COMPUTER PROGRAMS & SYSTEMS INC
Form 10-Q
August 08, 2017
Table of Contents

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

FORM 10-Q

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

For the quarterly period ended June 30, 2017.

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

For the transition period from to .
Commission file number: 000-49796

COMPUTER PROGRAMS AND SYSTEMS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	74-3032373
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
6600 Wall Street, Mobile, Alabama	36695
(Address of Principal Executive Offices)	(Zip Code)

(251) 639-8100
(Registrant’s Telephone Number, Including Area Code)
N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨		Accelerated filer	ý
Non-accelerated filer	¨	(Do not check if a smaller reporting company)	Smaller reporting company	¨
Emerging Growth Company	¨			

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

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

As of August 7, 2017, there were 13,755,726 shares of the issuer’s common stock outstanding.

Table of Contents

COMPUTER PROGRAMS AND SYSTEMS, INC.
Quarterly Report on Form 10-Q
(For the three and six months ended June 30, 2017)
TABLE OF CONTENTS

Table of Contents

PART I
FINANCIAL INFORMATION
Item 1. Financial Statements.
COMPUTER PROGRAMS AND SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$1,741	$ 2,220
Accounts receivable, net of allowance for doubtful accounts of $2,566 and $2,370, respectively	34,655	31,812
Financing receivables, current portion, net	5,899	5,459
Inventories	1,075	1,697
Prepaid income taxes	758	567
Prepaid expenses and other	3,808	2,794
Total current assets	47,936	44,549
Property and equipment, net	12,485	13,439
Financing receivables, net of current portion	9,093	5,595
Intangible assets, net	101,915	107,118
Goodwill	168,449	168,449
Total assets	$339,878	$ 339,150
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$11,429	$ 6,841
Current portion of long-term debt	7,389	5,817
Deferred revenue	8,564	5,840
Accrued vacation	4,604	3,650
Other accrued liabilities	10,079	8,797
Total current liabilities	42,065	30,945
Long-term debt, less current portion	136,011	146,989
Deferred tax liabilities	5,166	3,246
Total liabilities	183,242	181,180
Stockholders' equity:		
Common stock, $0.001 par value; 30,000 shares authorized; 13,756 and 13,533 shares issued and outstanding	14	13
Additional paid-in capital	150,878	147,911
Retained earnings	5,744	10,046
Total stockholders' equity	156,636	157,970
Total liabilities and stockholders' equity	$339,878	$ 339,150

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

Table of Contents

COMPUTER PROGRAMS AND SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Sales revenues:				
System sales and support	$45,474	$47,719	$88,897	$97,428
TruBridge	22,203	20,696	42,854	40,630
Total sales revenues	67,677	68,415	131,751	138,058
Costs of sales:				
System sales and support	18,859	21,886	37,789	44,153
TruBridge	11,933	11,616	23,520	22,903
Total costs of sales	30,792	33,502	61,309	67,056
Gross profit	36,885	34,913	70,442	71,002
Operating expenses:				
Product development	9,308	8,179	18,243	15,369
Sales and marketing	7,607	6,717	14,734	13,447
General and administrative	12,921	12,130	24,581	31,168
Amortization of acquisition-related intangibles	2,601	2,624	5,203	4,979
Total operating expenses	32,437	29,650	62,761	64,963
Operating income	4,448	5,263	7,681	6,039
Other income (expense):				
Other income	70	69	140	68
Interest expense	(1,938)	(1,642)	(3,745)	(3,110)
Total other income (expense)	(1,868)	(1,573)	(3,605)	(3,042)
Income before taxes	2,580	3,690	4,076	2,997
Provision for income taxes	993	1,694	2,243	2,664
Net income	$1,587	$1,996	$1,833	$333
Net income per common share—basic	$0.11	$0.15	$0.13	$0.03
Net income per common share—diluted	$0.11	$0.15	$0.13	$0.03
Weighted average shares outstanding used in per common share computations:				
Basic	13,420	13,317	13,397	13,171
Diluted	13,420	13,365	13,397	13,227
Dividends declared per common share	$0.20	$0.64	$0.45	$1.28

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

COMPUTER PROGRAMS AND SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$1,587	$1,996	$1,833	$333
Other comprehensive income, net of tax				
Change in unrealized income with realized income on the Statement of Income	—	6	—	38
Total other comprehensive income, net of tax	—	6	—	38
Comprehensive income	$1,587	$2,002	$1,833	$371

