

HEMISPHERE MEDIA GROUP, INC.  
Form SC 13D/A  
April 02, 2015

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

SCHEDULE 13D  
(RULE 13D - 101)

INFORMATION TO BE INCLUDED IN STATEMENTS FILED PURSUANT TO 13d-1(a) AND AMENDMENTS  
THERE TO FILED PURSUANT TO 13d-2(a)

(Amendment No. 3)\*

Hemisphere Media Group, Inc.  
(Name of Issuer)

Class A Common Stock, par value \$0.0001 per share  
(Title of Class of Securities)

42365Q103  
(CUSIP Number)

Jamie Nash, Esq.  
Kleinberg, Kaplan, Wolff & Cohen, P.C.  
551 Fifth Avenue, New York, New York 10176  
Tel: (212) 986-6000

(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)

March 31, 2015  
(Date of Event which Requires Filing of this Statement)

If the filing person has previously filed a statement on Schedule 13G to report the acquisition which is the subject of this Schedule 13D, and is filing this schedule because of Rule 13d-1(e), 13d-1(f) or 13d-1(g), check the following box [ ].

Note: Schedules filed in paper format shall include a signed original and five copies of the schedule, including all exhibits. See Rule 13d-7 for other parties to whom copies are to be sent.

\*The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter disclosures provided in a prior cover page.

The information required on the remainder of this cover page shall not be deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).



1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Luxor Capital Partners, LP

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

WC

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

1,221,191

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

1,221,191

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

1,221,191

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
8.1%
14. TYPE OF REPORTING PERSON  
PN
-

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Luxor Wavefront, LP

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

WC

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

1,781,903

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

1,781,903

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

1,781,903

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)

EXCLUDES CERTAIN SHARES

13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)

11.8%

14. TYPE OF REPORTING PERSON

PN

---

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)  
  
Luxor Capital Partners Offshore Master Fund, LP
  2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP  
  
(a)   
(b)
  3. SEC USE ONLY
  4. SOURCE OF FUNDS  
  
WC
  5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)
  6. CITIZENSHIP OR PLACE OF ORGANIZATION  
  
Cayman Islands
- NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:
7. SOLE VOTING POWER  
  
0
  8. SHARED VOTING POWER  
  
1,933,375
  9. SOLE DISPOSITIVE POWER  
  
0
  10. SHARED DISPOSITIVE POWER  
  
1,933,375
  11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON  
  
1,933,375

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
12.8%
14. TYPE OF REPORTING PERSON  
PN
-



1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)  
  
Luxor Capital Partners Offshore, Ltd.
  2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP  
  
(a)   
(b)
  3. SEC USE ONLY
  4. SOURCE OF FUNDS  
  
AF
  5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)
  6. CITIZENSHIP OR PLACE OF ORGANIZATION  
  
Cayman Islands
- NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:
7. SOLE VOTING POWER  
  
0
  8. SHARED VOTING POWER  
  
1,933,375
  9. SOLE DISPOSITIVE POWER  
  
0
  10. SHARED DISPOSITIVE POWER  
  
1,933,375
  11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON  
  
1,933,375

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
12.8%
14. TYPE OF REPORTING PERSON  
CO
-

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Luxor Spectrum Offshore Master Fund, LP

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

WC

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Cayman Islands

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

83,001

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

83,001

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

83,001

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
Less than 1%
14. TYPE OF REPORTING PERSON  
PN
-

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Luxor Spectrum Offshore, Ltd.

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

AF

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Cayman Islands

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

83,001

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

83,001

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

83,001

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
Less than 1%
14. TYPE OF REPORTING PERSON  
CO
-

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

LCG Holdings, LLC

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

AF

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

5,019,470

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

5,019,470

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

5,019,470

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
33.3%
14. TYPE OF REPORTING PERSON  
OO
-



1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Luxor Capital Group, LP

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

AF, OO

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

5,128,180

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

5,128,180

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

5,128,180

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
34.0%
14. TYPE OF REPORTING PERSON  
PN
-

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Luxor Management, LLC

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

AF

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

Delaware

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

5,128,180

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

5,128,180

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

5,128,180

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
34.0%
14. TYPE OF REPORTING PERSON  
OO
-

1. NAMES OF REPORTING PERSONS  
I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY)

Christian Leone

2. CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP

(a)

(b)

3. SEC USE ONLY

4. SOURCE OF FUNDS

AF

5. CHECK BOX IF DISCLOSURE OF LEGAL PROCEEDINGS IS  
REQUIRED PURSUANT TO ITEMS 2(d) or 2(e)

6. CITIZENSHIP OR PLACE OF ORGANIZATION

USA

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:

7. SOLE VOTING POWER

0

8. SHARED VOTING POWER

5,128,180

9. SOLE DISPOSITIVE POWER

0

10. SHARED DISPOSITIVE POWER

5,128,180

11. AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH  
REPORTING PERSON

5,128,180

12. CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (11)  
EXCLUDES CERTAIN SHARES
13. PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (11)  
34.0%
14. TYPE OF REPORTING PERSON  
IN
-

The following constitutes Amendment No. 3 to the Schedule 13D filed by the undersigned ("Amendment No. 3"). This Amendment No. 3 amends the Schedule 13D as specifically set forth herein.

ITEM 5. Interest in Securities of the Issuer.

Item 5(a) is hereby amended and restated to read as follows:

(a) The aggregate percentage of shares of Common Stock reported owned by each person named herein is based upon 15,091,401 shares of Common Stock outstanding as of March 20, 2015, which is the total number of shares of Common Stock outstanding as reported in the Issuer's Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on March 31, 2015.

As of the close of business on the date hereof, the Onshore Fund owned directly 1,221,191 shares of Common Stock, the Offshore Master Fund owned directly 1,933,375 shares of Common Stock, the Wavefront Fund owned directly 1,781,903 shares of Common Stock and the Spectrum Master Fund owned directly 83,001 shares of Common Stock, constituting approximately 8.1%, 12.8%, 11.8% and less than 1%, respectively of the shares of Common Stock outstanding.

The Offshore Feeder Fund, as the owner of a controlling interest in the Offshore Master Fund, may be deemed to have beneficially owned the 1,933,375 shares of Common Stock owned directly by the Offshore Master Fund, constituting approximately 12.8% of the shares of Common Stock outstanding. The Spectrum Feeder Fund, as the owner of a controlling interest in the Spectrum Master Fund, may be deemed to have beneficially owned the 83,001 shares of Common Stock owned directly by the Spectrum Master Fund, constituting less than 1% of the shares of Common Stock outstanding.

