

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON JANUARY 11, 1996

REGISTRATION NO. 33-

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

QUALITY SYSTEMS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

| | | |
|---|---|---|
| CALIFORNIA (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION) | 7373 (PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE NUMBER) | 95-2888568 (I.R.S. EMPLOYER IDENTIFICATION NO.) |
|---|---|---|

17822 EAST 17TH STREET
TUSTIN, CALIFORNIA 92680
(714) 731-7171
(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF
REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

SHELDON RAZIN
CHAIRMAN AND PRESIDENT
QUALITY SYSTEMS, INC.
17822 EAST 17TH STREET, SUITE 210
TUSTIN, CALIFORNIA 92680
(714) 731-7171
(NAME, ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE,
OF AGENT FOR SERVICE)

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:

As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. / /

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. / /

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. / /

If delivery of the Prospectus is expected to be made pursuant to Rule 434, please check the following box. / /

CALCULATION OF REGISTRATION FEE

| TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED | AMOUNT TO BE REGISTERED(1) | PROPOSED MAXIMUM OFFERING PRICE PER SHARE(2) | PROPOSED MAXIMUM AGGREGATE OFFERING PRICE(1)(2) | AMOUNT OF REGISTRATION FEE(3) |
|--|----------------------------------|--|---|-------------------------------------|
|--|----------------------------------|--|---|-------------------------------------|

| | | | | |
|--|-----------|----------|--------------|----------|
| Common Stock (\$.01 par value)..... | 1,725,000 | \$26.875 | \$46,359,375 | \$15,986 |
| ----- | | | | |
| ----- | | | | |

- (1) Includes up to 225,000 shares of Common Stock which may be purchased by the Underwriters to cover over-allotments, if any.
- (2) Estimated pursuant to Rule 457(c) solely for the purpose of calculating the registration fee.
- (3) Calculated pursuant to Rule 457(c) promulgated under the Securities Act of 1933, as amended, using the average of the high and low prices per share of the Registrant's Common Stock on January 5, 1996, as reported by the Nasdaq National Market.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(a), MAY DETERMINE.

QUALITY SYSTEMS, INC.

CROSS-REFERENCE SHEET SHOWING LOCATION IN PROSPECTUS
OF INFORMATION REQUIRED BY ITEMS OF FORM S-1

| FORM S-1 REGISTRATION STATEMENT ITEM AND HEADING | HEADING IN PROSPECTUS |
|--|--|
| 1. Forepart of the Registration Statement and Outside Front Cover Page of Prospectus.... | Facing Page; Cross Reference Sheet; Outside Front Cover Page; Additional Information |
| 2. Inside Front and Outside Back Cover Pages of Prospectus..... | Inside Front and Outside Back Cover Pages of Prospectus |
| 3. Summary Information, Risk Factors and Ratio of Earnings to Fixed Charges..... | Prospectus Summary; Risk Factors; The Company; Selected Financial Data |
| 4. Use of Proceeds..... | Prospectus Summary; Use of Proceeds; Capitalization |
| 5. Determination of Offering Price..... | Outside Front Cover Page of Prospectus; Underwriting |
| 6. Dilution..... | Not Applicable |
| 7. Selling Security Holders..... | Principal and Selling Shareholders |
| 8. Plan of Distribution..... | Outside and Inside Front Cover Pages; Underwriting |
| 9. Description of Securities to be Registered..... | Outside Front Cover Page; Prospectus Summary; Capitalization; Description of Capital Stock |
| 10. Interests of Named Experts and Counsel.... | Legal Opinions; Experts |
| 11. Information with Respect to the Registrant..... | Outside and Inside Front Cover Pages; Prospectus Summary; Risk Factors; The Company; Use of Proceeds; Price Range for Common Stock and Dividends; Capitalization; Selected Financial Data; Management's Discussion and Analysis of Financial Condition and Results of Operations; Business; Directors and Executive Officers; Principal and Selling Shareholders; Description of Capital Stock; Shares Eligible for Future Sale; Legal Opinions; Experts; Financial Statements |
| 12. Disclosure of Commission Position on Indemnification for Securities Act Liabilities..... | Not Applicable |

INFORMATION CONTAINED HEREIN IS SUBJECT TO COMPLETION OR AMENDMENT. A REGISTRATION STATEMENT RELATING TO THESE SECURITIES HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. THESE SECURITIES MAY NOT BE SOLD NOR MAY OFFERS TO BUY BE ACCEPTED PRIOR TO THE TIME THE REGISTRATION STATEMENT BECOMES EFFECTIVE. THIS PROSPECTUS SHALL NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY NOR SHALL THERE BE ANY SALE OF THESE SECURITIES IN ANY STATE IN WHICH SUCH OFFER, SOLICITATION OR SALE WOULD BE UNLAWFUL PRIOR TO REGISTRATION OR QUALIFICATION UNDER THE SECURITIES LAWS OF ANY SUCH STATE.

SUBJECT TO COMPLETION, DATED JANUARY 11, 1996

1,500,000 SHARES

LOGO
LOGO

COMMON STOCK

Of the 1,500,000 shares of Common Stock offered hereby, 1,000,000 shares are being sold by Quality Systems, Inc. ("QSI" or the "Company") and 500,000 shares are being sold by certain Selling Shareholders. The Company will not receive any of the proceeds from the sale of shares by the Selling Shareholders. See "Use of Proceeds." The Common Stock of the Company is quoted on the Nasdaq National Market under the symbol "QSII." On January 10, 1996, the last sale price per share of the Common Stock as reported by the Nasdaq National Market was \$23.50. See "Price Range for Common Stock and Dividends."

THE SECURITIES OFFERED HEREBY INVOLVE A HIGH DEGREE OF RISK.
SEE "RISK FACTORS" AT PAGES 6 THROUGH 10.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

| | PRICE TO PUBLIC | UNDERWRITING DISCOUNTS AND COMMISSIONS(1) | PROCEEDS TO COMPANY(2) | PROCEEDS TO SELLING SHAREHOLDERS |
|----------------|--------------------|---|---------------------------|--|
| Per Share..... | \$ | \$ | \$ | \$ |
| Total(3)..... | \$ | \$ | \$ | \$ |

- (1) The Company and the Selling Shareholders have agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933. See "Underwriting."
- (2) Before deducting expenses payable by the Company estimated at \$450,000.
- (3) Certain of the Selling Shareholders have granted to the Underwriters a 30-day option to purchase up to 225,000 additional shares of Common Stock at the Price to Public, less Underwriting Discount, solely to cover over-allotments, if any. If the Underwriters exercise such option in full, the total Price to Public, Underwriting Discount and Commissions, Proceeds to Company and Proceeds to Selling Shareholders will be \$, \$, and \$, respectively. See "Underwriting."

The shares are offered by the Underwriters when, as and if delivered to and accepted by the Underwriters, and subject to various prior conditions, including their right to reject orders in whole or in part. It is expected that delivery of share certificates will be made in New York, New York on or about , 1996.

PACIFIC GROWTH EQUITIES, INC. CRUTTENDEN ROTH

INCORPORATED

The date of this Prospectus is , 1996

[QSI LOGO]

[PHOTO]

[PHOTO]

Quality Systems' health care information systems automate medical and dental practices and improve efficiency in such areas as billing, patient scheduling and insurance processing. These systems also permit enhanced quality of care by giving the health care professional access to treatment and outcome data.

[PHOTO]

The Company's health care information systems automate both medical and dental physician group practices, management services organizations ("MSOs"), physician hospital organizations ("PHOs"), health maintenance organizations ("HMOs") and community health centers with a focus on improving overall practice efficiency. These systems offer a broad range of applications for a wide variety of health care organizations.

[PHOTO]

QSI provides hardware and software system support to its clients seven days a week, 24 hours a day. The Company offers a selection of other client services including training, consulting and custom software development.

IN CONNECTION WITH THIS OFFERING, CERTAIN UNDERWRITERS AND SELLING GROUP MEMBERS (IF ANY) OR THEIR RESPECTIVE AFFILIATES MAY ENGAGE IN PASSIVE MARKET MAKING TRANSACTIONS IN THE COMPANY'S COMMON STOCK ON THE NASDAQ NATIONAL MARKET IN ACCORDANCE WITH RULE 10b-6A UNDER THE SECURITIES EXCHANGE ACT OF 1934. SEE "UNDERWRITING."

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE COMMON STOCK OF THE COMPANY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by the more detailed information and financial data appearing elsewhere in this Prospectus. Unless otherwise indicated, all information in this Prospectus assumes that the Underwriters' over-allotment option is not exercised.

THE COMPANY

Quality Systems, Inc. ("QSI" or the "Company") develops and markets health care information systems that automate medical and dental group practices, physician hospital organizations ("PHOs"), management service organizations ("MSOs"), health maintenance organizations ("HMOs") and community health centers. In response to the growing need for more comprehensive, cost-effective information solutions for physician and dental practice management, the Company's systems provide clients with the ability to redesign patient care and other workflow processes, to improve productivity and reduce information processing and administrative costs and to provide multi-site access to patient information. The Company's proprietary software systems include general patient information and summary medical records, appointment scheduling, billing, insurance claims submission and processing, managed care implementation and referral management, treatment outcome studies, treatment planning, drug formularies, word processing and accounting. In addition to providing fully integrated information solutions to its clients, the Company provides comprehensive hardware and software installation, maintenance and support services, system training services and electronic claims submission services. The Company is also introducing patient medical records automation for medical and dental practices utilizing proprietary software developed by Clinitec International Inc. ("Clinitec"), a developer of electronic medical records software systems.

The Company currently has an installed base of more than 475 operating health care information systems serving PHOs, MSOs, HMOs and other health care organizations, each of which consists of one to 120 physicians or dentists. According to Medical Data International, it is estimated that the physician practice management information systems market is currently \$1.8 billion. The Company believes that as health care providers are increasingly required to reduce costs while maintaining the quality of health care, the Company will be able to capitalize on its strategy of providing fully integrated information systems and superior customer service.

The Company was founded in 1974, with an early focus on providing information systems and services primarily for dental group practices. The Company's initial "turnkey" systems were designed to improve productivity while reducing information processing costs and personnel requirements. In the mid-1980's, the Company capitalized on the opportunity presented by the increasing pressure of cost containment on physicians and health care organizations and further expanded its information processing systems into the broader medical market. Today, the Company develops and provides integrated UNIX-based health care information systems for both the medical and dental markets. These systems operate on a stand-alone basis or in a networked environment and are expandable to accommodate client needs.

Augmenting its practice management software, the Company added electronic medical records software to its product line in 1995 through a strategic relationship with Clinitec. The Company presently holds a 25% interest in Clinitec and expects to increase its holdings to 51% by March 31, 1996. The Clinitec product, NextGen, permits scanning, annotation, retrieval and analysis of medical records in all formats, from documents to photographs and X-rays. NextGen has been developed using a client/server platform, a graphical user interface for compatibility with UNIX, Microsoft Windows, Windows NT and Windows 95 operating systems, and a relational database for flexibility in screen customization and logic flow. The Company is also in the process of developing an alternative client/server version of its "back office" products utilizing a graphical user interface with screens and templates similar to those in the NextGen product to enable a more seamless integration of the QSI and NextGen applications. With the addition of NextGen, the Company is able to provide its clients with a comprehensive information management solution. NextGen, in conjunction with the Company's practice management software, was first installed at a beta site in August 1995 and is currently being installed in two additional sites. General release of the combined systems is expected to occur in the quarter ending June 30, 1996.

THE OFFERING

| | |
|--|--|
| Common Stock offered | |
| By the Company..... | 1,000,000 shares |
| By the Selling Shareholders..... | 500,000 shares |
| Total..... | 1,500,000 shares |
| Common Stock to be outstanding after the offering..... | 5,653,491 shares(1) |
| Use of proceeds..... | For acquisition of shares resulting in a majority interest in Clinitec and for general corporate purposes, including the financing of product sales growth, development of new products, working capital requirements and potential other acquisitions. See "Use of Proceeds." |
| Nasdaq National Market symbol..... | QSII |

(1) Excludes 119,125 shares of Common Stock which were subject to outstanding options as of January 4, 1996 at a weighted average exercise price of \$2.55 per share under the Company's 1989 Stock Option Plan (the "1989 Plan"). See "Directors and Executive Officers -- 1989 Stock Option Plan" and Note 6 to Notes to Financial Statements.

SUMMARY FINANCIAL INFORMATION
(IN THOUSANDS, EXCEPT FOR PER SHARE DATA)

| | YEAR ENDED MARCH 31, | | | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|----------------------|----------|----------|-----------------------------------|----------|
| | 1993 | 1994 | 1995 | 1994 | 1995 |
| STATEMENT OF OPERATIONS: | | | | | |
| Net revenues: | | | | | |
| Sales of computer systems, upgrades and supplies..... | \$ 6,274 | \$ 6,146 | \$ 5,681 | \$ 2,730 | \$ 4,648 |
| Maintenance and other services..... | 5,377 | 5,606 | 6,368 | 3,137 | 3,340 |
| | 11,651 | 11,752 | 12,049 | 5,867 | 7,988 |
| Cost of products and services..... | 6,992 | 6,527 | 6,060 | 3,108 | 3,785 |
| Gross profit..... | 4,659 | 5,225 | 5,989 | 2,759 | 4,203 |
| Earnings from operations..... | 517 | 855 | 986 | 363 | 1,619 |
| Net earnings..... | \$ 623 | \$ 906 | \$ 962 | \$ 386 | \$ 1,065 |
| Net earnings per share(1)..... | \$ 0.15 | \$ 0.21 | \$ 0.21 | \$ 0.08 | \$ 0.23 |
| Weighted average shares used in computation..... | 4,187 | 4,342 | 4,606 | 4,643 | 4,679 |

AT SEPTEMBER 30, 1995

| ACTUAL | PRO FORMA AS ADJUSTED(2) |
|--------|-----------------------------|
|--------|-----------------------------|

BALANCE SHEET DATA:

| | | |
|---|----------|-----------|
| Cash and cash equivalents and short-term investments..... | \$ 6,295 | \$ 27,297 |
| Working capital..... | 8,201 | 29,224 |
| Total assets..... | 14,363 | 35,148 |
| Shareholders' equity..... | 10,471 | 29,651 |

(1) Net earnings per share reflects primary earnings per share for all periods indicated. Primary and fully diluted net earnings per share were the same for all periods except for the year ended March 31, 1994, for which fully diluted net earnings per share were \$0.20.

(2) Gives pro forma effect to the acquisition of an additional interest in Clinitec, providing the Company with a 51% ownership interest in Clinitec as if such acquisition had occurred on September 30, 1995, and adjusted to reflect the sale of 1,000,000 shares of Common Stock by the Company in the offering at an assumed public offering price of \$23.50 per share and the application of the estimated net proceeds therefrom. See "Use of Proceeds."

RISK FACTORS

Prospective investors should consider carefully the following factors, in addition to the other information contained or incorporated by reference in this Prospectus. Unless the context otherwise requires, as used in these risk factors, the term Company shall also include Clinitec after it becomes a majority-owned subsidiary of QSI.

DEPENDENCE ON PRINCIPAL PRODUCT AND NEW PRODUCT DEVELOPMENT

The Company currently derives substantially all of its net revenues from sales of its health care information systems and related services. The Company believes that a primary factor in the market acceptance of its systems has been its ability to meet the needs of users of health care information systems. The Company's future financial performance will depend in large part on the Company's ability to continue to meet the increasingly sophisticated needs of its clients through the timely development and successful introduction of new and enhanced versions of its systems and other complementary products. The Company has historically expended a significant amount of its net revenues on product development and believes that significant continuing product development efforts will be required to sustain the Company's growth.

There can be no assurance that the Company will be successful in its product development efforts, that the market will continue to accept the Company's existing or new products, or that products or product enhancements will be developed in a timely manner, meet the requirements of health care providers or achieve market acceptance. If new products or product enhancements do not achieve market acceptance, the Company's business, operating results and financial condition could be adversely affected. At certain times in the past, the Company has also experienced delays in purchases of its products by clients anticipating the launch of new products by the Company. There can be no assurance that material order deferrals in anticipation of new product introductions will not occur. See "Business -- Products," "-- Relationship with Clinitec" and "-- Product Enhancement and Development."

COMPETITION

The market for health care information systems is intensely competitive and the Company faces significant competition from a number of different sources. In addition, several of the Company's competitors have significantly greater financial, technical, product development and marketing resources than the Company. The industry is highly fragmented and includes numerous competitors, none of which the Company believes dominates the overall market for group practice management systems.

Among the Company's principal competitors are health care information systems companies such as IDX Corporation, Medic Computer Systems, Physician Computer Networks, Inc., and Cycare Systems, Inc. Furthermore, the Company also competes indirectly and to varying degrees with other major health group information companies, information management companies generally, and other software developers which may more directly enter the markets in which the Company competes. There can be no assurance that future competition will not have a material adverse effect on the Company's business, financial condition and results of operations. Competitive pressures and other factors, such as new product introductions by the Company or its competitors, may result in price erosion that could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company believes that once a health care provider has chosen a particular health care information system vendor, the provider will, for a period of time, be more likely to rely on that vendor for its future information system requirements. As the health care industry undergoes further consolidation, each sale of the Company's systems assumes even greater importance to the Company's business, financial condition and results of operations. The Company's inability to make initial sales of its systems to health care providers that are replacing or substantially modifying their health care information systems could have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Industry Background," "-- Sales and Marketing" and "-- Competition."

TECHNOLOGICAL CHANGE

The software market generally is characterized by rapid technological change, changing customer needs, frequent new product introductions and evolving industry standards. The introduction of products incorporating new technologies and the emergence of new industry standards could render the Company's existing products obsolete and unmarketable. There can be no assurance that the Company will be successful in developing and marketing new products that respond to technological changes or evolving industry standards. If the Company is unable, for technological or other reasons, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, the Company's business, results of operations and financial condition could be materially adversely affected.

The Company is currently developing a new generation of its software products that will be designed for the client/server environment. There can be no assurance that the Company will successfully develop these new software products or that these products will operate successfully on the principal client/server operating systems, which include UNIX, Microsoft Windows, Windows NT and Windows 95, or that any such development, even if successful, will be completed concurrently with or prior to introductions by competitors of products designed for the client/server environment. Any such failure or delay could adversely affect the Company's competitive position or could make the Company's current product line designed for the UNIX environment obsolete.

FLUCTUATIONS IN QUARTERLY OPERATING RESULTS

The Company's revenues and operating results have in the past fluctuated, and may in the future fluctuate, from quarter to quarter and period to period as a result of a number of factors including, without limitation, the size and timing of orders from clients; the length of sales cycles and installation processes; the ability of the Company's clients to obtain financing for the purchase of the Company's products; changes in pricing policies or price reductions by the Company or its competitors; the timing of new product announcements and product introductions by the Company or its competitors; the availability and cost of supplies; the financial stability of major clients; market acceptance of new products, applications and product enhancements; the Company's ability to develop, introduce and market new products, applications and product enhancements and to control costs; the Company's success in expanding its sales and marketing programs; deferrals of client orders in anticipation of new products, applications or product enhancements; changes in Company strategy; personnel changes; and general economic factors.

The Company's products are generally shipped as orders are received and accordingly, the Company has historically operated with little backlog. As a result, sales in any quarter are dependent on orders booked and shipped in that quarter and are not predictable with any degree of certainty. In addition, the Company's initial contact with a potential customer depends in significant part on the customer's decision to replace, or substantially modify, its existing information system. How and when to implement, replace or substantially modify an information system are major decisions for health care providers. Accordingly, the sales cycle for the Company's systems can vary significantly and typically ranges from three to 12 months from initial contact to contract execution and the installation cycle is typically two to three months from contract execution to completion of installation. Because a significant percentage of the Company's expenses are relatively fixed, a variation in the timing of systems sales and installations can cause significant variations in operating results from quarter to quarter. As a result, the Company believes that interim period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

Further, the Company's historical operating results are not necessarily indicative of future performance for any particular period and there can be no assurance that the Company's recent revenue growth or its profitability will continue on a quarterly or annual basis. Due to all of the foregoing factors, it is possible that in some future quarter the Company's operating results may be below the expectations of public market analysts and investors. In such event, the price of the Company's Common Stock would likely be materially adversely affected. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

PROPRIETARY TECHNOLOGY

The Company is heavily dependent on the maintenance and protection of its intellectual property and relies largely on license agreements, confidentiality procedures and employee nondisclosure agreements to protect its intellectual property. The Company's software is not patented and existing copyright laws offer only limited practical protection. There can be no assurance that the legal protections and precautions taken by the Company will be adequate to prevent misappropriation of the Company's technology or that competitors will not independently develop technologies equivalent or superior to the Company's. Further, the laws of some foreign countries do not protect the Company's proprietary rights to as great an extent as do the laws of the United States.

The Company does not believe that its operations or products infringe on the intellectual property rights of others. However, there can be no assurance that others will not assert infringement or trade secret claims against the Company with respect to its current or future products or that any such assertion will not require the Company to enter into a license agreement or royalty arrangements with the party asserting the claim. As competing health care information systems increase in complexity and overall capabilities and the functionality of these systems further overlaps, providers of such systems may become increasingly subject to infringement claims. Responding to and defending any such claims may distract the attention of Company management and have an adverse effect on the Company's business, financial condition and results of operations. In addition, claims may be brought against third parties from which the Company purchases software, and such claims could adversely affect the Company's ability to access third party software for its systems.

CLINITEC RELATIONSHIP

A principal component of the Company's business strategy is the acquisition of shares resulting in a majority interest in Clinitec. The Company's future financial results will depend in part on the Company's ability to successfully integrate Clinitec's business with the Company's, including Clinitec's ability to hire and retain high quality personnel for its operations. There can be no assurance that the Company will be able to successfully coordinate its business activities with those of Clinitec. Furthermore, there can be no assurance that the Company will be successful in integrating Clinitec products with those of the Company or that the acquisition of a majority interest in Clinitec will not have an adverse effect upon the Company's operating results. In addition, Clinitec has sold only a limited quantity of products to date and there can be no assurance that its product will receive market acceptance. See "Use of Proceeds" and "Business -- Relationship with Clinitec."

ABILITY TO MANAGE GROWTH

The Company has recently experienced a period of growth and increased personnel which has placed, and will continue to place, a significant strain on the Company's resources. The Company anticipates expanding its overall software development, marketing, sales, client management and training capacity. In the event the Company is unable to identify, hire, train and retain qualified individuals in such capacities within a reasonable time frame, such failure could have a material adverse effect on the Company. In addition, the Company's ability to manage future increases, if any, in the scope of its operations or personnel will depend on significant expansion of its research and development, marketing and sales, management and financial and administrative capabilities. The failure of the Company's management to effectively manage expansion in its business could have a material adverse effect on the Company's business, results of operations and financial condition. See "Business -- Relationship with Clinitec."

PRODUCT LIABILITY

Certain of the Company's products provide applications that relate to patient medical information. Any failure by the Company's products to provide accurate and timely information could result in claims against the Company. The Company maintains insurance to protect against claims associated with the use of its products, but there can be no assurance that its insurance coverage would adequately cover any claim asserted against the Company. A successful claim brought against the Company in excess of its insurance coverage could have

a material adverse effect on the Company's business, financial condition and results of operations. Even unsuccessful claims could result in the Company's expenditure of funds in litigation and management time and resources. There can be no assurance that the Company will not be subject to product liability claims, that such claims will not result in liability in excess of its insurance coverages, that the Company's insurance will cover such claims or that appropriate insurance will continue to be available to the Company in the future at commercially reasonable rates. Such claims could have a material adverse affect on the Company's business, financial condition and results of operations.

UNCERTAINTY IN HEALTH CARE INDUSTRY; GOVERNMENT REGULATION

The health care industry is subject to changing political, economic and regulatory influences that may affect the procurement practices and operation of health care facilities. During the past several years, the health care industry has been subject to an increase in governmental regulation of, among other things, reimbursement rates and certain capital expenditures. Certain legislators have announced that they intend to examine proposals to reform certain aspects of the U.S. health care system including proposals which may increase governmental involvement in health care, lower reimbursement rates and otherwise change the operating environment for the Company's clients. Health care providers may react to these proposals and the uncertainty surrounding such proposals by curtailing or deferring investments, including those for the Company's systems and related services. Cost containment measures instituted by health care providers as a result of regulatory reform or otherwise could result in greater selectivity in the allocation of capital funds. Such selectivity could have an adverse effect on the Company's ability to sell its systems and related services. The Company cannot predict what impact, if any, such proposals or health care reforms might have on its business, financial condition and results of operations.

The Company's software may be subject to regulation by the U.S. Food and Drug Administration (the "FDA") as a medical device. Such regulation could require the registration of the applicable manufacturing facility and software/hardware products, application of detailed recordkeeping and manufacturing standards, and FDA approval or clearance prior to marketing. An approval or clearance could create delays in marketing, and the FDA could require supplemental filings or object to certain of these applications. See "Business -- Governmental Regulation."

DEPENDENCE UPON KEY PERSONNEL

The Company's future performance also depends in significant part upon the continued service of its key technical and senior management personnel, many of whom have been with the Company for a significant period of time. Because the Company has a relatively small number of employees when compared to other leading companies in the same industry, its dependence on maintaining its employees is particularly significant. The Company is also dependent on its ability to attract and retain high quality personnel, particularly highly skilled software engineers for applications development. The industry is characterized by a high level of employee mobility and aggressive recruiting of skilled personnel. There can be no assurance that the Company's current employees will continue to work for the Company. Loss of services of key employees could have a material adverse effect on the Company's business, results of operations and financial condition. The Company does not maintain key man life insurance on any of its employees. The Company may need to grant additional options to key employees and provide other forms of incentive compensation to attract and retain such key personnel. See "Business -- Product Enhancement and Development" and "-- Employees."

STOCK OWNERSHIP OF OFFICERS AND DIRECTORS

The Company's executive officers and directors will beneficially own approximately 32.9% of the Company's outstanding shares of Common Stock immediately following this offering, or 29.0% in the event the over-allotment option is exercised. Accordingly, these shareholders will be able to significantly influence the outcome of the election of the Company's directors and of corporate actions requiring shareholder approval,

such as mergers and acquisitions. Such a high level of ownership by such persons may have a significant effect in delaying, deferring or preventing a change in control of the Company and may adversely affect the voting and other rights of other holders of Common Stock.

VOLATILITY OF STOCK PRICE; NO DIVIDENDS

The trading price of the Common Stock has been and is likely to continue to be subject to significant fluctuations in response to variations in quarterly operating results, the gain or loss of significant contracts, changes in management, announcements of technological innovations or new products by the Company or its competitors, legislative or regulatory changes, general trends in the industry and other events or factors. In addition, the stock market has experienced extreme price and volume fluctuations which have particularly affected the market price for many technology companies for reasons frequently unrelated to the operating performance of these companies. These broad market fluctuations may adversely affect the market price of the Company's Common Stock. The Company currently intends to retain any future earnings for use in its business and does not anticipate any cash dividends in the future. See "Price Range for Common Stock and Dividends."

SHARES ELIGIBLE FOR FUTURE SALE

Sales of substantial amounts of Common Stock in the public market after this offering could adversely affect the market price of the Common Stock. Upon the completion of this offering, the Company will have 5,653,491 shares of Common Stock outstanding. Of this amount, the 1,500,000 shares sold in this offering (plus any additional shares sold upon the Underwriters' exercise of their over-allotment option) and approximately 2,289,357 other shares (subject in certain cases to the volume and other limitations of Rule 144 as promulgated under the Securities Act of 1933, as amended ("Rule 144")) will be available for immediate sale in the public market as of the date of this Prospectus. An additional 1,864,134 shares will be available for sale in the public market (subject to the volume and other restrictions of Rule 144) following the expiration of the 90-day lock-up agreement with the Representatives of the Underwriters. See "Principal and Selling Shareholders," "Shares Eligible for Future Sale" and "Underwriting."

BROAD MANAGEMENT DISCRETION IN USE OF PROCEEDS

The Company has not yet identified specific uses for all of the net proceeds of this offering. Accordingly, the Company's management will retain broad discretion as to the allocation of the net proceeds of this offering. The Company will not receive any of the proceeds from the sale of shares of Common Stock offered by the Selling Shareholders. See "Use of Proceeds."

THE COMPANY

The Company was incorporated under the laws of California in April 1974. The Company's executive offices are located at 17822 East 17th Street, Suite 210, Tustin, California 92680 and its telephone number at that location is (714) 731-7171.

QS Quality Systems, Inc.(R), QS Quality Systems(R), and Quality Systems, Inc.(R), are trademarks of the Company, and QSI(R) is a service mark of the Company. NextGen(TM) is a trademark of Clinitec. This Prospectus also includes trade names and trademarks of companies other than the Company.

USE OF PROCEEDS

The net proceeds to be received by the Company from the sale of the 1,000,000 shares of Common Stock offered hereby, at an assumed offering price of \$23.50 per share, after deducting estimated underwriting discounts and expenses of the offering payable by the Company, are approximately \$21.7 million.

The Company intends to use the net proceeds from the offering as follows: (i) \$3 million to purchase shares of Clinitec pursuant to an option held by the Company, thereby providing the Company a 51% ownership interest in Clinitec; and (ii) approximately \$18.7 million for general corporate purposes, including the financing of product sales growth, development of new products, working capital requirements and the possible acquisitions of complementary businesses and technologies. The Company currently has no agreement or understanding with respect to any such acquisitions. Pending the use thereof, the Company intends to invest the net proceeds in short-term, interest-bearing investment-grade securities. See "Business -- Relationship with Clinitec."

The Company will not receive any of the proceeds from the sale of shares of Common Stock offered by the Selling Shareholders.

