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QSII - Q3 2016 Quality Systems Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 revenue of $117.0m and GAAP fully diluted EPS of $0.12.

CORPORATE PARTICIPANTS

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Mike Newshel *JPMorgan - Analyst*

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PRESENTATION

Operator

Welcome to the Quality Systems Incorporated fiscal 2016 third quarter results conference call. Hosting the call today from Quality Systems is Rusty Frantz, President and Chief Executive Officer. Today's call is being recorded. At this time, all participants have been placed in a listen-only mode, and the floor will be opened for your question following the presentation. (Operator Instructions). It is now my pleasure to turn the floor over to Dan Morefield, Chief Operating Officer. Dan.

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

Good afternoon and welcome. Before turning things over to Rusty, I remind everyone that the comments made on this call may include statements that are forward-looking within the meaning of Federal Security laws, including without limitation, statements related to anticipated industry trends, the Company's plans, future performance, products, perspectives, and strategies. Risks and uncertainties exist that may cause results to differ materially from those expressed in these forward-looking statements, including the risks set forth in the Company's public filings with the US Securities and Exchange Commission. Including discussions under the heading Risk Factors in the Company's most recent Annual Report on Form 10-K, and subsequent quarterly reports on Form 10-Q. The Company expressly disclaims any intent or obligations to update these forward-looking statements. These remarks may also contain non-GAAP financial measures. The GAAP financial measure most directly comparable to each non-GAAP financial measure used or discussed, and a reconciliation of the differences between each non-GAAP financial measure and the comparable GAAP financial measure, can be found within our third quarter year 2016 earnings press release in the Investor section of our website. Rusty.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thank you, Dan. Thank you all for being on the call today. I'm excited to share our results and progress with you on my third quarterly call as CEO of Quality Systems. As I've mentioned to many of you over the past several months, we are at the beginning of what we believe will be a very positive and transformational journey for QSI NextGen, a journey that started with the Board's conviction and decision to hire a new CEO approximately six months ago.

Our third quarter results underscore the emphasis we're placing on bottom line discipline. Even as we work diligently to reignite solid top line growth through improved and expanded solutions for our clients. Since joining the Company, I have endeavored to gain a full understanding of our strengths and challenges, while challenging myself and the team to think about how we continue to enhance the experience with our solutions, for our over 90,000 users. In turn, of course we are focused on uplifting the value for investors of our remarkable ambulatory client base, which includes more than 7,000 clients. Specifically, while we understand our core software market is highly penetrated with conventional, EHR and EPM solutions, leading to a macro slowing, and therefore more variability in the timing of conventional system sales, we feel confident that the transformational changes in the healthcare industry, and continued advancements in Information Technology creates significant opportunities for future growth.

Therefore, we're taking very firm and tangible steps that we believe over time will initially provide disciplined earnings growth, followed by faster growth and profitable revenue. Since my arrival, our team has made progress on a number of dimensions. Going forward, we will talk about the business across five areas of strategic focus. Cloud transition. Reducing our client's total cost of ownership, as well as giving them continuous access to new capabilities. Second is focus on the ambulatory market. Delivering a great client experience, investing in new ambulatory capabilities and divesting non-core assets, as exemplified by our sales by our Hospital Solutions Division. Cross-selling, as we move through FY 2017, ensuring that we're selling and delivering the breadth of our solution to clients, through better commercial structure, sales processes, and a compensation plan that incents cross-selling. The fourth is better use of capital. Continued and increased focus on the margin and cost line, to both grow earnings and create dry powder for future investment, both organic and inorganic. Then finally, population health software and services. Developing solutions that enable our clients to thrive in the emerging value-based healthcare economy. We will be working through FY 2017 to build out the capabilities that will drive meaningful revenue growth as we move into FY 2018.

Today I'll mention a few areas of progress across these strategic dimensions. Within cloud transition, I would like to highlight our recent close of the HealthFusion acquisition, our largest to date. This transaction opens a new market for us, the small physician segment, while over time creating a pathway to the cloud for our larger clients. HealthFusion had their best bookings performance to-date in their last quarter prior to close, giving us confidence that they are on track to hit their $43 million revenue target for calendar year 2016. With our focus on the ambulatory market, we have seen meaningful increase in our client satisfaction scores, as measured by our Voice of the Client program. We remain very focused on the client experience, and Dan will share more in this area later on the call.

We're also continuing our drive to make better use of capital. The beginning of our cost reduction program is starting to be reflected marginally in this quarter's result. An example of this program is the closing of our Austin office. We expect this focus on the earnings line to continue and accelerate into FY 2017. However, no strategy is achievable without the necessary personnel and capabilities. We are continuing to build out both our management team and key roles throughout the Company.

To that end, I would like to discuss the hire of our new Chief Technology Officer, David Metcalfe. Prior to joining QSI NextGen, David served as VP of Product Development at CareFusion from 2012 to 2015. CareFusion was acquired in 2105 by Becton, Dickinson, and David continued with BD in a position of increased responsibility through January of 2016. Prior to CareFusion, David served as Vice President of Research & Development at AllScripts from 2008 through 2012, and as Director of Software Development for Hill Rom IT Solutions from 2004 to 2008. Correction. We're excited to bring David on to the team, and feel his contributions will be essential, as we increase both the quality and velocity of our client-focused innovation activities.