LCG Holdings, as the general partner of the Onshore Fund, the Wavefront Fund, the Offshore Master Fund and the Spectrum Master Fund, may be deemed to have beneficially owned the 5,019,470 shares of Common Stock owned in the aggregate by the Onshore Fund, the Wavefront Fund, the Offshore Master Fund and the Spectrum Master Fund, constituting approximately 33.3% of the shares of Common Stock outstanding.

Luxor Capital Group, as the investment manager of the Luxor Funds and the Separately Managed Account, may be deemed to have beneficially owned the 5,019,470 shares of Common Stock owned in the aggregate by the Luxor Funds and the 108,710 shares of Common Stock owned directly by the Separately Managed Account, constituting approximately 34.0% of the shares of Common Stock outstanding.

Luxor Management, as the general partner of Luxor Capital Group, may be deemed to have beneficially owned the 5,128,180 shares of Common Stock beneficially owned by Luxor Capital Group, constituting approximately 34.0% of the shares of Common Stock outstanding.

Mr. Leone, as the managing member of Luxor Management, may be deemed to have beneficially owned the 5,128,180 shares of Common Stock beneficially owned by Luxor Management, constituting approximately 34.0% of the shares of Common Stock outstanding.

SIGNATURES

After reasonable inquiry and to the best of its knowledge and belief, each of the undersigned certifies that the information with respect to it set forth in this statement is true, complete, and correct.

Dated: April 2, 2015

LUXOR CAPITAL PARTNERS, LP

By: LCG Holdings, LLC  
General Partner

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LUXOR WAVEFRONT, LP

By: LCG Holdings, LLC  
General Partner

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LUXOR CAPITAL PARTNERS OFFSHORE MASTER FUND, LP

By: LCG Holdings, LLC  
General Partner

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LUXOR CAPITAL PARTNERS OFFSHORE, LTD.

By: Luxor Capital Group, LP  
Investment Manager

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel





LUXOR SPECTRUM OFFSHORE MASTER FUND, LP

By: LCG Holdings, LLC  
General Partner

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LUXOR SPECTRUM OFFSHORE, LTD.

By: Luxor Capital Group, LP  
Investment Manager

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LUXOR CAPITAL GROUP, LP

By: Luxor Management, LLC  
General Partner

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LCG HOLDINGS, LLC

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

LUXOR MANAGEMENT, LLC

By: /s/ Norris Nissim  
Name: Norris Nissim  
Title: General Counsel

/s/ Norris Nissim  
NORRIS NISSIM, as Agent for Christian  
Leone

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Total income tax provision

\$8,152,314 \$4,319,545

The difference between income taxes at the U. S. federal statutory income tax rate of 35% and those reported in the Condensed Statements of Income for the six months ended June 30 is as follows:

	2011	2010
Income taxes at U. S. Federal statutory rate	\$ 7,504,570	\$ 4,037,548
State income tax, net of federal tax effect	964,562	517,480
Tax credits and other	(316,818)	(235,483)
Total income tax provision	\$ 8,152,314	\$ 4,319,545

The Company had unrecognized tax benefits of \$733,190 related to uncertain tax positions as of June 30, 2011 under the provisions of FASB Codification topic, *Income Taxes*, which is recorded in other accrued liabilities on the Condensed Balance Sheet. No accrued interest or penalties for such positions is recorded. The federal returns for the tax years 2004, 2005, and 2006 are currently under examination by the Internal Revenue Service, primarily in relation to research credits claimed on those returns by the Company. The federal returns for tax years 2007, 2008, 2009 and 2010 remain open to examination, and the tax years 2004 - 2010 remain open to other taxing jurisdictions to which the Company is subject.

#### 7. STOCK-BASED COMPENSATION AND EMPLOYEE INCENTIVE PROGRAMS

Stock-based compensation cost is measured at the grant date based on the fair value of the award, and is recognized as an expense over the employee's requisite service period. The Company recorded compensation costs as the requisite service was rendered for the unvested portion of previously issued awards that remained outstanding at the initial date of adoption and any awards issued, modified, repurchased, or cancelled after January 1, 2006.

The following table shows total stock-based compensation expense for the three and six months ended June 30, 2011 and 2010, included in the Condensed Statements of Income:

	Three Months Ended	Six Months Ended
--	--------------------	------------------

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	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Costs of sales	\$ 93,277	\$ 74,997	\$ 118,276	\$ 149,994
Operating expenses	154,113	125,835	199,946	280,833
Pre-tax stock-based compensation expense	247,390	200,832	318,222	430,827
Less: income tax effect	96,485	78,325	124,107	168,023
Net stock-based compensation expense	\$ 150,905	\$ 122,507	\$ 194,115	\$ 262,804

**Table of Contents****2005 Restricted Stock Plan**

On January 27, 2006, the Compensation Committee of the Board of Directors approved the grant of 116,498 shares of restricted stock, effective January 30, 2006, to certain executive officers of the Company under the 2005 Restricted Stock Plan. The grant date fair value was \$42.91 per share. Each restricted stock award provided for vesting in five equal annual installments commencing on the first anniversary of the date of grant, assuming that the recipient of the award continued to be an executive officer of the Company on each applicable vesting date. On May 17, 2006, the Compensation Committee of the Board of Directors approved the grant of 17,810 shares of restricted stock to the Company's then Chief Operating Officer. The grant date fair value was \$42.11 per share. The restricted stock award provided for vesting in five equal annual installments commencing on January 30, 2007, and each January 30 thereafter, assuming that the recipient of the award continued to be an executive officer of the Company on each applicable vesting date. All of the above awards of restricted stock were fully vested on January 30, 2011.

On January 23, 2008, the Compensation Committee of the Board of Directors approved the grant of 16,471 shares of restricted stock to the Company's then Vice President Finance and Chief Financial Officer of the Company. The grant date fair value was \$21.25 per share. The restricted stock award provided for vesting in five equal annual installments commencing on January 30, 2009, and each January 30 thereafter, assuming that the recipient of the award continued to be an executive officer of the Company on each applicable vesting date. On June 30, 2010, 9,883 shares of unvested restricted stock in this award were forfeited, cancelled and returned to the authorized and unissued shares of the Company as a result of the termination of employment of this individual on such date.

On April 18, 2011, the Compensation Committee of the Board of Directors approved the grant of a total of 100,346 shares of restricted stock, effective April 18, 2011, to certain executive officers of the Company. Under the terms of the restricted stock award agreements with the executive officers, the shares of restricted stock are scheduled to vest in five equal annual installments commencing on April 18, 2012 and each April 18 thereafter, assuming that the recipient of the award continues to serve as an executive officer of the Company on each applicable vesting date. Compensation expense for this grant will be recognized on a straight-line basis over five years.

