NIC INC
Form 10-Q
August 02, 2012
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

Commission file number 000-26621

NIC INC.
(Exact name of registrant as specified in its charter)

Delaware	52-2077581
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

25501 West Valley Parkway, Suite 300, Olathe, Kansas 66061
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (877) 234-3468

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

As of July 25, 2012, the number of shares outstanding of the registrant's common stock, $0.0001 par value per share, was 64,507,924.

PART I - FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

NIC INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
thousands except par value amount

		June 30, 2012		December 31, 2011
ASSETS				
Current assets:				
Cash and cash equivalents	$	70,175	$	61,639
Cash restricted for payment of dividend		-		16,231
Trade accounts receivable, net		55,129		49,306
Deferred income taxes, net		1,000		916
Prepaid expenses & other current assets		9,508		5,994
Total current assets		135,812		134,086
Property and equipment, net		12,133		8,853
Intangible assets, net		993		1,088
Deferred income taxes, net		-		83
Other assets		245		243
Total assets	$	149,183	$	144,353
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	48,191	$	45,038
Accrued expenses		20,050		16,293
Dividend payable		-		16,231
Other current liabilities		210		310
Total current liabilities		68,451		77,872
Deferred income taxes, net		465		-
Other long-term liabilities		1,332		1,405
Total liabilities		70,248		79,277
Commitments and contingencies (Notes 1, 2 and 5)		-		-
Stockholders' equity:				
Common stock, $0.0001 par, 200,000 shares authorized, 64,508 and 64,178 shares issued and outstanding		6		6
Additional paid-in capital		98,937		96,799
Accumulated deficit		(20,008)		(31,729)
Total stockholders' equity		78,935		65,076
Total liabilities and stockholders' equity	$	149,183	$	144,353

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

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NIC INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
thousands except per share amounts

	Three months ended June 30,		Six months ended June 30,	
Revenues:	2012	2011	2012	2011
Portal revenues	$49,042	$43,783	$94,754	$84,138
Software & services revenues	2,940	2,640	5,971	5,019
Total revenues	51,982	46,423	100,725	89,157
Operating expenses:				
Cost of portal revenues, exclusive of depreciation & amortization	30,550	26,362	59,301	51,783
Cost of software & services revenues, exclusive of depreciation & amortization	1,008	1,009	1,966	2,006
Selling & administrative	8,383	8,420	16,318	15,106
Amortization of acquisition-related intangible assets	81	81	161	161
Depreciation & amortization	1,319	1,109	2,630	2,194
Total operating expenses	41,341	36,981	80,376	71,250
Operating income	10,641	9,442	20,349	17,907
Other income (expense), net	-	1	(1)	4
Income before income taxes	10,641	9,443	20,348	17,911
Income tax provision	4,548	3,910	8,627	7,323
Net income	$6,093	$5,533	$11,721	$10,588
Basic net income per share (Note 1)	$0.09	$0.09	$0.18	$0.16
Diluted net income per share (Note 1)	$0.09	$0.09	$0.18	$0.16
Weighted average shares outstanding:				
Basic	64,489	63,998	64,393	63,885
Diluted	64,489	64,061	64,393	63,947

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

NIC INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)
thousands

	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Total
Balance, January 1, 2012	64,178	$6	$96,799	$ (31,729)	$65,076
Net income	-	-	-	11,721	11,721
Restricted stock vestings	361	-	204	-	204
Shares surrendered and cancelled upon vesting of restricted stock to satisfy tax withholdings	(109)	-	(1,295)	-	(1,295)
Stock-based compensation	-	-	1,857	-	1,857
Tax deductions relating to stock-based compensation	-	-	770	-	770
Shares issuable in lieu of dividend payments on unvested performance-based restricted stock awards	-	-	(204)	-	(204)
Issuance of common stock under employee stock purchase plan	78	-	806	-	806
Balance, June 30, 2012	64,508	$6	$98,937	$ (20,008)	$78,935

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

NIC INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
thousands

	Six months ended June 30, 2012	2011
Cash flows from operating activities:		
Net income	$11,721	$10,588
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of acquisition-related intangible assets	161	161
Depreciation & amortization	2,630	2,194
Stock-based compensation expense	1,857	2,365
Deferred income taxes	(464)	(426)
(Gain) loss on disposal of property and equipment	1	(2)
Changes in operating assets and liabilities:		
(Increase) in trade accounts receivable, net	(5,823)	(3,844)
(Increase) in prepaid expenses & other current assets	(2,586)	(2,169)
(Increase) decrease in other assets	(2)	10
Increase (decrease) in accounts payable	3,153	(2,156)
(Decrease) in accrued expenses	(502)	(277)
(Decrease) in other current liabilities	(100)	(181)
Increase (decrease) in other long-term liabilities	(73)	151
Net cash provided by operating activities	9,973	6,414
Cash flows from investing activities:		
Purchases of property and equipment	(2,664)	(2,573)
Capitalized internal use software development costs	(349)	(192)
Net cash used in investing activities	(3,013)	(2,765)
Cash flows from financing activities:		
Proceeds from employee common stock purchases	806	652
Tax deductions related to stock-based compensation	770	1,012
Net cash provided by financing activities	1,576	1,664
Net increase in cash and cash equivalents	8,536	5,313
Cash and cash equivalents, beginning of period	61,639	51,687
Cash and cash equivalents, end of period	$70,175	$57,000
Other cash flow information		
Non-cash investing activities:		
Capital expenditures accrued but not yet paid	$2,964	$-
Cash payments:		
Income taxes paid	$8,649	$7,145
Cash dividends on common stock previously restricted for payment of dividend	16,231	-

The accompanying Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The unaudited interim consolidated financial statements of NIC Inc. and its subsidiaries ("NIC" or the "Company") included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In management's opinion, the unaudited interim consolidated financial statements reflect all adjustments (which include only normal recurring adjustments, except as disclosed) necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company and its subsidiaries as of the dates and for the interim periods presented. These unaudited consolidated financial statements and notes should be read in conjunction with the audited consolidated financial statements and related notes and Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC on February 24, 2012, and Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10-Q. The consolidated balance sheet data included herein as of December 31, 2011 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of operations for the three- and six-month periods ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year ending December 31, 2012.

