

IBD INDUSTRY THEMES

Quality Systems Chief Says Boom Just Getting Started

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Recent blows dealt to medical software stocks raised concerns that the federally-funded boom in digital health care records systems may be slowing.

One of the hardest hit, Quality Systems (QSII), suffered primarily from two questions raised during the company's earnings conference call on Oct. 27.

First, there was a maintenance contract recorded as revenue in the company's electronic health records ambulatory business, part of its NextGen division. The company gave few details on the size of the previously deferred contract.

Avondale Partners analyst Richard Close — who called the results "a slight revenue beat, a

slight earnings beat" — said lack of specifics about one contract "created questions" about the company's results.

Quality Systems Chief Executive Steve Plochocki on Monday put the size of the contract at \$1 million — too small to account for all of the company's earnings win.

The second question: The company's pipeline of orders rose from \$170 million to \$173.5 million during the quarter. The 2% increase raised concerns of a flattening growth curve.

To complicate matters, the company mentioned some "replacement" sales.

"When people hear 'replacement' they think that the market is saturated," said Close, who subsequently upgraded the stock to market outperform.

Plochocki said worries about flattening and saturation were baseless.

"There is nothing drying up and there is nothing slowing down," he said.

If anything, Plochocki says, stimulus-fed demand is "shortening . . . our selling curve." Good for the company, but it poses challenges to pipeline accounting, which is typically based on six- to eight-month sales cycles.

(Thursday, this column inaccurately said Quality Systems missed expectations. IBD's EPS data did not take into account a stock split.)

So how far does the software boom have to run?

The Centers for Medicare & Medicaid Services reports that, as of Sept. 30, it had disbursed \$850 million of the \$27 billion pledged by the program.