A summary of activity under the 2005 Restricted Stock Plan during the six month periods ended June 30, 2011 and 2010 is as follows:

	Six Months Ended June 30, 2011		Six Months Ended June 30, 2010	
	Shares	Weighted-Average Grant-Date Fair Value	Shares	Weighted-Average Grant-Date Fair Value
Nonvested stock outstanding at beginning of year	19,871	\$ 42.77	52,920	\$ 37.41
Granted	100,346	60.79		
Forfeited			(9,883)	21.25
Vested	(19,871)	42.77	(23,166)	39.71
Nonvested stock outstanding at end of period	100,346	\$ 60.79	19,871	\$ 42.77

As of June 30, 2011, there was \$5,852,643 of unrecognized compensation cost related to non-vested restricted stock granted under the 2005 Restricted Stock Plan.

**2011 Incentive Program**

On April 18, 2011, the Board of Directors, upon the recommendation of the Compensation Committee, adopted a short-term incentive program for 2011 for certain executive officers of the Company (the 2011 Incentive Program). Under the 2011 Incentive Program, each executive officer of the Company, other than executive officers earning any commission-based compensation, has a short-term incentive cash bonus opportunity based on achievement of a specified level of financial performance, specifically the Company's EBITDA (as defined in the 2011 Incentive Program) in 2011 (2011 EBITDA) compared to the Company's EBITDA in 2010 (2010 EBITDA).

Participants in the 2011 Incentive Program will receive 100% of their target award if the Company's 2011 EBITDA is 105% of 2010 EBITDA, 50% of the target award if the Company achieves a minimum threshold level of performance (2011 EBITDA reaching 55% of 2010 EBITDA), and a maximum of 150% of the target award for a maximum level of performance (2011 EBITDA equaling or exceeding 155% of 2010 EBITDA). No payments will be made for performance below the specified threshold amount. Payouts between the threshold and maximum will be calculated by the Compensation Committee using a straight-line interpolation, as described in the 2011 Incentive Program. The

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Compensation Committee may make adjustments to the terms and conditions of, and the criteria included in, awards under the 2011 Incentive Program in recognition of unusual or nonrecurring events affecting a participant or the Company, or the financial statements of the Company, or in certain other instances specified in the 2011 Incentive Program.

Awards pursuant to the 2011 Incentive Program will be paid solely in cash. In addition, awards pursuant to the 2011 Incentive Program are subject to recovery or adjustment by the Company in certain circumstances in which the operating results on which payment was based are restated or otherwise adjusted or in the event that a participant's conduct is not in good faith and materially disrupts, damages, impairs, or interferes with the business of the Company.

**Table of Contents**

As of June 30, 2011, we had \$327,750 in accrued compensation cost for this program based on year to date performance under this program.

**8. FINANCING RECEIVABLES**

The Company leases its information and patient care systems to certain healthcare providers under sales-type leases expiring in various years through 2016. These receivables typically have terms from two to five years, bear interest at various rates, and are usually collateralized by a security interest in the underlying assets. Since the Company has a history of successfully collecting amounts due under the original payment terms of these extended payment arrangements without making any concessions to its customers, the Company satisfies the requirement for revenue recognition. The Company's history with these types of extended payment term arrangements supports management's assertion that revenues are fixed and determinable and probable of collection.

The components of these lease receivables were as follows on June 30, 2011 and December 31, 2010:

	6/30/2011	12/31/2010
Total minimum lease payments receivable	\$ 7,793,032	\$ 7,504,094
Less allowance for losses	(254,535)	(233,396)
Less unearned income	(676,594)	(796,610)
Lease receivables	6,861,903	6,474,088
Less current portion	(2,191,559)	(2,041,811)
Amounts due after one year	\$ 4,670,344	\$ 4,432,277

Future minimum lease payments to be received subsequent to June 30, 2011 are as follows:

2011	\$ 1,494,411
2012	2,475,780
2013	1,934,916
2014	1,115,095
2015	562,840
Thereafter	209,990
Total minimum lease payments to be received	7,793,032
Less unearned income	(676,594)
Net leases receivable	\$ 7,116,438

**Credit Quality of Financing Receivables and Allowance for Credit Losses**

The following table is a rollforward of the allowance for financing credit losses for the quarter and year ended June 30, 2011 and December 31, 2010:

	Beginning Balance	Provision	Charge-offs	Recoveries	Ending Balance
December 31, 2010	\$	\$ 233,396	\$	\$	\$ 233,396
June 30, 2011	\$ 233,396	\$ 21,139	\$	\$	\$ 254,535

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The Company established an allowance for financing receivable credit losses during 2010 upon adoption of ASU 2010-20. This allowance is based on the historical level of customer defaults under such arrangements. The Company has been successful collecting its financing receivables and considers the credit quality of such arrangements to be good, especially as the underlying assets act as collateral for the receivable.

The Company has also sold information and patient care systems to certain healthcare providers under extended payment terms. These receivables, included in current portion of financing receivables, typically have terms from 3 to 12 months. Total amounts receivable under these arrangements at June 30, 2011 and December 31, 2010 were \$1,107,057 and \$1,072,390, respectively.



**Table of Contents****9. COMPREHENSIVE INCOME**

FASB Codification topic, *Comprehensive Income*, requires the disclosure of certain revenue, expenses, gains and losses that are excluded from net income in accordance with accounting principles generally accepted in the United States of America. Total comprehensive income for the three and six months ended June 30, 2011 and 2010 is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Net income as reported	\$ 7,916,148	\$ 4,264,318	\$ 13,289,314	\$ 7,184,569
Other comprehensive income:				
Unrealized loss on investments available for sale, net of taxes	151	(12,524)	4,603	(14,343)
Total comprehensive income	\$ 7,916,299	\$ 4,251,794	\$ 13,293,917	\$ 7,170,226

**10. COMMITMENTS AND CONTINGENCIES**

As of June 30, 2011, the Company is contingently liable as guarantor on a lease obligation between Solis Healthcare, LP ( Solis Healthcare ), as lessee, and Winthrop Resources Corporation ( Winthrop ), as lessor. Solis Healthcare purchased a software system from the Company in the first quarter of 2008 and then entered into a sale-leaseback transaction with Winthrop. The Company provided this guarantee in order to facilitate Solis Healthcare in leasing the new system. The lease has an initial term of five years and continues from year to year thereafter until terminated. The Company is contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, the Company will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guarantee runs for the entire term of the lease; however, the maximum potential amount of future payments that the Company would be required to make to Winthrop under the guaranty is \$1,166,700, the balance of the lease payments as of June 30, 2011, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney fees and costs). Due to the contingent nature of the guaranty, the maximum amount of the guaranty is not recorded on the balance sheet; however, when necessary, reserves are recorded to cover potential losses. A liability in the amount of \$27,943, the amortized fair value of the guaranty, is recorded on the balance sheet as an other accrued liability at June 30, 2011. As of June 30, 2011, we were not aware of any conditions that would effect the payment or performance risk of the lease obligation.