PRICE RANGE FOR COMMON STOCK AND DIVIDENDS

The Company's Common Stock is traded on the Nasdaq National Market under the symbol "QSII." The following table sets forth for the quarters indicated, the reported high and low closing sales prices as reported by Nasdaq.

| | HIGH ---- | LOW ---- |
|--|--------------|-------------|
| FISCAL 1994: | | |
| First Quarter..... | \$ 2-3/4 | \$ 1-3/4 |
| Second Quarter..... | 2-1/4 | 1-1/2 |
| Third Quarter..... | 2-3/4 | 1-3/4 |
| Fourth Quarter..... | 8-1/4 | 2-1/2 |
| FISCAL 1995: | | |
| First Quarter..... | \$ 7 | \$ 4-1/4 |
| Second Quarter..... | 4-3/4 | 3-1/2 |
| Third Quarter..... | 4-3/8 | 2-1/2 |
| Fourth Quarter..... | 3-3/4 | 2-1/8 |
| FISCAL 1996: | | |
| First Quarter..... | \$ 4-7/8 | \$ 3 |
| Second Quarter..... | 17-1/8 | 4-1/2 |
| Third Quarter..... | 31-1/2 | 14-1/16 |
| Fourth Quarter (through January 10, 1996)..... | 29-1/2 | 23-1/2 |

At January 10, 1996 there were approximately 203 holders of record of the Company's outstanding shares of Common Stock, and the closing sale price of the Common Stock on the Nasdaq National Market was \$23.50 per share.

The Company anticipates that all future earnings, if any, will be retained for use in the Company's business and it does not anticipate paying any cash dividends in the future. Payment of future dividends, if any, will be at the discretion of the Company's Board of Directors after taking into account various factors, including the Company's financial condition, operating results, current and anticipated cash needs and plans for expansion.

CAPITALIZATION

The following table sets forth the actual capitalization of the Company at September 30, 1995, and the pro forma and as adjusted capitalization of the Company after giving effect to the acquisition of a majority interest in Clinitec and the sale of 1,000,000 shares of Common Stock offered hereby (assuming an offering price of \$23.50 per share) and the receipt of the estimated net proceeds therefrom, respectively.

| | SEPTEMBER 30, 1995 | | |
|--|------------------------|--------------|--------------------------|
| | ACTUAL | PRO FORMA(1) | PRO FORMA AS ADJUSTED(1) |
| | (DOLLARS IN THOUSANDS) | | |
| Shareholders' equity: | | | |
| Common stock, \$.01 par value, 20,000,000 shares authorized, 4,569,241 shares issued and outstanding(2)..... | \$ 46 | \$ 46 | \$ 56 |
| Additional paid-in capital..... | 6,169 | 6,169 | 27,859 |
| Unrealized loss on available-for-sale securities..... | (57) | (57) | (57) |
| Retained earnings..... | 4,313 | 1,793 | 1,793 |
| Total shareholders' equity..... | \$10,471 | \$7,951 | \$ 29,651 |
| | ===== | ===== | ===== |

(1) Gives pro forma effect to the acquisition of an additional interest in Clinitec, providing the Company with a 51% ownership interest in Clinitec as if such acquisition had occurred at September 30, 1995. See "Use of Proceeds" and "Business -- Relationship with Clinitec."

(2) Excludes 810,875 shares of Common Stock reserved for issuance under the Company's 1989 Plan of which 201,375 shares of Common Stock were subject to outstanding options at a weighted average exercise price of \$1.89. See "Directors and Executive Officers -- 1989 Stock Option Plan."

SELECTED FINANCIAL DATA
(IN THOUSANDS, EXCEPT FOR PER SHARE DATA)

The following selected financial data with respect to the Company's statements of operations for each of the five years in the period ended March 31, 1995 and the balance sheet data as of March 31, 1991, 1992, 1993, 1994 and 1995 are derived from the audited financial statements of the Company. The statement of operations data of the Company for the six months ended September 30, 1994 and 1995 and the balance sheet data as of September 30, 1995 are unaudited and were prepared by management of the Company on the same basis as the audited financial statements included elsewhere herein and, in the opinion of the Company, include all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the information set forth therein. The results for the six months ended September 30, 1995 are not necessarily indicative of the results to be expected for the full year ending March 31, 1996 or future periods. The pro forma financial data presented in the table below are derived from the unaudited pro forma consolidated financial statements of the Company included elsewhere in this Prospectus, which give effect to the Company's planned acquisition of a majority interest in Clinitec. The following information should be read in conjunction with the Financial Statements of the Company and Clinitec and the related notes thereto, the pro forma consolidated financial statements of the Company and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Prospectus.

| | YEAR ENDED MARCH 31, | | | | | SIX MONTHS ENDED SEPTEMBER 30, | | PRO FORMA(1) | |
|---|----------------------|-----------|----------|----------|----------|--------------------------------------|---------|---------------------------------|--|
| | 1991 | 1992 | 1993 | 1994 | 1995 | 1994 | 1995 | YEAR ENDED MARCH 31, 1995 | SIX MONTHS ENDED SEPTEMBER 30, 1995 |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| STATEMENT OF OPERATIONS DATA: | | | | | | | | | |
| Net revenues: | | | | | | | | | |
| Sales of computer systems, upgrades and supplies.... | \$ 8,844 | \$ 6,972 | \$ 6,274 | \$ 6,146 | \$ 5,681 | \$2,730 | \$4,648 | \$ 5,735 | \$ 5,221 |
| Maintenance and other services..... | 4,281 | 4,738 | 5,377 | 5,606 | 6,368 | 3,137 | 3,340 | 6,368 | 3,340 |
| | 13,125 | 11,710 | 11,651 | 11,752 | 12,049 | 5,867 | 7,988 | 12,103 | 8,561 |
| Cost of products and services..... | 8,815 | 7,506 | 6,992 | 6,527 | 6,060 | 3,108 | 3,785 | 6,080 | 3,983 |
| Gross profit..... | 4,310 | 4,204 | 4,659 | 5,225 | 5,989 | 2,759 | 4,203 | 6,023 | 4,578 |
| Operating expenses: | | | | | | | | | |
| Selling, general and administrative..... | 4,003 | 3,458 | 3,008 | 3,052 | 3,536 | 1,680 | 1,928 | 3,900 | 2,578 |
| Research and development... | 961 | 1,148 | 1,134 | 1,318 | 1,467 | 716 | 656 | 1,645 | 716 |
| Total operating expenses..... | 4,964 | 4,606 | 4,142 | 4,370 | 5,003 | 2,396 | 2,584 | 5,545 | 3,294 |
| Earnings (loss) from operations..... | (654) | (402) | 517 | 855 | 986 | 363 | 1,619 | 478 | 1,284 |
| Interest and investment income..... | 302 | 204 | 192 | 400 | 429 | 121 | 205 | 429 | 208 |
| Equity in loss of Clinitec... | -- | -- | -- | -- | -- | -- | (18) | -- | -- |
| Minority interest in loss of Clinitec..... | -- | -- | -- | -- | -- | -- | -- | 191 | 133 |
| Earnings (loss) before income tax provision..... | (352) | (198) | 709 | 1,255 | 1,415 | 484 | 1,806 | 1,098 | 1,625 |
| Income tax provision(3)..... | -- | -- | 86 | 349 | 453 | 98 | 741 | 406 | 717 |
| Net earnings (loss)..... | \$ (352) | \$ (198) | \$ 623 | \$ 906 | \$ 962 | \$ 386 | \$1,065 | \$ 692 | \$ 908 |
| Net earnings (loss) per share(4)..... | \$ (0.08) | \$ (0.05) | \$ 0.15 | \$ 0.21 | \$ 0.21 | \$ 0.08 | \$ 0.23 | \$ 0.15 | \$ 0.19 |
| Weighted average shares outstanding..... | 4,187 | 4,187 | 4,187 | 4,342 | 4,606 | 4,643 | 4,679 | 4,734(5) | 4,807(5) |

| | AS OF MARCH 31, | | | | | SEPTEMBER 30, 1995 | |
|--|-----------------|----------|----------|----------|----------|--------------------|--------------|
| | 1991 | 1992 | 1993 | 1994 | 1995 | ACTUAL | PRO FORMA(6) |
| | ----- | ----- | ----- | ----- | ----- | ----- | ----- |
| BALANCE SHEET DATA: | | | | | | | |
| Cash and cash equivalents and short term investments..... | \$ 3,197 | \$ 3,453 | \$ 4,778 | \$ 6,071 | \$ 7,322 | \$ 6,295 | \$ 5,597 |
| Working capital..... | 4,604 | 4,691 | 5,204 | 6,857 | 8,032 | 8,201 | 7,524 |
| Total assets..... | 8,942 | 8,805 | 9,596 | 11,094 | 12,668 | 14,363 | 13,448 |
| Total liabilities and minority interest..... | 2,844 | 2,906 | 3,074 | 3,054 | 3,480 | 3,892 | 5,497 |
| Shareholders' equity..... | 6,098 | 5,899 | 6,522 | 8,040 | 9,188 | 10,471 | 7,951 |

PRO FORMA
AS ADJUSTED(6)(7)

BALANCE SHEET DATA:

| | |
|---|----------|
| Cash and cash equivalents and short term investments..... | \$27,297 |
| Working capital..... | 29,224 |
| Total assets..... | 35,148 |
| Total liabilities and minority interest..... | 5,497 |
| Shareholders' equity..... | 29,651 |

- - - - -

- (1) Gives pro forma effect to the acquisition of an additional interest in Clinitec, providing the Company with a 51% ownership interest in Clinitec as if such acquisition had occurred on April 1, 1994. See "Use of Proceeds" and "Business -- Relationship with Clinitec."
- (2) Of the purchase price for the additional shares of Clinitec, \$3.8 million has been allocated to in-process research and development and is to be written off, net of tax benefit of \$1.3 million, at the time of the purchase. The effect of this write-off has not been reflected in the pro forma operating results.
- (3) The income tax provision for the year ended March 31, 1993 is net of an extraordinary credit resulting from the tax benefit from utilization of net operating loss carryforwards.
- (4) Net earnings (loss) per share reflects primary earnings (loss) per share for all periods indicated. Primary and fully diluted net earnings (loss) per share were the same for all periods except for the year ended March 31, 1994, for which fully diluted net earnings per share were \$0.20.
- (5) Assumes as outstanding 128,000 shares being offered by the Company hereby, which represents the approximate number of shares that have to be sold to fund the purchase of the additional shares of Clinitec.
- (6) Gives pro forma effect to the acquisition of an additional interest in Clinitec, providing the Company with a 51% ownership interest in Clinitec as if such acquisition had occurred on September 30, 1995 and the writeoff referenced in footnote 2 above.
- (7) Pro forma amounts adjusted to give effect to the sale of 1,000,000 shares of Common Stock by the Company in the offering at an assumed public offering price of \$23.50 per share and the application of the estimated net proceeds therefrom.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Since fiscal 1993, approximately one-half of the Company's revenues have been derived from sales of computer systems, upgrades and supplies, with the balance derived from systems maintenance agreements and other support services. On sales of its systems, upgrades and supplies, the Company recognizes revenues upon shipment of products. Revenues attributable to the Company's software products included with the systems are also recognized upon shipment, unless the Company's installation obligations after shipment are significant, in which case revenues are recognized on a percentage of completion basis. Revenues from systems maintenance are typically recognized ratably over the life of the contract. In the last five years, more than 90% of the Company's clients have elected to purchase the Company's maintenance and support services.

During the past five years, the Company's systems sales have been impacted by a number of factors which have had the effect of reducing systems sales and systems upgrade sales while at the same time increasing the relative profitability of these sales. Historically, the costs for the hardware components used in the Company's systems have consistently declined while the performance and capacity of such components have continually increased. Consistent with the marketplace, the Company has adjusted its systems pricing to its clients to reflect these decreased hardware costs. In addition, the Company increasingly encounters prospective clients that already own, or desire to acquire from third parties, significant quantities of hardware which may be utilized with the Company's software. In such instances, the sales generated from such clients are lower than they otherwise would be.

As a result of these market changes, the Company has increasingly focused its efforts on the sale of its software user licenses and services, resulting in higher margins. Aiding these efforts has been the continuing increase in the capacity of the hardware components which the Company markets. The Company has had a growing market for the sale of additional software user licenses to its existing clients as such clients can often add more software user capacity to their system with minimal or no change to their current central processing unit. Such clients frequently also purchase hardware peripherals from the Company for use with the newly purchased software user licenses.

The first six months of fiscal 1996 have seen a marked increase in the Company's system revenues. The Company attributes this increase to the dynamic changes currently occurring in the health care industry and to growing acceptance of the Company's products and services. Health care providers, faced with economic pressures to reduce costs and increase productivity, are increasingly aligning with HMOs, hospitals and other health care organizations as well as consolidating with other health care providers into larger, more efficient business entities. This trend results in an increase in the number of large and complex health care organizations that are potential clients for the Company's sophisticated systems. In addition, the continued growth of these organizations after they become clients of the Company presents the potential for the Company to increase sales of upgrades and additional software user licenses. The Company's ability to address the complex software requirements of such newly forming or growing business entities, in particular in the area of managed care, is a key to success in this changing health care delivery environment.

The sales cycle for the Company's systems typically ranges from three to 12 months from initial contact to contract execution. The installation cycle is typically two to three months from contract execution to completion of installation. Because a significant percentage of the Company's expenses are relatively fixed, a variation in the timing of systems sales and installations can cause significant variations in operating results from quarter to quarter.

The Company's products are generally shipped as orders are received and accordingly, the Company has historically operated with little backlog. As a result, sales in any quarter are dependent on orders booked and shipped in that quarter and are not predictable with any degree of certainty. As a result, the Company believes that interim period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

The Company's research and development expenses consist primarily of personnel and equipment costs required to conduct the Company's product development effort. The Company believes that significant investments in research and development are required to remain competitive. As a consequence, in recent years, the Company has increased the amount of its expenditures on research and development, mainly through the employment of additional development personnel. Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional development costs are capitalized and amortized over periods ranging from three to five years.

In connection with the acquisition of a 51% interest in Clinitec, the Company expects to take a writeoff for purchased in-process research and development of \$3.8 million in the quarter ending March 31, 1996. The exact amount of this writeoff is subject to change pending the timing of this transaction and ultimate purchase allocations to be made by the Company.

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Financial Statements and related notes thereto included elsewhere in this Prospectus. Historical results of operations, percentage margin fluctuations and any trends that may be inferred from the discussion below are not necessarily indicative of the operating results for any future period.

RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, the percentage of net revenues represented by each item in the Company's statement of operations.

| | YEAR ENDED MARCH 31, | | | SIX MONTHS ENDED SEPTEMBER 30, | |
|--|----------------------|-------|-------|--------------------------------------|-------|
| | 1993 | 1994 | 1995 | 1994 | 1995 |
| Net revenues: | | | | | |
| Sales of computer systems, upgrades and supplies..... | 53.8% | 52.3% | 47.1% | 46.5% | 58.2% |
| Maintenance and other services..... | 46.2 | 47.7 | 52.9 | 53.5 | 41.8 |
| | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of products and services..... | 60.0 | 55.5 | 50.3 | 53.0 | 47.4 |
| Gross profit..... | 40.0 | 44.5 | 49.7 | 47.0 | 52.6 |
| Operating expenses: | | | | | |
| Selling, general and administrative..... | 25.8 | 26.0 | 29.3 | 28.6 | 24.1 |
| Research and development..... | 9.7 | 11.2 | 12.2 | 12.2 | 8.2 |
| Total operating expenses..... | 35.5 | 37.2 | 41.5 | 40.8 | 32.3 |
| Earnings from operations..... | 4.5 | 7.3 | 8.2 | 6.2 | 20.3 |
| Interest and investment income..... | 1.6 | 3.4 | 3.6 | 2.1 | 2.6 |
| Equity in loss of Clinitec..... | -- | -- | -- | -- | (0.3) |
| Earnings before income tax provision..... | 6.1 | 10.7 | 11.8 | 8.3 | 22.6 |
| Income tax provision..... | 0.8 | 3.0 | 3.8 | 1.7 | 9.3 |
| Net earnings..... | 5.3% | 7.7% | 8.0% | 6.6% | 13.3% |

FOR THE SIX-MONTH PERIODS ENDED SEPTEMBER 30, 1995 AND 1994

NET REVENUES. Net revenues for the six months ended September 30, 1995 increased 36.1% to \$8.0 million from \$5.9 million for the six months ended September 30, 1994. This increase was due primarily to sales of computer systems, upgrades, including software user licenses, and supplies, which grew 70.4% to \$4.6 million from \$2.7 million. This growth resulted from an increase in the number of larger systems and from increased sales of upgrades. Net revenues from maintenance and other services grew 6.5% to \$3.3 million from \$3.1 million.

COSTS OF PRODUCTS AND SERVICES. Cost of products and services for the six months ended September 30, 1995 increased 21.8% to \$3.8 million from \$3.1 million for the six months ended September 30, 1994. This increase was due primarily to the increase in systems sold and in net revenues. As a percentage of net revenues, cost of products and services decreased to 47.4% from 53.0%. This decrease was due to an increase in the proportion of revenue from lower cost items.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses for the six months ended September 30, 1995 increased 14.8% to \$1.9 million from \$1.7 million for the six months ended September 30, 1994. This increase was primarily attributable to increases in sales and administrative personnel. These increases were more than offset by increased sales during the same period, resulting in a decrease in selling, general and administrative expenses, as a percentage of revenues, to 24.1% from 28.6%.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses for the six months ended September 30, 1995 decreased 8.4% to \$656,000 from \$716,000 for the six months ended September 30, 1994. The decrease in research and development expenses resulted from a higher proportion of capitalized software. Total research and development expenditures and capitalized software increased to \$869,000 from \$793,000. The Company anticipates increased expenditures in capitalized software in connection with developing an alternate version of certain of its products for the client/server environment to take advantage of new more powerful technologies and to allow for a more seamless integration of the Company's and Clinitec's NextGen applications.

INTEREST AND INVESTMENT INCOME. Interest and investment income for the six months ended September 30, 1995 increased 69.4% to \$205,000 from \$121,000 for the six months ended September 30, 1994. Current period investment results represent an annualized yield of approximately 6.0% on the Company's combined balances for cash and cash equivalents and short-term investments. Interest and investment income for the six months ended September 30, 1994 included prior year first quarter realized losses of \$81,000 from sales of short-term investments and first quarter unrealized losses of \$10,000 from trading securities.

INCOME TAX PROVISION. Income tax provision for the six months ended September 30, 1995 increased 656.1% to \$741,000 from \$98,000 for the six month ended September 30, 1994. This increase was due to increased earnings before income tax provision and an increase in effective tax rates. The effective tax rates for the respective periods were 41.0% and 20.2%. The rate for the prior period was lower due to utilization of a deferred tax valuation allowance related to net operating loss carryforwards.

FOR THE YEARS ENDED MARCH 31, 1995 AND 1994.

NET REVENUES. Net revenues were relatively unchanged for the year ended March 31, 1995 increasing 2.5% to \$12.0 million from \$11.8 million for the year ended March 31, 1994. Revenues derived from maintenance and other services increased 13.6% to \$6.4 million from \$5.6 million as a result of the Company's larger installed base of systems and higher prices for services. Revenues attributable to sales of computer systems, upgrades and supplies decreased 7.6% to \$5.7 million from \$6.1 million due to decreased systems sales during fiscal 1995.

COST OF PRODUCTS AND SERVICES. Cost of products and services for the year ended March 31, 1995 decreased 7.2% to \$6.1 million from \$6.5 million for the year ended March 31, 1994. This decrease was due to an increase in the proportion of revenues from lower cost items comprising net revenues and also resulted in these costs, as a percentage of net revenues, decreasing to 50.3% from 55.5%.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses for the year ended March 31, 1995 increased 15.9% to \$3.5 million from \$3.1 million for the year ended March 31, 1994 as a result of increases in selling efforts and sales personnel, thereby increasing these expenses, as a percentage of net revenues, to 29.3% from 26.0%.

RESEARCH AND DEVELOPMENT EXPENSES. The amount of expenditures charged to research and development expense for the year ended March 31, 1995 increased 11.3% to \$1.5 million from \$1.3 million for the year ended March 31, 1994. Total research and development expenditures, including the amount charged to capitalized software, increased 10.4% to \$1.7 million from \$1.5 million, and as a percentage of net revenues, to

13.8% from 12.8%. This increase was primarily attributable to development of enhancements and additions to the Company's systems.

INTEREST AND INVESTMENT INCOME. Interest and investment income for the year ended March 31, 1995 increased 7.3% to \$429,000 from \$400,000 for the year ended March 31, 1994. This increase was due to an increase in funds available for investment.

INCOME TAX PROVISION. Income tax provision for the year ended March 31, 1995 increased 29.8% to \$453,000 from \$349,000 for the year ended March 31, 1994. This was due to increased earnings before income tax provision and an increase in effective tax rates. The effective tax rates for the respective periods were 32.0% and 27.8%. These lower than normal rates were due to utilization of a deferred tax valuation allowance related to net operating loss carryforwards.

FOR THE YEARS ENDED MARCH 31, 1994 AND 1993.

NET REVENUES. Net revenues were relatively unchanged for the year ended March 31, 1994, increasing 0.9% to \$11.8 million from \$11.7 million for the year ended March 31, 1993. Revenues derived from maintenance and other services increased 4.3% to \$5.6 million from \$5.4 million. Revenues from sales of computer systems, upgrades and supplies decreased 2.0% to \$6.1 million from \$6.3 million.

COST OF PRODUCTS AND SERVICES. Cost of products and services for the year ended March 31, 1994 decreased 6.7% to \$6.5 million from \$7.0 million for the year ended March 31, 1993. This decrease was due to an increase in the proportion of revenues from lower cost items comprising net revenue and to successful results from the Company's cost containment program, resulting in reducing costs, as a percentage of revenues, to 55.5% from 60.0%.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses were relatively unchanged in the year ended March 31, 1994, increasing 1.5% to \$3.1 million from \$3.0 million for the year ended March 31, 1993, and as a percentage of net revenues to 26.0% from 25.8%.

RESEARCH AND DEVELOPMENT EXPENSES. The amount of expenditures charged to research and development expense for the year ended March 31, 1994 increased 16.2% to \$1.3 million from \$1.1 million for the year ended March 31, 1993. Total research and development expenditures, including the amount charged to capitalized software, increased 17.1% to \$1.5 million from \$1.3 million, and as a percentage of net revenues to 12.8% from 11.0%.

INTEREST AND INVESTMENT INCOME. Interest and investment income for the year ended March 31, 1994 increased 108.3% to \$400,000 from \$192,000 for the year ended March 31, 1993. This increase was due to an increase in funds available for investment and a change in the investment mix in order to increase yields.

INCOME TAX PROVISION. Income tax provision for the year ended March 31, 1994, increased 305.8% to \$349,000 from \$86,000 for the year ended March 31, 1993. The income tax expense for the year ended March 31, 1994, resulted from an initial tax expense of \$331,000 which was offset by a \$245,000 tax benefit from utilization of tax loss carryforwards. The effective tax rates were 27.8% and 12.1%, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Since inception, the Company has financed its operations primarily through cash generated from operations. Net cash provided by operating activities was \$1.8 million, \$1.2 million and \$1.2 million for the years ended March 31, 1993, 1994 and 1995 and \$563,000 and \$128,000 for the six months ended September 30, 1994 and 1995, respectively. Net cash provided from operating activities consists principally of net earnings plus increases in income taxes payable offset by increases in accounts receivables. The amounts for the period ended September 30, 1995 were reduced principally by an increase in accounts receivable of \$1.7 million.

Net cash provided by (used in) investing activities was \$1.3 million, \$(4.0) million, and \$3.6 million for the years ended March 31, 1993, 1994 and 1995 and \$1.1 million and \$(1.3) million for six months ended September 30, 1994 and 1995, respectively. Net cash provided by (used in) investing activities consists principally of changes in short-term investments as well as additions to equipment and improvements and

capitalized software. The amounts for the period ended September 30, 1995 were reduced by the Company's purchase of a 25% equity interest in Clinitec for \$1.0 million.

At September 30, 1995, the Company had cash and cash equivalents of \$5.0 million and short-term investments of \$1.3 million. Short-term investments include debt securities issued by foreign governments of \$314,000 and an investment in a hedge fund which trades in special situation securities of \$517,000. The Company does not believe these investments have significant principal risk; however, there can be no assurance that the markets for these securities will not change, causing a loss of principal.

Except for the Company's intention to exercise its option to obtain a majority interest of Clinitec, and to expend funds on capitalized software in connection with alternative versions of certain of its products for the client/server environment to take advantage of more powerful technologies and to enable a more seamless integration of the Company's and Clinitec's NextGen applications, the Company has no significant capital commitments and currently anticipates that additions to property and equipment for the remainder of fiscal 1996 and fiscal 1997 will be comparable to recent past years. See "Use of Proceeds" and "Business -- Relationship with Clinitec."

The Company believes that the net proceeds from the sale of the Common Stock offered hereby, together with its current cash balances and cash flow from operations, if any, will be sufficient to meet its working capital and capital expenditure requirements through fiscal 1997.

QUARTERLY RESULTS

The following tables set forth certain unaudited statement of operations data for the six quarters ended September 30, 1995. These data have been derived from unaudited financial statements that, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of such information when read in conjunction with the Company's audited financial statements and notes thereto.

The Company believes that results of operations for the interim periods are not necessarily indicative of the results to be expected for any future period.

| | QUARTER ENDED | | | | | |
|---|----------------|-------------------|------------------|---------------|--------------|-------------------|
| | JUNE 1994 | SEPTEMBER 1994 | DECEMBER 1994 | MARCH 1995 | JUNE 1995 | SEPTEMBER 1995 |
| | (IN THOUSANDS) | | | | | |
| Net revenues: | | | | | | |
| Sales of computer systems, upgrades and supplies..... | \$1,582 | \$ 1,148 | \$1,165 | \$1,786 | \$2,124 | \$ 2,524 |
| Maintenance and other services..... | 1,491 | 1,646 | 1,590 | 1,641 | 1,680 | 1,660 |
| | 3,073 | 2,794 | 2,755 | 3,427 | 3,804 | 4,184 |
| Cost of products and services..... | 1,652 | 1,456 | 1,390 | 1,562 | 1,713 | 2,072 |
| Gross profit..... | 1,421 | 1,338 | 1,365 | 1,865 | 2,091 | 2,112 |
| Operating expenses: | | | | | | |
| Selling, general and administrative..... | 836 | 844 | 901 | 955 | 926 | 1,002 |
| Research and development..... | 329 | 387 | 394 | 357 | 355 | 301 |
| Total operating expenses..... | 1,165 | 1,231 | 1,295 | 1,312 | 1,281 | 1,303 |
| Earnings from operations..... | 256 | 107 | 70 | 553 | 810 | 809 |
| Interest and investment income (loss).... | (12) | 133 | 128 | 180 | 104 | 101 |
| Equity in loss of Clinitec..... | -- | -- | -- | -- | (10) | (8) |
| Earnings before income tax provision..... | 244 | 240 | 198 | 733 | 904 | 902 |
| Income tax provision..... | 44 | 54 | 60 | 295 | 367 | 374 |
| Net earnings..... | \$ 200 | \$ 186 | \$ 138 | \$ 438 | \$ 537 | \$ 528 |

The Company's revenues and operating results have fluctuated from quarter to quarter as a result of a number of factors including, without limitation, the size and timing of orders from major clients; the length of sales cycles and installation processes; the ability of the Company's clients to obtain financing for the purchase of the Company's products; changes in pricing policies or price reductions by the Company or its competitors; the timing of new product announcements and product introductions by the Company or its competitors; the availability and cost of supplies; the financial stability of major clients; market acceptance of new products, applications and product enhancements; the Company's ability to develop, introduce and market new products, applications and product enhancements and to control costs; the Company's success in expanding its sales and marketing programs; deferrals of client orders in anticipation of new products, applications or product enhancements; changes in Company strategy; personnel changes; and general economic factors. Because a significant percentage of the Company's expenses are relatively fixed, a variation in the timing of systems sales and installations can cause significant variations in operating results from quarter to quarter. As a result, the Company believes that interim period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. Further, the Company's historical operating results are not necessarily indicative of future performance for any particular period and there can be no assurance that the Company's recent revenue growth or its profitability will continue on a quarterly or annual basis. Due to all of the foregoing factors, it is possible that in some future quarter the Company's operating results may be below the expectations of public market analysts and investors. In such event, the price of the Company's Common Stock would likely be materially adversely affected.

BUSINESS

Quality Systems, Inc. ("QSI" or the "Company") develops and markets health care information systems that automate medical and dental group practices, physician hospital organizations ("PHOs"), management service organizations ("MSOs"), health maintenance organizations ("HMOs") and community health centers. In response to the growing need for more comprehensive, cost-effective information solutions for physician and dental practice management, the Company's systems provide clients with the ability to redesign patient care and other workflow processes, to improve productivity and reduce information processing and administrative costs and to provide multi-site access to patient information. The Company's proprietary software systems include general patient information and summary medical records, appointment scheduling, billing, insurance claims submission and processing, managed care implementation and referral management, treatment outcome studies, treatment planning, drug formularies, word processing and accounting. In addition to providing fully integrated information solutions to its clients, the Company provides comprehensive hardware and software installation, maintenance and support services, system training services and electronic claims submission services. The Company is also introducing patient medical records automation for medical and dental practices utilizing proprietary software developed by Clinitec International Inc. ("Clinitec"), a developer of electronic medical records software systems.

The Company currently has an installed base of more than 475 operating health care information systems serving PHOs, MSOs, HMOs and other health care organizations, each of which consists of one to 120 physicians or dentists. According to Medical Data International, it is estimated that the physician practice management information systems market is currently \$1.8 billion. The Company believes that as health care providers are increasingly required to reduce costs while maintaining the quality of health care, the Company will be able to capitalize on its strategy of providing fully integrated information systems and superior customer service.

The Company was founded in 1974, with an early focus on providing information systems and services primarily for dental group practices. The Company's initial "turnkey" systems were designed to improve productivity while reducing information processing costs and personnel requirements. In the mid-1980's, the Company capitalized on the opportunity presented by the increasing pressure of cost containment on physicians and health care organizations and further expanded its information processing systems into the broader medical market. Today, the Company develops and provides integrated UNIX-based health care information systems for both the medical and dental markets. These systems operate on a stand-alone basis or in a networked environment and are expandable to accommodate client needs.

