

Quality Systems, Inc. QSH (NAS)

Last Close	Industry	Sector
67.38 USD	Health Information Services	Software

Profile

Pricing data through 13 Dec 2010

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Quality Systems, Inc. is a California corporation formed in 1974. The Company develops and markets healthcare information systems that automate certain aspects of medical and dental practices, networks of practices such as physician hospital organizations ("PHOs") and management service organizations ("MSOs"), ambulatory care centers, community health centers, and medical and dental schools. The Company also provides revenue cycle management ("RCM") services through the Practice Solutions Division. It operates three reportable operating segments comprised of the NextGen Division, the QSI Dental Division and the Practice Solutions Division. The NextGen Division provides integrated clinical, financial and connectivity solutions for ambulatory, inpatient and dental provider organizations. Its products utilize Microsoft Windows technology and can operate in a client-server environment as well as via private intranet, the Internet, or in an ASP environment. The QSI Dental Division focuses on developing, marketing and supporting software suites sold to dental and certain niche medical practices. It supports a number of medical clients that utilize its UNIX based medical practice management software product and Software as a Service, or SaaS model, based NextDDS financial and clinical software. The Practice Solutions Division focuses primarily on providing physician practices with RCM services, primarily billing and collection services for medical practices. This Division combines a web-delivered SaaS model and the NextGenepm software platform to execute its service offerings. The Company's training facilities are located in Horsham, Pennsylvania; Atlanta, Georgia; Dallas, Texas and Irvine, California. The Company's strategy is to focus on providing software and services to medical practices, dental practices, hospitals, health centers, and other healthcare providers. Its principal existing competitors in the healthcare information systems and services market include eClinicalWorks, GE Healthcare, Allscripts-Misys Healthcare Solutions, Inc. and EPIC.

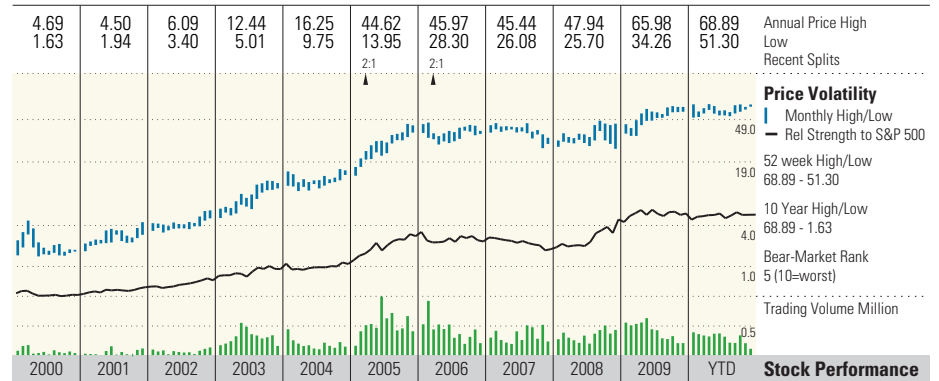
Quality Systems, Inc. QSH

Sales USD Mil 318 **Mkt Cap USD Mil** 1,951 **Industry** Health Information Services **Sector** Software

Quality Systems, along with its wholly-owned subsidiary NextGen Healthcare Information Systems, markets information-processing systems to medical and dental group practices, as well as to physician hospital organizations and health maintenance organizations. Its systems are used to manage medical records, treatment planning, appointment scheduling, third-party reimbursement, insurance claims, and other functions. The company also provides hardware and software maintenance and support services.

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Website: <http://www.qsii.com>
Employees: 1502

Morningstar Rating - **Last Price** 67.38 **Fair Value** - **Uncertainty** - **Economic Moat™** - **Stewardship Grade** -
per share prices in USD



Growth Rates	Compound Annual			
	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	18.9	22.9	26.8	23.1
Operating Income %	4.6	14.2	19.0	35.6
Earnings/Share %	3.7	11.6	22.5	32.6
Dividends %	4.3	—	—	—
Book Value/Share %	18.9	24.4	22.1	17.6
Stock Total Return %	14.3	31.8	11.6	42.9
+/- Industry	-4.1	15.0	1.4	32.6
+/- Market	2.2	37.7	12.0	44.0

