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QSII - Q3 2015 Quality Systems Inc Earnings Call

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OVERVIEW:

QSII reported 3Q15 consolidated revenue of $123.4m, net income of $6.7m and GAAP fully diluted EPS of $0.11.

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PRESENTATION

Operator

Welcome to Quality Systems, Inc. fiscal 2015 third-quarter results conference call. Hosting the call today from Quality Systems is Steven T. Plochocki, President and Chief Executive Officer. Today's call is being recorded. (Operator Instructions).

It is now my pleasure to turn the floor over to Steven T. Plochocki, President and Chief Executive Officer. You may begin.

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

Thank you, Christie, and welcome, everyone, to Quality Systems' fiscal 2015 third-quarter results call. With me this morning are Paul Holt, our CFO; Dan Morefield, our Chief Operating Officer; Monte Sandler, our Executive Vice President of RCM Services; and Gary Voydanoff, our Executive Vice President of Sales and Marketing.

Please note that the comments made on this call may include statements that are forward-looking within the meeting of securities laws, including, without limitation, statements related to anticipated industry trends; the Company's plans, products, perspective, and strategies, preliminary and projected; and capital equity initiatives to the implementation of potential impacts of legal, regulatory, or accounting principles.

I'll provide some opening comments and then turn it over to the team. Revenues for the fiscal 2015 third quarter reached $123.4 million, an increase of 13% when compared with $108.9 million reported for fiscal 2014 third quarter. Net income for the 2015 third quarter was $6.7 million, up 153% versus a net loss of $12.6 million in the 2014 third quarter when the Company recorded an impairment charge in its hospital divisions.

On a GAAP basis, fully diluted earnings per share was $0.11 in the fiscal 2015 third quarter, with fully diluted loss per share of 21% (sic - see press release, "$0.21") for the comparable period a year ago. On a non-GAAP basis, fully diluted earnings per share for fiscal 2015 third quarter was $0.16, an increase of 45% from the $0.11 reported in the fiscal 2014 third quarter.

At quarter-end, the Company's liquidity position was strong, with $124.8 million of cash and investments, and no debt.

During the quarter we saw improvements across all fronts within the organization. The significant progress we're making is having a cumulative effect which is creating a positive momentum in all our business lines. We continue to realize results from the initiatives we put in place over the past year, including the restructuring of our functional organizations, the cross-selling of our products and services, and the release of new solutions that cater to the evolving healthcare marketplace.

Revenue cycle management, population health, and interoperability are all among the key areas that are impacting the Company's sales and marketing efforts, in terms of both net new deals as well as cross-selling into the growing client base.

All these strengthen our position as we head into our fourth quarter. Quality Systems also announced that its Board of Directors declared a quarterly cash dividend of $0.175 per share on the Company's outstanding shares of common stock payable to the shareholders of record as of March 13, 2015, with an anticipated distribution date of April 3, 2015.

The $0.175 per share cash dividend is pursuant to the Company's current practice to pay a regular quarterly dividend on the Company's outstanding shares of common stock, subject to Board review and approval, and the (technical difficulty) record of distribution dates by the Board prior to the declaration and payment of such quarterly dividend.

We are very positive with the progress we have taken and that we're making at this present time. I think you'll hear from the fellows that each one of our respective areas is conducting itself in a very diligent manner. And we believe we're reaching a pivot point now where we can speak very positively about gains and growth in all our respective areas.

I'll now turn it over to Paul, who will take a deeper dive into the financials, and then on to the rest of the team. Paul?

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Thanks, Steve, and hello, everyone. Our consolidated third-quarter revenue of $123.4 million reflects a growth of 13% over prior year's $108.9 million, and 2% over last quarter's $120.5 million. This is our second consecutive quarter of record consolidated revenue.

The principal driver of our revenue increases, both on a year-over-year basis and sequentially, came primarily from recurring subscription and services revenue. This category as a whole grew 15% to $103.4 million from $89.7 million in the year-ago period. The largest contributors within this total were EDI, maintenance, revenue cycle management, SaaS, and other subscription-based revenue streams.

Subscription and SaaS-related revenue, which is included in other revenue, grew 59% on a year-over-year basis to $8.4 million compared to $5.2 million a year ago. Our growth in this category was largely related to growth in Mirth interoperability solutions, as well as continued growth in our Patient Portal user base. Our total bookings this quarter were $67.2 million. That's versus $66.5 million last quarter and $65 million a year ago.

Overall gross profit in terms of dollars grew $5.3 million compared to last quarter, and was up $11.2 million compared to our year-ago period. This is excluding the impact of our hospital-related impairment in the year-ago period. Our gross profit margin this quarter came in at 56% versus 53%, both last year as well as last quarter, exclusive again of the hospital impairment last year.

The increase that we achieved versus the year-ago period reflects both a slight change in revenue mix away from lower-margin implementation and training, as well as hardware, as well as higher margins achieved in our software, RCM, and subscription revenue categories.

Moving down to SG&A, SG&A expense declined to $42.4 million compared to last year's $44 million. However, if you exclude the impact of the impairment last year, our SG&A increased by $4.2 million compared to $38.2 million in the year-ago period. This increase was primarily related to employee-related expenses as well as a higher level of bad debt expense, as well as a higher level of legal expenses principally related to pre-existing shareholder litigation matters.

Our R&D operating expense increased to $18.5 million versus $13.2 million a year ago, reflecting both a higher level of investment as well as a smaller percentage of our expenses being capitalized. Our net R&D expense as a percentage of total revenue was 15% versus 12% a year ago. Total gross R&D investment for the quarter increased to $21.6 million versus $16.8 million a year ago.

We capitalized approximately $3.2 million in development costs this quarter versus $3.6 million a year ago. Declining capitalized software cost was driven by several factors, including the timing of projects reaching technological feasibility, and the cessation of capitalization in the hospital business due to the impairment that we charged last year.

The increase in our R&D expenditures reflects our continued commitment to our customers and our product offerings, both new and existing. Our ongoing commitment to continued investment in R&D will continue, as we see significant opportunities around the population health management and interoperability realms. In light of this, we expect the net cost of R&D as a percentage of revenues to maintain at these levels, or possibly exceed these levels slightly in future periods.

Our effective tax rate for the December quarter was 17.9% compared to 34.4% a year ago. The decline in our effective tax rate was primarily due to the December extension of the R&D tax credit, which expired on December 31, 2013, but was reenacted this quarter through the end of the calendar 2014.

On a GAAP basis, our fully diluted earnings per share for fiscal 2015 was $0.11, an increase from the loss of $0.21 per share reported a year ago. On a non-GAAP basis, our fully diluted earnings per share was $0.16 compared to $0.11 in the year-ago period. Our year-over-year increase in GAAP earnings was primarily driven by increased revenue and margins, as well as the impact of the hospital impairment in the year-ago quarter. On a sequential basis, both our GAAP and non-GAAP earnings improved by $0.03. Higher revenue and gross profit more than compensated for the increases in SG&A and R&D costs.

We are continuing to make incremental progress in the pace of cash collections and growing our cash balances. Our turnover of receivables was 78 days this quarter versus 106 days a year ago. And our cash and cash equivalents, plus marketable securities, ended the quarter at $124.8 million -- that's up $1.3 million from $123.5 million at the start of our quarter.