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

NIC is a leading provider of eGovernment services that helps governments use the Internet to reduce internal costs, increase efficiencies, and provide a higher level of service to businesses and citizens. The Company accomplishes this currently through two channels: its primary outsourced portal businesses and its software & services businesses.

In its primary outsourced portal businesses, the Company generally designs, builds, and operates Internet-based portals on an enterprise-wide basis on behalf of state and local governments desiring to provide access to government information and to complete government-based transactions online. These portals consist of websites and applications the Company has built that allow businesses and citizens to access government information online and complete transactions, such as applying for a permit, retrieving government records, or filing a government-mandated form or report. Operating under multiple-year contracts (see Note 2), NIC markets the services and solicits users to complete government-based transactions and to enter into subscriber contracts permitting users to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. The Company typically manages operations for each contractual relationship through separate local subsidiaries that operate as decentralized businesses with a high degree of autonomy. NIC’s self-funded business model allows the Company to generate revenues by sharing in the fees the Company collects from eGovernment transactions. The Company’s government partners benefit through reducing their financial and technology risks, increasing their operational efficiencies, and gaining a centralized, customer-focused presence on the Internet, while businesses and citizens receive a faster, more convenient, and more cost-effective means to interact with governments. The Company is typically responsible for funding up-front investment and ongoing operations and maintenance costs of the outsourced government portals.

The Company’s software & services businesses primarily include its subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies.

Basis of presentation

The Company classifies its revenues and cost of revenues into two categories: (1) portal and (2) software & services. The portal category generally includes revenues and cost of revenues from the Company’s subsidiaries operating enterprise-wide outsourced portals on behalf of state and local governments. The software & services category primarily includes revenues and cost of revenues from the Company’s subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies. The primary categories of operating expenses include: cost of portal revenues, cost of software & services revenues, selling & administrative, amortization of acquisition-related intangible assets, and depreciation & amortization. Cost of portal revenues consists of all direct costs associated with operating government portals on an outsourced basis including employee compensation (including stock-based compensation), subcontractor labor costs, telecommunications, fees required to process debit/credit card and automated clearinghouse transactions, and all other costs associated with the provision of dedicated client service such as dedicated facilities. Cost of software & services revenues consists of all direct project costs to provide software development and services such as employee compensation (including stock-based compensation), subcontractor labor costs, and all other direct project costs including hardware, software, materials, travel and other out-of-pocket expenses. Selling & administrative costs consist primarily of corporate-level expenses relating to human resource management, administration, information technology, security, legal, finance and accounting, and all costs of non-customer service personnel from the Company’s software & services businesses, including information systems and office rent. Selling & administrative costs also consist of stock-based compensation and corporate-level expenses for market development and public relations. In addition, selling & administrative costs include legal fees and other third-party costs, net of directors’ and officers’ liability insurance and other reimbursements received, incurred in connection with the previously disclosed SEC matter (see Note 5).

Earnings per share

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are considered participating securities and are included in the computation of earnings per share pursuant to the two-class method for all periods presented. The two-class method is an earnings allocation formula that treats a participating security as having rights to undistributed earnings that would otherwise have been available to common stockholders. The Company's service-based restricted stock awards contain non-forfeitable rights to dividends and are considered participating securities. Accordingly, service-based restricted stock awards were included in the calculation of earnings per share using the two-class method for all periods presented. Unvested service-based restricted shares totaled approximately 0.9 million and 1.0 million at June 30, 2012 and 2011, respectively. Basic earnings per share is calculated by first allocating earnings between common stockholders and participating securities. Earnings attributable to common stockholders are divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by giving effect to dilutive potential common shares outstanding during the period. The dilutive effect of shares related to the Company's employee stock purchase plan is determined based on the treasury stock method. The dilutive effect of service-based restricted stock awards is based on the more dilutive of the treasury stock method or the two-class method assuming a reallocation of undistributed earnings to common stockholders after considering the dilutive effect of potential common shares other than the participating unvested restricted stock awards. The dilutive effect of performance-based restricted stock awards is based on the treasury stock method.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Numerator:				
Net income	$ 6,093	$ 5,533	$ 11,721	$ 10,588
Less: Income allocated to participating securities	(78)	(80)	(152)	(155)
Net income available to common stockholders	$ 6,015	$ 5,453	$ 11,569	$ 10,433
Denominator:				
Weighted average shares - basic	64,489	63,998	64,393	63,885
Performance-based restricted stock awards	-	63	-	62
Weighted average shares - diluted	64,489	64,061	64,393	63,947
Basic net income per share:				
Net income	$ 0.09	$ 0.09	$ 0.18	$ 0.16
Diluted net income per share:				
Net income	$ 0.09	$ 0.09	$ 0.18	$ 0.16

Concentration of credit risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company limits its exposure to credit loss by depositing its cash with high credit quality financial institutions. In November 2010, the Federal Deposit Insurance Corporation ("FDIC") adopted a final rule to implement Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which provides temporary unlimited deposit insurance coverage for non-interest bearing transaction accounts at all FDIC-insured depository institutions effective December 31, 2010 through December 31, 2012. At June 30, 2012, the Company’s cash was held entirely in domestic non-interest bearing transaction accounts, which limits its exposure to credit loss. The Company performs ongoing credit evaluations of its customers and generally requires no collateral to secure accounts receivable.