Profitability Analysis	Current	5 Yr Avg	Ind	Mkt
	Return on Equity %	28.0	35.3	10.1
Return on Assets %	17.6	21.6	6.8	8.5
Fixed Asset Turns	37.9	38.4	9.9	7.2
Inventory Turns	87.0	68.1	107.4	13.8
Revenue/Employee USD K	211.6	217.9*	—	872.5
Gross Margin %	62.7	65.3	46.3	39.6
Operating Margin %	25.4	29.9	10.3	14.3
Net Margin %	16.3	19.5	6.1	9.6
Free Cash Flow/Rev %	20.4	17.9	11.0	0.1
R&D/Rev %	6.0	0.1	—	10.0

Financial Position	03-10 USD Mil	09-10 USD Mil
	Cash	85
Inventories	1	1
Receivables	110	113
Current Assets	220	237
Fixed Assets	8	9
Intangibles	78	79
Total Assets	310	328
Payables	12	15
Short-Term Debt	—	—
Current Liabilities	101	106
Long-Term Debt	—	—
Total Liabilities	122	127
Total Equity	188	201

Valuation Analysis	Current	5 Yr Avg	Ind	Mkt
	Price/Earnings	37.7	34.1	50.5
Forward P/E	24.8	—	—	14.6
Price/Cash Flow	28.3	30.5	23.4	8.4
Price/Free Cash Flow	30.0	38.5	27.9	16.8
Dividend Yield %	1.8	—	0.3	1.8
Price/Book	9.7	9.5	4.4	2.2
Price/Sales	6.1	6.6	3.1	1.3
PEG Ratio	1.3	—	—	1.6

Stock Performance	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD
Total Return %	0.0	110.5	23.2	121.8	34.1	161.7	-1.8	-13.5	46.7	46.7	8.7	8.7
+/- Market	10.1	123.5	46.6	95.4	25.1	158.7	-15.4	-17.0	85.2	23.3	-2.5	-2.5
+/- Industry	9.0	90.2	54.1	95.2	15.2	120.2	-9.0	-14.1	66.2	-31.8	-5.0	-5.0
Dividend Yield %	—	—	—	—	—	—	—	2.5	2.5	1.9	1.8	1.8
Market Cap USD Mil	48	98	123	280	386	1013	1004	835	1235	1800	1951	1951

Financials	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM
	Revenue USD Mil	40	44	55	71	89	119	157	187	246	292
Gross Margin %	63.5	56.7	56.6	59.6	63.3	66.6	67.7	66.5	63.8	62.0	62.7
Oper Income USD Mil	5	8	11	17	32	36	51	59	72	76	81
Operating Margin %	12.5	17.7	19.5	23.5	35.6	30.0	32.4	31.8	29.5	25.9	25.4
Net Income USD Mil	4	5	7	10	16	23	33	40	46	48	52
Earnings Per Share USD	0.14	0.21	0.28	0.40	0.61	0.85	1.21	1.44	1.62	1.68	1.79
Dividends USD	—	—	—	—	—	—	—	1.00	1.15	1.20	1.20
Shares Mil	25	25	26	26	26	27	28	28	28	29	29
Book Value Per Share USD	1.32	1.58	1.86	2.23	2.96	3.22	3.92	4.19	5.33	6.05	6.96
Oper Cash Flow USD Mil	6	8	13	17	22	31	30	44	49	55	69
Cap Spending USD Mil	-1	-1	-1	-1	-2	-6	-8	-8	-3	-5	-4
Free Cash Flow USD Mil	5	8	12	16	20	25	21	35	45	50	65

Profitability	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM
	Return on Assets %	7.9	10.9	11.8	13.5	17.3	21.0	24.4	23.7	21.4	17.5
Return on Equity %	10.6	14.3	16.1	19.2	26.0	34.5	40.6	39.1	34.3	28.1	28.0
Net Margin %	8.8	11.9	12.9	14.7	18.1	19.5	21.1	21.5	18.8	16.6	16.3
Asset Turnover	0.90	0.92	0.91	0.92	0.96	1.08	1.15	1.10	1.14	1.06	1.08
Financial Leverage	1.3	1.3	1.4	1.4	1.6	1.7	1.6	1.6	1.6	1.6	1.6

Financial Health	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	09-10
	Working Capital USD Mil	24	31	39	51	55	62	77	80	99	119
Long-Term Debt USD Mil	—	—	—	—	—	—	—	—	—	—	—
Total Equity USD Mil	34	40	48	61	63	72	91	114	156	188	201
Debt/Equity	—	—	—	—	—	—	—	—	—	—	—