And moving on to our segment-based revenue. Ambulatory business unit, $92 million; hospital, $5 million; dental, $4.5 million; and RCM, $21.9 million. And, once again, I'll provide our non-cash expenses for the quarter for those of you who are tracking our cash flows. Total amortization of capitalized software, $3.2 million; amortization of intangible assets, $1.8 million; total depreciation expense, $2.4 million; and stock comp expense, $1.0 million. Our investing activities: capitalized software, $3.2 million; fixed assets, $0.9 million.

I want to thank you all for being on this call and your interest in our Company.

I will now turn things over to Dan Morefield.

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

Thanks, Paul, and welcome, everybody. As Paul indicated, our ambulatory revenue of $92 million is up over 10% compared to this quarter last year. This increase continues to be driven by increases in maintenance, EDI subscriptions, and hosting. Professional services revenue was down compared to this quarter -- to the prior quarter. During the quarter, there was less demand for those services, in part due to our annual user group meeting and the major holidays throughout November and December. However, total system sales, less implementation revenue, was up sequentially quarter-over-quarter.

Gary Voydanoff will offer highlights of the system sales performance later on this quarter, which will include Gila River Health Center, Reno Sparks Tribal Health Center, and the expansion of our relationship with the Joslin Clinic, among other things.

During the quarter, we also announced more example of our work toward better interoperability. One of those is the collaboration efforts with InterSystems to connect Missouri's statewide health information exchange with existing NextGen clients. Among other things, this will enable the aggregation of patient data in real-time. Gary will also talk about another example of material interoperability when he discusses our partnership with Merge Healthcare.

As we move closer to implementing ICD-10 changeover, we continue to take steps to ensure our clients will be confident in our ability to support them. The recent CMS end-to-end testing that was performed by our ViaTrack group for seven Medicare payers in the EHNAC accreditation was announced this week are both example of those efforts. As we move toward the October deadline, we will continue to offer services and solutions that will enable our clients to be prepared for this changeover.

Mirth performance continues to exceed expectations. I will defer to Gary to review some of the quarter's more notable sales achievements.

Moving on to hospital solutions. Hospital solutions had moderate sequential revenue growth for the first time in the past several quarters, coming in at close to $1 million higher than the last quarter. Increases in cash collections, as well as additional sales of our emergency department module, more than offset declines in implementation revenues associated with seasonality in the holidays.

Operating losses also continued to decline as part of the ongoing strategy to aggressively manage overall G&A expenses while still supporting our existing inpatient installed base.

On the dental side, I will -- I continue to be pleased with the Park Dental and Pacific Dental implementations. We see continued interest from other large dental clients looking to move to our SaaS dental product, QSIDental Web.

With that, I will turn the call over to Monte Sandler.

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Thanks, Dan. Good morning, everyone. We had a great third quarter in RCM services, giving me a lot of very exciting things to speak about today. First, in November, KLAS released its first report on ambulatory RCM Services, titled, Uncovering Truths When Services Are Outsourced. The report ranks the best-performing healthcare IT vendors providing outsourced billing and revenue cycle management on their performance.

I'm extremely proud and humbled to tell you that NextGen RCM services was ranked first in overall satisfaction with RCM services. In addition, we were ranked the top performer as a trusted business partner, with 100% of respondents affirming the value we bring to these relationships. I'm particularly pleased that 100% of NextGen respondents view us as a trusted business partner based on our transparency, consistent delivery, and willingness to fix mistakes.

We were also ranked as a top performer in effectiveness of claim processing, a top performer in making our customers' organization more efficient, top performer in patient-facing support performance, and top performer in sustainability of our pricing model. It's these results and relationships with our customers that give me confidence that we are well positioned to support our growing customer base in the transformation from transactional fee-for-service reimbursement to fee-for-value reimbursement and risk contracting.

RCM services revenue for the third quarter was $21.9 million, resulting in an 18% increase over last quarter, and a 26% increase over the prior-year quarter. This represents a record quarter for the division and validates all the good things I've reported over the past few quarters, including the implementation of our Tenet relationship that was announced last quarter, as well as several other similarly large new relationships.

We had a strong quarter of bookings, including two large, multi-year customer renewals. And our RCM pipeline continues to grow, led by several large and creative deals that are very exciting for the future of RCM services, as a result of our continued investment in the marketing of our RCM services, both to our existing ambulatory customer base and the market at large.

I remain optimistic about the direction of the RCM business, and continue to feel confident that our tailored RCM services, driven by people, process, and technology, make us a great solution to help our customers successfully navigate the complex and ever-changing healthcare environment.

Thank you for your time and interest in the Company.

I will now turn it over to Gary.

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Thanks, Monte. Good morning, everyone. Shortened by the holiday season and impacted by the time spent preparing for and attending our annual user group meeting, Q3 can typically be a difficult quarter. However, despite these factors, we had a very successful quarter on all fronts.

In November, we held our annual user group meeting in Las Vegas, with over 4,300 attendees. During the opening general session, we unveiled several new solutions that will enhance and extend the usability and flexibility of our EHR platform. Those solutions included NextGen Care, a comprehensive and coordinated population health management solution that supports value-based care by providing clients with a data-driven approach to patient population health and proactively manages and improves both care and outcomes while encouraging disease management and prevention.

The NextGen EHR app for iOS expands NextGen Healthcare's mobility efforts through this natively integrated app designed for iPad users, a complete real-time solution designed to optimize workflow and productivity for physicians in high-volume settings.

NextGen Now, which will combine functionalities of the NextGen Ambulatory EHR and Practice Management solution suite, architected for cloud-based performance. Its open and interoperable platform will enable vendor, partner, and client communications as well as enhancements and toolsets without the impediment of disparate systems and proprietary technology silos. It is slated for initial release in 2015.

This year's user group meeting was by far the most successful and transformative experience to date; and, being the 19th annual event, that speaks volumes. Overall, the tone of the client base at our user group meeting was optimistic. The response to our new solutions was overwhelmingly positive, and survey feedback reflected the same, signifying that our clients are very confident about our future together.

Clients were also enthusiastic about our existing product improvements, including the latest release of 5.8/8.3 Ambulatory, EHR, and Practice Management. To that end, clients gathered in the Expo Hall to demo and purchase new and existing products, which resulted in over $1 million sales activities during the event. It's clear that as we continue to release products designed to help clients succeed in a connected and value-based healthcare environment, momentum continues to gain.

Mirth also had a successful run at our user group meeting. Hundreds of NextGen clients visited the Mirth booth in the Expo Hall and showed strong interest in Mirth solutions. Mirth's sales increased quarter-over-quarter with some big wins, including sizable deals from Arizona Health Information Network of Arizona, San Diego HIE, and a private payer HIE.

The Arizona network is Arizona's largest statewide health information organization. And its participants include hospitals, physicians, health plans, reference labs, and other healthcare organizations, representing more than half of all the licensed hospital beds and covered patients in the state.