We continue to make great progress as we move forwards FY 2017, a year that we call, building a platform for future growth. Our focus during this year will be on creating a nimble, capable organization, structured to efficiently deliver on emerging strategy, as well as continuing to deliver increasing performance on the EPS line, as we build the capabilities that will drive meaningful revenue growth as we move into FY 2018. Now I'll turn it over to John to talk numbers.

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John Stumpf - *Quality Systems, Inc. - Interim CFO*

Thanks Rusty. Hello everyone. I'm pleased to present you QSI's third quarter and year-to-date fiscal 2016 financial performance on today's call. Our revenue for the quarter reflects the disposition of our hospital business unit, prospectively from the mid-October sale date. Previously reporting quarters have not been retrospectively adjusted. Reported revenues for the current quarter were $117.0 million, compared with $123.4 million in the year ago quarter, and $125.4 million for our second quarter of fiscal 2016. On a pro forma basis, excluding the hospital business unit, revenues for the current quarter were $116.4 million, versus $118.4 million for the year ago period, and $122.2 million for our second quarter of fiscal 2016.

The overall down trend in quarterly revenue both on a sequential and year-over-year basis, principally reflects the hospital unit sale, as well as choppiness of ambulatory software license sales, and the impact on related professional service revenues and maintenance. Software revenue for this quarter also reflects the deferment of approximately $1.6 million, associated with a significant customer order, due to accounting requirements related to custom software enhancements. Our Q3 period has also historically reflected the impacts to our professional services revenues, specifically holidays and our annual user group meeting, an event focused on the client experience.

Revenue cycle management and EDI related revenues have continued to present a source of growth, both sequentially and as compared to the year ago period. Our revenue streams continue to be roughly 80% recurring in nature. On a year-to-date basis, total revenues are $364.6 million, up 1% from $361.8 million for the comparable period in fiscal 2015, excluding revenues of our disposed hospital business unit, pro forma year-to-date revenues are $357.1 million versus $348.5 million for the year ago period, and increase of 2.5%. Total contract bookings for the quarter were $52 million, reflecting a sequential decline from the $60 million reported in Q2. This decline is attributable mostly to a drop in RCM contracts signed in the quarter. As we have mentioned on prior earnings calls, our RCM bookings are a significant source of volatility and our quarter-to-quarter bookings metric, due to the varying lengths of such contracts. We believe that given the volatility of our current metric and the growing impact of revenue streams, it would be more beneficial for us to provide the expected value of the current bookings on a 12-month basis, rather than the multi year expected contract value that we have used in the past. The expected value of the current quarter bookings on our new basis of reporting is $36 million, nearly flat with $37 million generated for the second quarter of fiscal 2016, but down from $42 million for the year ago quarter. The decrease from the Q3 2015 book reflects a combination of lower system sales and RCM transactions.

Gross profit for the current quarter is down sequentially and as compared to the prior year, due to the relatively low revenue we posted for Q3. On a year-to-date basis, however, gross profit increase by $3.7 million, or 2% due to the growth in revenues for the 9-month period. Gross margin for the current quarter was 54%, which compares to 55% for Q2, and 56% for the year ago quarter. These margin declines principally reflect the relatively low license sales in the current quarter, and a mix shift towards RCM and EDI revenue. On a year-to-date basis, our gross margin is 54%, flat with the year ago period. SG&A, excluding amortization of intangible assets, decreased 5% from the year ago period, inclusive of a $1.8 million loss on the disposition of the hospital business unit in the current quarter. Excluding the current quarter loss on disposal, SG&A would have increased 9% versus the year ago period, with cost reductions spanning a variety of categories, reflecting our focus on expense control. Though SG&A did grow sequentially, Q2 benefited from favorable timing of costs, as we mentioned in our earnings call last quarter. Total gross R&D investment for the quarter decreased sequentially and from the year ago period, mostly due to the disposition of our hospital business unit and a reduction of third-party consulting costs.

We capitalized $4.9 million in development costs this quarter, representing at 25% capitalization rate. By comparison, our capitalization rate was 15% for both Q2 of this year and Q3 of last year. The current quarter capitalization rate benefited from the timing of project development efforts. Net R&D operating expense decreased to $14.5 million this quarter, or 12% of revenues, reflecting the decrease in gross investment and the relatively high capitalization rate. Our GAAP effective tax rate for the current quarter was 13.5%, compared to 17.9% a year ago, the exceptionally low GAAP tax rate in both periods, reflects the timing of expiration and Congressional reinstatement of the Federal R&D tax credit. Our non-GAAP effective tax rate for the current quarter is 30.5%, as compared to 24% in the year ago period. As previously announced, we commenced utilizing a static non-GAAP tax rate of 30.5% for each of the quarters in the fiscal 2016 period, to provide increased consistency of our inter quarter results, and to better reflect the longer term normalized outlook. For fiscal 2015, we have not yet adopted a static rate, which accounts for the volatility in our quarterly non-GAAP effective tax rate for fiscal 2016.