Valuation	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM
	Price/Earnings	16.8	20.1	18.9	31.9	27.3	50.8	31.6	22.7	26.7	38.8
P/E vs. Market	—	—	—	—	—	—	—	—	—	2.2	2.4
Price/Sales	1.3	2.3	2.5	4.3	4.8	9.4	6.9	4.7	5.3	6.5	6.1
Price/Book	1.5	2.6	2.7	5.0	5.0	11.9	9.5	7.3	8.2	10.4	9.7
Price/Cash Flow	14.8	10.9	11.3	19.5	17.2	33.4	35.7	22.0	31.8	29.5	28.3

Quarterly Results	Revenue USD Mil			
	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	75.0	78.5	82.9	81.5
Prior Year Period	65.5	65.8	66.6	71.7
Rev Growth %	Dec 09	Mar 10	Jun 10	Sep 10
	14.5	19.3	24.4	13.6
Prior Year Period	36.2	28.5	20.7	21.6
Earnings Per Share USD	Dec 09	Mar 10	Jun 10	Sep 10
	0.46	0.45	0.42	0.46
Prior Year Period	0.46	0.39	0.36	0.41

Industry Peers by Market Cap	Mkt Cap USD Mil			
	Rev USD Mil	P/E	ROE%	
Quality Systems, Inc	1951	318	37.7	28.0
Cerner Corporation	7641	1816	34.6	13.7
Allscripts-Misys Hea	3347	705	42.7	8.3

Major Fund Holders	% of shares	
	Holder	% of shares
Fidelity Contrafund	6.46	
Neuberger Berman Genesis Inv	4.05	
Columbia Acorn Z	3.93	

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	Insider Activity
SHELDON RAZIN	Founder/Chairman of the Board/ Director, Director	5,057,380	11 Aug 2010	-
AHMED HUSSEIN	Director	4,619,600	11 Aug 2010	-
PATRICK B. CLINE	COO/Director/Other Executive Officer/President/President, Subsidiary Director	13,750	29 Apr 2009	-
RUSSELL PFLUEGER	Director	4,500	11 Aug 2010	-
GEORGE H. BRISTOL	Director	3,500	11 Aug 2010	-
PAUL A. HOLT	COO/Executive VP	3,050	09 Dec 2010	-
DR. MURRAY BRENNAN, M.D.	Director	3,000	11 Aug 2010	-

* Report date represents the date on which the owner's common shares held was audited.

Fund Ownership

Top Owners	Morningstar Rating	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Fidelity Contrafund	QQQQQ	6.60	0.17	100	31 Oct 2010
Neuberger Berman Genesis Inv	QQQQQ	4.08	0.80	45	30 Sep 2010
Columbia Acorn Z	QQQQ	3.80	0.46	0	30 Sep 2010
Sentinel Small Company A	QQQQ	1.42	1.34	0	30 Sep 2010
Fidelity Advisor New Insights A	QQQQ	1.22	0.16	0	31 Oct 2010
Concentrated Holders					
Renaissance Global Science & Tech Cl F	QQQ	0.02	3.93	0	31 Oct 2010
CIBC Global Technology	QQ	0.07	3.87	0	31 Oct 2010
Bryce Capital Growth	QQQQ	0.01	3.65	0	30 Sep 2010
Virtus Small-Cap Sustainable Growth A	QQ	0.13	3.54	33	30 Jun 2010

Institutional Transactions

Top 5 Buyers	Morningstar Rating	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Metropolitan Ser NB Genesis A	QQ	0.35	0.80	102	30 Sep 2010
Fidelity Contrafund	QQQQQ	6.60	0.17	100	31 Oct 2010
Neuberger Berman Genesis Inv	QQQQQ	4.08	0.80	45	30 Sep 2010
Vanguard Explorer Inv	QQQQ	0.92	0.20	36	30 Sep 2010
Neuberger Berman Mid Cap Growth Inv	QQQ	0.12	0.46	35	30 Sep 2010
Top 5 Sellers					
AST Small Cap Growth	QQQ	0.27	0.95	-71	31 Oct 2010
Aston/TAMRO Small Cap N	QQQQ	0.98	2.20	-25	30 Sep 2010
ING (L) Invest US High Dividend I	QQQQQ	0.10	0.32	-23	30 Sep 2010
Assumption/MB Global Equity C	QQQ	0.03	1.03	-19	31 Oct 2010

Quality Systems, Inc. QSII (NAS)

Last Close 67.38 USD
Industry Health Information Services
Sector Software

Industry Focus: Application Software

From Data Centers to Private Clouds

29 October 2010

Sunit Gogia
 Senior Stock Analyst

Three companies are poised to be acquired as private clouds soar.