Augmenting its practice management software, the Company added electronic medical records software to its product line in 1995 through a strategic relationship with Clinitec. The Company presently holds a 25% interest in Clinitec and expects to increase its holdings to 51% by March 31, 1996. The Clinitec product, NextGen, permits scanning, annotation, retrieval and analysis of medical records in all formats, from documents to photographs and X-rays. NextGen has been developed using a client/server platform, a graphical user interface for compatibility with UNIX, Microsoft Windows, Windows NT and Windows 95 operating systems, and a relational database for flexibility in screen customization and logic flow. The Company is also in the process of developing an alternative client/server version of its "back office" products utilizing a graphical user interface with screens and templates similar to those in the NextGen product to enable a more seamless integration of the QSI and NextGen applications. With the addition of NextGen, the Company is able to provide its clients with a comprehensive information management solution. NextGen, in conjunction with the Company's practice management software, was first installed at a beta site in August 1995 and is currently being installed in two additional sites. General release of the combined systems is expected to occur in the quarter ending June 30, 1996.

INDUSTRY BACKGROUND

Health care costs in the United States have risen dramatically over the past two decades relative to the overall rate of inflation. Consequently, broad pressures to reduce costs without sacrificing the quality of care have caused significant changes in the health care industry. While reimbursement for health care has historically

been based on a fee-for-service model of payment, managed care organizations and other payors are increasingly utilizing alternative reimbursement models, including fixed fee and capitation, that shift the financial risk of delivering health care from payors to both physicians and institutional providers. Pressures to control costs have also contributed to the movement of care from more expensive inpatient settings, such as hospitals, to outpatient settings, such as clinics and physician offices. Today, outpatient care providers, particularly physician groups, deliver an increasing amount of health care services, bear an increasing share of the financial risk and control a substantial portion of total health care resources.

To compete in the changing health care environment, physicians and other outpatient care providers are increasingly joining and affiliating with other physicians, managed care organizations, hospitals and other enterprises to form larger health care organizations such as PHOs, MSOs and HMOs. These organizations are designed to take advantage of economies of scale associated with managing health care services for large patient populations across inpatient and outpatient settings, while achieving improved quality, reduced costs and strengthened negotiating positions with managed care entities. In the managed care environment, health care organizations are increasingly entering into contracts which define the terms under which care is administered. The expansion in the number of managed care and third-party payor organizations, as well as additional government regulation and changes in reimbursement models, has greatly increased the complexity of pricing practices, billing procedures and reimbursement policies impacting medical practices. In addition, to operate effectively, health care organizations must efficiently manage patient care and other workflow processes which may extend across multiple care locations and business entities.

To compete under the constraints of managed care while maintaining quality of services, health care organizations have placed increasing demands on their information systems. Initially, these information systems automated financial and administrative functions. As it became necessary to manage patient flow processes, the need arose to integrate all levels of "back-office" data with clinical information such as patient test results and office visits. Particularly for larger organizations and group practices, the Company believes information systems must allow enterprise-wide exchange of patient information incorporating administrative, financial and clinical information from multiple entities, while focusing on the physician as the primary care giver. In addition, large health care organizations increasingly require information systems that can deliver high-performance in environments with multiple concurrent computer users.

Many existing health care information systems, including systems designed for physicians and small group practices, were designed for limited administrative tasks such as billing and scheduling and can neither accommodate multiple computing environments nor operate effectively across multiple locations and entities. As the health care industry continues to evolve, physician groups and health care organizations will increasingly require systems that compile structured clinical information from multiple sources and enable measurement of treatment outcomes and management of clinical processes. Such systems must be integrated with financial and administrative information systems in order to maintain patient flow while continuing to reduce costs and improve quality of care. The Company believes that systems which integrate patient clinical data with administrative, financial and other practice management data are best positioned to succeed in the current managed care environment.

As health care organizations transition to new platforms and newer technologies, they will be migrating toward the implementation of enterprise-wide, patient-centered computing systems embedded with automated patient medical records. These organizations cannot afford significant downtime or re-education, nor can they risk choosing a system which has not proven its ability to handle high volume processing with continuous dependability. The Company believes that successful systems vendors in this market will have a sufficient installed base and adequate resources to offer high quality, fully integrated products and the value-added services needed to expand and support clients throughout this evolution process.

THE QSI SOLUTION

In response to the growing need for more comprehensive, cost-effective health care information solutions for physician and dental practice management, the Company's systems provide clients with the ability to redesign patient care and other workflow processes and improve productivity through multi-site and multi-entry access

to patient information. Utilizing proven third-party hardware solutions combined with the Company's proprietary software configured to maximize the efficiency of a health care organization's information processing requirements, the Company's solutions enable a seamless integration of a variety of administrative and patient information operations. In addition, as a result of its strategic relationship with Clinitec, the Company provides clients with an integrated medical records management system as part of a total information management solution. Leveraging over 20 years of experience in the health care information services industry, the Company believes that it continues to distinguish its solutions by providing its clients with sophisticated, full-featured software systems along with comprehensive systems implementation, maintenance and support.

QSI's systems automate many aspects of group practice management, including the retention of general patient information, appointment scheduling, billing, insurance claims submission and processing, managed care implementation and referral management, treatment outcome studies, treatment planning, drug formularies, word processing and accounting. The Company primarily uses the IBM RS6000 central processing unit and IBM'S AIX version of the UNIX operating system as a platform for its application software, which enables the Company to continue providing a wide range of flexible and functional systems to accommodate clients from solo practitioners to large group practices.

STRATEGY

The Company provides its clients with health care information systems designed to improve the quality and reduce the cost of health care delivery. The Company's strategy is to build on its experience as a provider of information systems solutions for health care organizations.

Key elements of the Company's strategy include:

Providing Increased Automation and Integration of Practice Management Systems. The Company's strategy is to provide user-friendly, comprehensive medical and dental practice management information systems that meet the information processing requirements of physician specialties and practices and are designed to manage the financial, administrative and practice management requirements of these practices. These products enable a single user to perform a larger number of tasks and operate more efficiently by providing real-time access to comprehensive patient information.

Expanding Professional and Technical Service Offerings. The Company will continue to expand its professional and technical services, including information systems planning, process redesign, new product offerings, project management, contract programming, client management, training services and network design, to assist health care organizations. In addition, the Company intends to expand its electronic data interchange capabilities by increasing the number of insurance carriers and services offered.

Leveraging Clinitec Relationship for Sale of NextGen Products. Leveraging on its recent alliance with Clinitec, the Company's strategy includes integration of a medical records management system into its product line. The Company believes that the "front office" electronic medical records solutions offered by Clinitec's NextGen software are a natural adjunct to the "back office" applications of QSI's existing software solutions.

Targeting Large Health Care Provider Groups. The number of physicians and dentists practicing in group settings or as a part of managed care organizations has increased significantly in recent years. The Company believes the number and size of such groups will continue to grow as economic pressures drive health care providers to affiliate with or form new larger group practices. The Company believes that the proven ability of its integrated information solutions to meet the needs of physician and dental groups, particularly those with eight or more affiliated physicians and six or more affiliated dentists, will allow the Company to capitalize on the continued growth of the group practice market. In addition, the Company intends to aggressively pursue certain target markets including large, federally funded community health centers and other opportunities that arise due to the increase in managed care.

Offering Comprehensive Services and Support. The Company believes its success is attributable in part to its exceptional customer service and support. The Company provides support to its clients seven days a week, 24 hours a day. In addition, the Company's policy is to respond to user defined system-down emergencies with a response time of 15 minutes or less. Further, the Company's employees have the ability to service clients by remote access, allowing for quick response to client inquiries and quick resolutions to system issues. The Company believes that its commitment to provide extensive support has contributed significantly to the development of its business.

PRODUCTS

The Company's health care information systems consist primarily of proprietary software applications and third-party hardware and software. The systems range in capacity from one to hundreds of users, allowing the Company to address the needs of both small and large clients. The software configuration of a typical system includes a basic medical or dental application and additional software applications. A typical system also consists of third party hardware components, including a UNIX-based central processing unit, disk drives, a magnetic tape unit, video display terminals, PCs, one or more printers, and telecommunications equipment. The systems are modular in design and may be expanded to grow with changing client requirements.

The Company purchases all the hardware components of its systems as well as the requisite operating system licenses from manufacturers or distributors of those components. It assembles and tests the hardware components and incorporates QSI's proprietary application software and other third party software into completed systems. The Company provides systems tailored to accommodate particular client requirements. The Company continually evaluates the hardware components of its systems with a view to utilizing hardware that is functional, reliable and cost-effective.

The Company's systems include application and system software modules that provide comprehensive solutions for physician and dental practices. Clients typically purchase a base medical or dental application and add on additional applications as desired. Systems have ranged in price from approximately \$10,000 to over \$900,000 depending upon size of group practice, number of system users and number of sites. The primary system software is comprised of the applications set forth in the table below.

| PRIMARY SYSTEM SOFTWARE | DESCRIPTION |
|-------------------------|--|
| QSI Medical | <p>Automates the financial and administrative functions of small to large multi-specialty medical practices, providing a range of functionality that includes:</p> <ul style="list-style-type: none"> - patient registration and benefits tracking - coordination of pre-paid and capitated health plans, including fee schedule maintenance and analysis of plan utilization and profitability, treatment status, and collections reports - extensive appointment inquiry and scheduling system - efficient and rapid assistance in the processing of electronic or manual insurance claims, patient billing and balance aging, including open item payment posting and on-line "paperless" collections features - thorough standard and custom reporting to analyze the various aspects of practice management - unattended processing of predetermined job functions |
| QSI Dental | <p>Automates the financial and administrative functions of small to large dental practices, providing a range of functionality that includes:</p> <ul style="list-style-type: none"> - patient registration and benefits tracking - coordination of pre-paid and capitated health plans, including fee schedule maintenance and analysis of plan utilization and profitability, treatment status, and collections reports - extensive appointment inquiry and scheduling system - full treatment planning and management, with insurance estimation and automated patient recalls - marketing of services to current and potential patients - efficient and rapid assistance in the processing of electronic or manual insurance claims, patient billing and balance aging - thorough standard and custom reporting to analyze the various aspects of practice management - unattended processing of predetermined job functions |

In addition to the primary packages set forth above, the Company offers the following add-on applications.

| ADD-ON APPLICATIONS | DESCRIPTION |
|--------------------------|--|
| Managed Care | Automates eligibility verification, scheduling, referral authorization and claims adjudication. Creates and tracks outside referral authorization requests with authorized procedures, diagnosis and number of visits. Maintains licensing and credential information on referral providers. Provides various statistical reports to manage patient care in an at-risk environment. |
| QSI Dental School | Automates student transaction grading, tracks academic progress and manages faculty rotations and student/patient assignment. |
| Health Care Eligibility | Enables a dental client to administer a dental insurance plan. Maintains accurate records of member enrollment and provides premium payment tracking, month-end processing, account balance tracking, automatic banking, word processing and file maintenance. |
| Accounting packages: | |
| - General Ledger | Provides general journal and ledger capabilities, including income statements, balance sheets, monthly journals, batch listings, transaction registers, charts of accounts worksheets, and ledger file listings. |
| - Accounts Payable | Produces and tracks batch/voucher listings, batch record listings, paid batch listings, check edit reports, distributions, void check distributions and vendor forecasts. Maintains a detailed check register. |
| - Payroll | Maintains organized payroll registers and payroll history, from which information can be accessed quickly and efficiently. Includes check reconciliation, system maintenance, earnings reports and payroll processing features. |
| QUIC Network | Provides clearing house services for electronic insurance claims and electronic patient statements. Billing and status data is transferred automatically over the Company's remote access to its clients. |
| NextGen (Clinitec) | Provides for electronic medical records. Automates the collection of clinical information through the use of pen-based wireless PCs, or fixed PC workstations. Stores patient medical histories, scanned images, X-rays, annotated documents, recorded voice and user-customizable exam data. Automates document generation and prescriptions. Allows for extensive outcome tracking and for a "chartless office." |
| Third Party Packages.... | Word processing applications, report writers, accounting packages, procedure code editors and maximizers and other software that a client may reasonably request. |

The Company continues to make enhancements to its hardware and software packages to provide increased functionality and flexibility to its clients. Recent enhancements include additional interfaces for electronic claims submission and insurance payments, increased ability to control managed care plans and fees, electronic patient eligibility, extensions for community health centers, drug formulary tracking, enhanced patient scheduling, and software to support paperless collections. The Company has continued to take advantage of new releases in the IBM RS6000 family, as well as new PC-based products utilizing the SCO UNIX operating system. This introduction of a PC-based UNIX system for physician and dental group practices allowed the Company increased pricing flexibility and enabled the Company's systems to be used in smaller practice settings. In addition, the Company has added enhanced telecommunications, full-featured color terminals and more versatile printer options.

RELATIONSHIP WITH CLINITEC

On April 21, 1995, the Company entered into a strategic relationship with Clinitec, a developer of electronic medical records software systems. As part of this relationship, the Company acquired a 25% equity interest in Clinitec for \$1 million. In addition to its 25% ownership position in Clinitec, the Company holds an option, exercisable until August 1997, to purchase additional shares in Clinitec for \$3 million which will result in the Company holding a majority interest in Clinitec. The Company will provide notice to Clinitec of its exercise of this option concurrent with the closing of this offering. Clinitec's software product, NextGen, has been developed using a graphical user interface client/server platform for compatibility with the UNIX, Microsoft Windows, Windows NT and Windows 95 operating systems and a relational database back end to permit flexibility in screen customization and logic flow. As part of its agreement with Clinitec, the Company received the non-exclusive right to market NextGen for medical applications, and the world-wide exclusive right to market NextGen for dental markets.

NextGen operates in a client/server environment, using a desktop, laptop or pen-based PC configuration. Medical records data can include:

- User customized templates for data capture and automatic document generation
- Scanned or electronically acquired images including X-rays and photographs
- Other records, documents and notes, including electronically captured handwriting and annotations
- Digital voice recordings embedded in documents

In addition, specific templates designed into the system will permit research and analysis of particular conditions and diagnoses, including the interaction between various prescribed pharmaceuticals, and will allow for extensive outcomes reporting.

NextGen offers software applications that are complementary to those offered by QSI. The key "back office" applications incorporated into QSI's solutions such as practice management, eligibility, claims processing and accounting can be augmented by the "front office" applications of the NextGen software. Because the Company's products are UNIX-based, the Company is able to add NextGen as part of an integrated system. To address the client/server marketplace, the Company is in the process of developing an alternative version of its products for the client/server environment. In addition to a graphical user interface, these client/server versions will include screens and templates similar to those in NextGen to enable a more seamless integration of the QSI and NextGen applications. The Company intends to leverage its existing client base for sales of NextGen.

SALES AND MARKETING

The Company sells and markets its products nationwide through a direct sales force operating from sales offices in California, Florida, Georgia, Massachusetts, New York and Texas. The Company's sales and marketing employees identify and contact prospective clients by a variety of means, including referrals from existing clients and contacts at professional society meetings and seminars with persons involved in group practice as well as trade journal advertising, direct mail advertising, and telemarketing. These employees are knowledgeable about medical and dental group practice management, as well as computer information systems and the Company's products. Typically, these employees make presentations to potential clients by demonstrating the QSI system and its capabilities on the prospective client's premises. In addition, the Company performs remote demonstrations by utilizing a prospective client's PC or by sending the prospective client a telecommunications kit including a terminal.

The Company's sales cycle can vary significantly and typically ranges from three to 12 months from initial contact to contract execution. Standard payment terms include a 25% down payment with the balance due when the hardware is installed and the installed system is ready for training. As part of the fees paid by its clients, the Company receives up-front licensing fees, a monthly service fee based on client configuration and the number of user ports and a nominal annual license renewal fee based on the number of user ports.

Several clients have purchased the Company's system and, in turn, are providing time-share services to local single and group practice practitioners. Under the time-share agreements, the client provides the use of its system for a fee to one or more practitioners. Although the Company does not receive a fee directly from the time-share client, implementation of time-share arrangements has resulted in the purchase of additional system capacity by the client offering the time-share services, as well as new system purchases made by the time-share clients. The Company continues to concentrate its sales and marketing efforts on medical and dental practices, dental schools, physician clinics, MSOs, PHOs and community health centers. MSOs and PHOs to which the Company has sold systems provide use of the Company's software to those group and single practices associated with the organization or hospital on either a time-sharing basis or by directing the Company to contract with those practices for the sale of stand-alone turnkey systems.

The Company has entered into marketing assistance agreements with certain of its clients pursuant to which the clients allow the Company to demonstrate to potential clients the use of systems on the existing clients' premises. In addition, the Company has established certain of its clients as dealers for its systems. Through this arrangement, the dealer markets and sells QSI systems to prospects in a local territory. These prospects are generally smaller health care facilities than those actively pursued by the Company. The Company's PC-based products are well suited to this dealer marketing. In addition, the dealer typically provides a variety of ongoing services for its clients. Dealers are compensated based on system size and profitability, and the services which they perform in lieu of the Company.

The Company often assists prospective clients in identifying third party sources for financing the purchase of QSI systems. The financing usually is obtained by the client directly from institutional lenders and typically takes the form of a loan from the institution secured by the system to be purchased. Most of the clients purchasing QSI systems have been assisted by the Company in finding sources of financing for such purchases.

The Company has numerous clients and does not believe that the loss of any single client would have a material adverse effect on the Company. No client accounted for ten percent or more of net revenues during fiscal years ended March 31, 1995 or 1994.

CUSTOMER SERVICE AND SUPPORT

The Company believes its success is attributable in part to its exceptional customer service and support. The Company provides support to its clients seven days a week, 24 hours a day. In addition, the Company's policy is to respond to user defined system-down emergencies with a response time of 15 minutes or less. All Company systems have a dedicated port for dial-up remote access, facilitating rapid diagnosis by QSI technicians of system inquiries. Most inquiries can be resolved without the need to dispatch Company technicians. These support services also provide the Company with the opportunity to monitor changes in each client's information processing requirements and to recommend the purchase of system hardware or software enhancements designed to satisfy these additional requirements. The Company believes that its commitment to provide extensive support has contributed significantly to the development of its business.

The Company offers clients support services for all system components, including hardware and software maintenance, for a fixed monthly fee. In the last five years, more than 90% of the Company's clients have elected to purchase the Company's maintenance and support services. Hardware maintenance services are coordinated through the Company's headquarters in California, with support from field service locations in Northern and Southern California, New Jersey, North Carolina and Wisconsin. The Company also subcontracts with IBM to perform specific hardware maintenance tasks under QSI's direction. This arrangement has provided the Company with economies of scale associated with IBM's service infrastructure while still maintaining service standards.

The Company's continuing system software support staff operates from the Company's offices in California and a location in Virginia. The support staff is comprised of specialists who are knowledgeable in the area of hardware and software technology as well as in the day-to-day operations of a group practice. The Company's on-line access to all client systems enables the support staff to provide immediate assistance to clients. This assistance ranges from correcting minor procedural problems in the client's system to performing complex

data base reconstructions or software updates. The Company also utilizes an automated on-line support system which assists clients in resolving minor problems and facilitates automated electronic retrieval of problems along with symptoms following a client's call to the Company's automated support system. Additionally, the on-line support system maintains a complete call record at the client's facility and the Company.

IMPLEMENTATION AND TRAINING

The Company provides implementation and training services from its headquarters in California as well as remote locations in Florida, Kansas, Texas, and Washington. The Company believes that its system delivery, implementation and support services are key elements of its successful client relationships. When a client signs a contract for the purchase of a system, a client manager, trained in physician group practice procedures, is assigned to ensure that the client is fully informed of system options and that the proper system configuration is installed. This information is determined through discussions with the client and observation of the client's practice. Once the set of software features is established, the software configuration unique to a given client can be created in an automated fashion.

Before activation of the client's system, Company personnel convert the relevant client data into the system. Typically, the Company interfaces electronically to convert the client's data from another computer system, allowing for a quick, cost-effective and accurate conversion. The system is then subjected to extensive testing which includes processing representative data using the client's system configuration. In some situations, the data may be retained by the client on ledger cards or other hard copy. In such situations, the Company maintains a data entry staff to input the required data.

One or more trainers experienced in group practice procedures are assigned to conduct an intensive training program for the client's employees. The program includes a combination of computer assisted instruction ("CAI"), remote training techniques and training classes conducted by QSI staff at the client's office(s). CAI consists of workbooks, computer interaction and personal instruction. CAI is also offered to clients, for an additional charge, after the initial training program is completed for the purpose of training new and additional employees. Remote training allows a trainer at the Company's office to train one or more people at a client site via telephone and computer connection, thus allowing an interactive and office-specific mode of training without the expense and time required for travel. The Company also provides ongoing training through electronic classrooms where employees at different locations from the same or different companies can simultaneously interact on-line with a trainer. In addition, the Company's on-line "help" documentation feature facilitates client training as well as ongoing support.

COMPETITION

The market for health care information systems is intensely competitive and the Company faces significant competition from a number of different sources. In addition, several of the Company's competitors have significantly greater financial, technical, product development and marketing resources than the Company. The Company believes its principal competitive advantages are the features and capabilities of its products and services, its high level of customer support and its 20 year experience in the industry. The industry is highly fragmented and includes numerous competitors, none of which the Company believes dominates the overall market for group practice management systems. The Company has not encountered substantial competition in the dental group practices market of six or more dentists. The Company believes that numerous firms sell computerized data processing systems to group dental practices consisting of five or fewer dentists.

Among the Company's principal competitors for medical group practice clients are health care information systems companies such as IDX Corporation, Medic Computer Systems, Physician Computer Networks, Inc., and Cycare Systems, Inc. Furthermore, the Company also competes indirectly and to varying degrees with other major health care information companies, information management companies generally, and other software developers which may more directly enter the markets in which the Company competes. There can be no assurance that future competition will not have a material adverse effect on the Company's business,

financial condition and results of operations. Competitive pressures and other factors, such as new product introductions by the Company or its competitors, may result in price erosion that could have a material adverse effect on the Company's business, financial condition and results of operations.

PRODUCT ENHANCEMENT AND DEVELOPMENT

The computer software and hardware and medical practice management industries are characterized by rapid technological change requiring the Company to engage in continuing efforts to improve its systems. During fiscal years 1995 and 1994, and the six months ended September 30, 1995 the Company expended approximately \$1,467,200, \$1,318,200 and \$656,200 respectively, on research and development activities. In addition, many of the Company's product enhancements have resulted from software development work performed under contracts with QSI clients. To the extent the Company fails to achieve technological advances comparable to those made by others in the computer and medical practice management industries, its products and services may become obsolete. See "Risk Factors -- Technological Change."

GOVERNMENTAL REGULATION

The health care industry is subject to changing political, economic and regulatory influences that may affect the procurement practices and operation of health care facilities. During the past several years the health care industry has been subject to an increase in governmental regulation of, among other things, reimbursement rates and certain capital expenditures. Certain legislators have announced that they intend to examine proposals to reform certain aspects of the U.S. health care system including proposals which may increase governmental involvement in health care, lower reimbursement rates and otherwise change the operating environment for the Company's clients. Health care providers may react to these proposals and the uncertainty surrounding such proposals by curtailing or deferring investments, including those for the Company's systems and related services. On the other hand, changes in the regulatory environment have increased and may continue to increase the needs of health care organizations for cost-effective data management and thereby enhance the marketability of the Company's systems and related services. The Company cannot predict what impact, if any, such proposals or health care reforms might have on the Company's business, financial condition and results of operations.

The Company's software may be subject to regulation by the U.S. Food and Drug Administration (the "FDA") as a medical device. Such regulation could require the registration of the applicable manufacturing facility and software/hardware products, application of detailed recordkeeping and manufacturing standards, and FDA approval or clearance prior to marketing. An approval or clearance could create delays in marketing, and the FDA could require supplemental filings or object to certain of these applications. See "Risk Factors -- Uncertainty in Health Care Industry; Government Regulation."

EMPLOYEES

As of January 4, 1996, the Company employed 126 persons. Systems analysts, programmers and qualified sales and marketing personnel are in short supply and, consequently, competition for such individuals is intense. The Company believes that its future success depends in part upon recruiting and retaining qualified marketing and technical personnel as well as other employees. The Company considers its employee relations to be good.

PROPERTIES

The Company's principal administrative, data processing, marketing and development operations are located in approximately 15,800 square feet of leased space in Tustin, California under a lease which expires in October 1996. In addition, the Company leases approximately 13,200 square feet of space in Santa Ana, California to house its assembly and warehouse operations, and an aggregate of approximately 1875 feet of space in Florida, Georgia, New York, Texas and Washington to house field sales, training and service operations. These leases, including options, have expiration dates ranging from month-to-month to October 31, 1996 and provide for aggregate annual rental payments of approximately \$379,000. The Company believes that its facilities are adequate for its current needs and that suitable additional or substitute space is available, if needed.

LEGAL PROCEEDINGS

The Company is a party to various legal proceedings incidental to its business, none of which are considered by the Company to be material.

DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth certain information concerning the executive officers and directors of the Company as of January 4, 1996.

| NAME | AGE | POSITION |
|-------------------|-----|--|
| Sheldon Razin | 58 | Chairman of the Board, President and Director |
| Robert Beck | 54 | Executive Vice President |
| Greg Flynn | 38 | Vice President Sales and Marketing |
| Abe LaLande | 45 | Vice President Hardware Research and Development |
| Donn Neufeld | 39 | Vice President Software and Operations |
| Janet Razin | 55 | Vice President, Corporate Secretary and Director |
| Irma Carmona | 40 | Corporate Controller |
| John Bowers, M.D. | 57 | Director(1) |
| William Bowers | 67 | Director(1) |
| George Bristol | 47 | Director(1) |
| Graeme Frehner | 56 | Director |
| Gordon Setran | 73 | Director(1) |

(1) Member of Audit Committee

Officers are appointed by, and serve at the discretion of, the Board of Directors. Except for Sheldon Razin and Janet Razin, who are husband and wife, there are no family relationships between any of the directors or executive officers of the Company. The Board has established an Audit Committee on which John Bowers, M.D., George Bristol, Gordon Setran and William Bowers serve.

SHELDON RAZIN is the founder of the Company and has served as Chairman of the Board of Directors and Chief Executive Officer since the Company's inception. He also has served as the Company's President since its inception except for the period from August 1990 to August 1991. Additionally, Mr. Razin served as Treasurer from the Company's inception until October 1982. Prior to founding the Company, he held various technical and managerial positions with Rockwell International Corporation and was a founder of the Company's predecessor, Quality Systems, a sole proprietorship engaged in the development of software for commercial and space applications and in management consulting work. Mr. Razin holds a B.S. degree in Mathematics from the Massachusetts Institute of Technology. Mr. Razin is the husband of Janet Razin.

ROBERT BECK joined the Company, and has served as its Executive Vice President, since April 1992. In this capacity, he is heavily involved in the Company's sales and marketing efforts. Mr. Beck has been associated with turnkey healthcare computing applications since 1975, holding a variety of increasingly responsible management positions in several companies. Prior to joining the Company, Mr. Beck served as Executive Vice President of Sandata, a provider of DME and Home Health Care Turnkey Systems. Mr. Beck's experience includes founding and running a corporation, The Hamilton Computer Group, Inc., which was at one time a major competitor to the Company. He holds a B.A. degree in Mathematics and Statistics from Hunter College.

GREG FLYNN has served as the Company's Vice President Sales and Marketing since January 1996 after serving as Vice President Administration since June 1992. In these capacities, Mr. Flynn has been responsible for numerous functions related to the ongoing management of the Company. Previously, Mr. Flynn served as the Company's Vice President Corporate Communications. Since joining the Company in January 1982, Mr. Flynn has held a variety of increasingly responsible management positions within the organization. Prior to joining the Company, Mr. Flynn was a scriptreader/script consultant for a film production company. He holds a B.A. degree in English from the University of California, Santa Barbara.

ABE LALANDE has served as the Company's Vice President Hardware Research and Development since February 1989. From 1979 to 1982, he served as the Company's senior field service engineer, and from 1982 to

1988, he served as Vice President Field Service and Production. During fiscal 1989, Mr. LaLande left the Company for three months to work for Toshiba America, Inc. Prior to joining the Company, Mr. LaLande held various senior field service engineering positions with Mini-Computer Systems (October 1978 to April 1979), Varian Associates (February 1978 to October 1978) and General Automation (July 1977 to February 1978), all of which are computer manufacturing companies. He holds an A.A. degree in Electronic Engineering from Fullerton College and an A.S. degree in Computer Science from Control Data Institute.

DONN NEUFELD has served as the Company's Vice President Operations since June 1986 and as its Vice President-Software since January 1996. From April 1981 until June 1986, Mr. Neufeld held the position of Manager of Customer Support. He joined the Company in December 1980 as part of the System Generation Department. Prior to joining the Company, Mr. Neufeld was a System Analyst/Programmer at Loma Linda University Medical Center.

JANET RAZIN has served as a Director, Vice President and Corporate Secretary of the Company since its inception and served as the Company's Controller until November 1981. She served as Vice President Chief Financial Officer from October 1982 until October 1984. Prior to joining the Company, she was a computer programmer for Rockwell International Corporation. Mrs. Razin holds a B.A. degree in Mathematics from Northeastern University. Mrs. Razin is the wife of Sheldon Razin.

IRMA CARMONA has served as the Company's Corporate Controller since June 1994. Since joining the Company in February 1980, Ms. Carmona has held a variety of increasingly responsible financial positions within the organization including Manager of Accounting from June 1984 until June 1994. Prior to joining the Company, Ms. Carmona was a staff accountant for Thomas Cook Bankers.