In addition, many of our concurrent Mirth clients are expanding their relationship with us and continuing to grow. We've added more enterprise-level sales talent to the Mirth sales team to meet the growing demand for the Mirth stack.

Our newest Mirth product, Mirth Care Enterprise, offers a comprehensive, collaborative care, population health and analytics solution for the ACO market, and is EHR vendor agnostic. We plan to launch this product at HIMSS in April, and will increase marketing efforts over the next several quarters. We already have some of our largest clients using it as beta partners and net new deals in the pipeline.

The success of the ambulatory division in Q3 was driven by a combination of new and existing client sales, as well as significant investments by two of our value-added resellers, GBS and Topaz. Both continue to successfully grow their NextGen user bases.

Several enterprise ambulatory clients expanded their relationships with us in Q3. CareMore Medical Enterprises made a significant purchase of EHR and PM licenses to support their national expansion. Jackson Community Medical Record made a large investment in licenses with its network growth in Southeast Michigan. And Joslin Diabetes Center, a long-time EHR client nationally renowned for diabetes care, extended its commitment to NextGen Healthcare with an enterprise Practice Management purchase.

In Q3 we were proud to add Reno Sparks Tribal Health Center to the NextGen Healthcare family. Reno Sparks Tribal Health is committed to enhancing the quality of life of the Native American community by providing a culturally competent and patient-centered continuum of care. We look forward to helping them achieve their mission by providing NextGen solutions for EHR, Practice Management, and Patient Portal.

We also welcomed new enterprise client, Center for Vein Restoration management, who will be using NextGen Ambulatory EHR, NextGen PM, NextGen RCM services, and NextGen Patient Portal to improve patient outcomes and drive efficiency.

NextGen RCM activity increased in Q3, following a Q2 slowdown, in as decision-making due to ICD-10. This was led by several 5- to 7-year multimillion dollar RCM deals with large groups, including multispecialty practices, orthopedic groups, and community health centers.

NextGen RCM services earned top ranking in the KLAS 2014 Ambulatory RCM Services report in Q3. The report ranked RCM vendors on their overall performance and performance in key RCM areas, such as effectiveness of claim processing, transparency into billing, financial operations, denials and rejection management, sustainability of pricing, trust as a business partner, and efficiencies gained through the partnership.

Connected patient care continues to be a strong driver in the market. Our recent announcement regarding our partnership with Merge Healthcare validates we are headed in the right direction, using NextGen Share as our backbone to generate revenue in this area and advance connectivity.

Merge and NextGen will link their interoperability platforms, enabling NextGen Share customers to seamlessly send electronic imaging orders, and receive imaging orders. The liquidity of data through our new interoperability platform, NextGen Share, extends the reach of our clients and allows them to improve care coordination while better managing referrals. We currently have approximately 500 clients using, or in the process of onboarding, NextGen Share.

This past October, we announced our strategic agreement with Patterson Dental. This strategic relationship with our QSIDental division is expected to accelerate our presence in the growing enterprise dental market with our cloud-based dental practice management system, QSIDental Web. We have already seen lead activity generated from this relationship.

Wrapping up our call this morning, I'd like to report that our combined division pipeline remained solid. It sits today at $162.3 million. The Company executed 81 new arrangements on a consolidated basis versus 96 the prior quarter. 52% of the arrangements were greenfield; 48% were replacement.

Discounting did not materially change in the quarter. And as of December 31, 2014, there are 127 quota-carrying sales and management positions. There was no material increase in the sales staff over Q2 of fiscal year 2015.

With that, I'd like to thank you for your time and continued interest.

Christie, I'd like to turn it over to you for questions now.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). David Larsen, Leerink.

David Larsen - *Leerink Partners - Analyst*

Congratulations on the progress you're making on the inpatient division. Can you maybe just talk about the sales activity on the inpatient side, the software? Are Opus and Sphere fully integrated? How are the ED sales progressing? And did you provide operating income for each of the divisions? Thanks.

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

Hi, this is Dan. First of all, we did not provide operating income -- I don't think, Paul -- for all the divisions. That will happen later, with the full disclosure of the Q, I think.

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Right. We'll file our Q shortly.

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

So that will be out soon. And then as far as your question of the sales, as we mentioned both in our prepared statements as well as prior releases, and consistent with prior earnings calls, our sales focus continues to be around emergency department modules and a number of other type of adjacent software sales to our existing and new client bases, as well as existing NextGen Ambulatory clients. We reported no major clinical or financial sales during the quarter, but that is not inconsistent with what we've talked about the last two or three quarters.

David Larsen - *Leerink Partners - Analyst*

Okay. So I think it was a $1 million sequential increase in hospital division revenue, and those were mainly sort of modular, if I'm hearing you correctly, not really full hospital sales. Is that correct?

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

The principle new sale components were module. And I just remind you, David, that our hospital division, after we took the impairment over a year ago, is principally on a cash collection basis. And so, much of the timing associated -- or much of the revenue recognition is depending on the actual collection of cash.

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David Larsen - *Leerink Partners - Analyst*

Okay, great. Thanks a lot.

Operator

Donald Hooker, KeyBanc.

Donald Hooker - *Keybanc Capital Markets - Analyst*

I was impressed by the revenue cycle growth this quarter. And I know, last year, you all called out an interesting win in the hospital space, which was new; and was curious if maybe you can you elaborate on that. And maybe talk about the differing economics of your revenue cycle deals in hospitals versus ambulatory. And if that's enough to be moving the numbers, or is it still too early?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

This is Monte. Thanks for the question. With respect to hospital RCM services, we have one customer that went live July 1. So we continue to improve upon that service offering, master our best practices and our processes. And to date, that's the only customer that we have in that space. I think as we move forward, we'll look to expand it, but do it when the time is right, and when it's right for those customers.

Donald Hooker - *Keybanc Capital Markets - Analyst*

Okay. And then one of the other broader themes is the pickup in patient volumes, potentially. And I was curious if you could maybe parse out revenue growth -- same-store revenue growth from that, or is that not a factor?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Well, I think there was certainly a flu season that contributed to a lot of visits. But I think also contributing were some of the new customers and the implementation of new relationships. So I think it's a combination. I don't have the exact same-store numbers in front of me, but I certainly think that that was contributing.

Donald Hooker - *Keybanc Capital Markets - Analyst*

Okay. And let me ask one more. And I don't know if you are willing to provide this data. But when I look at -- well, you had a nice bookings number in the quarter, as well; and was curious if you could maybe talk about the revenue cycle contribution to that, as we think about those revenues going forward.

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Yes, this is Paul. I think, qualitatively, we will speak to that. Certainly RCM has been a good contributors to our bookings. Mirth Solutions has been a good contributor. We haven't gotten into breaking that up by product line. But they're both -- RCM, for sure, is making its share of contributions to the bookings number.

Donald Hooker - *Keybanc Capital Markets - Analyst*

Okay, thanks.

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Operator

Jamie Stockton, Wells Fargo.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

One quick one, Monte, on the RCM business. The gross margin seemed to improve a decent amount sequentially for that business. Can you give us some color on what's going on there? Is that just, hey, we're utilizing the resources that we've got a little more efficiently? Or is there anything that you're doing to improve the profitability of that business, and maybe where could it go?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Well, I think we are always looking for ways to be more efficient, and certainly have a belief that the more we can automate, the more we can improve gross margin. Labor is certainly our biggest driver of cost of sales. And so, where we can get more efficient, we're always looking for ways to do that. So I think that contributes.