On a GAAP basis, fully earnings diluted per share for the current quarter was $0.12, as compared to $0.11 per share reported in the year ago quarter. On a non-GAAP basis, fully diluted earnings per share for the quarter was $0.16, flat with the year ago quarter. On a GAAP basis, the reduction in operating expenses mitigated the impact of lower revenues. On a non-GAAP basis, adjusted pre-tax income grew as adjusted operating expenses declined, partially offset by the low non-GAAP tax rate a year ago. On a GAAP basis year-to-date, fully diluted earnings per share was $0.36, as compared to $0.27 for the year ago period. On a non-GAAP basis, year-to-date fully diluted earnings per share was $0.53, as compared to $0.41 last year. On both a GAAP and non-GAAP basis, the increase in year-to-date earnings per share is due to the higher level of revenue, the resulted increase in gross profit, and the reduction in total operating expenses.

With regard to the balance sheet, total liquidity remains strong, with cash and investments totaling $105 million. This balance reflects a sequential decline attributable to our dividend payment. Our turnover receivables was flat sequentially, with both quarters at 72 days. Moving on to revenue trends by business unit. Our ambulatory unit posted $88.7 million this quarter, as compared to $92.1 million a year ago, that's a decrease of $3.4 million, or 4%. Our dental business unit posted $4.7 million in revenue this quarter, as compared to $4.5 million a year ago, an increase of $0.2 million, or 5%. The hospital business unit posted $0.6 million for the partial quarter this quarter, as compared to $5 million for the full quarter a year ago, a decrease of $4.4 million, or 88%. Our RCM business unit posted $23.0 million in revenue this year versus $21.9 million a year ago, an increase of $1.1 million, or 5%. Our consolidated revenue again, $117.0 million versus $123.4 million a year ago, a decrease of $6.4 million, or 5%.

I will now move on to a recap of select non-cash expenses for the quarter as follows. Amortization of capitalized software, $2.5 million, amortization of intangible assets $1.8 million, depreciation expense $2.1 million, stock compensation expense $0.7 million, bad debt expense $1.1 million. Our investing activities for the quarter were as follows. Internally generated capitalized software $4.9 million, and investments in fixed assets $3.9 million. This concludes my review of our financial performance for the quarter. With respect to our outlook for the fourth quarter, I am limiting my comments primarily to qualitative considerations. As of now, we are not prepared to issue formal guidance. We are, however, internally addressing the predictability of key business drivers as a prerequisite for meaningful guidance. We'll provide updates on our progress in this area on our next quarterly earnings call.

Similar to our experience in the first three quarters of the current year, we anticipate continued short-term choppiness in quarterly revenues, in light of our near-term revenue environment, we will continue to monitor and manage our expenses proactively, to help insure we achieve robust bottom line results. Our revenue and earnings of Q4 will reflect the accusation of HealthFusion as of January 4, 2016. I want to thank you all for being on the call, and for your continued interest in our Company. I will now turn things over to Dan Morefield, EVP and COO of Quality Systems.

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

Thank you John. Our annual user group meeting in November was highly successful, as we had thousands attend the 3-day event with over 250 educational sessions. One of the noticeable changes was around our clients positive sentiment on the work we're doing to improve client satisfaction. All of our internal client satisfaction metrics reflect a steady four-quarter increase. The overall voice of the clients satisfaction score increased 15% just in the last quarter. These results can be attributed to increase in quality and usability of our latest KBM release. The ICD-10 upgrade experience, and an overall increase in satisfaction with our client services teams. Our clients are experiencing quicker responses to their inquiries, with materially higher same day resolution to issues and questions. I expect these near-term indicators of client satisfaction will show up later in lagging indicator reports, such as class.

RCM Services had a record quarter, and is on track for another year of double-digit revenue growth. We typically see our collections impacted in our fiscal year fourth quarter impacts due to the reset of patient deductibles and the unpredictable of our winter storms. Our client satisfaction in our Best of Class RCM remains high, as we help our clients successfully navigate this complex payment environment. We continue to be disciplined in the use of our resources. We closed our Austin office while retaining much of the research and development talent. We have reduced our reliance on third-party R&D consultants, as we have enhanced our internal ambulatory development capabilities. Finally we have reduced our professional services team to be better aligned with the current market demand for training and implementation services. Core ambulatory sales benefited from a number of enterprise clients, such as Gateway Foundation and ADCS Clinics LLC. ADCS, also known as Advanced Dermatology and Cosmetic Surgery has been a NextGen EPM client since 2005. ADCS is implementing our EHR patient portal and population health management across their 130-plus practices. Gateway will increase our overall user base by over 600, as they implement our full suite of products, including EDI Services and Hosting. As we enter our third year post the Mirth acquisition, we enjoyed record Mirth bookings in Q3. Wrapping up the call this morning, we had 70 new arrangements on a consolidated basis versus 61 in the prior quarter. 56% of the arrangements were greenfield, and 44% were replacements.

