth in research and development spending. Research and development expenses are expected to continue at or above current levels.

Interest Income. Interest income for the six months ended September 30, 2007 decreased 6.9% to $1.4 million compared to $1.5 million in the six months ended September 30, 2006. Interest income in the six months ended September 30, 2007 decreased primarily due to a greater proportion of funds invested in tax favored auction rate securities which offer lower interest rates but higher after-tax yields compared to money market or short term U.S. Treasuries as well as comparatively lower amounts of funds available for investment during the six months ended September 30, 2007 due to the regular quarterly dividend program adopted by our Board of Directors commencing with conclusion of our first fiscal quarter of 2008 (June 30, 2007) and continuing each fiscal quarter thereafter.

Our investment policy is determined by our Board of Directors. We currently maintain our cash in very liquid short term assets including money market funds and auction rate securities with maturities or interest reset dates of less than 90 days. Our Board of Directors continues to review alternate uses for our cash including, but not limited to payment of a special dividend, initiation of a stock buy back program, an expansion of our investment policy to include investments with maturities of greater than 90 days, or other items. Additionally, it is possible that we will utilize some or all of our cash to fund an acquisition or other similar business activity. Any or all of these programs could significantly impact our investment income in future periods.

Provision for Income Taxes. The provision for income taxes for the six months ended September 30, 2007 and 2006 was $10.3 million as compared to $10.6 million for the prior year period. The effective tax rates for the six months ended September 30, 2007 and 2006 were 36.9% and 39.9%, respectively. The provision for income taxes for the six months ended September 30, 2007 and 2006 differ from the combined statutory rates primarily due to the impact of varying state income tax rates, research and development tax credits, and the qualified production activities deduction. The effective rate for the six months ended September 30, 2007 decreased from the prior year primarily from the increase in the statutory deduction for qualified production activities, the use of tax exempted investment vehicles, and increased deductions related to incentive stock option exercises.

Liquidity and Capital Resources

The following table presents selected financial statistics and information as of and for each of the six months ended September 30, 2007 and 2006:

	Six months ended September 30,	
	2007	2006
Cash and cash equivalents	$ 26,920	$ 74,700
Net (decrease) increase in cash and cash equivalents during the six month period	$ (33,108)	$ 17,475
Net income during the six month period	$ 17,612	$ 16,006
Net cash provided by operations during the six month period	$ 19,227	$ 15,797
Number of days of sales outstanding at start of the period	129	122
Number of days of sales outstanding at the end of the period	138	135

Cash provided by operations has historically been our primary source of cash and has primarily been driven by our net income and secondarily by non-cash expenses including depreciation, amortization of capitalized software, provisions for bad debts, net deferred income taxes and stock option expenses.

The following table summarizes our statement of cash flows for the six month period ended September 30, 2007 and 2006:

	Six months ended September 30,	
	2007	2006
Net income	$ 17,612	$ 16,006
Non-cash expenses	4,805	4,435
Change in deferred revenue	488	3,434
Change in accounts receivable	(4,649)	(11,038)
Change in other assets and liabilities	971	2,960
Net cash provided by operating activities	$ 19,227	$ 15,797

Net Income

As referenced in the above table, net income makes up the majority of our cash generated from operations for the six month period ended September 30, 2007 and 2006. Our NextGen Division's contribution to net income has increased each year due to that division's operating income increasing more quickly than the Company as a whole.

Non-Cash expenses

For the six months ended September 30, 2007, non-cash expenses include approximately $1.1 million of depreciation, $ 2.0 million of amortization of capitalized software, $0.2 million for the provision for bad debts and $2.0 million of stock option expenses offset by benefit from deferred income taxes. Total non-cash expense was approximately $4.8 million and $4.4 million for the six month periods ended September 30, 2007 and 2006, respectively.

Deferred Revenue

Cash from operations benefited from increases in deferred revenue primarily due to an increase in the volume of implementation and maintenance services invoiced by the NextGen Division which had not yet been rendered or recognized as revenue, but for which cash was received. Deferred revenue grew by approximately $0.5 million in the six month period ending September 30, 2007 versus $3.4 million in the prior year period. The six months ended September 30, 2007 included a smaller amount of deferred maintenance related to initial arrangements with Siemens Medical Solutions compared to the prior year period.