It's also mix of business. So where we have customers that are specialties that reimburse at a higher rate, the low-volume, high-dollar claims tend to have less labor, compared to low-dollar, high-volume tends to be more labor. So that mix contributes to gross margin, as well.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

Okay. Is it that the -- you guys have a solid base of employees today that are providing these services, and as you're bringing on more business you're leveraging that? Not really having to grow that headcount very much, and that's what's helping the gross margin?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Yes, I think that certainly contributes. There's a critical mass to perform the services. If you remember, we've talked a lot about it. Our service offering is very full-service, and so we're providing a high degree of service to help our customers achieve their goals. And certainly as we add more revenue and more business onto that infrastructure, we will continue to see gains from a gross margin perspective.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

Okay, that's great. And then maybe just one more quick one. Gary, when you look at the ambulatory space, there are obviously, I think, a couple of big themes out there that are very long-term in nature, which is single database and then also SaaS. And you guys are addressing that second theme with your newer platform.

But a lot of the market is still client/server today, including a lot of your customer base. Can you talk about why you think your base seems to be a little more stable in the client/server-dominated portion of the ambulatory market, versus some of the other significant players out there? What are you guys doing to differentiate yourselves with those clients, and keep them, as you invest in the new technology platform?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Well, it's a great question, Jamie. So I would say the things that those clients are asking us for, in addition to some always asking for some baseline improvements in the current product, but many of these clients today are heading into the value-based population health world. And it was significant over probably the last six months that we're having a lot of meetings with clients asking about, what's our roadmap? What's the current new population health platform look like?

We've had several clients that have been very engaged with us in helping us build out the newest release of population health, NextGen Care, that we'll have out and available shortly. A lot of interest in our UGM, and looking at that product.

And then there's another, larger segment of our client base that operates in environments -- ACOs and other value-based environments -- where there are multiple different products in the community. And so they are very interested in what we're doing with the Mirth Care enterprise product and the analytics that we're building around that. And, again, we have some very nice partnerships going with our clients who -- we really are lucky that we have the forward-thinking market leaders -- like the Crystal Runs and Mount Kiscos and CareMores and others like that -- that can really help us drive this, that are thought leaders.

So I think in terms of stickiness, and at the heart of your question, it's -- they really are interested, and want strong pop health solutions and consulting solutions around that. And that's where this organization is heading, and that's why I think our clients are positive about what they're seeing us build.

Jamie Stockton - *Wells Fargo Securities, LLC - Analyst*

Okay, thank you.

Operator

David Francis, RBC Capital Markets.

David Francis - *RBC Capital Markets - Analyst*

I guess Steve and Gary, can you talk about what the early customer feedback has been on their initial look at the NextGen Now Web-based ambulatory product?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

This is Gary. I'll jump into that one. So we started doing quite a bit of that with our clients at the user meeting, where we had usability labs, invited folks in the hands-on area to look at the system, get their hands on it. And we did a lot of surveying of those clients after.

I think they had some really good feedback in terms of usability. But from -- we do a lot of surveying on a lot of different areas at that meeting, and the feedback was very positive. I think they are very happy about the technology, the platform itself, which is really leading-edge. And then they were happy with the usability.

And some of the things that we showed them that were things that, frankly, maybe we couldn't do because of new technology that we couldn't do in the old platform. So I think they were excited about that. From a physician EHR standpoint, they were excited about the look and feel, and some of the things they could see there. And I think we're building in some very unique features on the practice management, the financial side.

I guess there have been financial systems out there forever. But to the point or the question earlier to Monte about (technical difficulty), and we're really trying to build new tools that have automation at the heart of the application, so we can help our clients drive out cost. And frankly, when Monte is able to begin using that application, he'll be able to drive out cost in his organization as well.

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

And the feedback was very positive.

David Francis - *RBC Capital Markets - Analyst*

I guess, as you say, you guys are looking to roll out active sales and implementation sometime here in the late winter/early spring. Can you remind us what kind of functionality will be available in the market at that time?

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

Let me respond to that, David. Two things. What we've said before is that the first product to come off the NG7 platform, NG Now, will be focused and basically aligned for small doctor practices. And full EHR, cloud-enabled, SaaS-based pricing. As Gary said, we did demo the product. We have done alpha testing with a number of clients as well. Also powered by, of course, NextGen and Mirth technologies.

We will be in beta either in late summer/early fall, with the current expectation to have a limited release later this year, and a full general release in 2016. And again, the product that we will bring to market first will be positioned for the small doctor practice.

David Francis - *RBC Capital Markets - Analyst*

That's helpful, thanks. And the last follow-up for you. Looking at the R&D line and continues step-up there, just a quick question. We had heard some things from certain clients about some issues that they had had with recent upgrades to the 5.8 and 8.3 product suite; and was wondering if the uptick in R&D expense is in part related to that, to try and accelerate fixes there, or if there is something else going on, relative to the investment profile of the business? That's it, thanks.

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

I'm going to take that question, as well, David, and I appreciate the question. Clearly when we have difficulties or an issue with any kind of releases, we will throw whatever resources are necessary to deal with those issues. But the investment in R&D is really about the investment in the future. We've talked about this on multiple occasions. We said it was a deliberate decision by the executive and the Board of this particular company to invest in the future.

Gary talked about the issue of value-based health care and having the tools necessary, not only driving out NG Now but our Population Health initiatives across the board. The investment into dental for our QSIDental Web product, that's having great success.

I wouldn't look at the increase in R&D expenses as a result of a short-term issue, but an investment into a much stronger future.

David Francis - *RBC Capital Markets - Analyst*

So I guess, more to the point, you guys feel pretty good about where you stand with 5.8/8.3 at this time?

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

I think those are two different things. I think that we understand the issues with 5.8 and 8.3, and we've been working those issues through with our clients. We have good roadmaps that we've discussed, and are comfortable that we have a path for those clients that felt they needed additional functionality and/or corrections to enhance the value of those upgrades for their practices.

David Francis - *RBC Capital Markets - Analyst*

Thank you, guys.

Operator

Michael Cherny, Evercore ISI.

Michael Cherny - *Evercore ISI - Analyst*

So, I just want to ask a little bit about -- you talked a lot about the developments on the product platforms. Obviously it's starting to show with the Mirth performance, with the performance in RCM. As you think about your current portfolio and think about the rollout of some of the new solutions, do you think that -- and you also talked about R&D.

Do you think that you're done in terms of needing the bolt-on additional platforms? Is there anything, from a capital deployment perspective, that you think would be easier to buy versus build, relative to the current platform you have in place right now?

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

Michael, thanks for the question. I think that's an analysis we do on a regular basis. We are continually looking at bolt-on acquisitions. We are continually making the analysis, or doing the analysis, of whether there is a better opportunity outside on the market where we can either get a better quality or get to market quicker.