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

Table of Contents

COMPUTER PROGRAMS AND SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
	Shares	Amount			
Balance at December 31, 2016	13,533	$ 13	$ 147,911	$ 10,046	$ 157,970
Net income	—	—	—	1,833	1,833
Common stock issued upon exercise of stock options	—	—	1	—	1
Issuance of restricted stock	223	1	(1)	—	—
Stock-based compensation	—	—	2,967	—	2,967
Dividends	—	—	—	(6,135)	(6,135)
Balance at June 30, 2017	13,756	$ 14	$ 150,878	$ 5,744	$ 156,636

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

Table of Contents

COMPUTER PROGRAMS AND SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2017	2016
Operating Activities:		
Net income	1,833	$333
Adjustments to net income:		
Provision for bad debt	473	451
Deferred taxes	1,920	1,748
Stock-based compensation	2,967	2,877
Excess tax benefit from stock-based compensation	—	(244)
Depreciation	1,419	1,740
Amortization of acquisition-related intangibles	5,203	4,979
Amortization of deferred finance costs	365	330
Changes in operating assets and liabilities (net of acquired assets and liabilities):		
Accounts receivable	(3,013)	(2,564)
Financing receivables	(4,241)	(574)
Inventories	622	(10)
Prepaid expenses and other	(1,014)	242
Accounts payable	4,588	(4,260)
Deferred revenue	2,724	(8,573)
Other liabilities	2,236	(5,825)
Prepaid income taxes/income taxes payable	(191)	868
Net cash provided by (used in) operating activities	15,891	(8,482)
Investing Activities:		
Purchases of property and equipment	(465)	(39)
Purchase of business, net of cash received	—	(162,611)
Sale of investments	—	10,861
Net cash used in investing activities	(465)	(151,789)
Financing Activities:		
Dividends paid	(6,135)	(17,244)
Proceeds from long-term debt	—	156,572
Payments of long-term debt principal	(9,771)	(1,562)
Proceeds from exercise of stock options	1	1,134
Excess tax benefit from stock-based compensation	—	244
Net cash provided by (used in) financing activities	(15,905)	139,144
Decrease in cash and cash equivalents	(479)	(21,127)
Cash and cash equivalents at beginning of period	2,220	24,951
Cash and cash equivalents at end of period	$1,741	$3,824
Supplemental disclosure of cash flow information:		
Cash paid for interest	$3,355	$2,780
Cash paid for income taxes, net of refund	$514	$—
Supplemental disclosure of non-cash information:		
Fair value of common stock and options issued as consideration for acquisition of HHI	$—	$97,017
Write-off of fully depreciated assets	$—	$2,769

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

Table of Contents

COMPUTER PROGRAMS AND SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

Basis of Presentation

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

Certain footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted. The condensed consolidated balance sheet as of December 31, 2016 was derived from the audited consolidated balance sheet at that date. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements of Computer Programs and Systems, Inc. ("CPSI" or the "Company") for the year ended December 31, 2016 and the notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Principles of Consolidation

The condensed consolidated financial statements of CPSI include the accounts of TruBridge, LLC ("TruBridge"), Evident, LLC ("Evident"), and Healthland Holding Inc. ("HHI"), all of which are wholly-owned subsidiaries of CPSI. The accounts of HHI include those of its wholly-owned subsidiaries, Healthland Inc. ("Healthland"), Rycan Technologies, Inc. ("Rycan"), and American HealthTech, Inc. ("AHT"). All significant intercompany balances and transactions have been eliminated.

Presentation

Effective January 1, 2017, we adopted a revised presentation of sales revenues and the associated costs of sales in our condensed consolidated statements of income, which we believe is better aligned with and representative of the amount and profitability of our revenue streams, as well as the way we manage our business, review our operating performance and market our products. Specifically:

- The Company's sales revenues and costs of sales amounts formerly presented with the caption "Business management, consulting, and managed IT services" are now presented within the caption "TruBridge" within the condensed consolidated statements of income;
- Rycan's sales revenues and costs of sales amounts formerly included within the caption "Systems sales and support" are now included within the caption "TruBridge" within the condensed consolidated statements of income;
- Healthland and AHT revenues and costs of sales related to hosting services formerly included within the caption "Systems sales and support" are now included within the caption "TruBridge" within the condensed consolidated statements of income; and
- Certain Rycan expenses formerly included within the caption "General and administrative" are now included in cost of sales with the caption "TruBridge" within the condensed consolidated statements of income.

These reclassifications had no effect on previously reported total sales revenues, operating income, income before taxes or net income.