The mergers and acquisitions wave sweeping through technology-land could get larger before it subsides. The tangible economic benefits of cloud computing are driving IT investments as traditional enterprise data centers are transformed into private clouds. With server and storage virtualization as the core building blocks, private clouds offer large enterprises a step change in the efficiency of their data centers without the perceived risks associated with evolving lower-cost public cloud services.

The IT industry had long expected these investments in private clouds, but Oracle's ORCL aggressive efforts to capture a larger portion of the IT spending has left most of its competitors on the defensive. Oracle's strategy of selling integrated hardware plus software solutions has exposed the software gaps in competitors' portfolios, as can be seen in the graphic below, and is forcing them to revisit their own strategies. Already IBM IBM has made an acquisition offer for Netezza NZ to combat the tremendous market success of Oracle's Exadata appliance, and Hewlett-Packard HPQ has installed a new CEO and a new chairman,

both long on software industry experience. We expect a continuing wave of hardware and software acquisitions as rivals including IBM, HP, Dell DELL, Cisco CSCO, and EMC EMC design competitive responses to Oracle's integrated solutions approach.

All acquisition candidates are not created equal—the ownership imperative is weak in some areas (such as operating systems), and sheer size and ownership considerations render some targets impractical to acquire (such as SAP SAP and SAS Institute). Additionally, stocks of some companies such as Isilon ISLN have already run up on acquisition rumors and are unlikely to offer significant acquisition premiums over their current market prices. Among potential takeouts, we think Teradata TDC, BMC BMC, and Compellent CML are likely candidates that offer investors the prospect of reasonable acquisition premiums to their current market valuations.

Teradata

An acquisition of Teradata could help HP or Dell compete head to head with Oracle's Exadata or IBM/Netezza's business analytics appliances. The business analytics market is heating up as enterprises try to extract information from mountains of data. For example, Oracle has stated that the pipeline for its Exadata product has grown to \$1.5 billion from \$1 billion sequentially over the past two quarters. Teradata also has proprietary database technologies that could be useful beyond its data warehousing specialty.

Any vendor attempting to compete with Oracle across the entire computing stack needs a credible database to offer its clients. This can be a tough nut to crack—independent proven database technologies that can reliably support high-end enterprise computing workloads are scarce. A lack of compelling database technology could well become the Achilles' heel of less capable rivals.

IBM's DB2, combined with its pending acquisition of

	Oracle	IBM	HP	Dell	Microsoft	Cisco, EMC, VMware*	Acquisition Candidates
Business Analytics	●	●	○	○	○	○	SAS Institute, TIBX, MSTR
Application Software	○	○	○	○	○	○	SAP, JDAS, LWSN, TDC, EPIC, PEGA, OTEX, AU
Middleware	●	●	○	○	○	○	RHT, TIBX
Database Software	●	●	○	○	○	○	PostgreSQL, Ingres
Operating System	●	●	○	○	○	○	RHT, NOVL
Virtualization (x86)	●	○	○	○	○	○	CTXS, RHT
Systems Management Software	○	●	○	○	○	○	BMC, CA, SWI, QSFT, CPWR
Application Delivery Systems	○	○	○	○	○	○	FFIV, CTXS, RDWR
Storage Solutions	○	●	○	○	○	○	ISLN, CVLT, CML, NTAP
Server Hardware	○	○	○	○	○	○	—
Networking	○	○	○	○	○	○	BRCD, JNPR
Security	○	○	○	○	○	○	CHKP, FIRE, FTNT, WBSN

*Cisco, EMC and VMware are combined for this analysis due to their ACADIA joint venture and Cisco's equity stake in VMware.
 Source: Morningstar

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Industry Focus: Application Software

Netezza, will hold that vendor in good stead, and SAP's recent acquisition of Sybase should reduce its dependence on Oracle in the long run. HP could continue to rely on its long-standing partnership with Microsoft to provide solutions based on SQL Server. However, a partnership approach might prove insufficient for Microsoft, HP, Dell, and other data center vendors if Oracle is able to gain Apple-esque innovation advantages from its ownership of database appliance hardware and software. Hardware vendors could look at piggybacking on some open-source database initiatives including PostgreSQL, but expensive acquisitions to gain access to talent could be hard to justify to shareholders.