So the answer is, is this is something that we do on a regular basis. We have said in the past that part of our strategy is to do bolt-on and strategic acquisitions that would enhance either a product set or a base technology. We are committed to that, and we will continue to do so. So I wouldn't make the assumptions that that's over. But again, we are selective; we're disciplined in our M&A process. And we believe it's an important part of our future.

Michael Cherny - *Evercore ISI - Analyst*

Thanks. That's all I have.

Operator

Ricky Goldwasser, Morgan Stanley.

Saurabh Singh - *Morgan Stanley - Analyst*

Hi, this is Saurabh Singh in for Ricky Goldwasser. I was wondering if you could clarify one thing about your bookings metric, whether or not it excludes renewals. And then as a follow-up, if you could give some color on the mix of reoccurring versus nonrecurring revenues in the booking? And how much of the bookings are coming from the installed base versus being new footprints?

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Okay, this is Paul. So I heard several pieces there in your question. The bookings number is going to be the contract value of what we're selling customers. Now that does not include things like maintenance. That is not something that we included in our bookings piece. But it does include software and services.

On the Mirth side, they have both software and services, as well as subscriptions. I would say our metric is typically not things like renewals. Maintenance is something that is just auto-renewed, and we're not arbitrarily throwing that into our bookings numbers. So I would say the same, for the most part, with EDI as well.

So, hopefully that gives you enough color on the first part of your question. In terms of the mix, I'd say there is a good -- given the large customer base that we have, and given part of our stated strategy of cross-selling products and services, and as well as many, many of our customers who are continuing to grow with us, there is a good portion of those bookings that is coming from existing customers; and a portion, though, as well, is coming from new customers.

Although the portion coming from existing customers is certainly a majority, but new customers, particularly on the Mirth side, I think we're looking forward to continuing to add new customers with some of these new products that we've been talking about around interoperability and population health.

Saurabh Singh - *Morgan Stanley - Analyst*

All right. If I could just ask one quick follow-up on the RCM business. When you compare the profile of the installed base for your current RCM clients with your broader ambulatory EHR installed base, how do they compare in terms of physician practice size, specialty, and hospital affiliation or ownership?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

This is Monte. Yes, I think it's largely representative of the customer base. I'll remind you, and I think we've reported in the past, that we still remain less than 10% penetrated in that NextGen customer base. But the makeup of the RCM customers, I would say, is largely consistent with the makeup of that NextGen customer base.

Saurabh Singh - *Morgan Stanley - Analyst*

Thank you.

Operator

Eric Coldwell, Robert W. Baird.

Eric Coldwell - *Robert W. Baird & Company, Inc. - Analyst*

Congrats on the continued turnaround and the progress you are making. I just have a very quick question on implementation. When I look at the quarter, software, maintenance, EDI, RCM, and other all grew nicely, but overall revenue performance was held back somewhat by implementation.

I know it's a lower-margin line and there is some seasonality there, but could you tell us what's going on with that segment? And while you have not yet provided guidance, maybe give us some sense on how we should be thinking about the revenue trend in implementation moving forward. Thanks so much.

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

Sure. Eric, this is Dan. Thanks for the question. First of all, you used the term that IT is a segment. And first of all, implementation training, professional services as a whole, really it supports our segments. It's not a unique segment on its own.

And as you mentioned, there is fluctuation in that number quarter-over-quarter depending on a number of factors. A couple of those factors we have talked about already earlier today in a couple places that we always have some issues in this quarter associated with that fluctuation, due to all the work that we have, and the distraction both we have and our clients have with our user group meeting, as well as multiple major holidays that distract both our clients and so forth.

We have also -- the continued or the delays in ICD-10, the extension of Meaningful Use 2, the delay of Meaningful Use 3 -- all of these things tend to postpone what our clients want to do and the upgrade requirements. So, previously we had expectations of a number of clients who were pretty aggressive on getting some upgrades done in the fourth quarter, or even late in the third quarter, all of which -- or not all of which, but some of which -- delayed into the first calendar quarter this year, or maybe even the second calendar quarter this year, because of the changes in Meaningful Use 2 requirements.

And so the way I would think about it is is that training implementation will fluctuate, and there are a number of variables that will drive that. And the one thing I would point out is that I think one of the things we have done successfully is we have done a lot of -- we have implemented a lot of things to help us have a greater degree of variable cost associated with these. So that as we have fluctuations, we also can then not necessarily have a constant cost associated with those. And those are helping us manage the bottom line, not just the top line.

Operator

Ryan Daniels, William Blair.

Ryan Daniels - *William Blair - Analyst*

One data point that stood out to me is the replacement activity ticking up to nearly half of the book of business this quarter. So I'm curious, number one, if there's any common themes there. And then, number two, if you look at the pipeline, is that also a similar 50-50 split, if you will, between greenfield and replacement opportunities?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Ryan, this is Gary. Yes, it did have an uptick from -- generally, we've been around 30%, and it went up to 52%. I guess we'll have to look at, over the coming quarters, is that a trend that's finally signaling that we're seeing that replacement market finally start to gain some momentum? It might have just been a blip on the radar this quarter. We don't know that yet.

In terms of looking at the overall pipeline, I think it's about the same mix that we've always had between clients and net new opportunities.

I mentioned earlier, we've got some forward-leading clients that continue to grow, physician-based practices that are growing significantly. So a lot of what we see is being driven by consolidation in the physician market side, and is really helping us grow some of those large group practices.

But, overall, I think the mix seems to be about the same. We'll see how coming quarters look.

Ryan Daniels - *William Blair - Analyst*

Okay, great. And then maybe one quick one for Monte. I think this was discussed in the prepared comments. But now that we're through year-end, and moving forward towards ICD-10 looking like it's actually going to happen this October, what is the impact you're seeing there, specifically on the RCM pipeline, or feedback you're getting from clients? How is that starting to manifest?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Well, I think clients are starting to be more aware, and engaging with us on our testing. We have successfully tested with all of our clearinghouse partners. We're now doing end-to-end testing with payers. So we continue to prepare for ICD-10 implementation and continue to work with our customers to do that.

We're actually, very shortly, going to release some offerings to attract those customers to RCM, prior to the implementation of ICD-10, to help them navigate what I think is going to be a challenging implementation for independent practices.

So look for that to come out shortly. We're offering some incentive. But we're definitely -- the conversation is picking up. The activity is picking up. And we think there's opportunity to gain market share as a result.

Operator

Steve Halper, FBR.

Steve Halper - *FBR Capital Markets - Analyst*

Just to follow up on the bookings question from earlier, are RCM renewals included in that bookings number?

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

This is Paul. No, the auto-renewals, similar to maintenance -- auto-renewals in RCM, we're not including those in the bookings.

Steve Halper - *FBR Capital Markets - Analyst*

Right, but (multiple speakers). Yes, but in your comments, you talked about two large, multi-year renewals in RCM. Is that an auto-renew, or is that included in the booking?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

So I think if -- our contracts include auto-renewals in them. So the lion's share of those renewals do not get included in bookings. In the event we repaper a contract for any number of reasons, I think those would likely show up in the bookings.