2. OUTSOURCED GOVERNMENT CONTRACTS

Outsourced State Portal Contracts

The Company's outsourced government portal contracts generally have an initial multi-year term with provisions for renewals for various periods at the option of the government. The Company's primary business obligation under these contracts is generally to design, build, and operate Internet-based portals on an enterprise-wide basis on behalf of governments desiring to provide access to government information and to complete government-based transactions online. NIC typically markets the services and solicits users to complete government-based transactions and to enter into subscriber contracts permitting the user to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. The Company enters into separate agreements with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These agreements preliminarily establish the pricing of the electronic transactions and data access services the Company provides and the division of revenues between the Company and the government agency. The government oversight authority must approve prices and revenue sharing agreements. The Company has limited control over the level of fees it is permitted to retain. Any changes made to the amount or percentage of fees retained by NIC, or to the amounts charged for the services offered, could materially affect the profitability of the respective contract to NIC.

The Company is typically responsible for funding up-front investment and ongoing operations and maintenance costs of the government portals, and generally owns all of the software developed under these contracts. After completion of the initial contract term, the government partner typically receives a perpetual, royalty-free license to use the software only in its own portal. However, certain customer management, billing and payment processing software applications that the Company has developed and standardized centrally and that are utilized by the Company’s portal businesses, are being provided to an increasing number of government partners on a software-as-a-service, or “SaaS,” basis, and thus would not be included in any royalty-free license. If the Company's contract were not to be renewed after a defined term, the government agency would be entitled to take over the portal in place with no future obligation of the Company, except as otherwise provided in the contract and except for services provided by the Company on a SaaS basis, which would be available to the partners on a fee-for-service basis.

Any renewal of these contracts beyond the initial term by the government is optional and a government may terminate its contract prior to the expiration date upon specific cause events that are not cured within a specified period. In addition, 15 contracts under which the Company provides outsourced state portal services can be terminated by the other party without cause on a specified period of notice. Collectively, revenues generated from these contracts represented 58% of the Company’s total consolidated revenues for each of the three- and six-month periods ended June 30, 2012. In the event that any of these contracts is terminated without cause, the terms of the respective contract may require the government to pay a fee to the Company in order to continue to use the Company’s software in its portal. In addition, the loss of one or more of the Company’s larger state portal partners, such as Alabama, Arkansas, Colorado, Indiana, Kansas, Oklahoma, Tennessee, Texas, or Utah, as a result of the expiration, termination or failure to renew the respective contract, if such partner is not replaced, could significantly reduce the Company’s revenues and profitability. See the discussion below under “Expiring Contracts” regarding the expiration of the contract with the Commonwealth of Virginia.

At June 30, 2012, the Company was bound by performance bond commitments totaling approximately $5.3 million on certain outsourced portal contracts. Under a typical portal contract, the Company is required to fully indemnify its government clients against claims that the Company’s services infringe upon the intellectual property rights of others and against claims arising from the Company’s performance or the performance of the Company’s subcontractors under the contract. The Company has never had any defaults resulting in draws on performance bonds.

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The following is a summary of the portals through which the Company provides outsourced portal services to state governments at June 30, 2012:

NIC Portal Entity	Portal Website (State)	Year Services Commenced	Contract Expiration Date (Renewal Options Through)
NICUSA, OR Division	www.oregon.gov (Oregon)	2011	11/22/2021
NICUSA, MD Division	www.maryland.gov (Maryland)	2011	8/10/2016 (8/10/2019)
Delaware Interactive, LLC	www.delaware.gov (Delaware)	2011	9/25/2014 (9/25/2017)
Mississippi Interactive, LLC	www.ms.gov (Mississippi)	2011	12/31/2015 (12/31/2021)
New Jersey Interactive, LLC	www.nj.gov (New Jersey)	2009	6/30/2013 (6/30/2014)
New Mexico Interactive, LLC	www.mvd.newmexico.gov (New Mexico)	2009	6/1/2013
Texas NICUSA, LLC	www.Texas.gov (Texas)	2009	8/31/2016
West Virginia Interactive, LLC	www.WV.gov (West Virginia)	2007	6/30/2013
NICUSA, AZ Division	www.AZ.gov (Arizona)	2007	6/26/2013
Vermont Information Consortium, LLC	www.Vermont.gov (Vermont)	2006	10/14/2012
Colorado Interactive, LLC	www.Colorado.gov (Colorado)	2005	5/18/2014
South Carolina Interactive, LLC	www.SC.gov (South Carolina)	2005	7/15/2014
Kentucky Interactive, LLC	www.Kentucky.gov (Kentucky)	2003	8/19/2013 (8/19/2015)
Alabama Interactive, LLC	www.Alabama.gov (Alabama)	2002	2/28/2015 (2/28/2017)
Rhode Island Interactive, LLC	www.RI.gov (Rhode Island)	2001	8/7/2012
Oklahoma Interactive, LLC	www.OK.gov (Oklahoma)	2001	12/31/2012 (12/31/2014)
Montana Interactive, LLC	www.MT.gov (Montana)	2001	12/31/2015 (12/31/2020)
NICUSA, TN Division	www.TN.gov (Tennessee)	2000	9/30/2014 (3/30/2016)
Hawaii Information Consortium, LLC	www.eHawaii.gov (Hawaii)	2000	1/3/2016 (unlimited 3-year renewal options)
Idaho Information Consortium, LLC	www.Idaho.gov (Idaho)	2000	6/30/2013 (6/30/2015)
Utah Interactive, LLC	www.Utah.gov (Utah)	1999	6/5/2013 (6/5/2019)
Maine Information Network, LLC	www.Maine.gov (Maine)	1999	7/1/2014 (3/14/2018)
Arkansas Information Consortium, LLC	www.Arkansas.gov (Arkansas)	1997	6/30/2018
Iowa Interactive, LLC	www.Iowa.gov (Iowa)	1997	3/31/2013
Virginia Interactive, LLC	www.Virginia.gov (Virginia)	1997	8/31/2012
Indiana Interactive, LLC	www.IN.gov (Indiana)	1995	7/1/2014
Nebraska Interactive, LLC	www.Nebraska.gov (Nebraska)	1995	1/31/2014 (1/31/2016)
Kansas Information Consortium, Inc.	www.Kansas.gov (Kansas)	1992	12/31/2013 (12/31/2016)