Discounting did not materially change in the quarter. Thank you for your continued interest. Holly, I would like to turn it over to you for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question is coming from Michael Cherny with Evercore ISI.

Michael Cherny - *Evercore ISI - Analyst*

-- get all of the details. So I want to focus --

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

Michael, I think we missed the first part of your question. You can start again?

Michael Cherny - *Evercore ISI - Analyst*

No, no, I just wanted to send my greetings. First I guess the positive question, then I will ask one of the more challenging questions. Clearly, a lot of operating expense leverage over the course of the quarter. If you think about where the cuts came, both on the SG&A line and R&D line. How much of that do you think was tied to essentially the pre-cuts related to bring on HealthFusion? As you think about the leverage of next year, obviously not providing guidance, much more conceptually, are those two areas where there is more room for optimization as you combine the two businesses? Is SG&A an area you'll need to reinvest as you go out to the small physician market? Trying to get a sense directionally how we should see that progressing?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Yes, Michael, I would say while some of it was certainly tied to HealthFusion, our view on HealthFusion is that it provides a great complementary value for the organization, and actually see that more as we move forward as an area where we'll invest, but we'll invest prudently based on growing, and looking into 2018 and how do we really truly grow the revenue footprint of that organization, or FY 2018, excuse me. I think as you look forward, I think to a large extent we as an organization have been built through acquisition over the years, and as I've discussed, we're really renewing and pivoting a little bit our strategic focus. Part of what the job will be as we really truly bring that strategy to life, is building an organizational structure that is optimized to achieve that strategy. As we take this organization that to some degree has been built through acquisition, and turn it into a very tight structure focused on achieving the strategy, we feel that there will be costs falling out of that transition. Does that help?

Michael Cherny - *Evercore ISI - Analyst*

Yes, it does, Rusty. And then if you think about, this is the challenging question, I promised both. If you think about the moving pieces of the P&L and rank order them by line item, as you see the business as it stands right now, where are the ones on a revenue basis, where you have the most degree of confidence, versus the ones where you'll see over time the most volatility?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I think as we said in our comments, especially in the larger part of the market, it's really transitioning to a replacement market, which means new system sales and new placements are by nature volatile at this point in time, and I think the last couple of quarters have shown that I expect that to continue. That being said, as we've talked about, we're an 80% recurring revenue company, so that base we feel is solid today, and will become increasingly solid, as we continue to expand our efforts on the voice of the client. And so I would say that, and from a positive trajectory standpoint, as I said, HealthFusion had their best bookings quarter in their history, and we feel confident that they're well set up to deliver on the growth number that gets them up to the $43 million in next year.

Michael Cherny - *Evercore ISI - Analyst*

Thanks Rusty. I'll let some other guys hop in.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Great. Thanks, Michael.

Operator

Your next question will come from the line of Mike Newshel with JPMorgan.

Mike Newshel - *JPMorgan - Analyst*

Good evening everybody. Now that you've named a new CTO, how long do you think that it will take to get him in there, and be able to evaluate the NextGen now development and determine if there's a potential to accelerate the launch timeline there?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Yes. So let me answer that in a couple of different ways. First of all, the new CTO will be starting on Monday, so not very long from now, but naturally it will take him some time to come up to speed. He does have experience in the HR EPM market from his four years at Allscripts, and so I expect him to get through the evaluation of where we are on the NextGen Now program quickly, but just to refresh your understanding. As we look forward, we are looking at what capabilities from the platform development that made up NG Now can we leverage as we move into population health software, whereas more on the EHR EPM side, we're really looking at, how do we expand our development efforts in both HealthFusion and our NextGen ambulatory platform, to be able to over time bring those together into a good solid EHR EPM platform, that scales all of the way from enterprise customers all of the way down to small clients. Is that helpful?

Mike Newshel - *JPMorgan - Analyst*

Yes, very much, thank you. How about is there any update on the timing for the CFO search as well?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I continue to be very aggressively moving forward on that search, but naturally, given the materiality of the nature of the hire, it's something that I really won't discuss until the day that I announce.

Mike Newshel - *JPMorgan - Analyst*

Great, thank you.

Operator

Our next question will come from the line of Sean Dodge with Jefferies.

Sean Dodge - *Jefferies LLC - Analyst*

Hi, good afternoon, thanks for taking the questions. This may be a little bit of a spin on what Michael had asked earlier, but back before the HealthFusion acquisition and the dividend cut you guys talked about, net R&D spend at around 15% of revenue, with all of the projects you've got going on now, has that view changed at all? I guess what I'm asking, is R&D going to be one of the primary buckets where you're planning to redeploy some of the capital from the dividend cut?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I would say that, first of all, I feel like 15% is probably an appropriate number until we make sure we have the return on the invested capital on that 15% to make an effective deployment. So if we show that we can spend 15% of our R&D dollars and generate great value for the clients which generates value for the investors, then perhaps we're look at that as a source of increasing leverage as we go forward, but today we're committed to that 15% number and less maybe transitionally as we continue to build out the strategy.