Steve Halper - *FBR Capital Markets - Analyst*

Okay. So how would you characterize those two large, multi-year renewals that you talked about?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Yes, I think those would be in the bookings. When you look at the bookings overall, it's immaterial.

Steve Halper - *FBR Capital Markets - Analyst*

Okay, that's fair. And then on the non-GAAP adjustments, when would the acquisition costs go away? And what about the shareholder litigation expenses that you backed out?

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Yes, this is Paul. I'm not going to comment on the shareholder litigation expenses, because I'm not going to tell you exactly how we think those are going to happen. I don't think I can really forecast that, and not going to even try.

But on the acquisition costs, the majority of that is -- that piece has to do with fair value market adjustments to contingent liability that we have primarily with Mirth. So that is -- we're going to continue to have those until that Mirth contingent piece plays out, so that's going to be around for another year.

Steve Halper - *FBR Capital Markets - Analyst*

Great, thanks.

Operator

Gene Mannheimer, Topeka.

Gene Mannheimer - *Topeka Capital Markets - Analyst*

Congrats on a good quarter. Just going back to an earlier question on capital deployment, looking at your business it seems that the majority of the growth that we've talked about today is coming from acquired businesses like RCM and Mirth. So what is your appetite to do some large deals? And, in particular, would you consider tapping the debt markets, giving you some leverage and the flexibility to do something larger than you have been accustomed to? Thanks.

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

Gene, this is Steve. We are currently in the process, as you typically know, of developing our strategic outlook for the upcoming year, and actually our three-year plan. Our fiscal year ends March 31. And we've been working very closely with our Board in these respective areas. And I think the opportunities that we have, because of the large installed base that we have, to branch out into other product and service offerings, is widely accepted by management and the Board.

And we would do that in a number of different ways, make or buy. And I don't think that there's any limitations that we're willing to place on the right strategic acquisition that could give us a great running start, or a great support start, in a respective area that we're looking to grow in.

So, there are no limitations. And I can tell you we are a Company that has -- we have a lot of cash; we have no debt. We also have the ability to raise money very easily. And I think we're in a position where, over the next few years, understanding the market dynamics, understanding the dynamics of group practices, where they're heading at our value-based modeling, the tools that they're going to need -- that we're in a great position to be able to bring those products and services to those customers. And we will do it through the combination of make and buy.

Gene Mannheimer - *Topeka Capital Markets - Analyst*

Great, thank you. That's all I had.

Operator

Mohan Naidu, Stephens.

Mohan Naidu - *Stephens, Inc. - Analyst*

Monte or Paul, one last question on bookings, I guess. Now you include the full contract value; can you comment on the typical period of your RCM contracts?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

This is Monte. So, our contracts are typically 3 to 5 years. We are seeing an uptick in some longer-term deals to the tune of 7 years or thereabout. And it's something that we've been incentivizing our sales organization to help us continue to expand the term of those agreements. And as was stated on a previous question, most, if not all, of those contracts have auto renewal previsions. And so it's our desire and intent every day to earn that business in perpetuity.

Mohan Naidu - *Stephens, Inc. - Analyst*

Got it. And in the long-term contracts, like 7-year contracts that are also included full-term in the bookings, right?

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

Yes.

Mohan Naidu - *Stephens, Inc. - Analyst*

Okay. Maybe one last question on Paul -- with Paul or Steve. Now that you guys are steadily improving and gaining confidence, should we expect to see guidance for fiscal 2016, next quarter or sometime?

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

The management team hasn't fully decided that yet. However, I will tell you it's more than reasonable to assume that this quarter that we've had, and the quarter that we believe we're going to have in the upcoming fourth quarter, will give us the confidence to provide directional guidance heading into our next fiscal year.

One of the things that we viewed as a great surprise to us is that we anticipated Stage 2 and ICD-10 delays were going to create a bit of a pause in momentum in our sector. Groups like the American Health Information Management Association, the College of Healthcare Management Executives, amongst many others, have indicated a deep disappointment in the government's continual delays of these projects.

They clearly do a disservice to all of us that are prepared for that, as well as our providers that are prepared for that. However, even with these delays, the momentum that we're starting to pick up is giving us enormous confidence.

I always love to be able to roll back of the calendar and say, if the government stuck to their original timeline of last October, we believe right now we'd be in the throes of a very big replacement market and a very, very momentous movement towards RCM.

But all that being said, we're still making progress in those areas. We're still seeing a replacement market. We are having great momentum in RCM. And if the government holds true to the timelines for this upcoming October, we should see a great run beginning this summer.

Mohan Naidu - *Stephens, Inc. - Analyst*

Great. Thanks a lot.

Operator

Bret Jones, Oppenheimer.

Bret Jones - *Oppenheimer & Co. - Analyst*

I wanted to start with the strength in Mirth, and where we're actually seeing that strength show up on the P&L. If I look at other services, it's been relatively flat for the last three quarters. So has there been a shift in how much Mirth revenue is recognized as software versus SaaS recurring? Or is there an offset within the other services line?

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Yes, this is Paul. So, the other services line is several pieces, most of it is recurring. We do have consulting services included in other revenue, but for the most part the balance is very recurring. And no, there isn't -- I wouldn't say there was a change in mix for Mirth this quarter. As I think I mentioned before, Mirth actually has both perpetual license offerings, as well as subscription-based offerings; although I'd say a majority is more on the subscription side.

And we did see, as I mentioned in my earlier prepared comments, we did see a nice uptick this quarter on the subscription line. And that was -- certainly a big portion of that came from growth on the Mirth side.

And that's been a steady growth there on that side. And I think it's one of the reasons why I called it out in my prepared statements, that that revenue line is nice because it's recurring, and it's much more consistent and reliable. And it's becoming a bigger part of our business.

Bret Jones - *Oppenheimer & Co. - Analyst*

Okay, great. And then if I could just shift back to some of the M&A discussions earlier in the call and ask Steve, do you feel any pressure to actually do a deal right now?

If I look at this, it's pretty early in the turnaround stage. And we're talking about a replacement cycle starting to pick up as we get into Meaningful Use 2; RCM picking up from ICD-10. Do you really feel the need to do a deal right now?

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

Well, we quite honestly never feel the need to do a deal. We've got our plans in place in development. As you know, we've invested in R&D. We know the product and service areas that are going to be required under value-based modeling.

We're in a position right now where we believe that on the run rates we're at, we'll probably finish our fiscal year somewhere around 10% revenue growth on a pure core basis, with zero acquisitions this year. There are probably aren't too many companies in our sector that can say that.

So, no, we don't feel the compelling need. However, we do want to make sure that we're always in a very powerful position with our customer base, and we want to stay at the forefront of all of these movements. Hence, in the mix of our growth, in the mix of our preparation for that, we will develop product and also consider doing acquisitions to help supplement and complement our product base.

Bret Jones - *Oppenheimer & Co. - Analyst*

All right, great. Thank you.

Operator

Richard Close, Avondale Partners.