JOHN BOWERS, M.D., has served as a Director since June 1987, and is the founder and Chief Executive Officer of the Heart Institute of Nevada, a major freestanding Cardiac Catheterization and Diagnostic Center. In 1970, Dr. Bowers moved to Las Vegas, Nevada to associate with Dr. P.R. Akre, who organized the first catheterization laboratory in Nevada. He subsequently became Director of Cardiology at Sunrise Hospital and Valley Hospital. On June 1, 1975, he founded Cardiology Associates of Nevada, John A. Bowers, M.D., FACC, a professional corporation, and the forerunner of the Heart Institute of Nevada. Prior to 1970, Dr. Bowers practiced cardiology in Santa Paula, California, after serving in the Air Force at Vandenberg Air Force Base, California and Wright-Patterson Air Force Base, Dayton, Ohio. Dr. Bowers graduated from Indiana University School of Medicine in 1960.

WILLIAM BOWERS has served as a Director since June 1989. He was co-founder and Chairman of MSI Data Corporation, a leading manufacturer of "on-the-move" hand-held data collection systems, headquartered in Costa Mesa, California. Founded in 1967, MSI was a public company until it was acquired by Symbol Technologies, Inc. in 1988. Mr. Bowers is also a Director of D.H. Technology, Inc., a publicly-owned company. Mr. Bowers has two Bachelors degrees, one in Advertising from USC and another in Electrical Engineering from UCLA.

GEORGE BRISTOL, who has served as a Director since December 1982, has been a member of the corporate finance group of Ernst & Young LLP, an international professional services firm, since February 1992. Prior to this, Mr. Bristol was a Managing Director with the investment banking firms of Dean Witter Reynolds Inc. from September 1989 and Prudential Securities, Inc., for more than eight years, until September 1989. Prior to joining Prudential Securities, Inc., Mr. Bristol served as First Vice President of Blyth Eastman Paine Webber Incorporated, an investment banking firm. He holds a B.A. degree from the University of Michigan and an M.B.A. degree from the Harvard Business School.

GRAEME FREHNER, a co-founder of the Company, has served as a Director since November 1982. He served as the Company's Vice President-Software from October 1982 to January 1996, when he retired from active management in the Company. Despite this retirement, he intends to consult with the Company from time to time. Mr. Frehner joined Quality Systems, the Company's predecessor, shortly after it was founded. Prior to that time, he held a number of technical, managerial and consulting positions with Planning Research Corporation and with Autonetics, formerly a division of North American Aviation and currently a division of Rockwell International Corporation. Mr. Frehner holds a B.S. degree in Mathematics, Education and Physics from Brigham Young University.

GORDON SETRAN has served as a Director since November 1982, and was a Vice President of California Federal Savings & Loan Association from 1975 until his retirement in December 1985. Mr. Setran was a founder, President and Director of First Federal Savings & Loan Association of Corona which was acquired by California Federal Savings & Loan Association in 1975.

EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE. The following table provides certain summary information concerning compensation paid or accrued by the Company and its subsidiaries, to or on behalf of the Company's Chief Executive Officer and each of the four other most highly compensated executive officers of the Company (determined as of the end of the last fiscal year) (the "Named Executive Officers") for the fiscal years ended March 31, 1993, 1994 and 1995:

SUMMARY COMPENSATION TABLE

| NAME AND PRINCIPAL POSITION | FISCAL YEAR | ANNUAL COMPENSATION | | LONG-TERM COMPENSATION | |
|--|-------------|---------------------|------------------------------|-------------------------------|---------------------------|
| | | SALARY | OTHER ANNUAL COMPENSATION(1) | SECURITIES UNDERLYING OPTIONS | ALL OTHER COMPENSATION(2) |
| Sheldon Razin..... Chairman and President | 1995 | \$213,750 | \$ 6,882 | -- | \$ 2,873 |
| | 1994 | 180,000 | 23,372 | -- | 2,235 |
| | 1993 | 180,000 | 19,518 | -- | 1,172 |
| Robert Beck(3)..... Executive Vice President | 1995 | 144,996 | -- | -- | 2,740 |
| | 1994 | 144,996 | -- | -- | 2,478 |
| | 1993 | 140,054 | -- | 75,000 | 728 |
| Greg Flynn..... Vice President Sales and Marketing | 1995 | 108,929 | -- | -- | 1,224 |
| | 1994 | 97,152 | -- | 22,000 | 945 |
| | 1993 | 89,760 | -- | 20,000 | 378 |
| Abe LaLande..... Vice President Hardware Research and Development | 1995 | 105,000 | -- | -- | 1,185 |
| | 1994 | 105,000 | -- | -- | 1,010 |
| | 1993 | 105,000 | -- | -- | 419 |
| Donn Neufeld..... Vice President Software and Operations | 1995 | 104,250 | -- | -- | 1,178 |
| | 1994 | 96,000 | -- | 30,000 | 935 |
| | 1993 | 96,000 | -- | -- | 394 |

(1) This column reflects perquisite compensation which exceeds the lesser of \$50,000 or 10% of the Named Executive Officer's total salary and bonus with the exception of Mr. Razin, which is included regardless. For the fiscal year ended March 31, 1995, no Named Executive Officer received perquisites exceeding that limit. For fiscal years ended March 31, 1995, 1994, and 1993, respectively, Mr. Razin's perquisites included \$5,982, \$22,472 and \$18,578 for the value of the use of a Company car, which includes insurance premiums, depreciation, and miscellaneous expenses.

(2) This column reflects (i) amounts attributable to Company contributions to the Company's Deferred Compensation Plan (or, for fiscal year ended March 31, 1993, contributions to the Company's Profit-Sharing and Retirement Plan for Employees) and (ii) income attributable to the provision of additional life insurance for the Named Executive Officers. For fiscal year ended March 31, 1995 such amounts were, respectively, as follows: Mr. Razin, \$2,138 and \$735; Mr. Beck \$1,570 and \$1,170; Mr. Flynn \$1,089 and \$135; Mr. LaLande, \$1,050 and \$135; and Mr. Neufeld, \$1,043 and \$135. For fiscal year ended March 31, 1994, such amounts were, respectively, as follows: Mr. Razin, \$1,500 and \$735; Mr. Beck, \$1,308 and \$1,170; Mr. Flynn, \$810 and \$135; Mr. LaLande, \$875 and \$135; and Mr. Neufeld, \$800 and \$135. For fiscal year ended March 31, 1993, such amounts were, respectively, as follows: Mr. Razin, \$417 and \$755; Mr. Beck, \$0 and \$728; Mr. Flynn, \$239 and \$139; Mr. LaLande, \$280 and \$139; and Mr. Neufeld, \$255 and \$139.

(3) The Company has an arrangement with Robert Beck under which Mr. Beck will receive, if the Company attains an aftertax profit of at least \$2.5 million in any fiscal year in which the Company's sales are at least \$25.0 million, a one-time grant of options for shares representing the difference between 225,000 shares of Common Stock and the number of shares of Common Stock Mr. Beck has purchased up to

such date pursuant to stock options granted by the Company. As of January 4, 1996, Mr. Beck had been granted options to purchase 75,000 shares and had exercised 53,750 shares of such options.

STOCK OPTIONS. No options were granted to the Named Executive Officers in the last fiscal year.

AGGREGATED OPTION EXERCISE TABLE. The following table sets forth information (on an aggregated basis) concerning the number of shares of the Company's Common Stock acquired upon exercise of options granted by the Company, and shares of the Company's Common Stock subject to exercisable and unexercisable stock options which the Named Executive Officers held at the end of the 1995 fiscal year. None of the Named Executive Officers held any stock appreciation rights at the end of that fiscal year.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

| NAME | SHARES ACQUIRED ON EXERCISE | VALUE REALIZED | NUMBER OF UNDERLYING UNEXERCISED OPTIONS AT MARCH 31, 1995 | | VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT MARCH 31, 1995(1) | |
|--------------------|-----------------------------------|-------------------|--|---------------|--|---------------|
| | | | EXERCISABLE | UNEXERCISABLE | EXERCISABLE | UNEXERCISABLE |
| Sheldon Razin..... | 0 | \$ 0 | 0 | 0 | \$ 0 | \$ 0 |
| Robert Beck..... | 8,000 | 22,875 | 10,750 | 37,500 | 18,813 | 65,625 |
| Greg Flynn..... | 2,000 | 3,125 | 15,500 | 26,500 | 28,375 | 47,625 |
| Abe LaLande..... | 10,000 | 24,375 | 12,500 | 7,500 | 20,313 | 12,188 |
| Donn Neufeld..... | 0 | 0 | 13,500 | 24,500 | 22,875 | 42,625 |

(1) The value of unexercised in-the-money options is the market price of the shares at fiscal year end (\$3.25) less the exercise price of the option.

1989 STOCK OPTION PLAN

The Company's 1989 Stock Option Plan (the "1989 Plan") was adopted by the Board of Directors on July 19, 1989 and approved by the shareholders on September 6, 1989. One million shares of Common Stock have been authorized for issuance under the 1989 Plan. The number of shares issued to directors under the 1989 Plan when added to the number of shares issuable to directors upon the exercise of stock options granted under any other stock option plan maintained by the Company shall not exceed 750,000.

The 1989 Plan provides that salaried officers or key employees, and non-employee directors of the Company or its subsidiaries may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock at an exercise price not less than 85% of their fair market value on the option grant date. However, any option granted to a person who owns stock possessing more than 10% of the total combined voting power of all classes of stock of the Company (or its parent or any subsidiary) must have a purchase price of at least 110% of the fair market value on the grant date, and a term not longer than five years.

The plan may be administered by the Board of Directors of the Company ("Board") or a Committee consisting of three or more directors who are appointed by, and serve at the pleasure of, the Board (the "Committee"). A Committee has not been appointed. The Board as Plan Administrator has complete discretion to determine which eligible individuals are to receive option grants, the number of shares subject to each such grant, the status of any granted option as either an incentive stock option or a non-statutory stock option under the federal tax laws, the vesting schedule to be in effect for the option grant, and the maximum term for which any granted option is to remain outstanding. Option grants to nonemployee directors must be approved by the Board. Upon an acquisition of the Company by merger or asset sale, each outstanding option may be subject to accelerated vesting under certain circumstances.

The Board may amend or modify the 1989 Plan at any time. The 1989 Plan will terminate on May 30, 1999, unless sooner terminated by the Board.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Company does not have a compensation committee or any other committee of the Board of Directors performing equivalent functions. Instead, the full Board of Directors makes decisions regarding executive officer compensation. During the Company's last complete fiscal year ended March 31, 1995, the members of the Board of Directors were Sheldon Razin, Janet Razin, John Bowers, M.D., William Bowers, George Bristol, Graeme Frehner and Gordon Setran.

EMPLOYMENT CONTRACTS

The Company does not presently have any employment contracts in effect with the President or any of the other Named Executive Officers other than the arrangement referenced above in "Executive Compensation" regarding Robert Beck. In connection with the Company's arrangement with Mr. Beck, Mr. Razin has agreed that in the event he sells more than 20% of the Common Stock of the Company beneficially owned by him at such time of sale, then Mr. Beck shall be entitled to sell, in the same transaction as Mr. Razin and on the same terms and conditions, a pro rata amount of the Common Stock held by Mr. Beck at such time pursuant to stock options granted by the Company. On December 12, 1995, Mr. Beck waived any and all rights under that agreement with respect to the offering contemplated hereby.

DIRECTOR COMPENSATION

Directors of the Company who are also employees of the Company are not compensated for their services as directors or committee members. Directors of the Company who are not also employees receive a fee of \$2,500 per year for serving on the Board of Directors. Directors who serve on a committee of the Board of Directors receive an annual fee of \$1,000 and a fee of \$250 for each committee meeting attended, together with reasonable expenses of attendance at committee meetings.

INDEMNIFICATION OF DIRECTORS AND OFFICERS

The Company's Articles of Incorporation provide that the liability of the Company's directors for monetary damages shall be eliminated to the fullest extent permissible under California law. This is intended to eliminate the personal liability of a director for monetary damages in an action brought by or in the right of the Company for breach of a director's duties to the Company or its shareholders except for liability: (1) for acts or omissions that involve intentional misconduct or a knowing and culpable violation of law; (2) for acts or omissions that a director believes to be contrary to the best interests of the Company or its shareholders or that involve the absence of good faith on the part of the director; (3) for any transaction from which a director derived an improper personal benefit; (4) for acts or omissions that show a reckless disregard for the director's duty to the Company or its shareholders in circumstances in which the director was aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the Company or its shareholders; (5) for acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of the director's duty to the Company or its shareholders; (6) with respect to certain transactions, or the approval of transactions in which a director has a material financial interest; and (7) expressly imposed by statute, for approval of certain improper distributions to shareholders or certain loans or guarantees. This provision does not eliminate or limit liability of an officer for any act or omission as an officer, notwithstanding that the officer is also a director or that his actions, if negligent or improper, have been ratified by the Board of Directors. Further, the provision has no effect on claims under federal or state securities laws and does not affect the availability of injunctions and other equitable remedies available to the Company's shareholders for any violation of a director's fiduciary duty to the Company or its shareholders. Although the validity and scope of the legislation underlying the provision have not yet been interpreted to any significant extent by the California courts, the provision may relieve directors of monetary liability to the Company for grossly negligent conduct, including conduct in situations involving attempted takeovers of the Company.

The Articles also provide that the Company is authorized to provide indemnification to its agents (as defined in Section 317 of the California Corporations Code), through the Company's Bylaws or through agreements

with such agents or both, for breach of duty to the Company and its shareholders, in excess of the indemnification otherwise permitted by Section 317 of the California Corporations Code, subject to the limits on such excess indemnification set forth in Section 204 of the California Corporations Code.

The Bylaws of the Company provide that a person sued as an agent of the Company may be indemnified by the Company for reasonable expenses incurred thereby, if (a) in the case of other than derivative suits, such person has acted in good faith and in a manner he or she reasonably believed to be in the best interests of the Company (and in the case of a criminal proceeding, had no reasonable cause to believe that his or her conduct was unlawful), and (b) in the case of a derivative suit, such person has acted in good faith in a manner he or she believed to be in the best interests of the Company and its shareholders, and with such care, including reasonable inquiry, as an ordinarily prudent person, in a like position would use under similar circumstances. The Bylaws further provide that no indemnification shall be made in the case of a derivative suit in respect of any claim as to which such person has been adjudged to be liable to the corporation, except with court approval, nor shall indemnification be made for amounts paid in settling or otherwise disposing of a threatened or pending action, with or without court approval, or for expenses incurred in defending a threatened or pending action which is settled or otherwise disposed of without court approval. Indemnification under the Bylaws is mandatory in the case of an agent of the Company (present or past) who is successful on the merits in defense of a suit against him or her in such capacity. In all other cases where indemnification is permitted by the Bylaws, a determination to indemnify such person must be made by a majority of a quorum of disinterested directors, a majority of disinterested shareholders, or the court in which the suit is pending.

The Company has entered into agreements to indemnify its directors in addition to the indemnification provided for in the Articles of Incorporation and Bylaws. Among other things, these agreements provide that the Company will indemnify, subject to certain requirements, each of the Company's directors for certain expenses (including attorneys' fees), judgments, fines and settlement amounts incurred by such person in any action or proceeding, including any action by or in the right of the Company, on account of services by such person as a director or officer of the Company, or as a director or officer of any other company or enterprise to which the person provides services at the request of the Company.

PRINCIPAL AND SELLING SHAREHOLDERS

The following table sets forth certain information with respect to the beneficial ownership of the Company's Common Stock as of January 4, 1996, and as adjusted to reflect the sale by the Company and the Selling Shareholders of the shares of Common Stock offered hereby, by (i) each person known by the Company to beneficially own more than 5% of the outstanding shares of Common Stock, (ii) each of the Selling Shareholders, (iii) each of the Company's directors, (iv) each of the Named Executive Officers and (v) all directors and executive officers of the Company as a group:

| PERSON | SHARES BENEFICIALLY OWNED PRIOR TO OFFERING(1) | | NUMBER OF SHARES BEING OFFERED | SHARES BENEFICIALLY OWNED AFTER OFFERING(1) | |
|---|--|---------|--------------------------------|---|---------|
| | NUMBER | PERCENT | | NUMBER | PERCENT |
| Janet Razin and Sheldon Razin(2)(3)..... | 2,186,220 | 47.1% | 451,000 | 1,735,220 | 30.7% |
| Ahmed Hussein(4)..... | 350,000 | 7.5 | -- | 350,000 | 6.2 |
| Graeme Frehner..... | 76,554 | 1.7 | 20,000 | 56,554 | 1.0 |
| John Bowers, M.D..... | 31,230 | * | -- | 31,230 | * |
| Fen Frehner(5)..... | 25,000 | * | 13,000 | 12,000 | * |
| George Bristol..... | 13,500 | * | -- | 13,500 | * |
| David Razin(6)..... | 12,000 | * | 10,000 | 2,000 | * |
| Greg Flynn(7)..... | 10,030 | * | -- | 10,030 | * |
| William Bowers..... | 10,000 | * | -- | 10,000 | * |
| Donn Neufeld(8)..... | 8,000 | * | -- | 8,000 | * |
| Michael Yerrid(9)..... | 5,000 | * | 5,000 | -- | * |
| Robert Beck(10)..... | 2,600 | * | -- | 2,600 | * |
| Gordon Setran..... | 1,500 | * | -- | 1,500 | * |
| Abe LaLande..... | 1,000 | * | 1,000 | -- | * |
| All directors and executive officers as a group (12 persons)(11)..... | 2,340,634 | 50.3% | 472,000 | 1,868,634 | 32.9% |

* Less than one percent

- (1) For purposes of this table, information as to shares of Common Stock assumes that (i) the persons in the table do not purchase shares in the offering and (ii) the Underwriters' over-allotment option is not exercised. Except as otherwise indicated, to the Company's knowledge, the persons named in the table have sole voting and sole investment power with respect to all shares beneficially owned, subject to community property laws where applicable.
- (2) Janet Razin and Sheldon Razin, each of whom is an officer and director of the Company, are married to one another and own their shares as community property.
- (3) The address of each of these persons is c/o Quality Systems, Inc., 17822 East 17th Street, Suite 210, Tustin, California 92680.
- (4) As reflected in Schedule 13D dated December 8, 1995. Mr. Hussein's address is 401 E. 34th Street, Apt. #N-25A, New York, NY 10016.
- (5) Mr. Frehner is currently the Company's Manager of Software Research and Development and is the son of Graeme Frehner.
- (6) Includes 10,000 shares of Common Stock subject to stock options which are currently exercisable or may become exercisable within 60 days after January 4, 1996. Mr. Razin is currently the Company's Director of Product Development and is the son of Janet and Sheldon Razin.
- (7) Includes 8,000 shares of Common Stock subject to stock options which are currently exercisable or may become exercisable within 60 days after January 4, 1996.
- (8) Includes 8,000 shares of Common Stock subject to stock options which are currently exercisable or may become exercisable within 60 days after January 4, 1996.
- (9) Includes 5,000 shares of Common Stock subject to stock options which are currently exercisable or may become exercisable within 60 days after January 4, 1996. Mr. Yerrid is currently the Company's Client Services Manager.
- (10) Includes 2,500 shares of Common Stock subject to stock options which are currently exercisable or may become exercisable within 60 days after January 4, 1996.
- (11) Includes shares of Common Stock subject to stock options which are currently exercisable or may become exercisable within 60 days after January 4, 1996, and are, respectively, as follows: Mr. Beck, 2,500; Mr. Flynn, 8,000; Mr. Neufeld, 8,000; and all directors and officers as a group, 18,500 shares.

DESCRIPTION OF CAPITAL STOCK

The Company's authorized capital stock consists of 20,000,000 shares of Common Stock, \$.01 par value per share.

COMMON STOCK

As of January 4, 1996, there were 4,638,491 shares of Common Stock outstanding and held of record by 203 shareholders. Each holder of Common Stock is entitled to one vote for each share held. Following this offering, the holders of Common Stock, voting as a single class, will be entitled to elect all of the directors of the Company. Matters submitted for shareholder approval generally require a majority vote.

The shareholders, upon giving the notice required by California law and the Company's Bylaws, may cumulate votes for the election of directors. Under cumulative voting, each shareholder may give one nominee, whose name is placed in nomination prior to the commencement of voting, a number of votes equal to the number of directors to be elected, multiplied by the number of votes to which a shareholder's shares are normally entitled, or distribute such number of votes among as many nominees as the shareholder sees fit. The effect of cumulative voting is that the holders of a majority of the outstanding shares of Common Stock may not be able to elect all of the Company's directors.

Holders of Common Stock are entitled to receive ratably such dividends as may be declared by the Board of Directors out of funds legally available therefor. See "Price Range for Common Stock and Dividends." In the event of a liquidation, dissolution or winding up of the Company, holders of Common Stock would be entitled to share ratably in the Company's assets remaining after the payment of liabilities. Holders of Common Stock have no preemptive or other subscription rights. The shares of Common Stock are not convertible into any other security. The outstanding shares of Common Stock are, and the shares being offered hereby will be, upon issuance and sale, fully paid and nonassessable.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the Company's Common Stock is U.S. Stock Transfer Corporation.

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this offering, the Company will have 5,653,491 shares of Common Stock outstanding, assuming only 15,000 of the 134,125 stock options outstanding as of January 4, 1996 will be exercised before the offering. Of this amount, the 1,500,000 shares sold in this offering (plus any additional shares sold upon the Underwriters' exercise of their over-allotment option) and approximately 2,289,357 other shares (subject in certain cases to the volume and other limitations of Rule 144) will be available for immediate sale in the public market as of the date of this Prospectus.

Upon the expiration of a 90-day Lockup Period (as defined below), approximately 1,864,134 shares of the Company's Common Stock will become available for sale in the public market subject to compliance with Rule 144.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated) who has beneficially owned shares for at least two years is entitled to sell within any three-month period a number of shares that does not exceed the greater of (i) 1% of the then outstanding shares of the Common Stock (approximately 56,535 shares immediately after this offering) or (ii) the average weekly trading volume during the four calendar weeks preceding such sale, subject to the filing of a Form 144 with respect to such sale. A person (or persons whose shares are aggregated) who is not deemed to have been an affiliate of the Company at any time during the 90 days immediately preceding the sale who has beneficially owned his or her shares for at least three years is entitled to sell such shares pursuant to Rule 144(k) without regard to the limitations described above. Persons deemed to be affiliates must always sell pursuant to Rule 144, even after the applicable holding periods have been satisfied.

In addition, the Commission has published a notice of proposed rulemaking which, if adopted as proposed, would shorten the applicable holding periods under Rule 144(d) and Rule 144(k) to one and two years, respectively (from the current two and three-year periods). The Company cannot predict whether such amendments will be adopted or the effect thereof on the trading market for its Common Stock. The Company is unable to estimate the number of shares that will be sold under Rule 144, since this will depend on the market price for the Common Stock of the Company, the personal circumstances of the sellers and other factors. There can be no assurance that a significant public market for the Common Stock will be sustained after the offering. Any future sale of substantial amounts of Common Stock in the open market may adversely affect the market price of the Common Stock offered hereby.

The Selling Shareholders of the Company, who in the aggregate will beneficially own, following the offering, 1,805,774 shares of Common Stock, have agreed that they will not, without the prior written consent of Pacific Growth Equities, Inc. offer, sell, contract to sell or otherwise dispose of any shares of Common Stock beneficially owned by them for a period of 90 days (the "Lockup Period") after the date of this Prospectus. In addition, the Company has agreed pursuant to the Underwriting Agreement that it will not sell any Common Stock without the prior consent of the Representatives of the Underwriters for a period of 90 days from the date of this Prospectus, except that the Company may, without such consent, grant certain options to purchase stock pursuant to the Company's 1989 Plan.

On November 6, 1989, the Company filed a registration statement on Form S-8 under the Securities Act to register shares of the Common Stock issued or reserved for issuance under the 1989 Plan, thus permitting the resale of such shares by nonaffiliates in the public market without restriction under the Securities Act.

UNDERWRITING

The Underwriters named below, represented by Pacific Growth Equities, Inc. and Cruttenden Roth Incorporated (the "Representatives"), have severally agreed, subject to the terms and conditions set forth in the Underwriting Agreement, to purchase from the Company and the Selling Shareholders the number of shares of Common Stock indicated below opposite their respective names at the public offering price less underwriting discounts and commissions set forth on the cover page of this Prospectus. The Underwriting Agreement provides that the obligations of the Underwriters are subject to certain conditions precedent and that the Underwriters are committed to purchase all of the shares if they purchase any.

| UNDERWRITER ----- | NUMBER OF SHARES ----- |
|-----------------------------------|------------------------------|
| Pacific Growth Equities, Inc..... | |
| Cruttenden Roth Incorporated..... | |
| | ----- |
| Total..... | 1,500,000 ===== |

The Representatives have advised the Company and the Selling Shareholders that the Underwriters propose initially to offer the Common Stock to the public on the terms set forth on the cover page of this Prospectus. The Underwriters may allow to selected dealers a concession of not more than \$ per share, and the Underwriters may allow, and such dealers may reallow, a concession of not more than \$ per share to certain other dealers. After the public offering, the offering price and the other selling terms may be changed by the Representatives. The Common Stock is offered subject to receipt and acceptance by the Underwriters and to certain other conditions, including the right to reject orders in whole or in part.

Certain of the Selling Shareholders have granted an option to the Underwriters, exercisable during the 30-day period after the date of this Prospectus, to purchase up to a maximum 225,000 additional shares of Common Stock to cover overallotments, if any, at the same price per share as the initial shares to be purchased from the Company and the Selling Shareholders by the Underwriters. To the extent that the Underwriters exercise this option, the Underwriters will be committed, subject to certain conditions, to purchase such additional shares in approximately the same proportion as set forth in the table shown above. The Underwriters may purchase such shares only to cover over-allotments made in connection with this offering. The Company will not receive any proceeds from the sale of shares of Common Stock by the Selling Shareholders.

The Underwriting Agreement provides that the Company and the Selling Shareholders will indemnify the Underwriters against certain liabilities, including civil liabilities under the Securities Act, or will contribute to payments the Underwriters may be required to make in respect thereof.

All of the Company's officers and directors have agreed not to offer for sale, sell or otherwise dispose of any shares of the Company's Common Stock for a period of 90 days after the date of this Prospectus without the prior written consent of Pacific Growth Equities, Inc. The Company has agreed that it will not issue, sell or grant options to purchase or otherwise dispose of any shares of its Common Stock or securities convertible into or exchangeable for its Common Stock, except with respect to options or other rights outstanding on the date of this Prospectus or pursuant to the 1989 Stock Option Plan, for a period of 90 days after the date of this Prospectus without the prior written consent of the Representatives.

In connection with this offering, certain Underwriters and selling group members (if any) who are qualifying registered market makers on Nasdaq may engage in passive market making transactions in the Common Stock on Nasdaq in accordance with Rule 10b-6A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the two business day period before commencement of sales in this offering. The passive market making transactions must comply with applicable price and volume limits and be identified as

such. In general, a passive market maker may display its bid at a price not in excess of the highest independent bid for the security. If all independent bids are lowered below the passive market maker's bid, however, such bid must then be lowered when certain purchase limits are exceeded. Net purchases by a passive market maker on each day are generally limited to a specified percentage of the passive market maker's average daily trading volume in the Common Stock during a price period and must be discontinued when such limit is reached. Passive market making may stabilize the market price of the Common Stock at a level above that which might otherwise prevail and, if commenced, may be discontinued at any time.

LEGAL OPINIONS

Certain legal matters with respect to the issuance of the Common Stock offered hereby will be passed upon for the Company and the Selling Shareholders by Brobeck, Phleger & Harrison LLP, Newport Beach, California. Certain legal matters relating to the offering will be passed upon for the Underwriters by Gibson, Dunn & Crutcher, Los Angeles, California. Gibson, Dunn & Crutcher has, from time to time, performed legal services for the Company and may, if requested, do so in the future.

EXPERTS

The financial statements of the Company as of March 31, 1995 and 1994 and for each of the three years in the period ended March 31, 1995 and the financial statements of Clinitec as of December 31, 1994 and for the period from January 31, 1994 (inception) to December 31, 1994 included in this Prospectus and the Registration Statement have been audited by Deloitte & Touche LLP, independent auditors, as stated in their reports thereon appearing elsewhere herein and in the Registration Statement, and are included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

ADDITIONAL INFORMATION

The Company has filed a Registration Statement on Form S-1 (the "Registration Statement") with the Securities and Exchange Commission (the "Commission") under the Securities Act of 1933, as amended (the "Securities Act"), pertaining to the Common Stock covered by this Prospectus. This Prospectus omits certain information and exhibits included in that Registration Statement, copies of which may be obtained upon payment of a fee prescribed by the Commission or may be examined free of charge at the principal office of the Commission in Washington, D.C.

The Company is subject to the informational requirements of the Securities Exchange Act of 1934, as amended, (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Commission. Such reports, proxy statements and other information filed by the Company can be inspected and copied at the public reference facilities maintained by the Commission at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the Commission's regional offices located at Room 1400, Citicorp Center, 500 West Madison Street, Chicago, Illinois 60661 and at Suite 1300, 7 World Trade Center, New York, New York 10048. Copies of such material can be obtained from the Public Reference Section of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. The Company's Common Stock is listed on the Nasdaq National Market (Symbol: QSII), and reports and information concerning the Company can be inspected at the National Association of Securities Dealers, Inc. at 1735 K Street, N.W. Washington, D.C. 20006.

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QUALITY SYSTEMS, INC.