During the first quarter of 2012, the Company was awarded a three-year contract with the state of Alabama to manage the state's official government portal, which includes options for the government to extend the contract for two additional one-year renewal terms. In addition, the Company received a one-year contract extension from the state of Kentucky, and the Company's contract with the state of Iowa was extended for six months.

During the second quarter of 2012, the Company received one-year contract extensions from the states of Arizona, Kansas, New Jersey, and West Virginia. The Company also entered into a two-year contract extension with the state of Maine, which includes options for the government to extend the contract for two additional two-year renewal terms.

During July of 2012, the Company received a three-year contract extension from the state of Hawaii.

Outsourced Federal Contracts

The Company currently has contracts with two federal agencies to provide outsourced services through its NIC Technologies subsidiary. NIC Technologies has entered into a contract with the Federal Motor Carrier Safety Administration (“FMCSA”) to develop and manage the FMCSA’s Pre-Employment Screening Program (“PSP”) for motor carriers nationwide, using the self-funded, transaction-based business model. During the first quarter of 2012, the FMCSA exercised the second of its four one-year renewal options for the PSP contract, extending its term through February 16, 2013. NIC Technologies also designs and develops online federal campaign expenditure and ethics compliance systems for federal agencies through its contract with the Federal Election Commission (“FEC”). The contract with the FEC expires on February 28, 2013, and includes an option for the government to extend the contract for an additional three months.

Any renewal of these contracts beyond the initial term is optional and a federal agency may terminate its contract prior to the expiration date upon specific cause events that are not cured within a specified period. The contract with the FMCSA can be terminated by the other party without cause on a specified period of notice. The loss of the contract with the FMCSA, as a result of the expiration, termination or failure to renew the contract, if not replaced, could significantly reduce the Company’s revenues and profitability. In addition, the Company has limited control over the level of fees it is permitted to retain under the contract with the FMCSA. Any changes made to the amount or percentage of fees retained by the Company, or to the amounts charged for the services offered, could materially affect the profitability of this contract to the Company.

Expiring Contracts

As of June 30, 2012, there were 15 contracts under which the Company provides outsourced portal services or software development and services (which includes NIC Technologies' contract with the state of Michigan) that have expiration dates within the 12-month period following June 30, 2012. Collectively, revenues generated from these contracts represented 30% of the Company's total consolidated revenues for both the three- and six-month periods ended June 30, 2012. As described above, if a contract is not renewed after a defined term, the government partner would be entitled to take over the portal in place with no future obligation of the Company, except as otherwise provided in the contract and except for the services the Company provides on a SaaS basis, which would be available to the government agency on a fee-for-service basis. One of the 15 expiring contracts is the contract under which the Company's indirect subsidiary, Virginia Interactive, LLC ("VI"), provides outsourced portal services to agencies of the Commonwealth of Virginia, which will expire on August 31, 2012. As more fully disclosed in a Form 8-K filed by the Company with the SEC on April 18, 2012, VI did not agree to terms mandated for a new contract by the Commonwealth of Virginia. In the bidding process for new contracts to replace current portal contract functions, the three Requests for Proposals decentralized to the agency level and disaggregated some of the enterprise-wide portal functions currently managed by VI. Other functions covered by the expiring VI contract were not bid out. Under the expiring contract, VI is required to provide transition services for up to one year following the contract expiration to the extent requested by agencies of the Commonwealth of Virginia. The Company has evaluated the potential costs of transitioning out of its contract with the Commonwealth of Virginia, including employee retention bonuses, operating lease termination costs, and fixed asset impairment, which are not expected to have a material impact on the Company's consolidated financial statements. In both the three- and six-month periods ended June 30, 2012, revenues from the Virginia portal contract accounted for approximately 4% of the Company's total consolidated revenues.

3. STOCKHOLDERS' EQUITY

On October 24, 2011, the Company's Board of Directors declared a special cash dividend of $0.25 per share, payable to stockholders of record as of December 19, 2011. The dividend, totaling approximately $16.2 million, was paid on January 3, 2012 on 64,173,368 outstanding shares of common stock. A dividend equivalent of $0.25 per share was also paid simultaneously on 750,497 unvested shares of restricted stock granted under the Company's 2006 Stock Option and Incentive Plan. The dividend was paid out of the Company's available cash, which had been classified as restricted at December 31, 2011.

4. STOCK BASED COMPENSATION

During the first and second quarters of 2012, the Board of Directors of the Company granted to certain management-level employees, executive officers, and non-employee directors, service-based restricted stock awards totaling 284,862 shares and 52,003 shares, respectively, with a grant-date fair value totaling approximately $3.6 million and $0.6 million, respectively. Such restricted stock awards vest beginning one year from the date of grant in cumulative annual installments of 25%. Restricted stock is valued at the date of grant, based on the closing market price of the Company's common stock, and expensed using the straight-line method over the requisite service period. The Company excludes compensation cost related to awards not expected to vest based upon estimated forfeitures.