Richard Close - *Avondale Partners - Analyst*

Congratulations. Thanks for slipping me in here. I wanted to hit on the RCM business again. And Monte, maybe you could help us out with respect to the 10% penetration into the existing ambulatory. Why isn't that a higher? Or how should we think about that on a go-forward basis?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

This is Gary. Let me take that one, and just give you a sense of what seems to be happening in the base. So, first of all, we've got a very, very large client base of around 80,000 physicians. So part of this is an ongoing education process. And while it may seem that in a few short months you should be able to market to every one of your clients, the key is getting to the decision-makers and educating the physicians on why RCM is the right way to go, and why RCM can improve their bottom line.

So that's a continual process of reps being in front of their clients, of doing the right things from a marketing standpoint, from continuing to grow a very positive reference base, which Monte is doing a great job of for us.

So, it's an ongoing educational kind of effort. I think, last year, we had a strong year. I think the delays that Steve mentioned and some of the regulatory things, ICD-10 in particular, I think we could pretty much track a slowdown in discussions around RCM when that happened.

And now we're seeing pipeline activity, discussions with clients really ramping up again. We had what I feel was a very nice increase in assessments and things that we do that are going to be a harbinger of what's going to happen later on.

So I think there's a tremendous opportunity across the entire base, still. And I think, as Steve mentioned, if we continue to get things from a regulatory standpoint on track and implement it, it's just going to continue to be positive.

Richard Close - *Avondale Partners - Analyst*

So, is it fair to say that on the RCM new sales, most of that is greenfield at this point?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

I think it's still a mix. We added some greenfield sales last quarter in RCM, plus a lot of client sales. So I'd say we're probably still a little more client sales versus greenfield, but it's nice to see that we have both.

Richard Close - *Avondale Partners - Analyst*

Okay. And then Monte mentioned large deals, several large deals, and creative deals in talking about the RCM. I was wondering if you could maybe add a little bit more meat to that bone, in terms of creative.

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Well, I think the big thing is clients are looking for us to sit down and look at what things can we include other than the practice management or the financial side? So, more and more, we're bundling in our other applications, whether they be Patient Portal or EHR, a variety of different products, again, keeping with the cross-sell theme.

So the one client that I had mentioned, the new one, Center for Vein Restoration, I think that's classic cross-sale, where not only did they buy software, but they bought RCM services because they felt that that was in their best interest for the future.

So, I look at that as creative. The longer-term contracts that Monte mentioned I think are also an example of us looking at ways to be more creative, to make it work financially for our clients.

Richard Close - *Avondale Partners - Analyst*

Okay, and then -- go ahead.

Monte Sandler - *Quality Systems, Inc. - EVP, NextGen RCM Services*

This is Monte. Just one thing I would add. Sorry, Richard. We've talked before about our offering, and the fact that it is full service and it is tailored. And so that really gives us an opportunity to sit down with prospective clients to really understand what their problems are, where there challenges lie, and tailor solutions that help them achieve their goals.

And so as the market continues to evolve, and we move from transactional fee-for-service to fee-for-value, we believe that that model really positions us well with our current customer base and prospective customers to tailor solutions that really meet their needs. And so that's a lot of the stuff I talk about when I talk about creative solutions as well.

Richard Close - *Avondale Partners - Analyst*

Okay. I wanted to ask a quick question on Mirth, and this will be my final one. With respect to -- it seems like you've had a good amount of success on the HIE interoperability part of it.

Maybe you could help us out, in terms of just framing up how much of Mirth's sales are coming through those information exchanges versus selling back into the provider base.

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

This is Gary again, Richard. So, we have again -- similar to RCM, I think we have a big greenfield opportunity with Mirth and the NextGen base. And we've started to see that ramp up. I won't get into specific numbers, but we've had great activity with some of our larger clients in the past.

We've mentioned CareMore and Trinity Health and Tenet -- a large organizations like that that have a need for interoperability products, data repository products, and now the Mirth Care products that we've been talking about.

So, we're continuing to see an uptick in activity. Again, it's an educational process with our clients. They have a need for interoperability solutions. And so that pipeline continues to grow in the activity.

At the same time, we've got an outbound sales team that is out there focusing on those large HIE opportunities that still exist out there. An opportunity like Arizona -- we can't emphasize enough how important that is. In just a couple of short years, Mirth has come from a small boutique vendor to a force to be reckoned with, and HIE is out there being selected.

Whether public or private, they're going to compete, and they're going to compete for that business. And they have an opportunity to win those large opportunities now.

Richard Close - *Avondale Partners - Analyst*

Great. Thank you.

Operator

Dave Windley, Jefferies.

Dave Windley - *Jefferies & Company - Analyst*

I'm going to follow up on Richard's last question. So, on Mirth, could you -- you are seeing growth. I've heard, from some work that I've done, that the price point on Mirth is fairly high. And so getting opportunities in the bigger clients or bigger targets certainly seems important on that front.

I guess I'm also wondering, on the other side of that coin, if there are things that you are doing to perhaps break the offering apart into smaller pieces, or make -- essentially improve the affordability of Mirth's offerings for what might be the majority of your current client base that would need a lower price point.

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Let me take a stab at that one. This is Gary again, Dave. I think it depends on the product line that we're talking about. So, Mirth and the Mirth products are becoming kind of the engine behind some of our Population Health offerings. And so certainly we bundle and package those, and price those in different fashions. That market is used to a different type of pricing, on a per-member, per-month basis, for example, versus another market or another area where maybe an IT shop is really just looking for an interoperability tool.

And so, yes, we will look at how we can package those things for the markets so that they're competitive. NextGen and QSI, Mirth -- we've never been the low-cost leaders. But I think certainly over the past year or so, we've been able with the Mirth tools to drop the cost of interoperability within our client base.

And, again, I will point to the success we're seeing with NextGen Share. It's a no-cost solution powered by Mirth. And we're going to continue to add functionality to that and connections to other vendors, other EHRs, other HIT systems, at a relatively low cost.

Dave Windley - *Jefferies & Company - Analyst*

Okay. A couple of maybe just quick housekeeping items. So, Paul, I think you mentioned that -- in your prepared remarks, the bad debt expense was a little higher. Could you elaborate on that? And then also tell us what you think the tax rate will be for the full year, given that it was kind of low in this quarter.

THOMSON REUTERS

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Okay. So, first piece, our year-ago quarter reflected an actual reduction of bad debt expense, but a credit. Because a big part -- because we've had great success in driving or accelerating the pace of our collections with customers, and driving down DSOs. And so just as a result of that, we actually had a benefit in the prior period.

This quarter, we went to a more normalized level of bad debt expense. But going from a credit to a debit is going to magnify the swing. So that was certainly -- that's what happened there on the bad debt item.

Dave Windley - *Jefferies & Company - Analyst*

Okay.

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

In terms of the tax rate, yes, for sure, the tax -- that R&D tax credit dropped our tax rate down significantly. We're not going to have that same effect next quarter, although we do get to the benefit of the full year for the value of that tax credit.

The reason why it was so large is that it was -- we retroactively got the benefit of almost a full year's worth of R&D tax credit in a single quarter. We'll still have some benefit next quarter, just because our rate that we use is for the full year. And so you'll see it come back, but you'll see it come back at a little lower level than what we were running at the first couple of quarters.

Dave Windley - *Jefferies & Company - Analyst*

So maybe low-30s instead of mid-30s, something like that?