 PRO FORMA CONSOLIDATED BALANCE SHEET
 AS OF SEPTEMBER 30, 1995 (UNAUDITED)
 (IN THOUSANDS)

| | AS OF SEPTEMBER 30, 1995 | AS OF JUNE 30, 1995 | | PRO FORMA ADJUSTMENTS | PRO FORMA | PRO FORMA AS ADJUSTED |
|--|--------------------------------|----------------------------|----------------------------|----------------------------|-----------------------------|----------------------------|
| | ----- QSI ----- | ----- CLINITEC ----- | ----- COMBINED ----- | ----- (NOTE 2) ----- | ----- PRO FORMA ----- | ----- (NOTE 3) ----- |
| ASSETS | | | | | | |
| CURRENT ASSETS: | | | | | | |
| Cash and cash equivalents..... | \$ 5,008 | \$ 802 | \$ 5,810 | \$(1,500)(a) | \$ 4,310 | \$26,010 |
| Short-term investments..... | 1,287 | | 1,287 | | 1,287 | 1,287 |
| Accounts receivable, net..... | 4,722 | 201 | 4,923 | | 4,923 | 4,923 |
| Inventories..... | 764 | 64 | 828 | | 828 | 828 |
| Deferred tax asset..... | 104 | | 104 | | 104 | 104 |
| Other current assets..... | 78 | 19 | 97 | | 97 | 97 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total current assets..... | 11,963 | 1,086 | 13,049 | | 11,549 | 33,249 |
| Equipment and improvements, net.... | 492 | 111 | 603 | | 603 | 603 |
| Capitalized software costs, net.... | 587 | 93 | 680 | (93)(c) | 587 | 587 |
| Investment in Clinitec International, Inc..... | 982 | | 982 | (982)(a, b, c, d) | | |
| Cash surrender value of life insurance..... | 270 | | 270 | | 270 | 270 |
| Other assets..... | 69 | 13 | 82 | 357(c) | 439 | 439 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total assets..... | \$14,363 | \$ 1,303 | \$15,666 | \$(2,218) | \$13,448 | \$35,148 |
| | ===== | ===== | ===== | ===== | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | | |
| CURRENT LIABILITIES: | | | | | | |
| Accounts payable..... | \$ 1,014 | \$ 36 | \$ 1,050 | \$ -- | \$ 1,050 | \$ 1,050 |
| Accrued payroll and related expenses..... | 555 | 51 | 606 | | 606 | 606 |
| Other accrued expenses..... | 489 | 176 | 665 | | 665 | 665 |
| Deferred service revenue..... | 1,011 | | 1,011 | | 1,011 | 1,011 |
| Deferred compensation..... | 270 | | 270 | | 270 | 270 |
| Estimated costs to complete system installations..... | 247 | | 247 | | 247 | 247 |
| Income taxes payable..... | 176 | | 176 | | 176 | 176 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total current liabilities..... | 3,762 | 263 | 4,025 | | 4,025 | 4,025 |
| DEFERRED TAX LIABILITY..... | 130 | | 130 | 143(c) | 273 | 273 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total liabilities..... | 3,892 | 263 | 4,155 | 143 | 4,298 | 4,298 |
| MINORITY INTEREST..... | | | | 1,199(d) | 1,199 | 1,199 |
| COMMITMENTS AND CONTINGENCIES | | | | | | |
| SHAREHOLDERS' EQUITY: | | | | | | |
| Preferred stock..... | | 1,000 | 1,000 | (1,000)(a, d) | | |
| Common stock..... | 46 | 824 | 870 | (824)(d) | 46 | 56 |
| Additional paid-in capital..... | 6,169 | | 6,169 | | 6,169 | 27,859 |
| Unrealized loss on available-for-sale securities..... | (57) | | (57) | | (57) | (57) |
| Retained earnings..... | 4,313 | (784) | 3,529 | (1,736)(f) | 1,793 | 1,793 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total shareholders' equity..... | 10,471 | 1,040 | 11,511 | (3,560) | 7,951 | 29,651 |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Total liabilities and shareholders' equity.... | \$14,363 | \$ 1,303 | \$15,666 | \$(2,218) | \$13,448 | \$35,148 |
| | ===== | ===== | ===== | ===== | ===== | ===== |

QUALITY SYSTEMS, INC.

PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS
 FOR THE YEAR ENDED MARCH 31, 1995 (UNAUDITED)
 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | YEAR ENDED MARCH 31, 1995 | YEAR ENDED DECEMBER 31, 1994 | | PRO FORMA ADJUSTMENTS (NOTE 2) | PRO FORMA |
|--|---------------------------------|------------------------------------|----------|--------------------------------------|-----------|
| | QSI | CLINITEC | COMBINED | | |
| NET REVENUES: | | | | | |
| Sales of computer systems, upgrades and supplies..... | \$ 5,681 | \$ 54 | \$ 5,735 | \$ | \$ 5,735 |
| Maintenance and other services..... | 6,368 | | 6,368 | | 6,368 |
| | 12,049 | 54 | 12,103 | | 12,103 |
| COST OF PRODUCTS AND SERVICES..... | 6,060 | 20 | 6,080 | | 6,080 |
| Gross profit..... | 5,989 | 34 | 6,023 | | 6,023 |
| OPERATING EXPENSES: | | | | | |
| Selling, general and administrative..... | 3,536 | 364 | 3,900 | | 3,900 |
| Research and development..... | 1,467 | 59 | 1,526 | 119(e) | 1,645 |
| | 5,003 | 423 | 5,426 | 119 | 5,545 |
| Earnings (loss) from operations..... | 986 | (389) | 597 | (119) | 478 |
| Interest and investment income..... | 429 | | 429 | | 429 |
| Minority interest in loss of Clinitec.... | | | | 191(d) | 191 |
| Earnings before income tax provision (benefit)..... | 1,415 | (389) | 1,026 | 72 | 1,098 |
| Income tax provision (benefit)..... | 453 | | 453 | (28)(e) | (425) |
| Net earnings (loss)..... | \$ 962 | \$ (389) | \$ 573 | \$ 100 | \$ 673 |
| Net earnings per share..... | \$ 0.21 | | | | \$ 0.15 |
| Weighted average shares used in calculation..... | 4,606 | | | | 4,734 |

QUALITY SYSTEMS, INC.

PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS
 FOR THE SIX MONTHS ENDED SEPTEMBER 30, 1995 (UNAUDITED)
 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | SIX MONTHS ENDED SEPTEMBER 30, 1995 | SIX MONTHS ENDED JUNE 30, 1995 | | PRO FORMA ADJUSTMENTS (NOTE 2) | PRO FORMA |
|--|--|---|---------------|--------------------------------------|----------------|
| | QSI | CLINITEC | COMBINED | | |
| NET REVENUES: | | | | | |
| Sales of computer systems, upgrades and supplies..... | \$ 4,648 | \$ 573 | \$5,221 | \$ | \$ 5,221 |
| Maintenance and other services..... | 3,340 | | 3,340 | | 3,340 |
| | 7,988 | 573 | 8,561 | | 8,561 |
| COST OF PRODUCTS AND SERVICES..... | 3,785 | 198 | 3,983 | | 3,983 |
| Gross profit..... | 4,203 | 375 | 4,578 | | 4,578 |
| OPERATING EXPENSES: | | | | | |
| Selling, general and administrative..... | 1,928 | 650 | 2,578 | | 2,578 |
| Research and development..... | 656 | | 656 | 60(e) | 716 |
| | 2,584 | 650 | 3,234 | 60 | 3,294 |
| Earnings (loss) from operations..... | 1,619 | (275) | 1,344 | (60) | 1,284 |
| Interest and investment income..... | 205 | 3 | 208 | | 208 |
| Equity in loss of Clinitec..... | (18) | | (18) | 18(b) | -- |
| Minority interest in loss of Clinitec.... | | | | 133(d) | 133 |
| Earnings (loss) before income tax provision..... | 1,806 | (272) | 1,534 | 91 | 1,625 |
| Income tax provision..... | 741 | | 741 | (24)(e) | 717 |
| Net earnings (loss)..... | \$ 1,065 | \$ (272) | \$ 793 | \$ 115 | \$ 908 |
| Net earnings per share..... | \$ 0.23 | | | | \$ 0.19 |
| Weighted average shares used in calculation..... | 4,679 | | | | 4,807 |

QUALITY SYSTEMS, INC.

NOTES TO PRO FORMA
CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The unaudited pro forma consolidated statements of operations and balance sheet give effect on a purchase accounting basis to the acquisition of an additional 26% equity interest in Clinitec International, Inc. (Clinitec) for \$3 million (the Acquisition) (resulting in a 51% majority ownership in Clinitec by the Company). The pro forma consolidated balance sheet also gives effect to the Offering and the application of the estimated net proceeds therefrom. The pro forma consolidated statement of operations for the fiscal year ended March 31, 1995 is comprised of the results of Quality Systems, Inc. (QSI) for the fiscal year ended March 31, 1995 and the results of Clinitec for the year ended December 31, 1994. The pro forma consolidated statement of operations for the six months ended September 30, 1995 is comprised of the results of QSI for the six months ended September 30, 1995 and the results of Clinitec for the six months ended June 30, 1995. The pro forma consolidated balance sheet as of September 30, 1995 has been prepared by consolidating the balance sheet of QSI as of September 30, 1995 with the balance sheet of Clinitec as of June 30, 1995.

The pro forma consolidated statements of operations for the fiscal year ended March 31, 1995 and the six months ended September 30, 1995 assume that the Acquisition occurred at April 1, 1994. The pro forma consolidated balance sheet as of September 30, 1995 assumes that the Acquisition of the majority interest in Clinitec and the Offering occurred on September 30, 1995. The pro forma consolidated statements of operations and balance sheet do not purport to represent the results of operations or financial position of the Company had the transactions and events assumed therein occurred on the dates specified, nor are they necessarily indicative of the results of operations that may be achieved in the future. The pro forma adjustments are based on management's preliminary assumptions regarding purchase accounting adjustments. The actual allocation of the purchase price will be adjusted to the extent that actual amounts differ from management's estimates in accordance with FAS No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises."

The pro forma consolidated financial information is based upon certain assumptions and adjustments described in the notes to the pro forma financial statements. The pro forma consolidated financial information should be read in conjunction with the historical financial statements, and related notes, of QSI and Clinitec contained elsewhere herein.

2. PRO FORMA ADJUSTMENTS

The following describe the pro forma adjustments made to reflect the acquisition of an additional 26% interest in Clinitec:

- a) To reflect the acquisition of an additional interest in Clinitec, providing QSI with a 51% ownership interest through a purchase of Clinitec convertible preferred stock for \$3 million. Concurrent with this acquisition, Clinitec is expected to distribute dividends to its common stockholders of \$1.5 million.
- b) To reverse QSI's equity accounting entry to record its portion of Clinitec's net loss.

- c) To record purchase accounting adjustments resulting from the acquisition of the aggregate 51% ownership interest based on an appraisal of the fair value of the net assets of Clinitec as follows:

| | |
|--|----------|
| Net tangible assets..... | \$ 1,248 |
| Intangible assets related to existing technology..... | 357 |
| In-process research and development..... | 3,846 |
| Deferred tax liability (\$143 related to intangible assets consisting of existing technology acquired and \$1,308 related to in-process research and development)..... | (1,451) |
| | ----- |
| Total purchase price..... | \$ 4,000 |
| | ===== |

- d) To eliminate Clinitec's equity accounts and QSI's investment account and set up 49% minority interest.
- e) To record amortization of the intangible assets related to existing technology based on the straight line method and a three year useful life and the corresponding tax benefit.
- f) To reflect the cumulative effect of the above adjustments on retained earnings.

In accordance with FASB Interpretation No. 4, the Company is required to write-off the \$3.8 million in-process research and development acquired in the acquisition, net of tax benefit of \$1.3 million. This write-off will be reflected in the quarter ending March 31, 1996 and has not been reflected in the Pro Forma Consolidated Financial Statements.

3. PRO FORMA AS ADJUSTED

Pro Forma As Adjusted amounts reflect the issuance of 1,000,000 shares of QSI common stock for estimated net proceeds of \$21.7 million.

4. PRO FORMA WEIGHTED AVERAGE SHARES OUTSTANDING

Pro forma weighted average shares assume as outstanding 128,000 of the shares being offered by the Company in the Offering, which represent the approximate number of shares that have to be sold to fund the incremental \$3,000,000 investment in Clinitec.

INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
Quality Systems, Inc.

We have audited the accompanying balance sheets of Quality Systems, Inc. as of March 31, 1994 and 1995 and the related statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Quality Systems, Inc. as of March 31, 1994 and 1995 and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP
Costa Mesa, CA
June 2, 1995

QUALITY SYSTEMS, INC.

BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

| | MARCH 31, | |
|--|-----------------|-----------------|
| | 1994 | 1995 |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents..... | \$ 1,093 | \$ 6,085 |
| Short-term investments (Note 2)..... | 4,978 | 1,237 |
| Accounts receivable, less allowance for doubtful accounts of \$66 (1994) and \$77 (1995)..... | 2,730 | 2,997 |
| Inventories (Note 3)..... | 895 | 783 |
| Deferred tax asset (Note 4)..... | 64 | 199 |
| Other current assets..... | 87 | 74 |
| | ----- | ----- |
| Total current assets..... | 9,847 | 11,375 |
| Equipment and improvements, net (Note 3)..... | 593 | 535 |
| Capitalized software costs, net (Note 1)..... | 509 | 502 |
| Cash surrender value of life insurance (Note 5)..... | 65 | 185 |
| Other assets..... | 80 | 71 |
| | ----- | ----- |
| Total assets..... | <u>\$11,094</u> | <u>\$12,668</u> |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable..... | \$ 849 | \$ 597 |
| Accrued payroll and related expenses..... | 398 | 427 |
| Other accrued expenses..... | 455 | 492 |
| Deferred service revenue..... | 876 | 952 |
| Deferred compensation (Note 5)..... | 65 | 185 |
| Estimated costs to complete system installations..... | 347 | 217 |
| Income taxes payable (Note 4)..... | ----- | 473 |
| | ----- | ----- |
| Total current liabilities..... | 2,990 | 3,343 |
| DEFERRED TAX LIABILITY (Note 4)..... | 64 | 137 |
| COMMITMENTS AND CONTINGENCIES (Note 7) | | |
| Shareholders' equity (Note 6): | | |
| Common stock, \$.01 par value; 20,000,000 shares authorized; 4,445,000 and 4,536,000 shares issued and outstanding, respectively..... | 44 | 45 |
| Additional paid-in capital..... | 5,789 | 5,978 |
| Unrealized loss on available-for-sale securities, net of tax benefit of \$60 (1994) and \$3 (1995)..... | (79) | (83) |
| Retained earnings..... | 2,286 | 3,248 |
| | ----- | ----- |
| Total shareholders' equity..... | 8,040 | 9,188 |
| | ----- | ----- |
| Total liabilities and shareholders' equity..... | <u>\$11,094</u> | <u>\$12,668</u> |
| | ===== | ===== |

See notes to financial statements.

QUALITY SYSTEMS, INC.

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | YEAR ENDED MARCH 31, | | |
|--|----------------------|----------|----------|
| | 1993 | 1994 | 1995 |
| NET REVENUES: | | | |
| Sales of computer systems, upgrades and supplies..... | \$ 6,274 | \$ 6,146 | \$ 5,681 |
| Maintenance and other services..... | 5,377 | 5,606 | 6,368 |
| | ----- | ----- | ----- |
| | 11,651 | 11,752 | 12,049 |
| COST OF PRODUCTS AND SERVICES..... | 6,992 | 6,527 | 6,060 |
| | ----- | ----- | ----- |
| Gross margin..... | 4,659 | 5,225 | 5,989 |
| OPERATING EXPENSES: | | | |
| Selling, general and administrative..... | 3,008 | 3,052 | 3,536 |
| Research and development..... | 1,134 | 1,318 | 1,467 |
| | ----- | ----- | ----- |
| | 4,142 | 4,370 | 5,003 |
| Earnings from operations..... | 517 | 855 | 986 |
| Interest and investment income (Note 2)..... | 192 | 400 | 429 |
| | ----- | ----- | ----- |
| Earnings before income tax provision..... | 709 | 1,255 | 1,415 |
| Income tax provision (Note 4)..... | 331 | 349 | 453 |
| | ----- | ----- | ----- |
| Earnings before extraordinary credit..... | 378 | 906 | 962 |
| Extraordinary credit -- tax benefit from utilization of net operating loss carryforwards..... | 245 | | |
| | ----- | ----- | ----- |
| NET EARNINGS..... | \$ 623 | \$ 906 | \$ 962 |
| | ===== | ===== | ===== |
| NET EARNINGS PER SHARE: | | | |
| Earnings before extraordinary credit..... | \$ 0.09 | \$ 0.21 | \$ 0.21 |
| Extraordinary credit..... | \$ 0.06 | -- | -- |
| | ----- | ----- | ----- |
| Net earnings per share..... | \$ 0.15 | \$ 0.21 | \$ 0.21 |
| | ===== | ===== | ===== |
| Fully diluted earnings per share..... | \$ 0.15 | \$ 0.20 | \$ 0.21 |
| | ===== | ===== | ===== |

See notes to financial statements.

QUALITY SYSTEMS, INC.

STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995
(IN THOUSANDS)

| | COMMON SHARES ISSUED | | ADDITIONAL PAID-IN CAPITAL | UNREALIZED LOSS ON AVAILABLE- FOR-SALE SECURITIES | RETAINED EARNINGS | TOTAL SHAREHOLDERS' EQUITY |
|---|-------------------------|--------|----------------------------------|---|----------------------|----------------------------------|
| | NUMBER | AMOUNT | | | | |
| Balance at April 1, 1992..... | 4,187 | \$ 42 | \$5,100 | \$ -- | \$ 757 | \$ 5,899 |
| Net earnings..... | | | | | 623 | 623 |
| Balance at March 31, 1993..... | 4,187 | 42 | 5,100 | | 1,380 | 6,522 |
| Exercise of stock options..... | 258 | 2 | 400 | | | 402 |
| Tax benefit resulting from stock options..... | | | 289 | | | 289 |
| Unrealized loss on available-for-sale securities, net of tax benefit of \$60..... | | | | (79) | | (79) |
| Net earnings..... | | | | | 906 | 906 |
| Balance at March 31, 1994..... | 4,445 | 44 | 5,789 | (79) | 2,286 | 8,040 |
| Exercise of stock options..... | 91 | 1 | 150 | | | 151 |
| Tax benefit resulting from stock options..... | | | 39 | | | 39 |
| Unrealized loss on available-for-sale securities, net of tax benefit of \$3..... | | | | (4) | | (4) |
| Net earnings..... | | | | | 962 | 962 |
| Balance at March 31, 1995..... | 4,536 | \$ 45 | \$5,978 | \$(83) | \$ 3,248 | \$ 9,188 |

See notes to financial statements.

QUALITY SYSTEMS, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995
(IN THOUSANDS)

| | YEARS ENDED MARCH 31, | | |
|--|-----------------------|----------|----------|
| | 1993 | 1994 | 1995 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net earnings..... | \$ 623 | \$ 906 | \$ 962 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation and amortization of equipment and improvements..... | 211 | 239 | 220 |
| Amortization of capitalized software costs..... | 147 | 165 | 198 |
| Realized gains from sales of short-term investments..... | (28) | (194) | (151) |
| Unrealized (gains) losses on trading securities..... | (11) | 99 | (82) |
| Deferred income taxes..... | | | (62) |
| Changes in: | | | |
| Accounts receivable..... | 264 | (284) | (267) |
| Inventories..... | 374 | 56 | 112 |
| Other current assets..... | 5 | 15 | 13 |
| Accounts payable..... | 157 | (153) | (252) |
| Accrued expenses..... | (15) | (57) | 66 |
| Deferred service revenue..... | 55 | 32 | 76 |
| Estimated costs to complete system installations..... | (116) | 115 | (130) |
| Income taxes payable and taxes related to equity accounts..... | 86 | 263 | 515 |
| Net cash provided by operating activities..... | 1,752 | 1,202 | 1,218 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Proceeds from sales of short-term investments..... | 12,042 | 10,074 | 12,725 |
| Purchases of short-term investments..... | (10,322) | (13,810) | (8,758) |
| Additions to equipment and improvements, net..... | (318) | (101) | (162) |
| Additions to capitalized software costs..... | (148) | (183) | (191) |
| Change in other assets..... | (1) | 17 | 9 |
| Net cash provided by (used in) investing activities..... | 1,253 | (4,003) | 3,623 |
| CASH FLOWS FROM FINANCING ACTIVITIES -- | | | |
| Proceeds from exercise of stock options..... | | 402 | 151 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS..... | 3,005 | (2,399) | 4,992 |
| CASH AND CASH EQUIVALENTS, beginning of year..... | 487 | 3,492 | 1,093 |
| CASH AND CASH EQUIVALENTS, end of year..... | \$ 3,492 | \$ 1,093 | \$ 6,085 |
| | ===== | ===== | ===== |

Supplemental Information: During fiscal 1993, 1994 and 1995, the Company made income tax payments of \$2, \$86 and \$10, respectively.

See notes to financial statements.

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business -- Quality Systems, Inc. (QSI or the Company) develops and markets proprietary information systems for medical and dental group practices, physician hospital organizations, management service organizations, health maintenance organizations and community health centers. The Company's proprietary software systems include summary medical records and general patient information, appointment scheduling, billing, insurance claims submission and processing, managed care implementation and referral management, treatment outcome studies, treatment planning, drug formularies, word processing and accounting. In addition to providing fully integrated solutions to its client, the Company provides its clients with comprehensive hardware and software maintenance and support services, system training services and electronic claims submission services.

Revenue Recognition -- Licenses, sales of computer systems and system upgrades are recognized at the time the basic software and hardware is shipped and the estimated costs to complete the systems are not considered significant in accordance with Statement of Position 91-1, Software Revenue Recognition. Estimated costs to complete are normally insignificant and are charged to expense in the period in which the sale is recognized. These costs typically include labor and travel costs associated with training, installation and data conversion. If estimated costs to complete are significant, revenue is recognized on a percentage of completion basis.

Maintenance revenue is recognized ratably over the life of the contract. Advance maintenance revenue billings are included in deferred service revenue on the accompanying balance sheets. Sales of supplies are recognized at the time of shipment.

Cash equivalents -- The Company considers all highly liquid interest earning deposits purchased with an original maturity of three months or less to be cash equivalents.

Short-term investments -- The Company adopted Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115), as of the end of the fiscal year ended March 31, 1994. The cumulative effect from the change in accounting principle was not material in determining net earnings for the year ended March 31, 1994. In accordance with SFAS No. 115, investments are classified into one of the following categories:

- Held to maturity -- Debt securities for which the Company has the intent and the ability to hold to maturity.
- Trading -- Debt securities that do not meet the "intent-to-hold" criterion and equity securities, both of which are bought and held principally for the purpose of being sold in the near term.
- Available-for-sale -- Debt securities that do not meet the "intent-to-hold" criterion and equity securities that are not classified as trading securities.

Held to maturity securities are carried in the balance sheet at cost (unless there is a decline in the value of the individual securities that is not due to temporary declines), and realized gains and losses are recorded in the income statement in the period that they are earned or incurred. Trading securities are carried in the balance sheet at fair market value and unrealized gains and losses are recorded in the statement of operations. Available-for-sale securities are carried in the balance sheet at fair market value. Realized gains and losses are recorded in the income statement when they are earned or incurred, and unrealized gains and losses, net of tax effect, are recognized as a component of shareholders' equity.

Realized gains and losses from investment transactions are determined on a first-in, first-out basis.

Accounts Receivable -- A majority of the Company's system sales are financed by third-party sources, while the Company provides credit for most maintenance contract sales. The Company performs ongoing

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995 -- (CONTINUED)

credit evaluations of its customers and maintains reserves for potential credit losses, which have been within management's expectations.

Inventories -- Inventories are valued at lower of cost (first-in, first-out) or market. Certain inventories are maintained for customer support pursuant to service agreements and are amortized over a five-year period using the straight-line method.

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

Software Development Costs -- Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional development costs are capitalized and amortized over the economic life of the related product in accordance with Statement of Financial Accounting Standards No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed. Accumulated amortization of capitalized software costs amounted to \$750,000 (1994) and \$582,400 (1995). The Company performs an annual review of the recoverability of such capitalized software costs. At the time a determination has been made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts would be written off.

Income Taxes -- Effective April 1, 1993, the Company adopted Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS No. 109). Financial statements for prior years have not been restated, and there was no material cumulative effect from the change in accounting principle.

In accordance with SFAS No. 109, income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of assets and liabilities for financial and tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. Valuation allowances are established as a reduction of net deferred tax assets when management cannot determine that the recoverability of such assets is probable.

Earnings per Share -- Primary and fully diluted earnings per share for the year ending March 31, 1994 are based on the weighted average number of common shares and common share equivalents outstanding of 4,342,000 and 4,461,000, respectively. The difference between primary and fully diluted earnings per share for the years ended March 31, 1993 and 1995 was not significant and earnings per share was calculated based on the weighted average number of common shares and common share equivalents outstanding of 4,187,000 and 4,606,000, respectively. Common stock equivalents consist primarily of stock options and are calculated using the treasury stock method.

2. SHORT-TERM INVESTMENTS

Short-term investments consist of the following components (in thousands):

| | YEAR ENDED MARCH | |
|------------------------------------|------------------|---------|
| | 31, | |
| | 1994 | 1995 |
| | ----- | ----- |
| Trading securities..... | \$1,038 | \$ 927 |
| Available-for-sale securities..... | 3,940 | 310 |
| | ----- | ----- |
| | \$4,978 | \$1,237 |
| | ===== | ===== |

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995 -- (CONTINUED)

As of March 31, 1995, trading securities consisted of equity securities with a fair market value of \$913,000 and collateral cash of \$790,000 offsetting firm commitments to purchase additional equity securities with a fair market value of \$776,000 to satisfy short positions.

The following is a summary of available-for-sale securities (in thousands):

| | MARCH 31, | |
|---|-----------|-------|
| | 1994 | 1995 |
| Aggregate market..... | \$3,940 | \$310 |
| Gross unrealized holding gains..... | 51 | |
| Gross unrealized holding losses..... | 190 | 146 |
| Amortized cost basis for: | | |
| Overland Express Variable Rate Government Fund..... | 1,590 | |
| Other equity securities..... | 1,947 | |
| Debt securities issued by foreign governments, denominated in U.S. dollars..... | 542 | 457 |

Interest and investment income includes realized gains on short-term investments of \$28,000, \$194,000 and \$151,000 for the years ended March 31, 1993, 1994 and 1995, respectively, unrealized gains of \$11,000 and \$82,000 for the years ended March 31, 1993 and 1995, respectively, and unrealized losses of \$99,000 for the year ended March 31, 1994.

3. COMPOSITION OF CERTAIN FINANCIAL STATEMENT CAPTIONS (IN THOUSANDS):

| | MARCH 31, | |
|---|-----------|-------|
| | 1994 | 1995 |
| Inventories: | | |
| Computer systems and components..... | \$419 | \$420 |
| Replacement parts for certain client systems, net of accumulated amortization of \$1,126 (1994) and \$1,026 (1995)..... | 422 | 308 |
| Maintenance parts..... | 34 | 36 |
| Supplies for resale..... | 18 | 17 |
| Discontinued equipment..... | 2 | 2 |
| | \$895 | \$783 |
| | ===== | ===== |

| | MARCH 31, | |
|--|-----------|----------|
| | 1994 | 1995 |
| Equipment and improvements: | | |
| Computers and electronic test equipment..... | \$ 1,215 | \$ 1,251 |
| Furniture and fixtures..... | 307 | 312 |
| Vehicles..... | 110 | 110 |
| Leasehold improvements..... | 119 | 117 |
| | 1,751 | 1,790 |
| Accumulated depreciation and amortization..... | (1,158) | (1,255) |
| | \$ 593 | \$ 535 |
| | ===== | ===== |

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995 -- (CONTINUED)

4. INCOME TAXES

The income tax provision consists of the following components (in thousands):

| | YEAR ENDED MARCH 31, | | |
|---------------------|----------------------|-------|-------|
| | 1993 | 1994 | 1995 |
| Federal: | | | |
| Current taxes..... | \$245 | \$309 | \$414 |
| Deferred taxes..... | | | (36) |
| | ---- | ---- | ---- |
| | 245 | 309 | 378 |
| | ---- | ---- | ---- |
| State: | | | |
| Current taxes..... | 86 | 40 | 101 |
| Deferred taxes..... | | | (26) |
| | ---- | ---- | ---- |
| | 86 | 40 | 75 |
| | ---- | ---- | ---- |
| | \$331 | \$349 | \$453 |
| | ===== | ===== | ===== |

The income tax provision differs from an amount computed at statutory rates as follows (in thousands):

| | YEARS ENDED MARCH 31, | | |
|---|-----------------------|--------|-------|
| | 1993 | 1994 | 1995 |
| Federal income tax provision at statutory rate..... | \$241 | \$ 426 | \$481 |
| Increases (decreases) resulting from: | | | |
| State income taxes, net of federal benefit..... | 86 | 121 | 107 |
| Change in valuation allowance..... | | (204) | (86) |
| Adjustment to reconcile to prior year return..... | | | (43) |
| Dividends received deduction..... | | (9) | (10) |
| Other..... | 4 | 15 | 4 |
| | ---- | ---- | ---- |
| | \$331 | \$ 349 | \$453 |
| | ===== | ===== | ===== |

The changes in valuation allowances are related to benefits arising from federal and state net operating loss carryforwards.

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995 -- (CONTINUED)

The net deferred tax benefits in the accompanying balance sheets include the following components (in thousands):

| | MARCH 31, | |
|--|-----------|-------|
| | 1994 | 1995 |
| Deferred tax assets: | | |
| Short-term investments..... | \$ 104 | \$ 71 |
| Accounts receivable..... | 29 | 33 |
| Inventory..... | 26 | 27 |
| Accumulated depreciation..... | 4 | 5 |
| Accrued vacation and sick leave..... | 147 | 164 |
| Accrued liability for deferred compensation..... | 28 | 100 |
| State income taxes..... | | 18 |
| Other accrued expenses..... | 13 | |
| Loss carryforwards..... | 195 | |
| | 546 | 418 |
| Deferred tax liabilities: | | |
| Inventory..... | (27) | (22) |
| Accumulated depreciation..... | (33) | (24) |
| Capitalized software..... | (220) | (217) |
| Deferred revenue..... | (180) | (93) |
| | (460) | (356) |
| Deferred tax asset valuation allowance..... | (86) | |
| | \$ -- | \$ 62 |
| | ==== | ==== |

As required by SFAS 109, on the accompanying balance sheets deferred tax assets and liabilities have been shown net based on the long-term or short-term nature of the items which give rise to the deferred amounts.