I would say that the dividend cut is much more focused on two things. Number one, on make sure that we are reinvesting money and driving client value, but most notably in building dry powder on the balance sheet, to let us be able to leverage inorganic opportunities for the client base, as well as the organic opportunities that 15% is driving.

Sean Dodge - *Jefferies LLC - Analyst*

Okay, thank you. John had mentioned the quarter was a little bit weak in terms of RCM bookings, realizing we're only about a quarter beyond the ICD-10 transition. Is it still the view or the hope that market is really going to begin to open up here over the next few quarters, and we'll see demand for RCM start to fly?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Let me answer that. As I said earlier, we still think that RCM is a growth opportunity for us, we still, as I mentioned in my prepared notes that we'll have a double-digit growth in revenue this year, and while we're continuing to study the market, and don't have a specific answer to your question, it is still an area where we believe there is a growth opportunity, and one that we will continue to focus on.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Let me just carry that a little bit further. I think classically the bread and butter of this organization has been in software sales. The RCM sale is a different, somewhat more complex sale than software sales, and so as I stated in my opening remarks, focusing not just on cross-selling as something we need to do, but cross-selling as something that we have both enabled, and incented and are expecting throughout the organization. I think those are affirmative steps that you'll see us making as we move into FY 2017, and as we move through FY 2017 I would expect to see those results start to show up on the revenue line.

Sean Dodge - *Jefferies LLC - Analyst*

Understood. Thanks again.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thank you.

Operator

Our next question will come from the line of Greg Bolan with Avondale Partners.

Greg Bolan - *Avondale Partners - Analyst*

Hi, good afternoon. Rusty, can you go back, or Dan, can you go back and explain again this new contract value that you're looking to initiate I guess in replacement of the revenue cycle bookings metric?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

No, let me just touch on this really quick, then I'll pass is over to John.

Greg Bolan - *Avondale Partners - Analyst*

Okay.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

One of my intents is always to make sure, to continue to migrate to providing numbers that are helping our investors truly understand what's going on. So when we have numbers that are maybe a mix and not as actionable as they could be, we're looking to provide an apples to apples, as well as a new set of oranges to help you better understand the business. So John, I'll turn that over to you.

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Yes, let me clarify. The old booking statistic and the new booking statistic still include all revenue sources. The only difference is the new statistic is measuring the predicted economic value over a 12-month period, as opposed to counting the multi year tail that some of our RCM contracts have. It's that multi year tail in the old method that created the excessive volatility in the quarter-to-quarter numbers. The new method as you've seen is creating less volatility, and seems to be more representative of what you can expect in near-term results.

Greg Bolan - *Avondale Partners - Analyst*

Okay, okay, I got it. Thanks, guys, that's very helpful. Last question, I think Dan you had mentioned record Mirth bookings. Can we just maybe delve into Mirth a little bit? It just seems like this is really the bridge, the HIE highway that's going to enable NextGen to really kind of connect to those evolving health systems, and potentially keep your seat at the table, as well as maybe even displacing others at the table, as some of these physician practices grow in these health systems. Is that kind of what you're seeing play out? Does Mirth come up as the vehicle by which you are maybe you are speeding past some of your other competitors, and displacing some of the maybe even the integrated acute ambulatory vendors, but probably more so my question would be related to the kind of sole ambulatory players that are out there?

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

The Mirth product line, both currently and the future, has a number of critical values to us. First of all, in just the HIE space, there's no question that Mirth is one of the best HIE products on the market, and we continue to see our ability to displace other HIE vendors in the replacement HIE market, so that's sort of a standalone piece. Then the whole issue of inter-connectivity and interoperability being the future of overall healthcare HIT healthcare becomes an important part and Mirth is playing a central role in that. It plays a central role in NextGen share, and our ability to connect not only among all of our NextGen users, but with significantly other networks as well, to be able to begin to bridge this gap away from specific vendor networks. The third piece that Mirth really provides to us is we have a number of critical components, including the HIE and Mirth Care, that are critical for our future population health management offerings. So it's a combination of specific products, products that I have met, NextGen ambulatory products and that experience, as well as products and services that are a critical part of the future of population health management.

Greg Bolan - *Avondale Partners - Analyst*

Okay, that's helpful. Just a real quick follow-up. Would you say that your physician hospital organization footprint has improved since the acquisition of Mirth, and do you feel like that that's been a big driver of that, if it has improved?

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

I believe that our position within the large hospital footprint is better today with Mirth than it would have been without Mirth. The very specific details and metrics I don't have off of the top of my head.

Greg Bolan - *Avondale Partners - Analyst*

That's great, thanks.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

What I would say is that I think Mirth is a key part of our go forward strategy. That interoperability and that ability to deliver the longitudinal view of the patient, is the foundation of a future strategy of delivering the applications and analytics, that help our clients truly managed a covered life and end.

Greg Bolan - *Avondale Partners - Analyst*

Thanks, guys.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Yes.