From time to time, the Company is involved in routine litigation that arises in the ordinary course of business. Management does not expect this to have a material adverse effect on the Company's financial position or results of operations or liquidity.

**11. FAIR VALUE**

FASB Codification topic, *Fair Value Measurements and Disclosures*, establishes a framework for measuring fair value and expands financial statement disclosures about fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The Codification does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements. The Codification requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The fair values of the Company's available-for-sale securities are based on matrix pricing for the periods ended June 30, 2011 and December 31, 2010, which basically treats all fixed income securities that derive price from yield and other market factors as Level 2. We generally apply fair value techniques on a non-recurring basis associated with (1) valuing potential impairment loss related to financing receivables accounted for pursuant to Codification topic, *Leases*, and (2) valuing potential impairment loss related to long-lived assets accounted for pursuant to

Codification topic, *Property, Plant and Equipment*.

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The following tables summarize the carrying amounts and fair values of certain assets and liabilities at June 30, 2011 and December 31, 2010:

Description	6/30/2011	Fair Value at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities				
Short-term investments (cash and accrued income)	\$ 265,967	\$	\$ 265,967	\$
Mortgage-backed securities	113,742		113,742	
Obligations of U.S. Treasury, U.S. government corporations and agencies	6,895,770		6,895,770	
Corporate bonds	9,208,483		9,208,483	
<b>Total available-for-sale securities</b>	<b>\$ 16,483,962</b>	<b>\$</b>	<b>\$ 16,483,962</b>	<b>\$</b>

Description	12/31/2010	Fair Value at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities				
Short-term investments (cash and accrued income)	\$ 521,356	\$	\$ 521,356	\$
Mortgage-backed securities	121,571		121,571	
Obligations of U.S. Treasury, U.S. government corporations and agencies	5,225,539		5,225,539	
Corporate bonds	7,533,457		7,533,457	
<b>Total available-for-sale securities</b>	<b>\$ 13,401,923</b>	<b>\$</b>	<b>\$ 13,401,923</b>	<b>\$</b>

Accrued income in the above tables represents earnings due and payable to our investment portfolio at any point in time but not yet received.

The carrying amount of other financial instruments reported in the balance sheet for current assets and current liabilities approximate their fair values because of the short-term nature of these instruments.

**12. RECENT ACCOUNTING PRONOUNCEMENTS***New Accounting Standards Adopted in 2011*

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Effective January 1, 2011, the Company prospectively adopted ASU 2009-14, *Software: Certain Revenue Arrangements That Include Software Elements*. This update addresses revenue recognition in situations where products or services are sold along with incidental software components. The update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. This update did not have an impact on our financial statements.

Effective January 1, 2011, the Company prospectively adopted ASU 2009-13, *Revenue Recognition: Multiple-Deliverable Revenue Arrangements*. This update addresses the criteria for separating consideration in multiple-element arrangements. It requires companies allocating the overall consideration to each deliverable to use an estimated selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. The update is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company's adoption of this update did not have a material impact on our financial statements.

### *New Accounting Standards Yet to be Adopted*

There are no new standards required to be adopted in 2011 that will have a material impact on our financial statements.

### **13. SUBSEQUENT EVENTS**

On July 25, 2011, the Company announced a dividend for the second quarter of 2011 in the amount of \$0.36 per share, payable on August 26, 2011, to stockholders of record as of the close of business on August 11, 2011.

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

You should read the following discussion and analysis of our financial condition and results of operations together with the unaudited financial statements and related notes appearing elsewhere herein.

This discussion and analysis contains forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified generally by the use of forward-looking terminology and words such as expects, anticipates, estimates, believes, predicts, intends, plans, potential, may, continue, should, will and similar words. Without limiting the generality of the preceding statement, all statements in this report relating to estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and future financial results are forward-looking statements. We caution investors that any such forward-looking statements are only predictions and are not guarantees of future performance. Certain risks, uncertainties and other factors may cause actual results to differ materially from those projected in the forward-looking statements. Such factors may include:

overall business and economic conditions affecting the healthcare industry;

potential effects of the federal health care reform legislation enacted in 2010, and implementing regulations, on the businesses of our hospital customers;

funding uncertainties associated with, and potential expenditures required by, the American Recovery and Reinvestment Act of 2009 in connection with the adoption of electronic health records;

saturation of our target market and hospital consolidations;

changes in customer purchasing priorities, capital expenditures and demand for information technology systems;

competition with companies that have greater financial, technical and marketing resources than we have;

failure to develop new technology and products in response to market demands;

fluctuations in quarterly financial performance due to, among other factors, timing of customer installations;

failure of our products to function properly resulting in claims for medical losses;

the implementation of health care reform and its effects on the financial condition of our hospital customers;

government regulation of our products and customers, including changes in healthcare policy affecting Medicare reimbursement rates and qualifying technological standards;

changes in accounting principles generally accepted in the United States of America;

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general economic conditions, including changes in the financial markets that may affect the availability and cost of credit to us or our customers; and

interruptions in our power supply and/or telecommunications capabilities.

Additional information concerning these and other factors which could cause differences between forward-looking statements and future actual results is discussed under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission.

### **Background**

CPSI was founded in 1979 and specializes in delivering comprehensive healthcare information systems and related services to community hospitals and other healthcare providers. Our systems and services are designed to support the primary functional areas of a hospital and to enhance access to needed financial and clinical information. Our comprehensive system enables healthcare providers to improve clinical, financial and administrative outcomes. Our products and services provide solutions in key areas, including patient management, financial management, patient care and clinical, enterprise and office automation.

We sell a fully integrated, enterprise-wide financial and clinical hospital information system comprised of all necessary software, hardware, peripherals, forms and office supplies, together with comprehensive customer service and support. We also offer business management services, including electronic billing submissions, patient statement processing and accounts receivable management, as part of our overall information system solution. We believe that as our customer base grows, the demand for our business management services will also continue to grow, supporting further increases in recurring revenues.

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Our target market includes acute care community hospitals with 300 or fewer beds and small specialty hospitals. Hospitals having 100 or fewer acute care beds comprise approximately 94% of our customers. In addition to servicing small-to-medium-sized hospitals, we provide technology services to other related entities in the healthcare industry, such as nursing homes, home health agencies and physician clinics. From our initial hospital installation in 1981, we have grown to serve more than 650 hospital customers across 45 states and the District of Columbia.