Table of Contents

Amounts presented for the three and six months ended June 30, 2016 have been reclassified to conform to the current presentation. The following table provides the amounts reclassified for the three months ended June 30, 2016:

(In thousands)	As previously reported	Reclassifications	As reclassified
Sales revenues:			
System sales	$ 50,561	$ (2,842)	$ 47,719
TruBridge	17,854	2,842	20,696
Costs of sales:			
System Sales	23,367	(1,481)	21,886
TruBridge	9,913	1,703	11,616
Operating expenses:			
General and administrative	12,352	(222)	12,130

The following table provides the amounts reclassified for the six months ended June 30, 2016:

(In thousands)	As previously reported	Reclassifications	As reclassified
Sales revenues:			
System sales	$ 102,941	$ (5,513)	$ 97,428
TruBridge	35,117	5,513	40,630
Costs of sales:			
System Sales	47,229	(3,076)	44,153
TruBridge	19,440	3,463	22,903
Operating expenses:			
General and administrative	31,555	(387)	31,168

2. BUSINESS COMBINATION

Acquisition of HHI

On January 8, 2016, we acquired all of the assets and liabilities of HHI, including its wholly-owned subsidiaries, Healthland, AHT and Rycan. Healthland provides electronic health records ("EHR") and clinical information management solutions to over 350 hospital customers at the time of acquisition. AHT is a provider of clinical and financial solutions in the post-acute care market, serving over 3,300 skilled nursing facilities at the time of acquisition. Rycan offered SaaS-based revenue cycle management workflow and automation software to over 290 hospital customers at the time of acquisition.

We believe the acquisition of HHI:

- strengthened our position in providing healthcare information systems to community healthcare organizations with approximately 1,200 combined hospital customers at the time of acquisition;
- introduced CPSI to the post-acute care market; and
- expanded the products offered by and capabilities of TruBridge with the addition of Rycan and its suite of revenue cycle management software products.

These factors, combined with the synergies and economies of scale expected from combining the operations of CPSI and HHI, were the basis for the acquisition.

Consideration for the acquisition included cash (net of cash of the acquired entities) of $162.6 million (inclusive of seller's transaction expenses), 1,973,880 shares of common stock of CPSI ("CPSI Common Stock"), and the assumption by CPSI of stock options that became exercisable for 174,972 shares of CPSI Common Stock. During the three and six months ended June 30, 2016, we incurred approximately $0.5 million and $8.0 million, respectively, of pre-tax acquisition costs in connection with the acquisition of HHI. Acquisition costs are included in general and administrative expenses in our condensed consolidated statements of income.

Table of Contents

(In thousands)	Purchase Price
Cash consideration, net of acquired cash received	$162,611
Fair value of common stock and options issued as consideration	97,017
Total consideration	$259,628

Our acquisition of HHI was treated as a purchase in accordance with Accounting Standards Codification (the "Codification") 805, Business Combinations, of the Financial Accounting Standards Board ("FASB"), which requires allocation of the purchase price to the estimated fair values of assets and liabilities acquired in the transaction. Our allocation of the purchase price was based on management's judgment after evaluating several factors, including a valuation assessment.

The allocation of the purchase price paid for HHI was as follows:

(In thousands)	Purchase Price Allocation
Acquired cash	$5,371
Accounts receivable	5,789
Financing receivables	2,184
Inventories	216
Prepaid expenses	3,228
Property and equipment	1,263
Intangible assets	117,300
Goodwill	168,449
Accounts payable and accrued liabilities	(17,490)
Deferred taxes, net	(4,010)
Contingent consideration	(1,620)
Deferred revenue	(15,681)
Net assets acquired	$264,999

The intangible assets in the table above are being amortized on a straight-line basis over their estimated useful lives. The amortization is included in amortization of acquisition-related intangibles in our condensed consolidated statements of income. Of the goodwill acquired, $23.3 million is expected to be tax deductible.

The fair value measurements of tangible and intangible assets and liabilities were based on significant inputs not observable in the market and thus represent Level 3 measurements within the fair value measurement hierarchy (see Note 13). Level 3 inputs included, among others, discount rates that we estimated would be used by a market participant in valuing these assets and liabilities, projections of revenues and cash flows, client attrition rates and market comparables.

The gross contractual amount of accounts receivable of HHI at the date of acquisition was $9.4 million.

3. REVENUE RECOGNITION

The Company recognizes revenue in accordance with U.S. GAAP, principally those required by the Software topic and Revenue Recognition subtopic of the FASB Codification and those prescribed by the SEC.

The Company's revenue is generated from two sources:

- System Sales and Support - the sale of information systems and the provision of system support services. The sale of information systems includes perpetual software licenses, conversion, installation and training services, hardware and peripherals, "Software as a Service" (or "SaaS") services, and forms and supplies. System support services includes software application support, hardware maintenance, and continuing education.
- TruBridge - the provision of business management services, which includes electronic billing, statement processing, payroll processing, accounts receivable management, contract management and insurance services, as

10

Table of Contents

well as Internet service provider ("ISP") services and consulting and managed IT services (collectively, "other professional IT services").