Accounts Receivable

Accounts receivable grew by approximately $4.6 million and $11.0 million in the six month periods ending September 30, 2007 and 2006, respectively. The increase in accounts receivable in both periods is due to the following factors:

- NextGen Division revenue grew 20.6% and 33.7% on a year over year basis, in the six month periods ended September 30, 2007 and 2006, respectively;

- The NextGen Division constituted a larger percentage of our receivables at September 30, 2007 compared to March 31, 2007. Turnover of accounts receivable in the NextGen Division is slower than the QSI Division due to the fact that the majority of the QSI Division's revenue is coming from maintenance and EDI services which typically have shorter payment terms than systems sales related revenue which historically have accounted for a major portion of NextGen Division sales; and

- We experienced an increase in the volume of undelivered services billed in advance by the NextGen Division which were unpaid as of the end of each period and included in accounts receivable. This resulted in an increase in both deferred revenue and accounts receivable of approximately $0.2 million in the six month period ended September 30, 2007 and approximately $4.7 million in the six month period ended September 30, 2006, respectively.

The six month period ended September 30, 2006 was also negatively impacted by an increase in accounts receivable with one significant customer and the period ended September 30, 2007 was positively impacted by a decrease in accounts receivable with this large customer.

The turnover of accounts receivable measured in terms of days sales outstanding (DSO) increased from 129 days to 138 days during the six month period ended September 30, 2007, due, in part, to the above mentioned factors. The beginning DSO figure of 129 days was also relatively lower due to a significant increase in revenue in the quarter ended March 31, 2007 which contributed to a lower beginning DSO calculation. DSO increased from 122 days to 135 days during the six month period ended September 30, 2006, primarily due to the above mentioned factors. DSOs can also be impacted by the effectiveness of the collection staff. We have not attempted to quantify the impact of these factors.

If amounts included in both accounts receivable and deferred revenue were netted, the Company's turnover of accounts receivable expressed as DSO would be 90 days as of September 30, 2007 and 81 days as of September 30, 2006, respectively. Provided turnover of accounts receivable, deferred revenue, and profitability remain consistent with the first six months ended September 30, 2007, we anticipate being able to continue to generate cash from operations during fiscal 2008 primarily from the net income of the Company.

Cash flows from operating activities

Cash and cash equivalents decreased by $33.1 million between March 31, 2007 and September 30, 2007 primarily as a result of the Company purchasing short-term investments in Auction Rate Securities (ARS) of approximately $46.0 million. These ARS are not classified as cash and cash equivalents but instead are classified as marketable securities on our Consolidated Balance

Sheets.

Cash and cash equivalents increased approximately $17.5 million during the six months ended September 30, 2006 compared to the same period in the prior year, primarily as a result of cash generated by operating activities.

Cash flows from investing activities

Net cash used in investing activities for the six months ended September 30, 2007 and 2006 was $50.2 million and $3.5 million, respectively. The increase in cash used in investing activities is a result of the Company purchasing short-term investments in ARS of approximately $46.0 million. As discussed above, these ARS are classified as short-term investments on the accompanying Consolidated Balance Sheets. In addition to purchases and sales of marketable securities, net cash used in investing activities for the six months ended September 30, 2007 consisted of additions to equipment and improvements and capitalized software. Net cash used in investing activities for the six months ended September 30, 2006 consisted of additions to equipment and improvements and capitalized software.

Cash flows from financing activities

During the six months ended September 30, 2007, we received proceeds of $3.5 million from the exercise of stock options, paid a dividend of $6.8 million and recorded a reduction in income tax liability of $1.2 million related to tax deductions received from employee stock option exercises. The benefit was recorded as additional paid in capital.

Cash and cash equivalents and marketable securities

At September 30, 2007, we had cash and cash equivalents of $26.9 million and marketable securities of $46.0 million. We intend to expend some of these funds for the development of products complementary to our existing product line as well as new versions of certain of our products. These developments are intended to take advantage of more powerful technologies and to increase the integration of our products. We have no additional significant current capital commitments.

In January 2007, our Board of Directors adopted a policy whereby we intend to pay a regular quarterly dividend of $0.25 per share on our outstanding common stock commencing with conclusion of our first fiscal quarter of 2008 (June 30, 2007) and continuing each fiscal quarter thereafter, subject to further review and approval as well as establishment of record and distribution dates by our Board of Directors prior to the declaration of each such quarterly dividend. We anticipate that future quarterly dividends, if and when declared by the Board pursuant to this policy, would likely be distributable on or about the fifth day of each of the months of October, January, April and July.

On July 31, 2007, our Board of Directors approved a regular quarterly dividend of twenty-five cents ($0.25) per share payable on its outstanding shares of common stock. The cash dividend record date was September 14, 2007 and was distributed to shareholders on or about October 5, 2007.

On October 25, 2007, the Board approved a quarterly cash dividend of $0.25 per share on our outstanding shares of common stock, payable to shareholders of record as of December 14, 2007 with an expected distribution date on or about January 7, 2007.