## **Management Overview**

We primarily seek revenue growth through sales of healthcare information technology systems and related services to existing and new customers within our historic target market. Our strategy has produced consistent revenue growth over the long-term, as reflected in five-and-ten-year compounded annual growth rates in revenues of approximately 7.1% and 12.0%, respectively. Selling new and additional products and services back into our existing customer base is an important part of our future revenue growth. We believe that as our customer base grows, the demand for additional products and services, including business management services, will also continue to grow, supporting further increases in recurring revenues. We also expect to drive revenue growth from new product development that we may generate from our research and development activities.

In addition to revenue growth, our business model is focused on earnings growth. Once a hospital has installed our system, we continue to provide support and maintenance services to our customers on an ongoing basis. These services are typically provided by the same personnel who perform our system installations but at a reduced cost to us, and therefore at an increased gross margin. We also look to increase margins through cost containment measures where appropriate.

As a result of the recent economic recession and credit crisis, hospitals have experienced reduced availability of third party credit and an overall reduction in their investment portfolios. In addition, healthcare organizations with a large dependency on Medicare and Medicaid populations, such as community-based hospitals, have been impacted by the challenging financial condition of the Federal government and many state governments and government programs. Accordingly, we recognize that prospective hospital customers often do not have the necessary capital to make investments in information technology. Additionally, in response to these challenges, hospitals have become more selective regarding where they invest capital, resulting in a focus on strategic spending that generates a return on their investment. Despite the current economic environment, we believe healthcare information technology is often viewed as more strategic to hospitals than other possible purchases because the technology offers the possibility of a quick return on investment. Information technology also plays an important role in healthcare by improving safety and efficiency and reducing cost. Additionally, we believe most hospitals recognize that they must invest in healthcare information technology to meet current and future regulatory, compliance and government reimbursement requirements.

We have experienced an increase in customers seeking financing arrangements from us over the past three years for system installations as a result of recent and ongoing economic conditions and disruptions in credit markets. Historically, we have made financing arrangements available to customers on a case-by-case basis depending upon various aspects of the proposed contract and customer attributes. These financing arrangements include short-term payment plans, longer-term lease financing through us and our facilitating third-party financing arrangements. We intend to continue to work with prospective customers to provide for financing arrangements to purchase our systems so long as such arrangements do not adversely affect our financial position and liquidity. We believe that meeting the financial needs of community-based hospitals while allowing for the profitable expansion of our footprint in this market will remain both an opportunity and a challenge for us in the foreseeable future.

Despite the recent economic recession, including the credit crisis, we have not experienced a decline in demand for our products and services. We experienced some slowing of customer payments during 2010 and the first half of 2011, and expect this trend to continue at least through the remainder of 2011 or until the economy shows significant signs of recovery.

## **American Recovery and Reinvestment Act of 2009**

While the recent economic recession and credit crisis has impacted and could continue to impact the community hospitals that comprise our target market, we believe that the American Recovery and Reinvestment Act of 2009 (the ARRA) has increased and will continue to increase demand for healthcare information technology and will have a positive impact on our business prospects. The ARRA includes more than \$19 billion in funding to aid healthcare organizations in modernizing their operations through the acquisition and wide-spread use of healthcare information technology. Included in the funding is approximately \$17.2 billion in incentives through Medicare and Medicaid reimbursement systems to encourage and assist healthcare providers in adopting and using electronic health records (EHRs). These incentive payments began in February 2011 and are expected to last through 2015. If an eligible healthcare provider does not begin to demonstrate meaningful use of EHRs by 2015, then reimbursement under Medicare will begin to be reduced. Some of our hospital customers began receiving some of these incentive payments under the ARRA in February 2011.

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We have been focused on ensuring that we take the necessary steps to meet the needs of community hospitals to help them gain access to the incentives made available under the ARRA. Primary among those steps was ensuring that our technology meets the ARRA's EHR certification requirements. During 2010, both our hospital and medical practice EHR solutions were certified as a complete EHR by CCHIT®. Receiving this certification for both our hospital and medical practice EHR products



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ensures that both hospitals and other healthcare providers using our EHR systems can attain meaningful use of EHRs and qualify for ARRA reimbursements. As a result of our obtaining this certification, the ARRA has had, and we believe will continue to have, a positive impact on our business and the businesses of the community hospitals that comprise our target market.

### **Health Care Reform**

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, collectively referred to as the Healthcare Legislation. This sweeping legislation implements changes to the healthcare and health insurance industries over the next several years through 2015, with the ultimate goal of requiring substantially all U.S. citizens and legal residents to have qualifying health insurance coverage by 2014 and providing the means by which it will be made available to them. We anticipate that the Healthcare Legislation will have little direct impact on our internal operation but may have a significant impact on the business of our hospital customers. We have not been able to determine at this point whether the impact will be positive, negative or neutral; however, it is likely that the Healthcare Legislation will affect hospitals differently depending upon the populations they service. Community hospitals typically service higher uninsured populations than larger urban hospitals and rely more heavily on Medicare and Medicaid for reimbursement. It remains to be seen whether the increase in the insured populations for community hospitals, as well as the increase in Medicare and Medicaid reimbursements under ARRA for hospitals that implement EHR technology, will be enough to offset proposed cuts in Medicare and Medicaid reimbursements contained in the Healthcare Legislation.

We believe healthcare initiatives will continue during the foreseeable future. If adopted, some aspects of previously proposed reforms, such as further reductions in Medicare and Medicaid payments, could adversely affect the businesses of our customers and thereby harm our business.

### **Deficit Reduction**

President Obama signed legislation on August 2, 2011, the Budget Control Act of 2011, to increase the U.S. debt ceiling. This legislation imposes significant cuts in federal spending over the next decade and involves a second increase to the debt limit pending further deficit reduction by a bipartisan Congressional committee later this year. This committee could propose cuts to, and restructuring of, entitlement programs such as Medicare and aid to states for Medicaid programs. Our hospital customers rely heavily on Medicare and Medicaid programs to fund their operations. Any cuts to these programs could negatively affect the business of our customers and our business.

### **Results of Operations**

In the six months ended June 30, 2011, we generated revenues of \$89.2 million from the sale of our products and services, as compared to \$69.3 million in the six months ended June 30, 2010, an increase of 28.8%. We installed our financial and patient accounting system in 11 new hospitals in the first six months of 2011 compared to 21 in the first six months of 2010. Our net income for the six months ended June 30, 2011 increased 84.3% from the first six months of 2010, while cash flow from operations increased 98.2%.