System Sales and Support

The Company enters into contractual obligations to sell perpetual software licenses, conversion, installation and training services, hardware and software application support and hardware maintenance services. On average, the Company is able to complete a system installation in three to four weeks. The methods employed by the Company to recognize revenue, which are discussed by element below, achieve results materially consistent with the provisions of Accounting Standards Update ("ASU") 2009-13, Multiple-Deliverable Revenue Arrangements, due to the relatively short period during which there are multiple undelivered elements, the relatively small amount of non-software related elements in the system sale arrangements, and the limited number of contracts in-process at the end of each reporting period. The Company recognizes revenue on the elements noted above as follows:

- Perpetual software licenses and conversion, installation and training services – The selling price of perpetual software licenses and conversion, installation and training services is based on management's best estimate of selling price. In determining management's best estimate of selling price, we consider the following: (1) competitor pricing, (2) supply and demand of installation staff, (3) overall economic conditions, and (4) our pricing practices as they relate to discounts. The method of recognizing revenue for the perpetual license of the associated modules included in the arrangement, and the related conversion, installation and training services over the term the services are performed, is on a module by module basis as the related perpetual licenses are delivered and the respective conversion, installation and training for each specific module is completed, as this is representative of the pattern of provision of these services.
- Hardware – We recognize revenue for hardware upon shipment. The selling price of hardware is based on management's best estimate of selling price, which consists of cost plus a targeted margin.
- Software application support and hardware maintenance – We have established vendor-specific objective evidence ("VSOE") of the fair value of our software application support and hardware maintenance services by reference to the price our customers are required to pay for the services when sold separately via renewals. Support and maintenance revenue is recognized on a straight-line basis over the term of the maintenance contract, which is generally three to five years.
- SaaS services - The Company accounts for SaaS arrangements in accordance with the requirements of the Hosting Arrangement section under the Software topic and Revenue Recognition subtopic of the Codification. The Codification states that the software elements of SaaS services should not be accounted for as a hosting arrangement "if the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software." Each SaaS contract entered into by the Company includes a system purchase and buyout clause, and this clause specifies the total amount of the system buyout. In addition, a clause is included in the contract which states that should the system be bought out by the customer, the customer would be required to enter into a general support agreement (for post-contract support services) for the remainder of the original SaaS term. Accordingly, the Company has concluded that SaaS customers do not have the right to take possession of the system without significant penalty (i.e., the purchase price of the system), resulting in the determination that these contracts are service contracts for which revenue is recognized when the services are performed.

TruBridge

TruBridge consists of electronic billing, statement processing, payroll processing, accounts receivable management, contract management and insurance services. While TruBridge arrangements are contracts separate from the system sale and support contracts, these contracts are often executed within a short time frame of each other. The amount of the total arrangement consideration allocated to these services is based on VSOE of fair value by reference to the rate at which our customers renew as well as the rate at which the services are sold to customers when the TruBridge agreement is not executed within a short time frame of the system sale and support contracts. If VSOE of fair value does not exist for these services, we allocate arrangement consideration based on third-party evidence ("TPE") of selling price or, if neither VSOE nor TPE is available, estimated selling price. Because the pricing is transaction based (per unit pricing), customers are billed and revenue recognized as services are performed based on transaction levels. The Company will occasionally provide ISP and other professional IT services. Depending on the nature of the services provided, these services may be considered software elements or non-software elements. The selling price of services

Table of Contents

considered to be software elements is based on VSOE of the fair value of the services by reference to the price our customers are required to pay for the services when sold separately. The selling price of services considered to be non-software elements is based on third-party evidence of selling price of similar services. Revenue from these elements is recognized as the services are performed.

4. PROPERTY AND EQUIPMENT

Property and equipment were comprised of the following at June 30, 2017 and December 31, 2016:

(In thousands)	June 30, 2017	December 31, 2016
Land	$2,848	$ 2,848
Buildings and improvements	9,432	9,432
Maintenance equipment	802	802
Computer equipment	5,639	5,174
Leasehold improvements	5,007	5,007
Office furniture and fixtures	3,591	3,591
Automobiles	335	335
	27,654	27,189
Less: accumulated depreciation	(15,169)	(13,750)
Property and equipment, net	$12,485	$ 13,439

5. OTHER ACCRUED LIABILITIES

Other accrued liabilities were comprised of the following at June 30, 2017 and December 31, 2016:

(In thousands)	June 30, 2017	December 31, 2016
Salaries and benefits	$ 4,098	