Management believes that its cash and cash equivalents on hand at September 30, 2007, together with its marketable securities and cash flows from operations, if any, will be sufficient to meet its working capital and capital expenditure requirements as well as any dividends paid in the ordinary course of business for the balance of fiscal 2008.

Contractual Obligations

The following table summarizes our significant contractual obligations at September 30, 2007, and the effect that such obligations are expected to have on our liquidity and cash in future periods:

Contractual Obligations – Non-cancelable lease obligations		**(in thousands)**
Year Ending March 31,		
2008	$	1,390
2009		2,458
2010		2,455
2011		2,472
2012 and beyond		927

Contractual Obligations – Non-cancelable lease obligations	**(in thousands)**
	$ 9,702

Item 3. Qualitative and Quantitative Disclosures About Market Risk

We have a significant amount of cash and short-term investments. This cash and investment portfolio exposes us to interest rate risk as short-term investment rates can be volatile. Given the short-term maturity structure of our cash portfolio and the short term reset dates of our ARS, we believe that it is not subject to principal fluctuations and the effective interest rate of our portfolio tracks closely to various short-term money market interest rate benchmarks.

As of September 30, 2007, we had short-term investments in tax exempt ARS of approximately $46.0 million. The ARS are rated AAA or AA by one or more national rating agencies and have contractual terms of up to 30 years, but generally have interest rate reset dates that occur every 7, 28 or 35 days and despite the long-term nature of their stated contractual maturities, we have the ability to quickly liquidate these securities at ongoing auctions every 35 days or less. The investments in ARS are classified as available-for-sale on our Consolidated Balance Sheets. The investments are recorded at cost which approximates fair market value due to their variable interest rates, which typically reset every 7, 28 or 35 days. As a result, no cumulative gross unrealized holding gains/losses from the investments have been realized. All income generated from these investments is recorded as interest income.

Item 4. Controls and Procedures

The Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively) conducted an evaluation of the design and operation of our “disclosure controls and procedures” (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”)). Based on their evaluation of our disclosure controls and procedures, as of September 30, 2007, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures result in the effective recordation, processing, summarization and reporting of information that is required to be disclosed in the reports that we file under the Exchange Act and the rules thereunder.

During the quarter ended September 30, 2007, no significant changes have occurred in our “internal controls 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 financial reporting function. We are performing ongoing evaluations and enhancements to our internal controls system.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 1A. Risk Factors.

None.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Securities Holders.

On August 8, 2007, the Company held its 2007 Annual Meeting. The total number of outstanding shares eligible to vote was 27,237,517. The Company’s shareholders were asked by the Company to consider and vote upon the following two proposals:

1.

To elect nine persons, as set forth below, to serve as directors of the Company until the next annual meeting.

2. To ratify the appointment of Grant Thornton LLP as the Company's independent registered public accounting firm for the fiscal year ending March 31, 2008.

The results of the vote were as follows:

Proposal 1: Election of Directors	*Name*	For	Withheld
	Patrick Cline	25,622,206	257,699
	Ibrahim Fawzy	25,542,430	337,475
	Edwin Hoffman	25,578,145	301,760
	Ahmed Hussein	25,534,338	345,567
	Vincent Love	25,627,331	252,574
	Russell Pflueger	25,627,592	252,313
	Steven Plochocki	25,624,670	255,235
	Sheldon Razin	21,584,888	4,295,017
	Louis Silverman	25,582,311	297,594

Proposal 2: Ratification of Accountants	For	Against	Abstain
	25,827,539	36,341	16,025

As a result, Messrs. Cline, Fawzy, Hoffman, Hussein, Pflueger, Love, Plochocki, Razin, and Silverman were elected to serve as directors. Also, proposal 2 was approved by the Company's shareholders.

Item 5. Other Information.

Item 6. Exhibits.

Exhibits:

10.1 Quality Systems, Inc. Amended and Restated 1998 Stock Option Plan.

10.2 Quality Systems, Inc. Amended and Restated 2005 Stock Option and Incentive Plan.

31.1 Certifications of Chief Executive Officer Required by Rule 13a-14 (a) of the Securities Exchange Act of 1934,as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certifications of Chief Financial Officer Required by Rule 13a-14 (a) of the Securities Exchange Act of 1934,as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

QUALITY SYSTEMS, INC.

Date: November 2, 2007	By: /s/ Louis Silverman
	Louis Silverman Chief Executive Officer
Date: November 2, 2007	By: /s/ Paul Holt
	Paul Holt Chief Financial Officer; Principal Accounting Officer