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The following table sets forth certain items included in our results of operations for three and six months ended June 30, 2011 and 2010, expressed as a percentage of our total revenues for these periods (dollar amounts in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2011		2010		2011		2010	
	Amount	% Sales	Amount	% Sales	Amount	% Sales	Amount	% Sales
<b>INCOME DATA:</b>								
<b>Sales revenues:</b>								
System sales	\$ 23,593	48.3%	\$ 14,867	39.4%	\$ 39,200	43.9%	\$ 24,567	35.5%
Support and maintenance	16,206	33.2%	14,468	38.4%	32,368	36.3%	28,674	41.4%
Business management services	9,040	18.5%	8,378	22.2%	17,651	19.8%	16,013	23.1%
Total sales revenues	48,839	100.0%	37,713	100.0%	89,219	100.0%	69,254	100.0%
<b>Costs of sales:</b>								
System sales	13,529	27.7%	11,719	31.1%	25,650	28.7%	21,186	30.6%
Support and maintenance	6,495	13.3%	5,929	15.7%	12,939	14.5%	11,459	16.5%
Business management services	4,658	9.5%	4,380	11.6%	9,337	10.5%	8,815	12.7%
Total costs of sales	24,682	50.5%	22,028	58.4%	47,926	53.7%	41,460	59.8%
Gross profit	24,157	49.5%	15,685	41.6%	41,293	46.3%	27,794	40.1%
<b>Operating expenses:</b>								
Sales and marketing	3,866	7.9%	2,804	7.4%	6,791	7.6%	5,003	7.2%
General and administrative	7,652	15.7%	6,067	16.1%	13,372	15.0%	11,578	16.7%
Total operating expenses	11,518	23.6%	8,871	23.5%	20,163	22.6%	16,581	23.9%
Operating income	12,639	25.9%	6,814	18.1%	21,130	23.7%	11,213	16.2%
<b>Other income:</b>								
Interest income	158	0.3%	119	0.3%	311	0.3%	291	0.4%
Total other income	158	0.3%	119	0.3%	311	0.3%	291	0.4%
Income before taxes	12,797	26.2%	6,933	18.4%	21,441	24.0%	11,504	16.6%
Income taxes	4,881	10.0%	2,669	7.1%	8,152	9.1%	4,320	6.2%
Net income	\$ 7,916	16.2%	\$ 4,264	11.3%	\$ 13,289	14.9%	\$ 7,184	10.4%

**Three Months Ended June 30, 2011 Compared with Three Months Ended June 30, 2010**

*Revenues.* Total revenues for the three months ended June 30, 2011 increased 29.5%, or \$11.1 million, compared to the three months ended June 30, 2010. This was largely attributable to an increase in system sales of clinical applications to existing customers attempting to attain meaningful use of EHRs under the ARRA.

System sales revenues increased by 58.7%, or \$8.7 million, for the comparative three month periods. We installed our core system at 7 new hospital clients in the second quarter of 2011 compared to 16 in the second quarter of 2010. Sales to existing customers accounted for 64.2% of our system sales revenue for the second quarter of 2011 compared to 64.1% for the first quarter of 2010. New hospital clients installing our core system are also installing our full suite of clinical applications as well in order to meet meaningful use under the ARRA, resulting in increased new client revenues on fewer installations for new customers.

Support and maintenance revenues increased by 12.0%, or \$1.7 million, for the comparative three month periods. This increase was attributable to an increase in recurring revenues as a result of a larger customer base, an increase in support fees for add-on business sold to existing customers, and increases in support rates from contractually agreed upon Consumer Price Index (CPI) rate increases.

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Business management services revenues increased by 7.9%, or \$0.7 million, for the comparative three month periods. We experienced this increase in business management services revenues primarily as a result of growth in customer demand for private pay collection services. We were providing our full suite of business management services to 29 customers at June 30, 2011, compared to 27 customers at June 30, 2010.

*Costs of Sales.* Total costs of sales increased by 12.0%, or \$2.7 million, for the comparative three month periods. As a percentage of total revenues, costs of sales decreased approximately 790 basis points to 50.5% from 58.4%.

Costs of system sales increased by 15.4%, or \$1.8 million, for the comparative three month periods. The increase in costs of system sales was due to an increase in travel, payroll and related costs and cost of third-party software relating to add-on system installations during the three months ended June 30, 2011 compared to the three month period ended June 30, 2010. The gross margin on system sales increased to 42.7% for the three month period ended June 30, 2011 from 21.2% in the three month period ended June 30, 2010. As a percentage of system sales, cost of equipment decreased to 11.0% in the three month period ended June 30, 2011 from 20.6% in the three month period ended June 30, 2010, payroll and related expenses decreased

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to 26.4% in the three month period ended June 30, 2011 from 35.4% in the three month period ended June 30, 2010 as a result of higher utilization of employees, travel expense decreased to 14.1% from 18.8% for the comparative three month periods due to increased company utilization of frequent flier programs, and cost of software increased to 5.2% from 3.1% for the comparative three month periods due to additional third-party licenses in the three month period ended June 30, 2011 to add functionality to our customers' operating system environments.

Cost of support and maintenance increased 9.5%, or \$0.6 million, for the comparative three month periods. The gross margin on support and maintenance revenues increased to 59.9% for the three month period ended June 30, 2011 from 59.0% for the three month period ended June 30, 2010. Quarter over quarter, the increase in the cost of support and maintenance was due to an increase in payroll and related costs of 14.4%, or \$0.7 million, as the result of adding more employees to support our growing customer base.

Our costs associated with business management services increased 6.3%, or \$0.3 million, for the comparative three month periods. The gross margin on business management services increased to 48.5% for the three month period ended June 30, 2011 from 47.7% for the three month period ended June 30, 2010 due to the realization of economies of scale of our existing business management staff across a larger customer base. Payroll and related expenses increased \$0.1 million for the comparative three month periods. Occupancy costs increased \$0.1 million for the comparative three month periods due to the opening of a new facility to house our business management services in June 2010.

*Sales and Marketing Expenses.* Sales and marketing expenses increased 37.9%, or \$1.1 million, for the comparative three month periods. The increase was attributable to increased sales commission expense as a result of increased sales.

*General and Administrative Expenses.* General and administrative expenses increased 26.1%, or \$1.6 million, for the comparative three month periods due to increased bad debt expense. Bad debt expense increased \$1.6 million for the comparative three month periods due to several customers declaring bankruptcy during the quarter as well as increased reserves for specific customers with which we have experienced collection problems. Payroll and related costs also increased by 24.9%, or \$0.3 million, for the comparative three month periods due to accrued costs for the new incentive bonus plan. This increase was offset by a 16.3%, or \$0.3 million, decrease in health insurance expense due to better claims experience in our self-insured program.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses remained flat at 23.5% for the three month periods ended June 30, 2011 and 2010.

As a result of the foregoing factors, income before taxes increased by 84.6%, or \$5.9 million, from the first three months of 2010.

*Income Taxes.* Our effective income tax rate for the three months ended June 30, 2011 and 2010 was 38.1% and 38.5%, respectively. We utilized research and development tax credits to lower our effective tax rate in 2011 and 2010. We are unaware of any pending legislation that would affect our current income tax rate for the remainder of 2011.