5. EMPLOYEE BENEFIT PLANS

The Company has a profit sharing and retirement plan (the Retirement Plan) for the benefit of substantially all of its employees. The Retirement Plan was amended during the fiscal year ended March 31, 1994 to add 401(k) features. Participating employees may defer up to 15% of compensation per year. The Company's annual contribution is determined by the Company's Board of Directors and the Retirement Plan may be amended or discontinued at the discretion of the Board of Directors. Contributions of \$10,000, \$19,000 and \$21,000 were made to the Retirement Plan for the years ended March 31, 1993, 1994 and 1995, respectively.

During the fiscal year ended March 31, 1994, the Company initiated a deferred compensation plan (the Deferral Plan) for the benefit of officers and key employees. Participating employees may defer all or a portion of their compensation for a Deferral Plan year. In addition, the Company may, but is not required to, make contributions into the Deferral Plan on behalf of participating employees. Each participating employee's deferred compensation and share of Company contributions have been invested in a life insurance policy which has death benefit and mutual fund features. Investment decisions are made by each participating employee from a family of mutual funds. The Company is the owner and beneficiary of the life insurance policies and has an obligation to pay the greater of the death benefit or the net cash surrender value upon each employee's death or termination. The net cash surrender value of the life insurance policies and the related

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995 -- (CONTINUED)

Company obligation for deferred compensation was \$65,000 and \$185,000 at March 31, 1994 and 1995, respectively, which have been included in the accompanying balance sheets. The Company made contributions of \$8,000 and \$10,000 to the Deferral Plan for the fiscal years ended March 31, 1994 and March 31, 1995, respectively.

6. EMPLOYEE STOCK OPTIONS PLANS

1981 Stock Option Plan -- Under a shareholder approved incentive stock option plan (1981 Plan) for officers and key employees, 365,384 shares of common stock were reserved for the issuance of options to purchase shares of common stock at the fair market value at the date of grant. On October 31, 1991, the 1981 incentive stock option plan expired, and no additional shares could be granted under the plan. As of March 31, 1995, all outstanding shares under this plan had been exercised. A summary of option transactions follows:

| | YEARS ENDED MARCH 31, | | |
|---------------------------------------|-----------------------|---------------|----------|
| | 1993 | 1994 | 1995 |
| Options: | | | |
| Outstanding at beginning of year..... | 224,500 | 199,000 | 33,300 |
| Granted..... | | | |
| Exercised..... | | (162,700) | (33,300) |
| Cancelled..... | (25,500) | (3,000) | |
| Outstanding at end of year..... | 199,000 | 33,300 | -- |
| Range of option exercise prices: | | | |
| Granted..... | \$ -- | \$ -- | \$ -- |
| Exercised..... | \$ -- | \$1.06-\$1.69 | \$ 1.69 |
| Cancelled..... | \$1.06-\$2.06 | \$1.06-\$1.69 | \$ -- |

1989 Stock Option Plan -- During fiscal 1990, the Company's shareholders approved a stock option plan (1989 Plan) under which 1,000,000 shares of common stock have been reserved for the issuance of options.

The 1989 Plan provides that salaried officers or key employees, and non-employee directors of the Company or its subsidiaries may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock at an exercise price not less than 85% of their fair market value on the option grant date.

The Plan may be administered by the Board of Directors of the Company (Board) or a Committee consisting of three or more directors who are appointed by, and serve at the pleasure of, the Board (the Committee). A Committee has not been appointed. The Board as Plan Administrator has complete discretion to determine which eligible individuals are to receive option grants, the number of shares subject to each such grant, the status of any granted option as either an incentive stock option or a non-statutory stock option under federal tax laws, the vesting schedule to be in effect for the option grant, and the option grant, and the maximum term for which any granted option is to remain outstanding.

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED MARCH 31, 1993, 1994 AND 1995 -- (CONTINUED)

Option grants to non-employee directors must be approved by the Board. Upon an acquisition of the Company by merger or asset sale, each outstanding option will be subject to accelerated vesting under certain circumstances. The Board may amend or modify the 1989 Plan at any time. The 1989 Plan will terminate on May 30, 1999, unless sooner terminated by the Board.

| | YEARS ENDED MARCH 31, | | |
|---------------------------------------|-----------------------|---------------|---------------|
| | 1993 | 1994 | 1995 |
| Options -- | | | |
| Outstanding at beginning of year..... | 207,000 | 337,000 | 272,200 |
| Granted..... | 130,000 | 101,000 | 5,000 |
| Exercised..... | | (95,800) | (57,500) |
| Cancelled..... | | (70,000) | |
| Outstanding at end of year..... | 337,000 | 272,200 | 219,700 |
| Range of option exercise prices: | | | |
| Granted..... | \$1.38-\$1.81 | \$1.50 | \$3.75 |
| Exercised..... | \$ -- | \$1.50-\$1.69 | \$1.50-\$1.69 |
| Cancelled..... | \$ -- | \$1.63-\$1.81 | \$ -- |

At March 31, 1995, options for 155,750 shares were exercisable, and 624,500 shares were available for future grant under the 1989 Plan.

7. COMMITMENTS AND CONTINGENCIES

The Company leases its facilities and office under noncancelable operating lease agreements which contain lease renewal options through October 1996. The Company has rental commitments in fiscal 1996 and 1997 of \$345,000 and \$196,000, respectively. Total rental expense for all operating leases was \$423,000, \$412,000 and \$387,000 for the years ended March 31, 1993, 1994 and 1995, respectively.

The Company is a party to various claims, legal actions and complaints arising in the ordinary course of business. The Company believes such matters are without merit, or involve such amounts that unfavorable disposition would not have a material adverse effect on the Company's financial statements.

8. SUBSEQUENT EVENT

In May 1995, the Company entered into a strategic relationship with Clinitec International, Inc. (Clinitec), a developer of electronic medical records software systems marketed under the trade name "NextGen". As part of this relationship, the Company acquired a 25% equity interest in Clinitec for \$1 million, and acquired an option to purchase an aggregate 51% equity interest in Clinitec for an additional \$3 million, exercisable at any time through August 1997.

As part of the agreement with Clinitec, the Company received the non-exclusive right to market NextGen for medical applications, and the world-wide exclusive right to market NextGen for dental markets. The Company anticipates being able to integrate its medical and dental practice management systems with NextGen software in order to provide medical and dental group practices with a state-of-the-art healthcare office of the future.

The investment will be accounted for using the equity method of accounting, whereby the original investment is recorded at cost and is adjusted periodically to recognize the Company's 25% share of Clinitec's earnings or losses after the date of investment.

QUALITY SYSTEMS, INC.

BALANCE SHEET
AS OF SEPTEMBER 30, 1995 (UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

| | |
|---|----------|
| ASSETS | |
| CURRENT ASSETS: | |
| Cash and cash equivalents..... | \$ 5,008 |
| Short-term investments..... | 1,287 |
| Accounts receivable, net..... | 4,722 |
| Inventories..... | 764 |
| Deferred tax asset..... | 104 |
| Other current assets..... | 78 |
| | ----- |
| Total current assets..... | 11,963 |
| EQUIPMENT AND IMPROVEMENTS, net..... | 492 |
| CAPITALIZED SOFTWARE COSTS, net..... | 587 |
| INVESTMENT IN CLINITEC INTERNATIONAL, INC..... | 982 |
| CASH SURRENDER VALUE OF LIFE INSURANCE..... | 270 |
| OTHER ASSETS..... | 69 |
| | ----- |
| Total assets..... | \$14,363 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| CURRENT LIABILITIES: | |
| Accounts payable..... | \$ 1,014 |
| Accrued payroll and related expenses..... | 555 |
| Other accrued expenses..... | 489 |
| Deferred service revenue..... | 1,011 |
| Deferred compensation..... | 270 |
| Estimated costs to complete system installations..... | 247 |
| Income taxes payable..... | 176 |
| | ----- |
| Total current liabilities..... | 3,762 |
| DEFERRED TAX LIABILITY..... | 130 |
| | ----- |
| Total liabilities..... | 3,892 |
| COMMITMENTS AND CONTINGENCIES | |
| SHAREHOLDERS' EQUITY: | |
| Common stock, \$.01 par value; 20,000,000 shares authorized; 4,569,000 shares issued and outstanding..... | 46 |
| Additional paid-in capital..... | 6,169 |
| Unrealized loss on available-for-sale securities, net of tax benefit of \$43..... | (57) |
| Retained earnings..... | 4,313 |
| | ----- |
| Total shareholders' equity..... | 10,471 |
| | ----- |
| Total liabilities and shareholders' equity..... | \$14,363 |
| | ===== |

See notes to financial statements.

QUALITY SYSTEMS, INC.

STATEMENTS OF OPERATIONS
 FOR THE SIX MONTHS ENDED SEPTEMBER 30, 1994 AND 1995 (UNAUDITED)
 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|-----------------------------------|---------|
| | 1994 | 1995 |
| NET REVENUES: | | |
| Sales of computer systems, upgrades and supplies..... | \$2,730 | \$4,648 |
| Maintenance and other services..... | 3,137 | 3,340 |
| | 5,867 | 7,988 |
| COST OF PRODUCTS AND SERVICES..... | 3,108 | 3,785 |
| Gross profit..... | 2,759 | 4,203 |
| OPERATING EXPENSES: | | |
| Selling, general and administrative..... | 1,680 | 1,928 |
| Research and development..... | 716 | 656 |
| | 2,396 | 2,584 |
| Earnings from operations..... | 363 | 1,619 |
| Interest and investment income..... | 121 | 205 |
| Equity in loss of Clinitec International, Inc..... | | (18) |
| Earnings before income tax provision..... | 484 | 1,806 |
| Income tax provision..... | 98 | 741 |
| NET EARNINGS..... | \$ 386 | \$1,065 |
| NET EARNINGS PER SHARE..... | \$ 0.08 | \$ 0.23 |
| Weighted average common and common equivalent shares..... | 4,643 | 4,679 |

See notes to financial statements.

QUALITY SYSTEMS, INC.

STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED SEPTEMBER 30, 1994 AND 1995 (UNAUDITED)
(IN THOUSANDS)

| | SIX MONTHS ENDED SEPTEMBER 30, | |
|---|-----------------------------------|----------|
| | 1994 | 1995 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net earnings..... | \$ 386 | \$ 1,065 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization of equipment and improvements..... | 115 | 111 |
| Amortization of capitalized software costs..... | 95 | 127 |
| Realized gains from sales of short-term investments..... | 135 | 11 |
| Unrealized (gains) losses on trading securities..... | (171) | (33) |
| Equity in loss of Clinitec International, Inc. | | 18 |
| Deferred income taxes..... | | 88 |
| Changes in: | | |
| Accounts receivable..... | 99 | (1,725) |
| Inventories..... | 49 | 19 |
| Other current assets..... | (9) | (4) |
| Accounts payable..... | (172) | 417 |
| Accrued expenses..... | (41) | 125 |
| Deferred service revenue..... | 61 | 59 |
| Estimated costs to complete system installations..... | (82) | 30 |
| Income taxes payable and taxes related to equity accounts..... | 98 | (180) |
| Net cash provided by operating activities..... | 563 | 128 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sales of short-term investments..... | 6,785 | 1,068 |
| Purchases of short-term investments..... | (5,605) | (1,049) |
| Investment in Clinitec International, Inc. | | (1,000) |
| Additions to equipment and improvements, net..... | (48) | (67) |
| Additions to capitalized software costs..... | (77) | (213) |
| Change in other assets..... | 30 | 2 |
| Net cash provided by (used in) investing activities..... | 1,085 | (1,259) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options..... | 44 | 54 |
| Net increase (decrease) in cash and cash equivalents..... | 1,692 | (1,077) |
| Cash and cash equivalents, beginning of period..... | 1,093 | 6,085 |
| Cash and cash equivalents, end of period..... | \$ 2,785 | \$ 5,008 |

Supplemental Information: During the six months ended September 30, 1994 and 1995, the Company made income tax payments of \$10 and \$832, respectively.

QUALITY SYSTEMS, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED SEPTEMBER 30, 1994 AND 1995 (UNAUDITED)

1. BASIS OF PRESENTATION

The information set forth in these financial statements of Quality Systems, Inc. (the Company) as of September 30, 1995 and for the six months ended September 30, 1994 and 1995 is unaudited. The information reflects all adjustments consisting only of normal recurring entries that, in the opinion of management, are necessary to present fairly the financial position and results of operations of the Company for the periods indicated. Results of operations for the interim periods are not necessarily indicative of the results of operations for the full fiscal year or for any future period.

Certain information in footnote disclosures normally included in financial statements has been condensed or omitted, in accordance with the rules and regulations of the Securities and Exchange Commission.

The information contained in these interim financial statements should be read in conjunction with the Company's audited financial statements contained elsewhere in this Registration Statement.

2. NET EARNINGS PER SHARE

Net earnings per share for the six months ended September 30, 1994 and 1995 was computed based on the weighted average number of shares actually outstanding, plus the shares that would be outstanding, using the treasury stock method, assuming the exercise of all outstanding options which were considered to be common stock equivalents.

3. NEW ACCOUNTING PRONOUNCEMENT

The Financial Accounting Standards Board has recently issued Financial Accounting Standards No. 123, Accounting for Stock-based Compensation, which requires the determination and disclosure of compensation costs implicit in stock option grants. The Company is required to adopt this standard beginning in fiscal 1997. The Company does not plan to implement this standard until that time and has not been able to quantify the effect of this standard.

INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders
Clinitec International, Inc.

We have audited the accompanying balance sheet of Clinitec International, Inc. as of December 31, 1994 and the related statements of operations, shareholders' equity and cash flows for the period from January 31, 1994 (inception) to December 31, 1994. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Clinitec International, Inc. as of December 31, 1994 and the results of its operations and its cash flows for the period from January 31, 1994 (inception) to December 31, 1994, in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP
Costa Mesa, CA
December 17, 1995

CLINITEC INTERNATIONAL, INC.

BALANCE SHEET
AS OF DECEMBER 31, 1994
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)

| | |
|--|--------|
| ASSETS | |
| CURRENT ASSETS: | |
| Cash and cash equivalents..... | \$ 112 |
| Accounts receivable (Note 5)..... | 34 |
| Inventories..... | 22 |
| Other current assets..... | 12 |
| | ----- |
| Total current assets..... | 180 |
| EQUIPMENT AND IMPROVEMENTS, net (Note 2)..... | 81 |
| CAPITALIZED SOFTWARE COSTS, net (Note 1)..... | 68 |
| OTHER ASSETS..... | 13 |
| | ----- |
| Total assets..... | \$ 342 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| CURRENT LIABILITIES: | |
| Accounts payable..... | \$ 35 |
| Accrued payroll and related expenses..... | 15 |
| Other accrued expenses..... | 1 |
| | ----- |
| Total current liabilities..... | 51 |
| COMMITMENTS AND CONTINGENCIES (Note 4) | |
| SHAREHOLDERS' EQUITY (Note 4): | |
| Common stock, no par value; 3,000,000 shares authorized; 970,000 shares issued and outstanding..... | 680 |
| Accumulated deficit..... | (389) |
| | ----- |
| Total shareholders' equity..... | 291 |
| | ----- |
| Total liabilities and shareholders' equity..... | \$ 342 |
| | ===== |

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

STATEMENT OF OPERATIONS
FOR THE PERIOD FROM JANUARY 31, 1994 (INCEPTION) TO DECEMBER 31, 1994
(IN THOUSANDS)

| | |
|--|---------|
| NET REVENUES (Note 5)..... | \$ 54 |
| COST OF PRODUCTS AND SERVICES..... | 20 |
| | ----- |
| Gross profit..... | 34 |
| OPERATING EXPENSES: | |
| Selling, general and administrative..... | 364 |
| Research and development..... | 59 |
| | ----- |
| | 423 |
| | ----- |
| Net loss..... | \$(389) |
| | ===== |

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

STATEMENT OF SHAREHOLDERS' EQUITY
 FOR THE PERIOD FROM JANUARY 31, 1994 (INCEPTION) TO DECEMBER 31, 1994
 (IN THOUSANDS, EXCEPT SHARE AMOUNTS)

| | COMMON SHARES ISSUED | | ACCUMULATED DEFICIT | TOTAL SHAREHOLDERS' EQUITY |
|--|-------------------------|--------|------------------------|----------------------------------|
| | NUMBER | AMOUNT | | |
| BALANCE, January 31, 1994 (inception)..... | -- | \$ -- | \$ -- | \$ -- |
| Issuance of common stock..... | 970,000 | 680 | | 680 |
| Net loss..... | | | (389) | (389) |
| BALANCE, December 31, 1994..... | 970,000 | \$680 | \$(389) | \$ 291 |
| | ===== | ===== | ===== | ===== |

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

STATEMENT OF CASH FLOWS
 FOR THE PERIOD FROM JANUARY 31, 1994 (INCEPTION) TO DECEMBER 31, 1994
 (IN THOUSANDS)

| | |
|---|---------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net loss..... | \$(389) |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| Depreciation and amortization of equipment and improvements..... | 9 |
| Amortization of capitalized software costs..... | 9 |
| Changes in: | |
| Accounts receivable..... | (34) |
| Inventories..... | (22) |
| Other current assets..... | (12) |
| Accounts payable..... | 35 |
| Accrued expenses..... | 16 |
| | ----- |
| Net cash used in operating activities..... | (388) |
| | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Additions to equipment and improvements..... | (90) |
| Additions to capitalized software costs..... | (77) |
| Change in other assets..... | (13) |
| | ----- |
| Net cash used in investing activities..... | (180) |
| | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES -- | |
| Proceeds from issuance of common stock..... | 680 |
| | ----- |
| NET INCREASE IN CASH AND CASH EQUIVALENTS..... | 112 |
| CASH AND CASH EQUIVALENTS, January 31, 1994 (inception)..... | ----- |
| CASH AND CASH EQUIVALENTS, December 31, 1994..... | \$ 112 |
| | ===== |

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE PERIOD FROM JANUARY 31, 1994 (INCEPTION) TO DECEMBER 31, 1994

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Clintec International, Inc. (the "Company") was incorporated on January 31, 1994. The Company designs, assembles, markets, installs, maintains and supports electronic medical records software systems using a client/server platform, a graphical user interface and a relational database format to permit flexibility in screen customization and logic flow.

Revenue Recognition -- In accordance with Statement of Position 91-1, Software Revenue Recognition, sales of electronic medical records software systems are recorded when the basic software and hardware is shipped if the Company's future obligations are not considered significant and collection is probable. Estimated costs to complete system installations and modifications are charged to expense in the period in which the sale is recorded. If the Company's future obligations are considered significant, revenue is recognized on the percentage of completion basis. Maintenance revenue is recognized ratably over the life of the contract.

Cash equivalents -- The Company considers all highly liquid interest earning deposits purchased with an original maturity of three months or less to be cash equivalents.

Accounts Receivable -- The Company provides credit terms for most sales. The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses, which have been within management's expectations.

Inventories -- Inventories are valued at lower of cost (first-in, first-out) or market. The Company provides an allowance for excess and obsolete inventories based on estimates using experience and projected sales.

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

Software Development Costs -- Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. After technological feasibility is established, any additional development costs are capitalized and amortized over the economic life (generally three years) of the related product in accordance with Statement of Financial Accounting Standards No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed. Accumulated amortization of capitalized software costs amounted to \$9,000 for the period from January 31, 1994 (inception) to December 31, 1994. The Company performs an annual review of the recoverability of such capitalized software costs. At the time a determination has been made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts would be written off.

Income Taxes -- The Company had elected to be taxed as a S corporation under the provisions of the Internal Revenue Code and similar state statutes. Accordingly, the Company's taxable income or loss is treated as if it were distributed to the shareholders. In May 1995, concurrent with the sale of preferred stock (Note 6), the Company terminated its S corporation status.

The Company accounts for income taxes under Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS No. 109). In accordance with SFAS No. 109, income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of assets and liabilities for financial and tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes also

CLINITEC INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS
 FOR THE PERIOD FROM JANUARY 31, 1994 (INCEPTION) TO DECEMBER 31,
 1994 -- (CONTINUED)

are recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. Valuation allowances are established as a reduction of net deferred tax assets when management cannot determine that it is more likely than not the assets are recoverable.

Stock Split -- During 1995, the Company effected two stock splits aggregating 4,075:1. All share amounts in the accompanying financial statements have been restated to reflect the splits.

New Accounting Pronouncement -- The Financial Accounting Standards Board has recently issued Financial Accounting Standards No. 123, Accounting for Stock-based Compensation, which requires the determination and disclosure of compensation costs implicit in stock option grants. The Company is required to adopt this standard beginning fiscal 1996. The Company does not plan to implement this standard until that time and has not been able to quantify the effect of this standard at the present time.

2. EQUIPMENT AND IMPROVEMENTS

Equipment and improvements consisted of the following at December 31, 1994 (in thousands):

| | |
|--|------|
| Computers and electronic test equipment..... | \$48 |
| Purchased computer software..... | 17 |
| Furniture and fixtures..... | 25 |
| | --- |
| | 90 |
| Accumulated depreciation and amortization..... | (9) |
| | --- |
| | \$81 |
| | === |

3. EMPLOYEE BENEFIT PLAN

The Company has a Simplified Employee Pension (SEP) plan for the benefit of substantially all of its employees. The SEP is a type of defined contribution plan whereby participating employees may defer compensation up to certain annual IRS limitations. The Company does not make any contributions to the plan.

4. COMMITMENTS AND CONTINGENCIES

Leases -- The Company leases its principal facility and office under a noncancelable operating lease agreement which expires May 1997. The Company has rental commitments in fiscal 1995, 1996 and 1997 of \$26,200, \$26,700 and 18,000, respectively.

Total rental expense for the period from January 31, 1994 (Inception) to December 31, 1994 was approximately \$10,000.

Litigation -- The Company is a party to various claims, legal actions and complaints arising in the ordinary course of business. The Company believes such matters are without merit, or involve such amounts that unfavorable disposition would not have a material adverse effect on the Company's financial statements.

Employment Agreements -- The Company has entered into employment agreements of three to five years with certain key employees. Such agreements may normally be terminated by the Company if specified performance criteria are not met. Under the term of the agreements, the Company is obligated to pay aggregate base salaries of \$256,000, \$256,000, \$228,000, \$132,000 and \$115,000 in fiscal 1995, 1996, 1997, 1998 and 1999, respectively. Certain agreements have provisions for the payment of cash or stock bonus' based on specified performance criteria. The aggregate maximum number of shares of common stock which may be issued pursuant to employment agreements as of December 31, 1994 is 42,600 common shares.

CLINITEC INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE PERIOD FROM JANUARY 31, 1994 (INCEPTION) TO DECEMBER 31,
1994 -- (CONTINUED)

Stock Options -- As of December 31, 1994, three customers, who are also stockholders, hold options to purchase an aggregate of approximately 55,000 common shares at a weighted average price of approximately \$2.80 per share, all of which were exercised in 1995.

5. RELATED PARTY TRANSACTIONS

All significant sales in 1994 were to customers which are also shareholders in Clinitec. As of December 31, 1994, all accounts receivable were from related parties.

6. SUBSEQUENT EVENT

In May 1995, the Company entered into a strategic relationship with Quality Systems, Inc. (QSI) to market the Company's product. As part of this relationship, the Company sold convertible preferred stock representing a 25% equity interest in Clinitec to QSI for \$1 million and granted QSI an option to acquire an aggregate 51% equity interest in Clinitec for an additional \$3 million, exercisable at any time through August 1997.

CLINITEC INTERNATIONAL, INC.

BALANCE SHEET
AS OF SEPTEMBER 30, 1995 (UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE DATA)

| | |
|--|---------|
| ASSETS | |
| CURRENT ASSETS: | |
| Cash and cash equivalents..... | \$ 344 |
| Accounts receivable..... | 336 |
| Inventories..... | 30 |
| Other current assets..... | 26 |
| | ----- |
| Total current assets..... | 736 |
| EQUIPMENT AND IMPROVEMENT, net..... | 154 |
| CAPITALIZED SOFTWARE COSTS, net..... | 216 |
| OTHER ASSETS..... | 12 |
| | ----- |
| Total assets..... | \$1,118 |
| | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | |
| CURRENT LIABILITIES: | |
| Accounts payable..... | \$ 25 |
| Accrued payroll and related expenses..... | 21 |
| Other accrued expenses..... | 14 |
| Estimated costs to complete system installations..... | 40 |
| | ----- |
| Total current liabilities..... | 100 |
| | ----- |
| COMMITMENTS AND CONTINGENCIES | |
| SHAREHOLDERS' EQUITY: | |
| Series A convertible preferred stock, no par value; 1,000,000 shares authorized, 338,300 shares issued and outstanding..... | 1,000 |
| Common stock, no par value; 3,000,000 shares authorized; 1,053,800 shares issued and outstanding..... | 843 |
| Accumulated deficit..... | (825) |
| | ----- |
| Total shareholders' equity..... | 1,018 |
| | ----- |
| Total liabilities and shareholders' equity..... | \$1,118 |
| | ===== |

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

STATEMENTS OF OPERATIONS
 FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1994 AND 1995 (UNAUDITED)
 (IN THOUSANDS)

| | SEPTEMBER 30, | |
|--|---------------|----------|
| | 1994 | 1995 |
| | ----- | ----- |
| NET REVENUES..... | \$ 36 | \$1,066 |
| COST OF PRODUCTS AND SERVICES..... | 15 | 379 |
| | ----- | ----- |
| Gross profit..... | 21 | 687 |
| OPERATING EXPENSES: | | |
| Selling, general and administrative..... | 156 | 988 |
| Research and development..... | 59 | 20 |
| | ----- | ----- |
| | 215 | 1,008 |
| | ----- | ----- |
| Loss from operations..... | (194) | (321) |
| INTEREST AND INVESTMENT INCOME..... | | 9 |
| | ----- | ----- |
| NET LOSS..... | \$(194) | \$ (312) |
| | ===== | ===== |

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1994 AND 1995 (UNAUDITED)
(IN THOUSANDS)

| | SEPTEMBER 30, | |
|---|---------------|---------|
| | 1994 | 1995 |
| | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss..... | \$(194) | \$(312) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization of equipment and improvements..... | 5 | 19 |
| Amortization of capitalized software costs..... | 1 | 43 |
| Compensation expense related to stock grants..... | | 87 |
| Changes in: | | |
| Accounts receivable..... | (51) | (302) |
| Inventories..... | (4) | (8) |
| Other current assets..... | (3) | (14) |
| Accounts payable..... | 19 | (10) |
| Accrued expenses..... | 13 | 19 |
| Estimated costs to complete system installations..... | | 40 |
| | ----- | ----- |
| Net cash used in operating activities..... | (214) | (438) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to equipment and improvements..... | (77) | (92) |
| Additions to capitalized software costs..... | (20) | (191) |
| Change in other assets..... | (13) | 1 |
| | ----- | ----- |
| Net cash used in investing activities..... | (110) | (282) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock..... | 450 | 76 |
| Proceeds from issuance of preferred stock..... | | 1,000 |
| Dividends paid on common stock..... | | (124) |
| | ----- | ----- |
| Net cash provided by financing activities..... | 450 | 952 |
| | ----- | ----- |
| NET INCREASE IN CASH AND CASH EQUIVALENTS..... | 126 | 232 |
| CASH AND CASH EQUIVALENTS, beginning of period..... | -- | 112 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, end of period..... | \$ 126 | \$ 344 |
| | ===== | ===== |

NONCASH FINANCING TRANSACTION --

During the nine months ended September 30, 1994, the Company issued common shares for a \$200,000 receivable, which was paid in full during the fourth quarter of fiscal 1994.

See notes to financial statements.

CLINITEC INTERNATIONAL, INC.

NOTES TO FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1994 AND 1995 (UNAUDITED)

1. BASIS OF PRESENTATION

The information set forth in these financial statements of Clinitec International, Inc. (the Company) as of September 30, 1995 and for the nine months ended September 30, 1994 and 1995 is unaudited. The information reflects all adjustments consisting only of normal recurring entries that, in the opinion of management, are necessary to present fairly the financial position and results of operations of the Company for the periods indicated. Results of operations for the interim periods are not necessarily indicative of the results of operations for the full fiscal year.

Certain information in footnote disclosures normally included in financial statements has been condensed or omitted, in accordance with the rules and regulations of the Securities and Exchange Commission.

The information contained in these interim financial statements should be read in conjunction with the Company's audited financial statements contained elsewhere in this Registration Statement.

2. SALE OF CONVERTIBLE PREFERRED STOCK

In May 1995, the Company entered into a strategic relationship with Quality Systems, Inc. (QSI) to market the Company's product. As part of this relationship, the Company sold convertible preferred stock representing a 25% equity interest in Clinitec to QSI for \$1 million and granted QSI an option to acquire an aggregate 51% equity interest in Clinitec for an additional \$3 million, exercisable at any time through August 1997. The preferred stock is convertible to common stock on a 1:1 basis, which may be adjusted based on certain provisions limiting dilution.

As a result of the above transaction, the Company terminated its S Corporation election for tax purposes. The cumulative effect of such change in tax status on the Company's financial position and results of operations was not significant.

[PHOTO]

When QSI's technologically advanced health care information system is used in conjunction with NextGen's power and flexibility, the health care professional benefits from an integrated solution that positively affects numerous aspects of patient care and practice management.

Used in conjunction with a wireless, portable workstation, NextGen allows the health care provider to retrieve and update patient records while moving from examination room to examination room, and even from office to office.

[PHOTO]

NextGen processes, manipulates and manages patient information in data, visual and audio formats. NextGen stores patient medical histories, scanned images, X-rays, annotated documents, recorded voice and user customizable exam data.

[PHOTO]

 No dealer, salesperson or other person has been authorized to give any information or to make any representations other than those contained or incorporated by reference in this Prospectus in connection with the offer made by this Prospectus and, if given or made, such information or representations must not be relied upon as having been authorized by the Company, the Selling Shareholders or any of the Underwriters. Neither the delivery of this Prospectus nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of the Company since the date hereof. This Prospectus does not constitute an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorized or which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such qualified solicitation.