During the first quarter of 2012, the Board of Directors of the Company also granted certain executive officers performance-based restricted stock awards pursuant to the terms of the Company's executive compensation program totaling 134,982 shares, with a grant date fair value of $12.36 per share, totaling approximately $1.7 million, which represents the maximum number of shares able to be earned by the executive officers at the end of a three-year performance period ending December 31, 2014. The actual number of shares earned will be based on the Company's performance related to the following performance criteria over the performance period:

Operating income growth (three-year compound annual growth rate)

Total consolidated revenue growth (three-year compound annual growth rate)

Cash flow return on invested capital (three-year average)

At the end of the three-year period, the executive officers will receive a specified number of shares based upon certain historical performance criteria. In addition, the executive officers will accrue dividend equivalents for any cash dividend declared during the performance period, payable in the form of shares of Company common stock, based upon the maximum number of shares to be earned by the executive officers for each performance-based restricted stock award. Such hypothetical cash dividend payment shall be divided by the fair value of the Company’s common stock on the dividend payment date to determine the maximum number of notional shares to be awarded. At the end of the three-year performance period and on the date some or all of the shares are paid under the agreement, a pro rata number of notional dividend shares will be converted into an equivalent number of dividend shares paid and granted to the executive officers based upon the actual number of underlying shares earned during the performance period.

At December 31, 2011, the three-year performance period related to the performance-based restricted stock awards granted to certain executive officers on February 1, 2009 ended. Based on the Company's actual financial results from 2009 through 2011, 172,751 of the shares subject to the awards and 25,008 dividend shares were earned and vested on February 1, 2012.

Stock-based compensation cost for performance-based restricted stock awards is measured at the grant date based on the fair value of shares expected to be earned at the end of the performance period, and is recognized as expense over the performance period based upon the probable number of shares expected to vest. The Company estimates and excludes compensation cost related to awards not expected to vest.

The following table presents stock-based compensation expense included in the Company's unaudited consolidated statements of income (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Cost of portal revenues, exclusive of depreciation & amortization	$275	$254	$488	$487
Cost of software & services revenues, exclusive of depreciation and amortization	21	18	30	33
Selling & administrative	838	802	1,339	1,845
Stock-based compensation expense before income taxes	1,134	1,074	1,857	2,365
Income tax benefit	(485)	(445)	(787)	(967)
Net stock-based compensation expense	$649	$629	$1,070	$1,398

5. COMMITMENTS AND CONTINGENCIES

SEC Matter

Selling & administrative expenses for the three-month period ended June 30, 2012 include approximately $1.5 million of legal fees and other third-party costs related to the previously disclosed SEC matter. These expenses were reduced by approximately $1.4 million of reimbursement from the Company's directors' and officers' liability insurance carrier, resulting in a net increase in expense of approximately $0.1 million for the period. The $1.4 million reimbursement was approved for payment during the second quarter of 2012 and was subsequently collected during the third quarter of 2012. Selling & administrative expenses for the six-month period ended June 30, 2012 include approximately $2.3 million of legal fees and other third party costs related to the SEC matter, net of approximately $2.1 million of insurance reimbursement, resulting in a net increase in expense of approximately $0.2 million for the period. The Company promptly submits any invoices potentially reimbursable under its directors' and officers' liability insurance policies to its carrier for reimbursement. For expenses that are subject to reimbursement, the Company does not generally receive reimbursement for 90 to 120 days. To the extent that the carrier agrees to reimburse the Company for expenses previously recorded in selling & administrative expenses, the Company treats any such reimbursement as a reduction of selling & administrative expenses in the period such reimbursement is determined to be estimable and probable.

Selling & administrative expenses for the three- and six-month periods ended June 30, 2011 include approximately $1.1 million and $1.9 million, respectively, of legal fees and other third party costs related to the SEC matter and the previously disclosed derivative action that was concluded in the fourth quarter of 2011. These expenses were reduced by approximately $0.6 million and $1.8 million, respectively, of insurance reimbursement, resulting in a net increase in expense of approximately $0.5 million and $0.1 million, respectively, for the three- and six-month periods ended

June 30, 2011.

The Company expects to continue to incur obligations to advance legal fees and other expenses to the Company’s Chief Financial Officer in connection with the previously disclosed civil action by the SEC against him. The Company is not party to the civil action, but is obligated to provide indemnification in certain circumstances (including advancing certain defense costs) to its Chief Financial Officer in accordance with the Company’s certificate of incorporation and bylaws and its indemnification agreement with him. In addition, the Company expects to incur costs responding to subpoenas and other discovery requests relating to the civil action. The civil action seeks from the Company’s Chief Financial Officer civil money penalties, and injunction against further violations of certain federal securities laws, a prohibition against his acting as an officer or director of a publicly-traded company, and disgorgement. The Company’s directors’ and officers’ liability insurance carrier has agreed to reimburse the Company for reasonable costs of defense advanced by the Company to its Chief Financial Officer in the SEC civil action. Because the Company is not directly involved in the defense of the proceeding and because of the inherent uncertainty in predicting any future settlement or judicial decision and any indemnification obligation of the Company in connection with any such resolution, the Company is not able to estimate or predict the extent of any indemnification obligation of the Company to its Chief Financial Officer or other costs resulting from the civil action, the amount or timing of and eligibility for reimbursements from the Company’s directors’ and officers’ liability insurance carrier associated with the civil action, any possible loss or possible range of loss associated with the civil action, or any potential effect on the Company’s business, results of operations, cash flows, or financial condition.

Litigation

The Company is involved from time to time in legal proceedings and litigation arising in the ordinary course of business. However, the Company is not currently a party to any material legal proceedings.