*Net Income.* Net income for the three months ended June 30, 2011 increased by 85.8%, or \$3.7 million, to \$7.9 million, or \$0.72 per diluted share, as compared with net income of \$4.3 million, or \$0.39 per diluted share, for the three months ended June 30, 2010. Net income represented 16.2% of revenue for the three months ended June 30, 2011, as compared to 11.3% of revenue for the three months ended June 30, 2010.

### **Six Months Ended June 30, 2011 Compared with Six Months Ended June 30, 2010**

*Revenues.* Total revenues for the six months ended June 30, 2011 increased by 28.8%, or \$20.0 million, compared to the six months ended June 30, 2010.

System sales revenues increased by 59.6%, or \$14.6 million, for the comparative six month periods. This was comprised of a 73.2%, or \$8.5 million, increase in software sales, a 24.3%, or \$1.8 million, increase in equipment sales, and a 76.3%, or \$4.3 million, increase in installation and training related fees, for the comparative six month periods. System sales should remain at increased levels from the prior year for the remainder of 2011. Sales to existing customers accounted for 67.7% of system sales revenue for the first six months of 2011 as compared to 65.4% for the first six months of 2010.

Support and maintenance revenues increased by 12.9%, or \$3.7 million, for the comparative six month periods. This increase was attributable to an increase in recurring revenues as a result of a larger customer base and increased sales of add-on business to existing customers.

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Business management services revenues increased by 10.2%, or \$1.6 million, for the comparative six month periods. We experienced an increase in business management services revenues as a result of continued growth in existing customer demand for insurance follow-up and private pay collection services.

*Costs of Sales.* Total costs of sales increased by 15.6%, or \$6.5 million, for the comparative six month periods. As a percentage of total revenues, costs of sales decreased 620 basis points to 53.7% from 59.9%.

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Cost of system sales increased by 21.1%, or \$4.5 million, for the comparative six month periods. Payroll and related costs increased by 17.6%, or \$1.8 million, due to the addition of new personnel. Travel and related costs increased by 35.4%, or \$1.5 million, due to the increased number of new and add-on system installations. Gross margin on system sales increased to 34.6% in the first six months of 2011 compared to 13.8% in the first six months of 2010. We believe that the margins on system sales should remain stable through at least the second half of 2011. As a percentage of system sales, cost of equipment decreased to 13.9% for the six month period ended June 30, 2011 from 23.8% for the six month period ended June 30, 2010, payroll and related expenses decreased to 31.1% in the six month period ended June 30, 2011 from 42.2% for the six month period ended June 30, 2010 as a result of higher utilization of employees, travel expenses decreased to 14.7% from 17.4% for the comparative six month periods, and cost of software increased to 4.9% from 3.3% for the comparative six month periods due to additional third-party software license fees to add functionality to our customers' operating system environments.

Cost of support and maintenance increased by 12.9%, or \$1.5 million, for the comparative six month periods. The gross margin on support and maintenance revenues remained flat at 60.0% for the six month periods ended June 30, 2011 and 2010.

Our costs associated with business management services increased by 5.9%, or \$0.5 million, for the comparative six month periods. This increase was caused by an increase in occupancy costs associated with the new facility opened in June 2010 to house our business management services group.

*Sales and Marketing Expenses.* Sales and marketing expenses increased 35.7%, or \$1.8 million, for the comparative six month periods due to increased commission expense due to increased add-on system sales.

*General and Administrative Expenses.* General and administrative expenses increased by 15.5%, or \$1.8 million, for the comparative six month periods. This increase was attributable to a \$1.5 million increase in bad debt expense due to several customers declaring bankruptcy in the second quarter of 2011 and additional reserves for specific customers with payment issues.

As a percentage of total revenues, sales and marketing expenses, and general and administrative expenses declined to 22.6% for the six months ended June 30, 2011 compared to 23.9% for six months ended June 30, 2010.

*Income Taxes.* Our effective income tax rate for the six months ended June 30, 2011 and 2010 was 38.0% and 37.6%, respectively. We utilized research and development tax credits to lower our effective tax rate in 2011 and 2010. We are unaware of any pending legislation that would affect our current income tax rate for the remainder of 2011.

*Net Income.* Net income for the six months ended June 30, 2011 increased by 85.0%, or \$6.1 million, to \$13.3 million, or \$1.21 per diluted share, as compared with net income of \$7.2 million, or \$0.66 per diluted share, for the six months ended June 30, 2010. Net income represented 14.9% of revenue for the six months ended June 30, 2011, as compared to 10.4% of revenue for the six months ended June 30, 2010.

## **Liquidity and Capital Resources**

As of June 30, 2011, we had cash and cash equivalents of \$8.5 million, compared to \$1.7 million at June 30, 2010. Management believes that cash and investments plus cash generated from our normal operating activities should be adequate to fund our business through the remainder of 2012. Our principal source of liquidity has been cash provided by operating activities. Cash provided by operating activities has been used primarily to fund the growth in our business and return cash to shareholders in the form of dividends. We believe that paying dividends is an effective way of providing an investment return to our stockholders and a beneficial use of our cash. However, the declaration of dividends by CPSI is subject to the discretion of our Board of Directors. Our Board of Directors will continue to take into account such matters as general business conditions, our financial results and such other factors as our Board of Directors may deem relevant.

Net cash provided by operating activities for the six months ended June 30, 2011 was \$17.1 million, compared to \$8.6 million for the six months ended June 30, 2010. The increase was primarily due to higher net income. Accounts receivable stabilized during the first quarter of 2011 from recent trends of slower customer payments, however several customers did experience bankruptcies in the second quarter of 2011. We continue to experience an increase in requests by customers for payment terms and financing arrangements as a result of the challenging economic environment and availability of credit from third parties.

Net cash used in investing activities totaled \$3.8 million for the six months ended June 30, 2011, compared to \$3.4 million for the six months ended June 30, 2010. We used cash for the purchase of \$0.7 million of property and equipment and for the purchase of investments of \$3.1 million during the six months ended June 30, 2011. We move idle cash to our investment portfolio that we do not anticipate needing within a one-year time frame.

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Net cash used in financing activities totaled \$7.9 million for each of the six months ended June 30, 2011 and June 30, 2010. Net cash used in financing activities remained stable since our dividend rate remained the same as in the same quarter of the prior year.

We currently do not have a bank line of credit or other credit facility in place. Because we have no debt, we are not subject to contractual restrictions or other influences on our operations, such as payment demands and restrictions on the use of operating funds that are typically associated with debt. If we borrow money in the future, we will likely be subject to operating and financial covenants that could limit our ability to operate as profitably as we have in the past. Defaults under applicable loan agreements could result in the demand by lenders for immediate payment of substantial funds and substantial restrictions on expenditures, among other things. Due to the recent economic recession and disruption in the capital markets, additional capital, if needed, may not be available on terms favorable to us, or at all.