Teradata would offer an acquirer proven, purpose-built analytics appliances as well as database expertise that could provide the foundation for new software solutions. Comparable transactions in the business analytics space include Hyperion's acquisition by Oracle for an enterprise value (EV) of 3.4 times trailing 12-month (TTM) sales, SAP's acquisition of Business Objects for 4.5 times EV/TTM sales and IBM's acquisition of Cognos for 4.1 times EV/TTM sales. We estimate that an acquirer of Teradata would have to pay an EV of at least 4 times TTM sales, or \$51 per share.

BMC

BMC would catapult a potential acquirer into a leadership position in IT infrastructure management tools. We see Dell, Cisco, and EMC as the most likely potential acquirers for BMC.

Comprehensive enterprise data center solutions require management tools to provision and manage IT assets. HP and IBM already have the most comprehensive management toolsets and are unlikely to venture beyond small acquisitions of niche technologies. Oracle needs to beef up its management tools portfolio, but BMC's mainframe management business (40% of revenues) would be a complete misfit in Oracle's stated strategy.

Dell, Cisco, and EMC need stronger management toolsets

to position themselves as one-stop shops for data center infrastructure. Dell has assembled an impressive portfolio of server and storage infrastructure organically and through acquisitions, but a lack of comprehensive infrastructure management tools leaves it competitively disadvantaged relative to HP and IBM. The Cisco/EMC partnership similarly lacks proprietary management tools that extend beyond network and storage systems, and an acquisition of BMC by a competitor would put their ambitions of a larger role in data centers at risk.

An acquisition of BMC would have negative implications for competitor CA. CA has one of the largest management tools businesses, but we think the firm's desirability to potential acquirers is compromised by its significant exposure to mainframe management revenues (60% of total revenues). CA has been attempting to diversify its revenue sources, and distributed systems management tools now account for 40% of the firm's revenues. Undoubtedly, CA would face a tougher competitive environment in the distributed systems segment, and we would reassess our current valuation assumptions for the company.

BMC shares are currently trading near our fair value estimate, but an acquisition of the company would likely fetch a higher multiple to current valuation levels. Past acquisitions in the systems management software space have commanded a wide range of multiples: HP acquired Opsware and Mercury Interactive for 13.8 times and 5.3 times EV/TTM sales, respectively, and BMC bought BladeLogic for 10.1 times EV/TTM sales. BMC is much larger compared with these takeouts, and we expect the company to command a lower premium. Applying an EV/TTM sales multiple of about 4.5, we expect BMC to command an acquisition price of about \$10.9 billion, or \$61 per share.

Compellent

An acquisition of Compellent's midrange storage arrays would enable Dell to capture a larger portion of customer's IT spend while creating value for shareholders by adding much-needed distribution prowess to Compellent's

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Industry Focus: Application Software

technology.

After the bidding war that Hewlett-Packard and Dell fought over storage firm 3PAR PAR , the entire market is evaluating the few remaining storage entities. Compellent and Isilon are the most likely takeout candidates, and Isilon's stock has already run up on rumors that the company is in acquisition talks with storage giant EMC.

Compellent's midrange storage technology would make it an attractive target for Dell, which is committed to building its data center portfolio and lost the bidding war for 3Par. We think Compellent's storage solutions would be an easy sell into Dell's existing customer base, allowing the firm ample opportunity to create shareholder value even if it has to pay premiums in line with recent acquisitions.

Having said that, we expect the acquisition premium for Compellent to be lower than levels seen in recent transactions because we don't foresee a bidding war breaking out for the company. Large storage specialists EMC and NetApp already possess or are in the process of developing competing products, and server vendors IBM and HP are likely content with their current storage products and internal development efforts. Oracle has expressed an interest in building out its midrange storage portfolio, but we expect the firm to prefer an acquisition of Pillar Data Systems, which is slightly higher-end and happens to be owned by Oracle CEO Larry Ellison.

Recent acquisitions in the storage space have included the acquisition of EqualLogic by Dell for 12.3 times EV/TTM sales, HP's proposed acquisition of 3Par for 11.2 times EV/TTM sales, and EMC's acquisition of Data Domain for 7.1 times EV/TTM sales. We estimate Compellent could command an EV/TTM sales multiple of about 8, translating to about \$43 per share.