6. SEGMENTS AND RELATED INFORMATION

The Outsourced Portals segment is the Company's only reportable segment and generally includes the Company's subsidiaries operating enterprise-wide outsourced state and local government portals and the corporate divisions that directly support portal operations. The Other Software & Services category primarily includes the Company's subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies. Each of the Company's businesses within the Other Software & Services category is an operating segment and has been grouped together to form the Other Software & Services category, as none of the operating segments meets the quantitative threshold of a separately reportable segment. Unallocated corporate-level expenses are reported in the reconciliation of the segment totals to the related consolidated totals as "Other Reconciling Items." There have been no significant intersegment transactions for the periods reported. The summary of significant accounting policies applies to all reportable and operating segments.

The measure of profitability by which management, including the Company's chief operating decision maker, evaluates the performance of its segments and allocates resources to them is operating income (loss). Segment asset or other segment balance sheet information is not presented to the Company's chief operating decision maker. Accordingly, the Company has not presented information relating to segment assets.

The table below reflects summarized financial information for the Company's reportable and operating segments for the three months ended June 30 (in thousands):

	Outsourced Portals	Other Software & Services	Other Reconciling Items	Consolidated Total
2012				
Revenues	$49,042	$2,940	$-	$51,982
Costs & expenses	32,606	1,075	6,260	39,941
Amortization of acquisition-related intangible assets	81	-	-	81
Depreciation & amortization	1,247	14	58	1,319
Operating income (loss)	$15,108	$1,851	$(6,318)	$10,641
2011				
Revenues	$43,783	$2,640	$-	$46,423
Costs & expenses	28,096	1,345	6,350	35,791
Amortization of acquisition-related intangible assets	81	-	-	81
Depreciation & amortization	1,032	13	64	1,109
Operating income (loss)	$14,574	$1,282	$(6,414)	$9,442

The following is a reconciliation of total segment operating income to total consolidated income before income taxes for the three months ended June 30 (in thousands):

	2012	2011

Total segment operating income	$16,959	$15,856
Other reconciling items	(6,318)	(6,414)
Other income, net	-	1
Consolidated income before income taxes	$10,641	$9,443

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The table below reflects summarized financial information for the Company's reportable segments for the six months ended June 30 (in thousands):

	Outsourced Portals	Other Software & Services	Other Reconciling Items	Consolidated Total
2012				
Revenues	$94,754	$5,971	$-	$100,725
Costs & expenses	63,022	2,074	12,489	77,585
Amortization of acquisition-related intangible assets	161	-	-	161
Depreciation & amortization	2,481	28	121	2,630
Operating income (loss)	$29,090	$3,869	$(12,610)	$20,349
2011				
Revenues	$84,138	$5,019	$-	$89,157
Costs & expenses	55,033	2,367	11,495	68,895
Amortization of acquisition-related intangible assets	161	-	-	161
Depreciation & amortization	2,034	30	130	2,194
Operating income (loss)	$26,910	$2,622	$(11,625)	$17,907

The following is a reconciliation of total segment operating income to total consolidated income before income taxes for the six months ended June 30 (in thousands):

	2012	2011
Total segment operating income	$32,959	$29,532
Other reconciling items	(12,610)	(11,625)
Other income (expense), net	(1)	4
Consolidated income before income taxes	$20,348	$17,911

For the three- and six-month periods ended June 30, 2012, the Company's Texas portal contract accounted for approximately 20% and 21% of the Company's total consolidated revenues, respectively. For both the three- and six-month periods ended June 30, 2011, the Company's Texas portal contract accounted for approximately 21% of the Company's total consolidated revenues. No other state portal contract accounted for more than 10% of the Company's total consolidated revenues for the three- and six-month periods ended June 30, 2012 or 2011, respectively.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTION ABOUT FORWARD-LOOKING STATEMENTS

Statements in this Quarterly Report on Form 10-Q regarding NIC Inc. and its subsidiaries (the “Company”, “NIC”, “we” or “us”) and its business, which are not current or historical facts, are “forward-looking statements” that involve risks and uncertainties. Forward-looking statements include, but are not limited to, statements of plans and objectives, statements of future economic performance or financial projections, statements regarding the planned implementation of new portal contracts and an application consolidation project in Texas, statements of assumptions underlying such statements, and statements of the Company's or management's intentions, hopes, beliefs, expectations, or predictions of the future. For example, statements like we "expect," we "believe," we "plan," we "intend," or we "anticipate" are forward-looking statements. Investors should be aware that our actual operating results and financial performance may differ materially from our expressed expectations because of risks and uncertainties about the future including those risks discussed in this Quarterly Report on Form 10-Q and in our 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on February 24, 2012.

There are a number of important factors that could cause actual results to differ materially from those suggested or indicated by such forward-looking statements. These include, among others, NIC’s ability to successfully integrate into its operations recently awarded eGovernment contracts; NIC’s ability to implement its new portal contracts and an application consolidation project in Texas in a timely and cost-effective manner; NIC’s ability to successfully increase the adoption and use of eGovernment services; the possibility of reductions in fees or revenues as a result of budget deficits, government shutdowns, or changes in government policy; the success of the Company in renewing existing contracts and in signing contracts with new states and federal government agencies; continued favorable government legislation; NIC’s ability to successfully transition out of expired contracts; NIC's ability to develop new services; existing states and agencies adopting those new services; acceptance of eGovernment services by businesses and citizens; competition; the possibility of security breaches through cyber-attacks; and general economic conditions and the other factors discussed under “CAUTIONS ABOUT FORWARD LOOKING STATEMENTS” in Part I and “RISK FACTORS” in Part I, Item 1A of NIC’s 2011 Annual Report on Form 10-K filed on February 24, 2012 with the SEC. Investors should read all of these discussions of risks carefully.