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Yes, approximately in that range.

Dave Windley - *Jefferies & Company - Analyst*

Okay. Great, thanks.

Operator

Garen Sarafian, Citigroup.

Garen Sarafian - *Citigroup - Analyst*

Just a couple quickies. One is on the RCM side. Congrats on scoring well in KLAS on NextGen RCM. Just doing a little bit on the displacements, are you guys seeing a trend -- I mean, it was a little bit higher. But is it due to any sort of competitive environment where you guys are able to take advantage of some weaknesses, or newer weaknesses among competitors? Or is it just more of the same, but just an anomaly this quarter that it's higher?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Yes, this is Gary. Again, I don't know if it's an anomaly or a trend yet, obviously. But I will say I think Monte continues to talk about the tailored solution and the tailored aspect of our offering. I think, competitively, it's compelling. And that's what I think we've seen a lot of the RCM business -- even when we're selling into our own customer base, it's competitive. There are a lot of RCM vendors that are looking to put our clients on their solutions. This just isn't a walk in and sign the contract.

So we know, competitively, we've got an advantage with those tailored solutions. And I think that's really helped us. It's helped us in terms of replacements, as well. We know that other vendors that purely just have technology solutions that they're going to slap in and try and automate the billing, that don't have that kind of oversight that Monte's team provides, that they can be replaced because they don't do the same -- they don't offer the same level of service. So, yes, I think, competitively, we've got some advantages there.

Garen Sarafian - *Citigroup - Analyst*

Got it, great. And the second question is on the clinical side. On the scoring front on external surveys, you haven't reached the same levels as on the RCM side. So I know that in the past, you guys have spoken about a plan to improve external rankings, but I haven't seen that yet.

So I'm just wondering, are you guys seeing anything in your internal indicators to suggest that that will be -- that's turning around; that we can expect an uptick in coming quarters? Or is it still too early, and that we need to have a longer timeline?

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

This is Dan. Let me take that question. We are seeing some things in our internal surveys that are leading to greater client satisfactions: things like our hosting solutions, internally, are up; a number of pieces like that that we know will impact the external surveys.

We tend to do a great deal more of real-time, where some of the external surveys have a little bit of a lag component. We are spending a lot of time and effort on quality initiatives associated with our software. Made it very, very clear, and our customers made it clear that the quality component is incredibly important. And so we've had a lot of focus and energy to make sure that as we deliver new updates that those are very well-received in the marketplace.

So early indications on the inside are positive. But we also know this is a longer-term trend, and we know that it is enterprise-level software that is, in many cases, customized uniquely for the client that has great benefits for the client.

And as this goes forward, as they bring in updates and as those modifications are made to really add value in that environment, that we will see client satisfaction go up. So, yes, we understand it; we know it; we're tracking it. It's not where we want it to be, obviously. But, absolutely, we're seeing some trends that tell us that we're doing the right things.

Garen Sarafian - *Citigroup - Analyst*

Got it. Appreciate the comments, thanks.

Operator

George Hill, Deutsche Bank.

George Hill - *Deutsche Bank - Analyst*

I think most of mine have been hit. Just a couple of housekeeping items. The Gila River deal, was that a meaningful contributor to bookings and software revenue in the quarter?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

Well, Gila River was -- we announced that one last quarter, and I would say it was significant in terms of the system sales last quarter. The Reno Sparks, I think maybe that was the other one. I don't know if you were confused with that one at all. That was probably the other Tribal Health Center deal, similar type of organization, that we sold last quarter. And yes, I think it was a significant contributor to the system sales number.

George Hill - *Deutsche Bank - Analyst*

Okay, that's helpful. And then should we think about I guess the -- if we look at the last five or six quarters, the software contribution in the quarter has been kind of hovering in that high 14s to mid-15s, low-16s number. Is that a number that you feel like is a comfortable run rate that is generally falling out of the sales funnel, or falling out of the pipeline into the software number each quarter? Or are there other things that should drive volatility in that line that we can't see?

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

Yes George, this is Steve. I'd like to roll back a little bit to answer your question in terms of that Stage 2 ICD-10 delay. We all know that once Stage 2 and ICD-10 become operable and required, that there's going to be a huge movement towards our Mirth-based products for interoperability. There's going to be a large replacement market. As you know, there's over 490 companies that have Stage 1 certified products that have not yet been certified for Stage 2. That's going to produce an enormous replacement market.

And then of course the ICD-10, the doctors have not felt the pain of operating under ICD-10. When they start feeling the pain, we believe our RCM business will start moving up.

So, in all three of those areas, we think that there's a sleeping giant out there. Once the government puts in stone that Stage 2 and ICD-10 will be required for operability at a certain point in time -- right now, it's October 2015 -- we think that there's going to be nice run in those three areas for us.

And so, yes, I would guess -- and I'll leave it to Gary -- but I would think, based on where we're at right now for software sales, we're comfortable. But as soon as the government puts something in stone, and necessity becomes the mother of invention for providers, we believe there's going to be a nice movement in that area, as well as RCM and our Mirth-based products.

Gary, you want to add anything to that?

Gary Voydanoff - *Quality Systems, Inc. - EVP, Sales and Marketing*

No. I think, Steve, that pretty much sums it up. I think, yes, we've been in that zone that you mentioned. And unless we have other delays or things that change with respect to regulations, we'll probably continue to see that. Whenever there is something that hits on the regulatory side, then you find folks taking a pause in their decision-making process. And that can affect a quarter.

George Hill - *Deutsche Bank - Analyst*

Okay. That's good color, I appreciate it. Thank you, guys.

Operator

Thank you. Our final question is coming from Frank -- I'm sorry, he withdrew his question.

Paul Holt - *Quality Systems, Inc. - EVP and CFO*

Okay, so we're done, Christie?

Operator

Yes, I will now turn the floor back over to Mr. Steven T. Plochocki for any closing remarks.

Steven Plochocki - *Quality Systems, Inc. - President and CEO*

Okay, great. Well, we want to thank everyone for being on the call today. We were glad to take so many questions. We're pretty excited about where we are positioned right now. As I indicated, the progress we're making is progress, in spite of the fact that Stage 2 and ICD-10 have been delayed. We anticipate that once those things become required in terms of operability, we're going to have a very nice buildup and run in our interoperability areas, our replacement market, and RCM.

So we think that the future is very good in terms of future growth. And as a result of that, we're pleased with where we're at. And I, quite honestly, am in a position now, when I take a look at the work we're doing -- our revenue, our EPS, our cash, our bookings, our pipeline, our DSOs are improved, our gross margin is up.

A lot of these categorical areas that, as you know, we have been going through a few years of improving on, are now starting to become consistent in terms of improvement and growth. That gives me a lot of confidence, knowing that Stage 2 and ICD-10, quickly to be followed by Stage 3 and ICD-11 written into law, will become very strong catalysts for our growth. And those are coming right down the road.

So, again, thank you very much for joining us. Thanks for being with us. And I look forward to seeing many of you in my travels. Take care.

Operator

Thank you. This does conclude today's teleconference. If you'd like to listen to a replay of today's conference please dial 800-585-8367, and reference conference ID 66989201. 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.

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