Operator

Your next question will come from the line of Sean Wieland with Piper Jaffray.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

Thank you very much. What kind of interest have you gotten among your NextGen base to migrate over, or begin thinking about migrating over to HealthFusion?

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

Thanks John, appreciate the question. Interesting enough, we've had a number of inquiries across various different sizes, scopes and specialties, but at this point it's really with the exception of a couple of very specialized cases, early. So the answer to your question is, we've gotten inquiries, and people are considering different components, but it's very, very different based upon the unique needs of the specific client that we have, and not in any way a general trend.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Yes, Sean, let me just add a little more color to that. We're three weeks in now, into the deal, our CTO joins on Monday next week. Fielding those questions to a large degree is a function of the road map of capabilities as we expand the capabilities of HealthFusion, as we move through this calendar year and next calendar year. So I would expect us as we certainly as we get towards our June Analyst Day, to have a much crisper road map and a much crisper answer to how do we look at our client base, and how do we see that client base footprint evolving between NextGen ambulatory and HealthFusion as we move through the next two years.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

All right. You talked about some pro forma numbers excluding the hospital divisions. Can you talk about a pro forma bookings number including HealthFusion? Basically, what was HealthFusion's bookings?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

This is John. We didn't own them in the quarter, so I don't want for go over what their bookings were for the quarter ended December. As Rusty pointed out, their bookings and revenue are highly correlated since their month-to-month SaaS arrangement, and he's indicated that we believe they'll be on track to hit their $43 million next year in revenue, and that would equate to a bookings number for them for next year.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

Okay. If I can slide a couple more in here. Your new bookings expected value, could you fill in some of the blank spots in my model on what that was on a historical basis, or provide that offline?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

I understand. I've got a few data points for you. As a cited the number for Q3 of fiscal 2015 was $42 million, Q4 of fiscal 2015 was $45 million, Q1 of fiscal 2016, $29 million, that actually corresponds as you will all recall, was a weaker quarter for us. Q2 rebounded to $37 million, and Q3 is $36 million.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

Oh, I think I got those wrong. Hang on a second. Sorry. I think we're all catching this. So what was Q3 of 2015?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

$42 million.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

$42 million, I got those backwards, okay. Are you running maintenance through that?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Yes.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

So you're running everything through that?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Yes.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

Okay. Were you running maintenance through your old bookings number?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Yes.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

Okay. One last one, if I could. You mentioned in the release about we are restructuring the sales organization, and I didn't really hear many comments around that. Could you give us some detail around the sales force reorganization?

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

I guess I'll talk qualitatively. As we move into our placement market from a greenfield market, especially at the larger end of the client size, I think it's important to change our approach to be much more client focused on a consistent basis, and constantly looking at how is their strategy evolving, how do we make sure they're having a great experience, and then also how do we position the right evolutions with our system at the right time. It's really starting to migrate to more of a higher touch sales effort at the larger, while still hunting in the middle tier of the market, and still selling from the inside and the small side of the market. With that different structure, as well, folks will be much more accountable to carrying the entire solution, not simply the software piece or the RCM piece, so it creates a more consistent and intimate relationship with our clients, at what I believe will be an overall favorable cost structure.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

All right. Did you layoff reps?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

We have not.

Sean Wieland - *Piper Jaffray & Co. - Analyst*

Okay. Thank you very much.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thank you.

Operator

Your next question will come from the line of David Larsen with Leerink.

David Larsen - *Leerink Partners - Analyst*

I think you mentioned that HealthFusion had their best bookings quarter ever. You can give a little bit more color around that, like any sense on who they're winning shares from? Is it from the EMR practice management solutions for physician practices, any sense for the size of those practices, are there other products that HealthFusion has that are selling well? Thanks.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I think it mostly comes from their core offering, It's actually interesting that it spans clients of a number of sizes. We don't want to get too deep into it because as John stated, a lot of this is from a company we acquired, and quite frankly before we talk too much about it, we need to validate and verify the numbers, and make sure that they meet our standard as a private company gets acquire into a public company. But what I would say is, they saw more larger sized deals for them than they have in the past. Some running up into to the multi-hundred thousand dollar level. What we're seeing is we are seeing them continue to leverage having a great user experience, a great touch enabled product that is very much setup for that part of the market, and continuing to sell against some solutions that are giveaways. And yet, still generate great progress. Their consistent performance exemplified by having their largest bookings quarter. It's not necessarily that this was an outlier. It just shows steady and consistent performance as they continue to grow. We are very gratified to see that. It gives us great confidence in both their ability to hit our numbers now, as well as it gives us great confidence once again in validating the user acceptance of their solution.