All forward-looking statements made in this Form 10-Q speak only as of the date of this report. We will not necessarily update the information in this Form 10-Q if any forward-looking statement later turns out to be inaccurate. Investors are cautioned not to put undue reliance on any forward-looking statement.

WHAT WE DO – AN EXECUTIVE SUMMARY

We are a leading provider of eGovernment services that help governments use the Internet to reduce internal costs, increase efficiencies, and provide a higher level of service to businesses and citizens. We accomplish this currently through two channels: our primary outsourced portal businesses and our software & services businesses.

In our primary outsourced portal businesses, we generally enter into contracts primarily with state and local governments to design, build, and operate Internet-based enterprise-wide portals on their behalf. We typically enter into multi-year contracts and manage operations for each government partner through separate local subsidiaries that operate as decentralized businesses with a high degree of autonomy. Our portals consist of websites and applications that we build, which allow businesses and citizens to access government information online and complete transactions, including applying for a permit, retrieving government records, or filing a government-mandated form or report. We help increase our government partners’ revenues by expanding the distribution of their information assets and increasing the number of financial transactions conducted with governments. We do this by marketing portal services and soliciting users to complete government-based transactions and to enter into subscriber contracts that permit users to access the portal and the government information contained therein in exchange for transactional and/or subscription user fees. We are typically responsible for funding up-front investment and ongoing operations and maintenance costs of the government portals. Our unique self-funded business model allows us to generate revenues by sharing in the fees collected from eGovernment transactions. Our partners benefit because they reduce their financial and technology risks, increase their operational efficiencies, and gain a centralized, customer-focused presence on the Internet, while businesses and citizens gain a faster, more convenient, and more cost-effective means to interact with governments.

On behalf of our government partners, we enter into separate agreements with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These agreements preliminarily establish the pricing of the electronic transactions and data access services we provide and the division of revenues between the Company and the government agency. The government oversight authority must approve prices and revenue sharing agreements. We have limited control over the level of fees we are permitted to retain. Any changes made to the amount or percentage of fees retained by us, or to the amounts charged for the services offered, could materially affect the profitability of the respective contract to us. We typically own all the intellectual property in connection with the applications developed under these contracts. After completion of the initial contract term, the government partner typically receives a perpetual, royalty-free license to use the software only in its own portal. However, certain customer management, billing and payment processing software applications that we have developed and standardized centrally and that are utilized by our portal businesses, are being provided to an increasing number of our government partners on a software-as-a-service, or “SaaS,” basis, and thus would not be included in any royalty-free license. If our contract was not renewed after a defined term, the government agency would be entitled to take over the portal in place with no future obligation of the Company, except as otherwise provided in the contract and except for the services we provide on a SaaS basis, which would be available to our partners on a fee-for-service basis. We also provide certain payment processing services on a SaaS basis to a few private sector companies and non-NIC portal states, and may continue to market these services to other entities in the future. Historically, however, revenues from these services have not been significant. In some cases, we enter into contracts to provide consulting, application development and portal management services to governments in exchange for an agreed-upon fee.

Any renewal of the outsourced portal contracts beyond the initial term is optional and a government may terminate its contract prior to the expiration date upon specific cause events that are not cured within a specified period. In addition, 15 contracts under which we provide outsourced state portal services can be terminated without cause on a specified period of notice. Collectively, revenues generated from these contracts represented 58% of our total consolidated revenues for the three- and six-month periods ended June 30, 2012. In the event that any of these contracts is terminated without cause, the terms of the respective contract may require the government to pay a fee to us in order to continue to use our software in its portal. In addition, the loss of one or more of our larger state portal partners, such as Alabama, Arkansas, Colorado, Indiana, Kansas, Oklahoma, Tennessee, Texas, or Utah, as a result of the expiration, termination or failure to renew the respective contract, if such partner is not replaced, could significantly reduce our revenues and profitability. See the discussion below regarding the expiration of the contract with the Commonwealth of Virginia.

In our software & services businesses, the majority of our revenues are generated from contracts with two federal agencies to provide outsourced services through our NIC Technologies subsidiary. NIC Technologies has entered into a contract with the Federal Motor Carrier Safety Administration (“FMCSA”) to develop and manage the FMCSA’s Pre-Employment Screening Program (“PSP”) for motor carriers nationwide, using the self-funded, transaction-based business model. During the first quarter of 2012, the FMCSA exercised the second of four one-year renewal options for the PSP contract, extending its term through February 16, 2013. NIC Technologies also designs and develops online campaign expenditure and ethics compliance systems for federal and state government agencies through its contracts with the Federal Election Commission (“FEC”) and the state of Michigan. The contract with the FEC expires on February 28, 2013, and includes an option for the government to extend the contract for an additional three months, and the contract with the state of Michigan expires on December 31, 2012.

Any renewal of these software & services contracts beyond the initial term is optional and a government may terminate its contract prior to the expiration date upon specific cause events that are not cured within a specified period. The contract with the FMCSA can be terminated by the other party without cause on a specified period of notice. The loss of the contract with the FMCSA, as a result of the expiration, termination or failure to renew the contract, if not replaced, could significantly reduce our revenues and profitability. In addition, we have limited control over the level of fees we are permitted to retain under the contract with the FMCSA. Any changes made to the amount or percentage of fees retained by us, or to the amounts charged for the services offered, could materially affect the profitability of this contract to us. Also see Note 2 in the Notes to Unaudited Consolidated Financial Statements included in this Form 10-Q.