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Our future capital requirements will depend upon a number of factors, including the rate of growth of our sales, cash collections from our customers and our future investments in fixed assets. We believe that our available cash and cash equivalents, investments and anticipated cash generated from operations will be sufficient to meet our operating requirements for at least the next 12 months.

### **Off Balance Sheet Arrangements**

Our only off-balance sheet arrangement, as defined by Item 303(a)(4) of SEC Regulation S-K, consists of our guarantee of certain lease obligations of Solis Healthcare, LP ( Solis Healthcare ) to Winthrop Resources Corporation ( Winthrop ) under a lease agreement. Solis Healthcare purchased a software system from us and then entered into a sale-leaseback transaction with Winthrop in the first quarter of 2008. We provided this guarantee in order to facilitate Solis Healthcare in leasing the new system.

The lease has an initial term of five years and continues from year to year thereafter until terminated. We are contingently liable as guarantor under the lease such that, if at any time prior to the termination of the lease, Solis Healthcare (i) enters into bankruptcy or (ii) defaults for more than 60 days in its payments or performance under the lease, we will be obligated to perform under the guaranty by making the required lease payments, including late fees and penalties. The guaranty runs for the entire term of the lease; however, the maximum potential amount of future payments that we would be required to make to Winthrop under the guaranty is \$1,166,700, the amount outstanding under the lease at June 30, 2011, plus any fees and costs that Winthrop incurs in collecting amounts due under the lease (including attorney fees and costs). Due to the contingent nature of the guaranty, the maximum amount of the guaranty is not recorded on our balance sheet; however, when necessary, we record reserves to cover potential losses. A liability in the amount of \$27,943, the amortized fair value of the guaranty, is recorded on our balance sheet as an other accrued liability at June 30, 2011. See Note 10 to the financial statements for additional information.

### **Critical Accounting Policies**

Our Management Discussion and Analysis is based upon our Condensed Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make subjective or complex judgements that may affect the reported financial condition and results of operations. We base our estimates on historical experience and other assumptions that we believe to be reasonable in the circumstances, the results of which form the basis for making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We continually evaluate the information used to make these estimates as our business and the economic environment changes.

In our Annual Report on Form 10-K for the year ended December 31, 2010, we identified our critical accounting policies related to cash and cash equivalents, investments, income taxes, accounts receivable and allowance for doubtful accounts, inventories, property and equipment, deferred revenue, revenue recognition, stock based compensation, research and development costs, advertising, and shipping and handling costs. There have been no significant changes to these critical accounting policies for the three or six months ended June 30, 2010.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Our exposure to market risk relates primarily to the potential change in the value of our investment portfolio as a result of fluctuations in interest rates. The primary purpose of our investment activities is to preserve principal while maximizing the income we receive from our investments without significantly increasing risk of loss. As of June 30, 2011, our investment portfolio consisted of a variety of financial instruments, primarily including, but not limited to, money market securities and high quality government and corporate obligations. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We do not hold financial instruments for trading or other speculative purposes. The securities in our investment portfolio are classified as available-for-sale and, consequently, are recorded on our balance sheet at fair market value with their related unrealized gain or loss reflected as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates.

We believe that the market risk arising from our holdings of these financial instruments is minimal. Due to the conservative allocation of our investment portfolio, we do not believe that an immediate 10% increase in interest rates would have a material effect on the fair market value of our portfolio. Additionally, since we believe we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows



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to be materially affected to any significant degree by a sudden change in market interest rates on our investment portfolio. We do not utilize derivative financial instruments to manage our interest rate risks.

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The table that follows presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of June 30, 2011.

	Aggregate Fair Value	Weighted Average Interest Rate
<b>Short-Term Investments: (1)</b>		
Accrued Income	\$ 119,924	0.00%
Money market funds	126,044	0.01%
U.S. Treasury Bills	19,999	0.00%
Obligations of the U.S. Treasury, U.S government corporations and agencies	3,704,510	1.82%
Corporate debt securities	3,191,260	4.23%
<b>Total short-term investments</b>	<b>\$ 7,161,737</b>	
<b>Long-Term Investments: (2)</b>		
Obligations of the U.S. Treasury, U.S government corporations and agencies	\$ 4,083,689	0.99%
Mortgage backed securities	113,742	5.00%
Corporate debt securities	5,124,794	1.43%
<b>Total long-term investments</b>	<b>\$ 9,322,225</b>	

(1) Reflects instruments with a contractual maturity of less than one year.

(2) Reflects instruments with a contractual maturity of one year or more.

As of June 30, 2011, the Company had no borrowings and, therefore, is not subject to interest rate risks related to debt instruments.

**Item 4. Controls and Procedures.***Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that the information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of the inherent limitations to the effectiveness of any system of disclosure controls and procedures, no evaluation of disclosure controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, with a company have been prevented or detected on a timely basis. Even disclosure controls and procedures determined to be effective can only provide reasonable assurance that their objectives are achieved.

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As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

### *Changes in Internal Control over Financial Reporting*

There were no changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II**

### **OTHER INFORMATION**

#### **Item 1. Legal Proceedings.**

From time to time, we are involved in routine litigation that arises in the ordinary course of business. We are not currently involved in any litigation that we believe could reasonably be expected to have a material adverse effect on our business, financial condition, or results of operations.

#### **Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

Not applicable.

#### **Item 3. Defaults Upon Senior Securities.**

Not applicable.

#### **Item 4. Reserved**

Not applicable.

#### **Item 5. Other Information.**

None

**Item 6. Exhibits.**

- 3.1 Certificate of Incorporation (filed as Exhibit 3.4 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 3.2 Bylaws (filed as Exhibit 3.6 to CPSI's Registration Statement on Form S-1 (Registration No. 333-84726) and incorporated herein by reference)
- 10.1 2011 Incentive Program (filed as Exhibit 10.1 to CPSI's Current Report on Form 8-K dated April 21, 2011, and incorporated herein by reference)
- 10.2 Separation Agreement between CPSI and CPSI's former Chief Operating Officer
- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 Interactive Data Files for CPSI s Form 10-Q for the period ended June 30, 2011

**SIGNATURES**

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

**COMPUTER PROGRAMS AND SYSTEMS, INC.**

Date: August 8, 2011

By: /s/ J. BOYD DOUGLAS  
**J. Boyd Douglas**  
**President and Chief Executive Officer**

Date: August 8, 2011

By: /s/ DAVID A. DYE  
**David A. Dye**  
**Chief Financial Officer**

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**Exhibit Index**

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