David Larsen - *Leerink Partners - Analyst*

Okay. Then with Mirth, do you now have sort of the financial piece of population health management sort of terms built into Mirth, so if a group wants to accept the risk from a plan, can Mirth help them manage through that, and look at the budget for all of the lives, and reconcile all of the claims in the budget? Is that something that Mirth can do now, or is that something you're going to create or implement with Mirth?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I talked about this a little bit in some remarks that JPMorgan conference, and what I said was we right now have established some very strong development partnerships with some large physician-led ACOs that are today engaged in shared risk contracts, and we are bringing that data together and helping them to build out the analytics necessary, to make sure that they're not just finding out how they did at the end of the year, but are able to actually control those results as we move through. What I would say is, it is early days in that part of the market.

We have a number of population health capabilities, including our emerging outreach capability that are helping clients today, but as we step back and really understand the solutions that are going to win during this migration the value-based reimbursement, we're really stepping back and taking a look at where our clients are, building those data platforms, then working with them tightly to understand the capabilities necessary to truly drive value for them, and revenue for us as we move into FY 2018.

David Larsen - *Leerink Partners - Analyst*

Sounds great, Rusty, thank you.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thank you.

Operator

Your next question will come from the line of Donald Hooker with KeyBanc.

Donald Hooker - *KeyBanc Capital Markets - Analyst*

Good afternoon. Thanks for taking a couple of questions. So just with the hospital business coming out and HealthFusion coming in, I just want to make sure that I get some of the dynamics between some of the line items if you don't mind. The software subscription services, it looks like it's kind of down sequentially. It surprised me a little bit. Can you elaborate on, I assume a lot of that is Mirth, so can you elaborate on some of the trends in the revenue line, the subscription services?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Yes, this is John. That subscription line includes a number of things. A good amount of Mirth is in that line, our hosting, our dental PBW product, patient portal product, and the majority of that decline was the disposition of our hospital business unit in the current quarter, as many of the lines were in our P&L from Q2 to Q3. Largely impacted by the hospital business unit. We've also in the past couple of quarters had some significant customers on a cash basis revenue recognition, and we have less of that this time.

Donald Hooker - *KeyBanc Capital Markets - Analyst*

Got you. That makes sense. I didn't think of that being in that line, I apologize. That's probably true for the support and maintenance as well?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Yes, most of the drop was hospital again.

Donald Hooker - *KeyBanc Capital Markets - Analyst*

Yes, yes, got you, got you. And then I guess maybe one last question, then I'll jump off. In terms of over time, you talk about I guess ultimately migrating sort of legacy NextGen users, to I Division is to a HealthFusion-like cloud platform. What is the revenue generation from you for that service, that migration? Do you sell them, is there an extra service fee associated with that, or do you get revenue as they migrate potentially over time? I guess this would be a longer term question, but how should I think about that?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I would think about it as a longer term question. Certainly, right now we're simply focused on the blocking and tackling of integration, then starting to have conversations with the HealthFusion team about how we can intelligently augment their R&D capabilities, but that's certainly something that we will be working through and addressing as we move through this year.

Donald Hooker - *KeyBanc Capital Markets - Analyst*

Okay, that's fair. Thank you.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thank you.

Operator

Your next question comes from the like of George Hill with Deutsche Bank.

George Hill - *Deutsche Bank - Analyst*

Hey, good afternoon and thanks for taking the question. Don stole my question about maintenance revenue. Can you talk about what would have happened to the maintenance revenue, X the hospital business? Would that have been up or down sequentially this quarter?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

This is John. Excluding hospital, it still would have been down in the sense that our new system sales, which have been lower this year than last year, have added less maintenance revenue to the pool than we've seen in the past, so it still would have been down. Also in a given quarter, we do have sales return adjustments and credit and other accounting adjustments that can go up and down. This quarter happened to be net down and that put pressure on the number as well.

George Hill - *Deutsche Bank - Analyst*

What drives a negative sales adjustment in the maintenances line, other than client churn?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Right. Negative accounting adjustment or negative directional movement?

George Hill - *Deutsche Bank - Analyst*

A negative churn would obviously be a negative directional movement. What would drive a negative accounting adjustment?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

If sales return reserves that are applied to different levels, different line items in the P&L, they're a function of the concept of sales return reserves, you think it pertains only to sales less revenue line item, it does not. They can affect all of our revenue line items. In sales credit, sometimes maintenance as you would imagine can be currency, related to addressing a matter of client satisfaction because it's convenient to use that. Sometimes like a month of free maintenance let's say, to address a concern pertaining implementation from six months ago, so in the sense it could be used as a form of currency. It can go up or down in a given quarter, depending upon the extent to which you're resolving client matters, and part of the thing when we've reduced our DSO, is to unlock maybe cash balances that had been held up in the past, we may end up resolving an old item with regard to client satisfaction through the maintenance line item, that's an example.

George Hill - *Deutsche Bank - Analyst*

Okay. Just lastly. On the new bookings metric, so we know that there's a combination of kind of software services and maintenance services that are rolled up into that number. Want to ask if we look at the numbers for the five quarters that you gave us, Has that mix historically been stagnant, or has it normally been fixed, or does the software component to maintenance component bounce around a lot, and if that's the case, will you provide any more color on that?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

We are not going to disaggregate it. And the software bounces around just like it does in the space of our P&L, and there's much I can do about that part.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I think, George, we're kind of at the lowest level that we plan to provide there. You see the volatility in the top line with the choppy top line revenue, and that choppy top line revenue also shows up in that bookings number.