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Until _____, 1996 (25 days after the date of this Prospectus), all dealers effecting transactions in the Common Shares offered hereby, whether or not participating in this distribution, may be required to deliver a Prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

 1,500,000 SHARES
 [QSI LOGO]
 [QUALITY SYSTEMS, INC. LOGO]
 COMMON STOCK

 PROSPECTUS

PACIFIC GROWTH EQUITIES, INC.

CRUTTENDEN ROTH
 INCORPORATED

, 1996

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following table sets forth the costs and expenses, other than underwriting discounts and commissions, payable in connection with the sale and distribution of the securities being registered. All amounts are estimated except the Securities and Exchange Commission, NASD registration fees and the Nasdaq National Market additional listing fee. All of the expenses below will be paid by the Company.

| ITEM ---- | AMOUNT ----- |
|--|--------------------|
| Registration fee..... | \$ 15,986 |
| NASD Filing Fee..... | 5,136 |
| Nasdaq National Market additional listing fee..... | 17,500 |
| Blue Sky fees and expenses..... | * |
| Printing and engraving expenses..... | * |
| Legal fees and expenses..... | * |
| Accounting fees and expenses..... | * |
| Transfer Agent and Registrar fees..... | * |
| Miscellaneous..... | * |
| | --- |
| Total..... | \$450,000 ===== |

* To be filed by amendment.

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section 317 of the California General Corporation Law provides generally that a person sued as a director, officer or agent of a corporation may be indemnified by the corporation for reasonable expenses, including counsel fees, if (a) in the case of other than derivative suits, he has acted in good faith and in a manner he reasonably believed to be in the best interests of the corporation (and in the case of a criminal proceeding, had no reasonable cause to believe that his conduct was unlawful), and (b) in the case of a derivative suit, he has acted in good faith in a manner he believed to be in the best interests of the corporation and its shareholders, and with such care, including reasonable inquiry, as an ordinarily prudent person, in a like position would use under similar circumstances. Section 317 provides that no indemnification shall be made in the case of a derivative suit in respect of any claim as to which a director, officer or agent has been adjudged to be liable to the corporation, except with court approval, nor shall indemnification be made for costs of and expenses in connection with settlement, with court approval. Indemnification is mandatory in the case of a director, officer, or agent who is successful on the merits in defense of a suit against him. The determination whether to indemnify a director, officer or agent is made by a majority of disinterested directors, a majority of disinterested shareholders, or the court in which the suit is pending.

The Company's Articles of Incorporation provide that the liability of the Company's directors for monetary damages shall be eliminated to the fullest extent permissible under California law. This is intended to eliminate the personal liability of a director for monetary damages in an action brought by or in the right of the Company for breach of a director's duties to the Company or its shareholders except for liability: (1) for acts or omissions that involve intentional misconduct or a knowing and culpable violation of law; (2) for acts or omissions that a director believes to be contrary to the best interests of the Company or its shareholders or that involve the absence of good faith on the part of the director; (3) for any transaction from which a director derived an improper personal benefit; (4) for acts or omissions that show a reckless disregard for the director's duty to the Company or its shareholders in circumstances in which the director was aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the Company or its shareholders; (5) for acts or omissions that constitute an unexcused pattern of inattention that amounts

to an abdication of the director's duty to the Company or its shareholders; (6) with respect to certain transactions, or the approval of transactions in which a director has a material financial interest; and (7) expressly imposed by statute, for approval of certain improper distributions to shareholders or certain loans or guarantees. This provision does not eliminate or limit liability of an officer for any act or omission as an officer, notwithstanding that the officer is also a director or that his actions, if negligent or improper, have been ratified by the Board of Directors. Further, the provision has no effect on claims under federal or state securities laws and does not affect the availability of injunctions and other equitable remedies available to the Company's shareholders for any violation of a director's fiduciary duty to the Company or its shareholders. Although the validity and scope of the legislation underlying the provision have not yet been interpreted to any significant extent by the California courts, the provision may relieve directors or monetary liability to the Company for grossly negligent conduct, including conduct in situations involving attempted takeovers of the Company.

The Articles also provide that the Company is authorized to provide indemnification to its agents (as defined in Section 317 of the California Corporations Code), through the Company's Bylaws or through agreements with such agents or both, for breach of duty to the Company and its shareholders, in excess of the indemnification otherwise permitted by Section 317 of the California Corporations Code, subject to the limits on such excess indemnification set forth in Section 204 of the California Corporations Code.

The Bylaws of the Company provide that a person sued as an agent of the Company may be indemnified by the Company for reasonable expenses incurred thereby, if (a) in the case of other than derivative suits, such person has acted in good faith and in a manner he or she reasonably believed to be in the best interests of the Company (and in the case of a criminal proceeding, had no reasonable cause to believe that his or her conduct was unlawful), and (b) in the case of a derivative suit, such person has acted in good faith in a manner he or she believed to be in the best interests of the Company and its shareholders, and with such care, including reasonable inquiry, as an ordinarily prudent person, in a like position would use under similar circumstances. The Bylaws further provide that no indemnification shall be made in the case of a derivative suit in respect of any claim as to which such person has been adjudged to be liable to the corporation, except with court approval, nor shall indemnification be made for amounts paid in settling or otherwise disposing of a threatened or pending action, with or without court approval, or for expenses incurred in defending a threatened or pending action which is settled or otherwise disposed of without court approval. Indemnification under the Bylaws is mandatory in the case of an agent of the Company (present or past) who is successful on the merits in defense of a suit against him or her in such capacity. In all other cases where indemnification is permitted by the Bylaws, a determination to indemnify such person must be made by a majority of a quorum of disinterested directors, a majority of disinterested shareholders, or the court in which the suit is pending.

The Company has entered into agreements to indemnify its directors in addition to the indemnification provided for in the Articles of Incorporation and Bylaws. Among other things, these agreements provide that the Company will indemnify, subject to certain requirements, each of the Company's directors for certain expenses (including attorneys' fees), judgments, fines and settlement amounts incurred by such person in any action or proceeding, including any action by or in the right of the Company, on account of services by such person as a director or officer of the Company, or as a director or officer of any other company or enterprise to which the person provides services at the request of the Company.

The Underwriting Agreement (Exhibit 1.1 hereto) provides for indemnification by the Underwriters of the Company and its officers and directors and the Selling Shareholders, and by the Company and the Selling Shareholders of the Underwriters, for certain liabilities arising under the Securities Act of 1933 or otherwise.

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES

During the last three years preceding the date hereof there were no transactions involving sales of the Registrant's securities.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) EXHIBITS

The following Exhibits are attached hereto and incorporated herein by reference:

| EXHIBIT NO. | DESCRIPTION |
|----------------|--|
| 1.1* | Form of Underwriting Agreement. |
| 3.1 | Restated Articles of Incorporation of the Company. |
| 3.2 | Bylaws of the Company.(1) |
| 3.2.1 | Certificate of Amendment of Bylaws of the Company. |
| 5.1* | Form of Opinion of Brobeck, Phleger & Harrison LLP regarding the validity of the securities being registered. |
| 10.1 | 1989 Incentive Stock Option Plan.(2) |
| 10.2 | Form of Incentive Stock Option Agreement. |
| 10.3 | Form of Non-Qualified Stock Option Agreement. |
| 10.4 | Quality Systems, Inc. Retirement Savings Plan.(3) |
| 10.5 | Deferred Compensation Plan.(4) |
| 10.6 | Lease Agreement dated March 11, 1993 between the Registrant and Craig Development Corporation.(5) |
| 10.7 | Lease Agreement dated September 12, 1994 between the Registrant and Koll/Realty Orangewood Business Center General Partnership.(6) |
| 10.8 | Series "A" Convertible Preferred Stock Purchase Agreement, as amended, dated April 21, 1995 between the Registrant and Clinitec International, Inc.(7) |
| 10.9 | Marketing Agreement, as amended, dated April 1, 1995 between the Registrant and Clinitec International, Inc.(8) |
| 10.10 | Form of Indemnification Agreement. |
| 23.1 | Independent Auditors' Consent -- Deloitte & Touche LLP. |
| 23.2* | Consent of Brobeck, Phleger & Harrison LLP (contained in Exhibit 5.1) |
| 24.1 | Power of Attorney (contained on signature page on page II-5). |

* To be filed by amendment

- (1) Incorporated by reference to Exhibit 3.3 of Amendment No. 2 to the Company's Registration Statement on Form S-1 dated November 30, 1982, File No. 2-80056.
- (2) Incorporated by reference to the Company's Registration Statement on Form S-8, File No. 33-31949.
- (3) Incorporated by reference to Exhibit 10.4.2 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1994, File No. 0-13801.
- (4) Incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1994, File No. 0-13801.
- (5) Incorporated by reference to Exhibit 10.35 of the Company's Annual Report on Form 10-K for the year ended March 31, 1993, File No. 0-13801.
- (6) Incorporated by reference to Exhibit 10.8 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- (7) Incorporated by reference to Exhibit 10.11 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- (8) Incorporated by reference to Exhibit 10.12 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.

(B) FINANCIAL STATEMENT SCHEDULES

Schedule II -- Valuation and Qualifying Accounts

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

ITEM 17. UNDERTAKINGS

The Registrant hereby undertakes to provide the Underwriters at the closing specified in the Underwriting Agreements certificates in such denominations and registered in such names as required by the Underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted as to directors, officers, and controlling persons of the Registrant pursuant to the foregoing provisions or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer, or controlling person of the Registrant in the successful defense of any action, suit, or proceeding) is asserted by such director, officer, or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue. The undersigned Registrant hereby undertakes that: (1) for purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus as filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective, and (2) for the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, as amended, the Registrant certifies that it has reasonable grounds to believe that it meets all the requirements for filing Form S-1 and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Tustin, State of California, on the 10th day of January 1996.

QUALITY SYSTEMS, INC.

By: /s/ SHELDON RAZIN

Sheldon Razin
President and Chairman of the Board

POWER OF ATTORNEY

We, the undersigned officers and directors of Quality Systems, Inc., do hereby constitute and appoint Sheldon Razin and Janet Razin, and each of them, our true and lawful attorneys-in-fact and agents, each with full power of substitution and resubstitution, for him/her and in his/her name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Registration Statement, and to file the same, with exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done in connection therewith, as fully to all intents and purposes as he/she might or could do in person, hereby ratifying and confirming all that each of said attorneys-in-fact and agents, or his/her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement on Form S-1 has been signed by the following persons in the capacities and on the dates indicated:

| SIGNATURE ----- | TITLE ----- | DATE ----- |
|---|--|------------------|
| /s/ SHELDON RAZIN ----- Sheldon Razin | Chairman, President and Director (Principal Executive Officer) | January 10, 1996 |
| /s/ JANET RAZIN ----- Janet Razin | Vice President, Secretary and Director | January 10, 1996 |
| /s/ IRMA CARMONA ----- Irma Carmona | Corporate Controller (Principal Financial and Accounting Officer) | January 10, 1996 |
| /s/ GRAEME FREHNER ----- Graeme Frehner | Director | January 10, 1996 |
| /s/ JOHN BOWERS, M.D. ----- John Bowers, M.D. | Director | January 10, 1996 |
| /s/ WILLIAM BOWERS ----- William Bowers | Director | January 10, 1996 |
| /s/ GEORGE BRISTOL ----- George Bristol | Director | January 10, 1996 |
| /s/ GORDON SETRAN ----- Gordon Setran | Director | January 10, 1996 |

SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

| DESCRIPTION | BALANCE AT BEGINNING OF PERIOD | ADDITIONS ----- CHARGED TO COSTS AND EXPENSES | DEDUCTIONS | BALANCE AT END OF PERIOD |
|----------------------------------|--------------------------------------|--|------------|-----------------------------|
| ----- | ----- | ----- | ----- | ----- |
| Allowance for doubtful accounts: | | | | |
| Fiscal 1993..... | \$ 106 | \$ 7 | \$(20) | \$93 |
| Fiscal 1994..... | 93 | 7 | (34) | 66 |
| Fiscal 1995..... | 66 | 28 | (17) | 77 |

S-1

EXHIBIT INDEX

| EXHIBIT NO. | DESCRIPTION |
|-------------|--|
| 1.1* | Form of Underwriting Agreement. |
| 3.1 | Restated Articles of Incorporation of the Company. |
| 3.2 | Bylaws of the Company.(1) |
| 3.2.1 | Certificate of Amendment of Bylaws of the Company. |
| 5.1* | Form of Opinion of Brobeck, Phleger & Harrison LLP regarding the validity of the securities being registered. |
| 10.1 | 1989 Incentive Stock Option Plan.(2) |
| 10.2 | Form of Incentive Stock Option Agreement. |
| 10.3 | Form of Non-Qualified Stock Option Agreement. |
| 10.4 | Quality Systems, Inc. Retirement Savings Plan.(3) |
| 10.5 | Deferred Compensation Plan.(4) |
| 10.6 | Lease Agreement dated March 11, 1993 between the Registrant and Craig Development Corporation.(5) |
| 10.7 | Lease Agreement dated September 12, 1994 between the Registrant and Koll/Realty Orangewood Business Center General Partnership.(6) |
| 10.8 | Series "A" Convertible Preferred Stock Purchase Agreement, as amended, dated April 21, 1995 between the Registrant and Clinitec International, Inc.(7) |
| 10.9 | Marketing Agreement, as amended, dated April 1, 1995 between the Registrant and Clinitec International, Inc.(8) |
| 10.10 | Form of Indemnification Agreement. |
| 23.1 | Independent Auditors' Consent -- Deloitte & Touche LLP. |
| 23.2* | Consent of Brobeck, Phleger & Harrison LLP (contained in Exhibit 5.1) |
| 24.1 | Power of Attorney (contained on signature page on page II-5). |

* To be filed by amendment

- (1) Incorporated by reference to Exhibit 3.3 of Amendment No. 2 to the Company's Registration Statement on Form S-1 dated November 30, 1982, File No. 2-80056.
- (2) Incorporated by reference to the Company's Registration Statement on Form S-8, File No. 33-31949.
- (3) Incorporated by reference to Exhibit 10.4.2 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1994, File No. 0-13801.
- (4) Incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1994, File No. 0-13801.
- (5) Incorporated by reference to Exhibit 10.35 of the Company's Annual Report on Form 10-K for the year ended March 31, 1993, File No. 0-13801.
- (6) Incorporated by reference to Exhibit 10.8 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- (7) Incorporated by reference to Exhibit 10.11 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.
- (8) Incorporated by reference to Exhibit 10.12 of the Company's Annual Report on Form 10-KSB for the year ended March 31, 1995, File No. 0-13801.

QUALITY SYSTEMS, INC.

RESTATED ARTICLES OF INCORPORATION

Sheldon Razin and Janet Razin certify that:

1. They are the duly elected and acting President and Secretary, respectively, of QUALITY SYSTEMS, INC., a California corporation.

2. The Articles of Incorporation of this corporation are amended and restated to read in their entirety as follows:

"FIRST: The name of this corporation is

QUALITY SYSTEMS, INC.

SECOND: The purpose of the corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

THIRD: This corporation is authorized to issue only one class of shares, to be called "Common Stock." The total number of such shares which this corporation shall have authority to issue is TWENTY MILLION (20,000,000) and each such share shall have a par value of one cent (\$.01).

FOURTH: The corporation elects to be governed by all of the provisions of Division 1 of Title 1 of the California Corporations Code (as amended by act of the California Legislature, 1975-1976 regular session, effective January 1, 1977, as defined in Section 2300 of the California General Corporation Law) not otherwise applicable to the corporation under Chapter 23 of said Division 1.

FIFTH: (A) The liability of the directors of the corporation for monetary damages shall be eliminated to the fullest extent permissible under California law. Any repeal or modification of the foregoing provision of this Article FIFTH by the shareholders of this corporation shall not adversely affect any right or protection of a director of this corporation existing at the time of such repeal or modification.

(B) The corporation is authorized to provide indemnification of agents (as defined in section 317 of the Corporations Code) for breach of duty to the corporation and its shareholders through bylaw provisions or through agreements with the agents, or both, in excess of the indemnification otherwise permitted by Section 317 of the Corporations Code, subject to the limits on such excess indemnification set forth in Section 204 of the Corporations Code. Any repeal or modification of the foregoing provision of this Article FIFTH by the shareholders of this corporation shall not adversely affect any right or protection of any agent of this corporation existing at the time of such repeal or modification."

3. The foregoing amendment and restatement of the Articles of Incorporation of this corporation has been duly approved by the board of directors of the corporation.

4. The foregoing amendment and restatement of the Articles of Incorporation of this corporation has been duly approved by the required vote of shareholders in accordance with Section 902 of the California Corporations Code. The total number of outstanding shares of the corporation is 4,184,116. The number of shares voting in favor of the amendment equaled or exceeded the vote required. The percentage vote required was more than 50%.

We further declare under penalty of perjury under the laws of the State of California that the matters set forth in this certificate are true and correct of our own knowledge.

Executed this 7th day of September 1989, at Tustin, California.

/s/ SHELDON RAZIN

Sheldon Razin, President

/s/ JANET RAZIN

Janet RAZIN, Secretary

CERTIFICATE OF AMENDMENT OF BYLAWS

The undersigned hereby certifies that she is the duly elected and acting Secretary of Quality Systems, Inc., a California corporation ("QSI"), and that the following amendment was duly adopted by the Board of Directors of QSI at a duly called and noticed meeting thereof, held on June 14, 1989:

WHEREAS, Article III, Section 2 of the Bylaws of the Corporation currently provides that the authorized number of directors of the Corporation shall be not less than five (5) and not more than nine (9), with the exact number of directors having been fixed within those limits at six (6); and

WHEREAS, the exact number of directors, within the limits specified, may be altered from time to time by an amendment of the last sentence of Article III, Section 2 of the Bylaws duly adopted by the Board of Directors or the shareholders; and

WHEREAS, it is deemed to be advisable and in the best interests of this Corporation and its shareholders that this Board of Directors adopt an amendment to the last sentence of Article III, Section 2 of the Bylaws so as to increase the actual number of directors to seven (7) from six (6).

NOW, THEREFORE, BE IT RESOLVED, that the last sentence of Article III, Section 2 of the Bylaws of the Corporation be, and hereby is, amended to read in its entirety as follows:

"The exact number of directors shall be seven (7) until changed as provided in this Section 2."

and that the foregoing amendment has not been rescinded, modified or revoked and is full force and effect.

Executed in Tustin, California this 11 day of July 1989.

/s/ JANET RAZIN

Janet Razin, Secretary

INCENTIVE STOCK OPTION AGREEMENT

THIS INCENTIVE STOCK OPTION AGREEMENT, dated this day of , between QUALITY SYSTEMS, INC., a California corporation (hereinafter referred to as the "Company"), and , an employee of the Company, its parent or one or more of its subsidiaries (hereinafter referred to as the "Optionee"), is made with reference to the following facts:

The Company desires, by affording the Optionee an opportunity to purchase shares of Common Stock, \$0.01 par value, in the Company (hereinafter called "Common Stock"), as hereinafter provided, to carry out the purpose of the Company's 1989 Stock Option Plan (the "Plan").

NOW, THEREFORE, IN CONSIDERATION of the mutual covenants hereinafter set forth, and for other good and valuable consideration, the parties hereto have agreed, and do hereby agree, as follows:

1. GRANT OF OPTION.

The Company hereby irrevocably grants to the Optionee the right and option (hereinafter called the "Option") to purchase all or any part of an aggregate of shares (such number being subject to adjustment as provided in Paragraph 7 hereof) on the terms and conditions herein set forth. The Option granted herein is an "incentive option" within the meaning of the Plan and Section 422A of the Internal Revenue Code of 1986, as amended (the "Code").

2. PURCHASE PRICE.

The purchase price of the Common Stock covered by the Option shall be \$ per share, representing percent (%) of the fair market value of the shares as determined pursuant to Section 5 of the Plan as of the date hereof. The purchase price of the Common Stock as to which the Option shall be exercised shall be paid in full at the time of exercise in cash or by certified check or by bank draft; or, with the consent of the Company's Board of Directors or Stock Option Committee for the Plan, (i) by delivery of shares of Common Stock of the Company already owned by the Optionee which shall be deemed to have a value per share equal to the fair market value per share of such shares determined in accordance with Section 5 of the Plan; or (ii) any combination of cash and shares of Common Stock as permitted by clause (i) of this sentence.

3. TERM OF OPTION.

The term of the Option shall commence on the date hereof and all rights to purchase Shares hereunder shall cease at 11:59 P.M. on the day before the anniversary of the date hereof, subject to earlier termination as provided herein. Except as may otherwise be provided in this Agreement, options granted hereunder shall become exercisable in cumulative installments as follows:

| Date Installments First Become Exercisable | Percent of Option Shares Subject to Installment |
|---|--|
| ----- | ----- |

Once an installment of the Option granted hereunder becomes exercisable for the first time, the shares subject thereto will be purchasable thereafter by the Optionee at any time in whole, or from time-to-time in part, prior to the expiration or earlier termination of the Option granted hereunder. Except as provided in Paragraph 5 hereof, the Option may not be exercised at any time unless the Optionee shall have been continuously, from the date hereof to the date of the exercise of the Option, an employee of the Company, its parent, if any, or of one or more of its subsidiaries or a corporation or a parent or subsidiary of a corporation issuing or assuming an option to which Section 425(a) of the Code applies. The holder of the Option shall not have any of the rights of a shareholder with respect to the shares covered by the Option as to any shares of Common Stock not actually issued and delivered to such holder.

4. NON-TRANSFERABILITY.

The Option shall not be transferable otherwise than by will or the laws of descent and distribution, and the Option may be exercised, during the lifetime of the Optionee, only by the Optionee. More particularly (but without limiting the generality of the foregoing), the Option may not be assigned, transferred (except as provided in Paragraph 5 hereof), pledged or hypothecated in any way, shall not be assignable by operation of law and shall not be subject to execution, attachment or similar process. Any attempted assignment, transfer, pledge, hypothecation or other disposition of the Option contrary to the provisions hereof, and the levy of any execution, attachment or similar process upon the Option, shall be null and void and without effect.

5. TERMINATION OF EMPLOYMENT.

(A) TERMINATION OF EMPLOYMENT EXCEPT UPON DEATH OR DISABILITY. In the event that the Optionee shall cease to be employed by the Company or a parent or subsidiary corporation of the Company (or a corporation or a parent or subsidiary corporation of a corporation issuing or assuming an incentive option to which Section 425(a) of the Code applies), for any reason other than death or disability (within the meaning of Section 105(d)(4) of the code) (hereinafter "disability"), this Option shall terminate immediately and become void and of no effect; provided, however, that the Optionee shall have the right to exercise this Option, but only with respect to the number of shares which the Optionee was entitled to purchase under this Agreement immediately prior to such cessation, at any time within one (1) month after such cessation, but in no event later than the date of expiration of the option period set forth in Paragraph 3 above, if the termination of his position as an employee of the Company or any parent or subsidiary thereof was due to his or her voluntary resignation or to the termination of such employment by the Company for cause (which shall be determined in the Company's sole judgment). Notwithstanding the provisions of the foregoing sentence, if the Optionee's employment or position with the Company or any parent or subsidiary corporation is terminated by the Company or the parent or subsidiary without cause, this Option shall terminate immediately and become void and of no effect; provided, however, that the Optionee shall have the right to exercise this Option at any time within three

(3) months after such termination, but in no event later than the date of expiration of the option period set forth in Paragraph 3 above, but the number of shares purchasable upon such exercise of the Option shall not in any case exceed the number which could have been purchased if the Optionee had exercised the Option immediately prior to such termination of employment.

(B) TERMINATION OF EMPLOYMENT UPON DEATH OR DISABILITY. In the event that the Optionee shall cease to be employed by the Company or any of its subsidiaries by reason of death or disability and shall not have fully exercised his or her Option granted hereunder, such Option may be exercised, but only with respect to the number of shares which the Optionee could have purchased had the Optionee exercised this Option as of the date of his or her cessation of employment, at any time within twelve (12) months after the Optionee's cessation of employment as a result of such death or disability, but in any event no later than the date or expiration of the Option period, by the Optionee or, in the event of death, by the executors or administrators of the Optionee's estate or by any person or persons who shall have acquired the Option directly from the Optionee by bequest or inheritance. At the end of such twelve (12) month period, the Option, to the extent it remains unexercised, shall terminate and become void and of no effect.

6. OTHER EXPIRATIONS.

In addition to any other event causing an expiration or termination of this Option, this Option shall expire and all rights to purchase the Common Stock shall cease (to the extent not theretofore terminated or expired as herein provided) upon the effective date of (i) the dissolution or liquidation of the Company, or (ii) a merger, consolidation, acquisition of property or shares, separation or reorganization of the Company with one or more entities, corporate or otherwise, as a result of which the Company is not the surviving entity, or (iii) a "reverse merger" in which the Company is a surviving entity but more than 50% of its voting shares are converted into cash, property or the securities of another entity, or (iv) a sale of substantially all of the property or shares of the Company to another entity, corporate or otherwise; provided, however, that the Company may, in its discretion, and immediately prior to any such transaction, cause a new option to be substituted for this Option or cause this Option to be assumed by an employer entity or a parent or subsidiary of such entity; and such new option shall apply to all shares issued in addition to or substitution, replacement or modification of the shares theretofore covered by such option; provided that,

(a) The excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares shall not be more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

(b) The new option or the assumption of the existing option shall not give the Optionee additional benefits which he or she did not have under the old option prior to such assumption, and

(c) An appropriate adjustment of the original option price shall be made among original shares subject to the option and any additional shares or shares issued in substitution, replacement or modification thereof.

If no provision is made for the continuance of the option plan and the assumption of this Option, or the substitution of new options for this Option as hereinabove provided, then the Company shall cause written notice to be given to the Optionee of the proposed transaction not less than thirty (30) days prior to the anticipated effective date thereof, and at the sole option and discretion of the Company's Board of Directors, this Option, if not already fully exercisable, may thereupon become fully exercisable, in which event the Optionee shall have the right to exercise this Option at any time prior to the effective date of the proposed transaction. The failure of the Company to give the written notice specified hereinabove shall not affect the validity, nor shall it be a basis for delaying or restraining the consummation, of any such transaction.

7. ADJUSTMENTS.

The number and class of shares subject to this Option, and the purchase price per share (but not the total purchase price), and the minimum number of shares as to which this Option may be exercised at any one time, shall all be proportionately adjusted in the event of any change or increase or decrease in the number of issued shares of Common Stock in the Company, without receipt of consideration by the Company, which results from a split-up or consolidation of shares, payment of a share divided (in excess of two percent), a recapitalization, a combination of shares or other like capital adjustment, or a reincorporation of the Company, so that, upon exercise of this Option, the Optionee shall receive the number and class of shares he would have received had he been the holder of the number of shares of Common Stock in the Company, for which this Option is being exercised, on the date of such change or increase or decrease in the number of issued shares of Common Stock in the Company. Subject to any required action by its shareholders, if the Company shall be a surviving entity in any reorganization, merger or consolidation (other than in a "reverse merger" in which more than 50% of the Company's voting shares are converted into cash, property or the securities of another entity), this Option shall be proportionately adjusted so as to apply to the securities to which the holder of the number of shares of Common Stock in the Company subject to this Option would have been entitled. Adjustments under this paragraph shall be made by the Board of Directors whose determination with respect thereto shall be final and conclusive. No fractional share shall be issued under this Option or upon any such adjustment.

8. METHOD OF EXERCISING OPTION.

Subject to the terms and conditions of this Option Agreement, this Option may be exercised by written notice to the Company, at its administrative office in the State of California, which presently is located at 17822 East 17th Street, Suite 210, Tustin, California 92680. Such notice shall state the election to exercise the Option and the number of shares in respect of which it is being exercised and shall be signed by the person so exercising the Option. Such notice shall be accompanied by payment in cash, certified check or bank draft in the amount of, or with the prior consent of the Board of Directors or the Stock Option Committee, certificates for shares of Common Stock of the Company having an aggregate fair market value (determined in the manner provided in Section 5 of the Plan) equal to, the full purchase price of such shares, and the Company shall deliver a certificate or certificates representing the shares subject to such exercise as soon as practicable after the notice shall be received. The certificate or certificates for the shares as to which the Option shall have been so exercised shall be registered in the name of the person or persons so exercising the Option and shall be delivered as provided above to or upon the written order of the person or persons exercising the Option. In the event the Option shall be exercised by any person or persons other than the Optionee in accordance with the terms hereof, such notice shall be accompanied by appropriate proof of the right of such person or persons to exercise the Option. All shares that shall be purchased upon the exercise of the Option as provided herein shall be fully paid and non-assessable. The holder of this Option shall not be entitled to the privileges of share ownership as to any shares of Common Stock not actually issued and delivered to him.

9. GENERAL.

(a) The Company shall at all times during the term of the Option reserve and keep available such number of shares of Common Stock as will be sufficient to satisfy the requirements of this Option Agreement, shall pay all original issue and transfer taxes with respect to the issue and transfer of shares pursuant hereto and all other fees and expenses necessarily incurred by the Company in connection therewith, and will from time to time use its best efforts to comply with all laws and regulations, which, in the opinion of counsel for the company, shall be applicable thereto.

(b) The granting of the Option hereunder shall not impose any obligation on the Company to continue the employment of the Optionee; nor shall it impose any obligation on the Optionee to exercise this Option.

(c) This Agreement embodies the entire agreement of the parties, and supersedes any and all other prior or contemporaneous agreements, whether written or oral, between the parties hereto, with respect to the subject matter hereof.

(d) This Agreement shall be governed by and construed in accordance with the internal laws of the State of California.

(e) The Company may require, as a condition precedent to the Company's obligation to sell and issue, and the Optionee's right to purchase, shares of common stock of the Company on exercise of this Option, that the Optionee shall certify, in writing, that he or she is acquiring such shares for investment and not with a view or the intent to sell or redistribute such shares.

IN WITNESS WHEREOF, the Company has caused this Option Agreement to be duly executed by its officers thereunto duly authorized, and the Optionee has hereunto set his or her hand, all as of the day and year first above written.

QUALITY SYSTEMS, INC.

By: _____

Title: _____
"Company"

Address: _____

"Optionee"

NONQUALIFIED STOCK OPTION AGREEMENT

THIS NONQUALIFIED STOCK OPTION AGREEMENT, dated this day of , between QUALITY SYSTEMS, INC., a California corporation (hereinafter referred to as the "Company"), and , an employee or non-employee director of the Company, its parent or one or more of its subsidiaries (hereinafter referred to as the "Optionee"), is made with reference to the following facts:

The Company desires, by affording the Optionee an opportunity to purchase shares of Common Stock, \$0.01 par value, in the Company (hereinafter called "Common Stock"), as hereinafter provided, to carry out the purpose of the Company's 1989 Stock Option Plan (the "Plan").

NOW, THEREFORE, IN CONSIDERATION of the mutual covenants hereinafter set forth, and for other good and valuable consideration, the parties hereto have agreed, and do hereby agree, as follows:

1. GRANT OF OPTION.

The Company hereby irrevocably grants to the Optionee the right and option (hereinafter called the "Option") to purchase all or any part of an aggregate of shares (such number being subject to adjustment as provided in Paragraph 7 hereof) on the terms and conditions herein set forth.

2. PURCHASE PRICE.

The purchase price of the Common Stock covered by the Option shall be \$ per share, representing percent (%) of the fair market value of the shares as determined pursuant to Section 5 of the Plan as of the date hereof. The purchase price of the Common Stock as to which the Option shall be exercised shall be paid in full at the time of exercise in cash or by certified check or by bank draft; or, with the consent of the Company's Board of Directors or Stock Option Committee for the Plan, (i) by delivery of shares of Common Stock of the Company already owned by the Optionee which shall be deemed to have a value per share equal to the fair market value per share of such shares determined in accordance with Section 5 of the Plan, or (ii) any combination of cash and shares of Common Stock as permitted by clause (i) of this sentence.

3. TERM OF OPTION.

The term of the Option shall commence on the date hereof and all rights to purchase Shares hereunder shall cease at 11:59 P.M. on the day before the anniversary of the date hereof, subject to earlier termination as provided herein. Except as may otherwise be provided in this Agreement, options granted hereunder shall become exercisable in cumulative installments as follows:

| Date Installments First Become Exercisable | Percent of Option Shares Subject to Installment |
|---|--|
| ----- | ----- |

Once an installment of the Option granted hereunder becomes exercisable for the first time, the shares subject thereto will be purchasable thereafter by the Optionee at any time in whole or from time-to-time in part prior to the expiration or earlier termination of the Option. Except as provided in Paragraph 5 hereof, the Option may not be exercised at any time unless the Optionee shall have been continuously, from the date hereof to the date of the exercise of the Option, an employee or non-employee director of the Company, its parent, if any, or of one or more of its subsidiaries or a corporation or a parent or subsidiary of a corporation issuing or assuming an option to which Section 425(a) of the Internal Revenue Code of 1986, as amended (the "Code"), applies. The holder of the Option shall not have any of the rights of a shareholder with respect to the shares covered by the Option as to any shares of Common Stock not actually issued and delivered to such holder.

4. NON-TRANSFERABILITY.

The Option shall not be transferable otherwise than by will or the laws of descent and distribution, and the Option may be exercised, during the lifetime of the Optionee, only by the Optionee. More particularly (but without limiting the generality of the foregoing), the Option may not be assigned, transferred (except as provided in Paragraph 5 hereof), pledged or hypothecated in any way, shall not be assignable by operation of law and shall not be subject to execution, attachment or similar process. Any attempted assignment, transfer, pledge, hypothecation or other disposition of the Option contrary to the provisions hereof, and the levy of any execution, attachment or similar process upon the Option, shall be null and void and without effect.

5. TERMINATION OF EMPLOYMENT.

(A) TERMINATION OF EMPLOYMENT EXCEPT UPON DEATH OR DISABILITY. In the event that the Optionee shall cease to be employed by, or cease to be a director of, the Company or a parent or subsidiary corporation of the Company (or a corporation or a parent or subsidiary corporation of a corporation issuing or assuming an incentive option to which Section 425(a) of the Code applies), for any reason other than death or disability (within the meaning of Section 105(d)(4) of the code) (hereinafter "disability"), this Option shall terminate immediately and become void and of no effect; provided, however, that the Optionee shall have the right to exercise this Option, but only with respect to the number of shares which the Optionee was entitled to purchase under this Agreement immediately prior to such cessation, at any time within one (1) month after such cessation, but in no event later than the date of expiration of the option period set forth in Paragraph 3 above, if the termination of the Optionee's position as an employee or director, as the case may be, was due to his or her voluntary resignation or to termination by the Company for cause (as determined in the sole judgment of the Company). Notwithstanding the provisions of the foregoing sentence, if the Optionee's employment or position with the Company or any parent or subsidiary corporation is terminated by the Company or the parent or subsidiary without cause, this Option shall terminate immediately and become void and of no effect; provided, however, that the Optionee shall have the right to exercise

this Option at any time within three (3) months after such termination, but in no event later than the date of expiration of the option period set forth in Paragraph 3 above, but the number of shares purchasable upon such exercise of the Option shall not in any case exceed the number which could have been purchased if the Optionee had exercised the Option immediately prior to such termination.

(B) TERMINATION OF EMPLOYMENT UPON DEATH OR DISABILITY. In the event that the Optionee shall cease to be employed by, or to be a director of, the Company or any of its subsidiaries by reason of death or disability and shall not have fully exercised his or her Option granted hereunder, such Option may be exercised, but only with respect to the number of shares which the Optionee could have purchased had the Optionee exercised this Option as of the date of his or her cessation of employment or his position as a director (as the case may be), at any time within twelve (12) months after the Optionee's cessation of employment or as a director as a result of such death or disability, but in any event no later than the date or expiration of the Option period, by the Optionee or, in the event of death, by the executors or administrators of the Optionee's estate or by any person or persons who shall have acquired the Option directly from the Optionee by bequest or inheritance. At the end of such twelve (12) month period, the Option, to the extent it remains unexercised, shall terminate and become void and of no effect.

6. OTHER EXPIRATIONS.

In addition to any other event causing an expiration or termination of this Option, this Option shall expire and all rights to purchase the Common Stock shall cease (to the extent not theretofore terminated or expired as herein provided) upon the effective date of (i) the dissolution or liquidation of the Company, or (ii) a merger, consolidation, acquisition of property or shares, separation or reorganization of the Company with one or more entities, corporate or otherwise, as a result of which the Company is not the surviving entity, or (iii) a "reverse merger" in which the Company is a surviving entity but more than 50% of its voting shares are converted into cash, property or the securities of another entity, or (iv) a sale of substantially all of the property or shares of the Company to another entity, corporate or otherwise; provided, however, that the Company may, in its discretion, and immediately prior to any such transaction, cause a new option to be substituted for this Option or cause this Option to be assumed by an employer entity or a parent or subsidiary of such entity; and such new option shall apply to all shares issued in addition to or substitution, replacement or modification of the shares theretofore covered by such option; provided that,

(a) The excess of the aggregate fair market value of the shares subject to the option immediately after the substitution or assumption over the aggregate option price of such shares shall not be more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and

(b) The new option or the assumption of the existing option shall not give the Optionee additional benefits which he or she did not have under the old option prior to such assumption, and

(c) An appropriate adjustment of the original option price shall be made among original shares subject to the option and any additional shares or shares issued in substitution, replacement or modification thereof.

If no provision is made for the continuance of the Option Plan and the assumption of this Option, or the substitution of new options for this Option as hereinabove provided, then the Company shall cause written notice to be given to the Optionee of the proposed transaction not less than thirty (30) days prior to the anticipated effective date thereof, and at the sole option and discretion of the Company's Board of Directors, this Option, if not already fully exercisable, may thereupon become immediately and fully exercisable, in which event the Optionee shall have the right to exercise this Option at any time prior to the effective date of the proposed transaction. The failure of the Company to give the written notice specified hereinabove shall not affect the validity, nor shall it be a basis for delaying or restraining the consummation, of any such transaction.

7. ADJUSTMENTS.

The number and class of shares subject to this Option, and the purchase price per share (but not the total purchase price), and the minimum number of shares as to which this Option may be exercised at any one time, shall all be proportionately adjusted in the event of any change or increase or decrease in the number of issued shares of Common Stock in the Company, without receipt of consideration by the Company, which results from a split-up or consolidation of shares, payment of a share divided (in excess of two percent), a recapitalization, a combination of shares or other like capital adjustment, or a reincorporation of the Company, so that, upon exercise of this Option, the Optionee shall receive the number and class of shares he or she would have received had he or she been the holder of the number of shares of Common Stock in the Company, for which this Option is being exercised, on the date of such change or increase or decrease in the number of issued shares of Common Stock in the Company. Subject to any required action by its shareholders, if the Company shall be a surviving entity in any reorganization, merger or consolidation (other than in a "reverse merger" in which more than 50% of the Company's voting shares are converted into cash, property or the securities of another entity), this Option shall be proportionately adjusted so as to apply to the securities or other rights or property to which the holder of the number of shares of Common Stock in the Company subject to this Option would have been entitled. Adjustments under this paragraph shall be made by the Board of Directors whose determination with respect thereto shall be final and conclusive. No fractional share shall be issued under this Option or upon any such adjustment.

8. METHOD OF EXERCISING OPTION.

Subject to the terms and conditions of this Option Agreement, this Option may be exercised by written notice to the Company, at its administrative office in the State of California, which presently is located at 17822 East 17th Street, Suite 210, Tustin, California 92680. Such notice shall state the election to exercise the Option and the number of shares in respect of which it is being exercised and shall be signed by the person or persons so exercising the Option. Such notice shall be accompanied by payment in cash, certified check or bank draft in the amount of, or with the prior consent of the Board of Directors or the Stock Option Committee, certificates for shares of Common Stock of the Company having an aggregate fair market value (determined in accordance with Section 5 of the Plan) equal to, the full purchase price of such shares, and the Company shall deliver a certificate or certificates representing the shares subject to such exercise as soon as practicable after the notice shall be received. The certificate or certificates for the shares as to which the Option shall have been so exercised shall be registered in the name of the person or persons so exercising the Option and shall be delivered as provided above to or upon the written order of the person or persons exercising the Option. In the event the Option shall be exercised by any person or persons other than the Optionee in accordance with the terms hereof, such notice shall be accompanied by appropriate proof of the right of such person or persons to exercise the Option. All shares that shall be purchased upon the exercise of the Option as provided herein shall be fully paid and non-assessable. The holder of this Option shall not be entitled to the privileges of share ownership as to any shares of Common Stock not actually issued and delivered to him or her.

9. GENERAL.

(a) The Company shall at all times during the term of the Option reserve and keep available such number of shares of Common Stock as will be sufficient to satisfy the requirements of this Option Agreement, shall pay all original issue and transfer taxes with respect to the issue and transfer of shares pursuant hereto and all other fees and expenses necessarily incurred by the Company in connection therewith, and will from time to time use its best efforts to comply with all laws and regulations, which, in the opinion of counsel for the company, shall be applicable thereto.

(b) The granting of the Option hereunder shall not impose any obligation on the Company to continue the employment or directorship of the Optionee; nor shall it impose any obligation on the Optionee to exercise this Option.

(c) This Agreement embodies the entire agreement of the parties, and supersedes any and all other prior or contemporaneous agreements, whether written or oral, between the parties hereto, with respect to the subject matter hereof.

(d) This Agreement shall be governed by and construed in accordance with the internal laws of the State of California.

(e) The Company may require, as a condition precedent to the Company's obligation to sell and issue, and the Optionee's right to purchase, shares of common stock of the Company on exercise of this Option, that the Optionee shall certify, in writing, that he or she is acquiring such shares for investment and not with a view or the intent to sell or redistribute such shares.

IN WITNESS WHEREOF, the Company has caused this Option Agreement to be duly executed by its officers thereunto duly authorized, and the Optionee has hereunto set his or her hand, all as of the day and year first above written.

QUALITY SYSTEMS, INC.

By: _____

Title: _____
"Company"

Address: _____

"Optionee"

INDEMNIFICATION AGREEMENT

THIS INDEMNIFICATION AGREEMENT ("Agreement") is made as of this day of , by and between QUALITY SYSTEMS, INC., a California corporation (the "Company"), and ("Indemnitee").

WHEREAS, the Company and Indemnitee recognize the increasing difficulty in obtaining directors' and officers' liability insurance, the significant increases in the cost of such insurance and the general reductions in the coverage of such insurance;

WHEREAS, the Company and Indemnitee further recognize the substantial increase in corporate litigation in general, subjecting officers and directors to expensive litigation risks at the same time as the availability and coverage of liability insurance has been severely limited;

WHEREAS, Indemnitee does not regard the current protection available as adequate under the present circumstances, and Indemnitee and other officers and directors of the Company may not be willing to continue to serve as officers and directors without additional protection; and

WHEREAS, the Company desires to attract and retain the services of highly qualified individuals, such as Indemnitee, to serve as officers and directors of the Company, and to indemnify such officers and directors so as to provide them with the maximum protection permitted by law.

NOW, THEREFORE, the Company and Indemnitee hereby agree as follows:

1. Indemnification.

(a) Third Party Proceedings. The Company shall indemnify Indemnitee if Indemnitee is or was a party or is threatened to be made a party to any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the Company) by reason of (i) the fact that Indemnitee is or was a director, officer, employee or agent of the Company, or any subsidiary of the Company, or (ii) any action or inaction on the part of Indemnitee while an officer or

director, or (iii) the fact that Indemnitee is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement (if such settlement is approved in advance by the Company, which approval shall not be unreasonably withheld) actually and reasonably incurred by Indemnitee in connection with such action or proceeding, if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in the best interests of the Company, and, with respect to any criminal action or proceeding, had no reasonable cause to believe Indemnitee's conduct was unlawful. The termination of any action or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that Indemnitee did not act in good faith and in a manner which Indemnitee reasonably believed to be in the best interests of the Company, or, with respect to any criminal action or proceeding, had no reasonable cause to believe that Indemnitee's conduct was unlawful.

(b) Proceedings By or in the Right of the Company. The Company shall indemnify Indemnitee if Indemnitee was or is a party or is threatened to be made a party to any threatened, pending or completed action or proceeding by or in the right of the Company or any subsidiary of the Company to procure a judgment in its favor by reason of (i) the fact that Indemnitee is or was a director, officer, employee or agent of the Company, or any subsidiary of the Company, or (ii) any action or inaction on the part of Indemnitee while an officer or director, or (iii) the fact that Indemnitee is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees) and, to the fullest extent permitted by law, amounts paid in settlement, in each case to the extent actually and reasonably incurred by Indemnitee in connection with the defense or settlement of such action or proceeding, if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in the best interests of the Company and its shareholders, except that no indemnification shall be made in respect of any claim, issue or matter as to which Indemnitee shall have been adjudged to be liable to the Company in the performance of Indemnitee's duty to the Company and its shareholders unless and only to the extent that the court in which such action or proceeding is or was pending shall determine upon application that, in view of all the circumstances of the case, Indemnitee is fairly and reasonably entitled to indemnity for expenses and then only to the extent that the court shall determine.

2. Agreement to Serve. In consideration of the protection afforded by this Agreement, if Indemnitee is a director of the Company, he agrees to serve at least for the balance of the current term as a director and not to resign voluntarily during such period without the written consent or approval of a majority of the Board of Directors. If Indemnitee is an officer of the Company not serving under an employment contract, he agrees to serve in such capacity at least for the balance of the current fiscal year of the Company and not to resign voluntarily during such period without the written consent or approval of a majority of the Board of Directors. Following the applicable period set forth above, Indemnitee agrees to continue to serve in such capacity at the will of the Company (or under separate agreement, if such agreement exists) so long as he is duly appointed or elected and qualified in accordance with the applicable provisions of the Bylaws of the Company or any subsidiary of the Company or until such time as he tenders his resignation in writing. This Agreement is not intended to create, and shall not create, in Indemnitee any right to continued employment.

3. Expenses; Indemnification Procedure.

(a) Advancement of Expenses. The Company shall advance all expenses incurred by Indemnitee in connection with the investigation, defense, settlement or appeal of any civil or criminal action or proceeding referenced in Section 1(a) or (b) hereof (but not amounts actually paid in settlement of any such action or proceeding). Indemnitee hereby undertakes to repay such amounts advanced only if, and to the extent that, it shall ultimately be determined that Indemnitee is not entitled to be indemnified by the Company as authorized hereby. The advances to be made hereunder shall be paid by the Company to Indemnitee within twenty (20) days following delivery of a written request therefor by Indemnitee to the Company.

(b) Notice/Cooperation by Indemnitee. Indemnitee shall, as a condition precedent to his right to be indemnified under this Agreement, give the Company notice in writing as soon as practicable of any claim made against Indemnitee for which indemnification will or could be sought under this Agreement. Notice to the Company shall be directed to the Chief Executive Officer of the Company at the address shown on the signature page of this Agreement (or such other address as the Company shall designate in writing to Indemnitee). Notice shall be deemed received three business days after the date postmarked if sent by certified or registered mail, properly addressed; otherwise notice shall be deemed received when such notice shall actually be received by the Company. In addition, Indemnitee shall give the Company such information and cooperation as it may reasonably require and as shall be within Indemnitee's power.

(c) Procedure. Any indemnification provided for in Section 1 shall be made no later than forty-five (45) days after receipt of the written request of Indemnatee. If a claim under this Agreement, under any statute, or under any provision of the Company's Articles of Incorporation or Bylaws providing for indemnification, is not paid in full by the Company within forty-five (45) days after a written request for payment thereof has first been received by the Company, Indemnatee may, but need not, at any time thereafter bring an action against the Company to recover the unpaid amount of the claim and, subject to Section 14 of this Agreement, Indemnatee shall also be entitled to be paid for the expenses (including attorneys' fees) of bringing such action. It shall be a defense to any such action (other than an action brought to enforce a claim for expenses incurred in connection with any action or proceeding in advance of its final disposition) that Indemnatee has not met the standards of conduct which make it permissible under applicable law for the Company to indemnify Indemnatee for the amount claimed, but the burden of proving such defense shall be on the Company, and Indemnatee shall be entitled to receive interim payments of expenses pursuant to Section 3(a) unless and until such defense may be finally adjudicated by court order or judgment from which no further right of appeal exists. It is the parties' intention that if the Company contests Indemnatee's right to indemnification, the question of Indemnatee's right to indemnification shall be for the court to decide, and neither the failure of the Company (including its Board of Directors, any committee or subgroup of the Board of Directors, independent legal counsel, or its shareholders) to have made a determination that indemnification of Indemnatee is proper in the circumstances because Indemnatee has met the applicable standard of conduct required by applicable law, nor an actual determination by the Company (including its Board of Directors, any committee or subgroup of the Board of Directors, independent legal counsel, or its shareholders) that Indemnatee has not met such applicable standard of conduct, shall create a presumption that Indemnatee has or has not met the applicable standard of conduct.

(d) Notice to Insurers. If, at the time of the receipt of a notice of a claim pursuant to Section 3(b) hereof, the Company has director and/or officer liability insurance in effect, the Company shall give prompt notice of the commencement of such proceeding to the insurers in accordance with the procedures set forth in the respective policies. The Company shall thereafter take all necessary or desirable action to cause such insurers to pay, on behalf of the Indemnatee, all amounts payable as a result of such proceeding in accordance with the terms of such policies.

(e) Selection of Counsel. In the event the Company shall be obligated under Section 3(a) hereof to pay the expenses of any proceeding against Indemnatee, the Company, if

appropriate, shall be entitled to assume the defense of such proceeding, with counsel approved by Indemnitee, which approval shall not be unreasonably withheld, upon the delivery to Indemnitee of written notice of its election so to do. After delivery of such notice, approval of such counsel by Indemnitee and the retention of such counsel by the Company, the Company will not be liable to Indemnitee under this Agreement for any fees of counsel subsequently incurred by Indemnitee with respect to the same proceeding, provided that (i) Indemnitee shall have the right to employ his or her counsel in any such proceeding at Indemnitee's expense; and (ii) if (A) the employment of counsel by Indemnitee has been previously authorized by the Company, (B) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Company and Indemnitee in the conduct of any such defense or (C) the Company shall not, in fact, have employed counsel to assume the defense of such proceeding, then the fees and expenses of Indemnitee's counsel shall be at the expense of the Company.

4. Additional Indemnification Rights; Non-Exclusivity.

(a) Scope. Notwithstanding any other provision of this Agreement, the Company hereby agrees to indemnify the Indemnitee to the fullest extent permitted by law, notwithstanding that such indemnification is not specifically authorized by the other provisions of this Agreement, the Company's Articles of Incorporation, the Company's Bylaws or by statute. In the event of any change, after the date of this Agreement, in any applicable law, statute or rule which expands the right of a California corporation to indemnify a member of its board of directors or an officer, such changes shall be, ipso facto, within the purview of Indemnitee's rights and Company's obligations, under this Agreement. In the event of any change in applicable law, statute or rule which narrows the right of a California corporation to indemnify a member of its board of directors or an officer, such changes, to the extent not otherwise required by such law, statute or rule to be applied to this Agreement shall have no effect on this Agreement or the parties' rights and obligations hereunder.

(b) Non-Exclusivity. The indemnification provided by this Agreement shall not be deemed exclusive of any right to which Indemnitee may be entitled under the Company's Articles of Incorporation, its Bylaws, any agreement, any vote of shareholders or disinterested directors, the General Corporation Law of the State of California, or otherwise, both as to action in Indemnitee's official capacity and as to action in another capacity while holding such office. The indemnification provided under this Agreement shall continue as to Indemnitee for any action taken or not taken while serving in an indemnified capacity even though he or she is not serving in such capacity or in any capacity with the Company at the time of any action or other covered proceeding.

5. Partial Indemnification. If Indemnitee is entitled under any provision of this Agreement to indemnification by the Company for some or a portion of the expenses, judgments, fines or penalties actually or reasonably incurred by him in the investigation, defense, appeal or settlement of any civil or criminal action or proceeding, but not, however, for the total amount thereof, the Company shall nevertheless indemnify Indemnitee for the portion of such expenses, judgments, fines or penalties to which Indemnitee is entitled.

6. Mutual Acknowledgment. Both the Company and Indemnitee acknowledge that in certain instances, Federal law or applicable public policy may prohibit the Company from indemnifying its directors and officers under this Agreement or otherwise. Indemnitee understands and acknowledges that the Company has undertaken or may be required in the future to undertake with the Securities and Exchange Commission to submit the question of indemnification to a court in certain circumstances for a determination of the Company's right under public policy to indemnify Indemnitee and, in that event, the Indemnitee's rights and the Company's obligations hereunder shall be subject to that determination.

7. Directors' and Officers' Liability Insurance. The Company shall, from time to time, make a good faith determination whether or not it is practicable for the Company to obtain and maintain a policy or policies of insurance with reputable insurance companies providing the officers and directors of the Company with coverage for losses from wrongful acts, or to ensure the Company's performance of its indemnification obligations under this Agreement. Among other considerations, the Company will weigh the costs of obtaining such insurance coverage against the protection afforded by such coverage. In all policies of directors' and officers' liability insurance, Indemnitee shall be named as an insured in such a manner as to provide Indemnitee the same rights and benefits as are accorded to the most favorably insured of the Company's directors, if Indemnitee is a director; or of the Company's officers, if Indemnitee is not a director of the Company but is an officer; or of the Company's key employees, if Indemnitee is not an officer or director but is a key employee. Notwithstanding the foregoing, the Company shall have no obligation to obtain or maintain such insurance if the Company determines in good faith that such insurance is not reasonably available, or that the premium costs for such insurance are disproportionate to the amount of coverage provided, or that the coverage provided by such insurance is limited by exclusions so as to provide an insufficient benefit, or if Indemnitee is covered by similar insurance maintained by a subsidiary or parent of the Company.

8. Severability. Nothing in this Agreement is intended to require or shall be construed as requiring the Company to do or fail to do any act in violation of applicable law. The Company's inability, pursuant to court order, to perform its obligations under this Agreement shall not constitute a breach of this Agreement. The provisions of this Agreement shall be severable as provided in this Section 8. If this Agreement or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the Company shall nevertheless indemnify Indemnitee to the full extent permitted by any applicable portion of this Agreement that shall not have been invalidated, and the balance of this Agreement not so invalidated shall be enforceable in accordance with its terms.

9. Exceptions. Any other provision herein to the contrary notwithstanding, the Company shall not be obligated pursuant to the terms of this Agreement:

(a) Excluded Acts. To indemnify Indemnitee for any acts or omissions or transactions for which a director may not be relieved of liability under the California General Corporation Law or the Federal Securities Laws; or

(b) Claims Initiated by Indemnitee. To indemnify or advance expenses to Indemnitee with respect to proceedings or claims initiated or brought voluntarily by Indemnitee and not by way of defense, except with respect to proceedings brought to establish or enforce a right to indemnification under this Agreement or any other statute or law or otherwise as required under Section 317 of the California General Corporation Law, but such indemnification or advancement of expenses may be provided by the Company in specific cases if the Board of Directors has approved the initiation or bringing of such suit; or

(c) Lack of Good Faith. To indemnify Indemnitee for any expenses incurred by the Indemnitee with respect to any proceeding instituted by Indemnitee to enforce or interpret this Agreement, if a court of competent jurisdiction determines that each of the material assertions made by the Indemnitee in such proceeding was not made in good faith or was frivolous; or

(d) Insured Claims. To indemnify Indemnitee for expenses or liabilities of any type whatsoever (including, but not limited to, judgments, fines, ERISA excise taxes or penalties, and amounts paid in settlement) which have been paid directly to Indemnitee by an insurance carrier under a policy of directors' and officers' liability insurance maintained by the Company or any parent or subsidiary of the Company; or

(e) Claims Under Section 16(b). To indemnify Indemnitee for expenses and the payment of profits and other amounts, if any, arising from the purchase and sale by

Indemnitee of securities in violation of Section 16(b) of the Securities Exchange Act of 1934, as amended, or any similar successor statute.

10. Effectiveness of Agreement. To the extent that the indemnification permitted under the terms of certain provisions of this Agreement exceeds the scope of the indemnification provided for in the California General Corporation Law, such provisions shall not be effective unless and until the Company's Articles of Incorporation authorize such additional rights of indemnification. In all other respects, the balance of this Agreement shall be effective as of the date set forth on the first page and may apply to acts or omissions of Indemnitee which occurred prior to such date if Indemnitee was an officer, director, employee or other agent of the Company, or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, at the time such act or omission occurred.

11. Construction of Certain Phrases.

(a) For purposes of this Agreement, references to the "Company" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, employees or agents, so that if Indemnitee is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, Indemnitee shall stand in the same position under the provisions of this Agreement with respect to the resulting or surviving corporation as Indemnitee would have with respect to such constituent corporation if its separate existence had continued.

(b) For purposes of this Agreement, references to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on Indemnitee with respect to an employee benefit plan; and references to "serving at the request of the Company" shall include any service as a director, officer, employee or agent of the Company which imposes duties on, or involves services by, such director, officer, employee or agent with respect to an employee benefit plan, its participants, or beneficiaries.

12. Counterparts. This Agreement may be executed in one or more counterparts, each of which shall constitute an original.

13. Successors and Assigns. This Agreement shall be binding upon the Company and its successors and assigns, and shall inure to the benefit of Indemnatee and Indemnatee's estate, heirs, legal representatives and assigns.

14. Attorneys' Fees. In the event that any action is instituted by Indemnatee under this Agreement to enforce or interpret any of the terms hereof, Indemnatee shall be entitled to be paid all court costs and expenses, including reasonable attorneys' fees, incurred by Indemnatee with respect to such action, unless as a part of such action, the court of competent jurisdiction determines that each of the material assertions made by Indemnatee as a basis for such action were not made in good faith or were frivolous. In the event of an action instituted by or in the name of the Company under this Agreement or to enforce or interpret any of the terms of this Agreement, Indemnatee shall be entitled to be paid all court costs and expenses, including attorneys' fees, incurred by Indemnatee in defense of such action (including with respect to Indemnatee's counterclaims and cross-claims made in such action), unless as a part of such action the court determines that each of Indemnatee's material defenses to such action were made in bad faith or were frivolous.

15. Notices. All notices, requests, demands and other communications under this Agreement shall be in writing and shall be deemed duly given (i) if delivered by hand and receipted for by the party addressee, on the date of such receipt, or (ii) if mailed by certified or registered mail with postage prepaid, on the third business day after the date postmarked. Addresses for notice to either party are as shown on the signature page of this Agreement, or as subsequently modified by written notice.

16. Consent to Jurisdiction. The Company and Indemnatee each hereby irrevocably consent to the jurisdiction of the courts of the State of California for all purposes in connection with any action or proceeding which arises out of or relates to this Agreement and agree that any action instituted under this Agreement shall be brought only in the state courts of the State of California.

17. Choice of Law. This Agreement shall be governed by and its provisions construed in accordance with the laws of the State of California as applied to contracts between California residents entered into and to be performed entirely within California.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written.

QUALITY SYSTEMS, INC.

By: _____

Title: _____

Address: _____

AGREED TO AND ACCEPTED:

INDEMNITEE:

(type name)

(signature)

(address)

INDEPENDENT AUDITORS' CONSENT AND REPORT ON SCHEDULE

To the Board of Directors and Shareholders of
Quality Systems, Inc.:

We consent to the use in this Registration Statement of Quality Systems, Inc. on Form S-1 of our report dated June 2, 1995 on the financial statements of Quality Systems, Inc. and our report dated December 17, 1995 on the financial statements of Clinitec International, Inc., both appearing in the Prospectus, which is a part of this Registration Statement, and to the references to us under the heading "Experts" in such Prospectus.

Our audit of the financial statements of Quality Systems, Inc. referred to in our aforementioned report also included the financial statement schedule, listed in Item 16. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

DELOITTE & TOUCHE LLP
Costa Mesa, California
January 10, 1996