George Hill - *Deutsche Bank - Analyst*

All right, thanks guys, I appreciate the color.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thanks, George.

Operator

Your next question will come from the line of Garen Sarafian with Citi Research.

Garen Sarafian - *Citi Research - Analyst*

Good afternoon guys, thanks for take the questions. Just a couple of clarification questions actually. You touched on NextGen in terms of still having meetings to figure out where you guys are going with HealthFusion, but has there been any decision as to portions of the NextGen components that you've invested in no longer being required, or is it able to be re-purposed? What do you do with those portions? Can you sell that to a willing buyer, or if you can clarify that, if any decisions have been made?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

I think as we've said in prior calls, we're evaluating the applicability of the work done on NG Now to future strategies. The hiring of the CTO is a material event in that evaluation, so once the CTO comes onboard, I expect that one of the first roles of the CTO is to understand the applicability of that software to future strategy and based on that, will make decisions in coordination with our auditors.

Garen Sarafian - *Citi Research - Analyst*

Fair enough. Just a follow-up. John and Rusty, you touched on, I want to clarify. You mentioned some commentary about more formal guidance. Are you contemplating on issuing formal guidance, or just what metrics you'll provide? If you could just clarify to how you're thinking through it?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

So certainly from my standpoint, my preference is to provide guidance to our investors. However, I will only provide guidance when I feel I'm providing a number that our investors can make decisions based on and that has credibility. To that end, as John stated, we're now to really looking to get our hands on those input levers, and as I bring in a new CFO, my expectation is that when the CFO says I am ready, we will be providing guidance.

Garen Sarafian - *Citi Research - Analyst*

Okay. Fair enough. Thank you.

Operator

Your next question will come from the line of Gene Mannheimer with Topeka Capital.

Gene Mannheimer - *Topeka Capital - Analyst*

Thanks, good afternoon. What else can you tell us about HealthFusion? I realize It's a SaaS model. How does that revenue stack up with your traditional NextGen line items, say across EDI and services, and then how should we view the organic growth of HealthFusion?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

This is John, almost all of their revenues are subscription, and that would flow into our revenue line item on our P&L where Mirth flows, and I mentioned earlier on the call that's the subscriptions row, and the little bit that they have that is EDI would flow into our EDI line item. They don't have software sales, they don't have maintenance, they don't have RCM currently, so they wouldn't show up in any of those line items.

Gene Mannheimer - *Topeka Capital - Analyst*

And how do we look at the organic growth of HealthFusion?

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Yes, I guess I'm going to wind back to what we said at the announcement, which is HealthFusion is generating meaningful double-digit revenue growth. We acquired them, we said it was a number north of $30 million. Our expectation is that they are going to hit $43 million, or in the neighborhood of that this year, and by the neighborhood, my hope is the neighborhood above it. I think you can extrapolate from there that a number in there somewhere north of $30 million turns into $43 million, but we really haven't talked beyond that from a standpoint of growth percentages. I will add the fact that they do deliver meaningful SaaS-based EBITDA, and that we absolutely expect HealthFusion to represent an accretive add of $0.11 to $0.13 of EPS as we move into FY 2017.

Gene Mannheimer - *Topeka Capital - Analyst*

Perfect, thank you.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

Thank you.

Operator

Your next question will come from the line of Zack Sopcak with Morgan Stanley.

Zack Sopcak - *Morgan Stanley - Analyst*

Thank you for the question. Piggybacking on your last comment. Is there any accretion expected in the fourth fiscal quarter of FY 2016, or should we think about the $0.11 to $0.13 for next year?

John Stumpf - *Quality Systems, Inc. - Interim CFO*

This is John. We're not giving any guidance for our fourth quarter, and the only guidance we've given with regard to HealthFusion is our fiscal 2017 year, which starts in April.

Rusty Frantz - *Quality Systems, Inc. - President, CEO*

What I would say is, is that you can assume they're a growing business, and that we have a full quarter of contribution in Q4.

Zack Sopcak - *Morgan Stanley - Analyst*

That's helpful, thanks. Can I just ask, on the RCM revenue line, the year-over-year growth, so in the first half of your fiscal year, close to 20% growth in the third quarter, mid single digits. Is hospital related to that change in growth at all? I know you reiterated 10%, or at least double digits for the first year?

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

We had very little if any impact from the hospital sale on the RCM line item, so I don't think those two are related.

John Stumpf - *Quality Systems, Inc. - Interim CFO*

Correct.

Zack Sopcak - *Morgan Stanley - Analyst*

Okay, great. Thank you.

Dan Morefield - *Quality Systems, Inc. - EVP, COO*

Thank you.

Operator

This will concluded the allotted time today. If you'd like to listen to a replay of today's conference, please dial 1-800-585-8367, and refer to conference ID 29627511. A webcast archive of this call can also be found at www.QSII.com. Please disconnect your lines at this time, and have a wonderful day.