As of June 30, 2012, there were 15 contracts under which we provide outsourced portal services or software development and services (which includes NIC Technologies’ contract with the state of Michigan) that have expiration dates within the 12-month period following June 30, 2012. Collectively, revenues generated from these contracts represented 30% of our total consolidated revenues for both the three- and six-month periods ended June 30, 2012. As described above, if a contract is not renewed after a defined term, the government partner would be entitled to take over the portal in place with no future obligation on our part, except as otherwise provided in the contract and except for the services we provide on a software-as-a-service, or “SaaS,” basis, which would be available to the government agency on a fee-for-service basis. One of the 15 expiring contracts is the contract under which our indirect subsidiary, Virginia Interactive, LLC ("VI"), provides outsourced portal services to agencies of the Commonwealth of Virginia, which will expire on August 31, 2012. As more fully disclosed in a Form 8-K filed by us with the SEC on April 18, 2012, VI did not agree to terms mandated for a new contract by the Commonwealth of Virginia. In the bidding process for new contracts to replace current portal contract functions, the three Requests for Proposals decentralized to the agency level and disaggregated some of the enterprise-wide portal functions currently managed by VI. Other functions covered by the expiring VI contract were not bid out. We are not aware of other states that utilize outsourced services moving toward disaggregating outsourced portal functions. Under the expiring contract, VI is required to provide transition services for up to one year following the contract expiration to the extent requested by agencies of the Commonwealth of Virginia. We have evaluated the potential costs of transitioning out of our contract with the Commonwealth of Virginia, including employee retention bonuses, operating lease termination costs, and fixed asset impairment, which are not expected to have a material impact on our consolidated financial statements. In both the three- and six-month periods ended June 30, 2012, revenues from the Virginia portal contract accounted for approximately 4% of our total consolidated revenues.

REVENUE RECOGNITION

We classify our revenues and cost of revenues into two categories: (1) portal and (2) software & services. The portal category includes revenues and cost of revenues primarily from our subsidiaries operating state and local government portals on an enterprise-wide outsourced basis. The software & services category primarily includes revenues and cost of revenues from our subsidiaries that provide software development and services, other than enterprise-wide outsourced portal services, to state and local governments as well as federal agencies. We currently derive revenues from three main sources: transaction-based fees, time and materials-based fees for application development, and fixed fees for portal management services. Each of these revenue types and the corresponding business models are further described below.

Our outsourced portal businesses

We categorize our portal revenues according to the underlying source of revenue. A brief description of each category follows:

DMV transaction-based: these are transaction fees from the sale of electronic access to motor vehicle driver history records, referred to as DMV records, from our state portals to data resellers, insurance companies, and other pre-authorized customers on behalf of our state partners, and are generally recurring.

Non-DMV transaction-based: these are transaction fees from sources other than the sale of DMV records, for transactions conducted by business users and consumer users through our portals, and are generally recurring. For a representative listing of non-DMV services we currently offer through our portals, refer to Part I, Item 1 in our Annual Report on Form 10-K, for the year ended December 31, 2011, filed with the SEC on February 24, 2012.

Portal software development: these are revenues from the performance of application development projects and other time and materials services for our government partners. While we actively market these services, they do not have the same degree of predictability as our transaction-based or portal management revenues. As a result, these revenues are excluded from our recurring portal revenue percentage.

Portal management: these are revenues from the performance of fixed fee portal management services for our government partners in the states of Arizona, Indiana, and Delaware and are generally recurring.

Our software & services businesses

NIC Technologies currently derives a significant portion of its revenues from a contract with the FMCSA to develop and manage the PSP for motor carriers nationwide, using a self-funded, transaction-based business model. NIC Technologies recognizes revenues from this contract (primarily transaction-based information access fees) when the services are provided. NIC Technologies also derives a portion of its revenues from fixed fee and time and materials application development and outsourced maintenance contracts with the FEC and the state of Michigan and recognizes revenues as services are provided.

CRITICAL ACCOUNTING POLICIES

There have been no material changes in our critical accounting policies and estimates from the information provided in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” included in our Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC on February 24, 2012.

RESULTS OF OPERATIONS

The following discussion summarizes the significant factors affecting operating results for the three- and six-month periods ended June 30, 2012 and 2011. This discussion and analysis should be read in conjunction with our unaudited interim consolidated financial statements and the related notes included in this Form 10-Q.

	Three months ended June 30,		Six months ended June 30,	
Key Financial Metrics	2012	2011	2012	2011
Revenue growth - outsourced portals	12 %	11 %	13 %	10 %
Same state revenue growth - outsourced portals	6 %	9 %	8 %	9 %
	90 %	90 %	91 %	91 %

Recurring portal revenue as a % of total portal revenues				
Gross profit % - outsourced portals	38 %	40 %	37 %	38 %
Revenue growth - software & services	11 %	110 %	19 %	116 %
Gross profit % - software & services	66 %	62 %	67 %	60 %
Selling & administrative expenses as a % of total revenues	16 %	18 %	16 %	17 %
Operating income margin % (operating income as a % of total revenues)	20 %	20 %	20 %	20 %

PORTAL REVENUES. In the analysis below, we have categorized our portal revenues according to the underlying source of revenue (in thousands), with the corresponding percentage increase or decrease from the prior year period.

	Three months ended June 30,			Six months ended June 30,		
Portal Revenue Analysis	2012	% Change	2011	2012	% Change	2011
DMV transaction-based	$ 17,697	8 %	$ 16,394	$ 35,116	6 %	$ 33,093
Non-DMV transaction-based	24,298	16 %	21,010	46,610	19 %	39,319
Portal software development	4,697	8 %	4,342	8,328	9 %	7,651
Portal management	2,350	15 %	2,037	4,700	15 %	4,075
Total	$ 49,042	12 %	$ 43,783	$ 94,754	13 %	$ 84,138

Portal revenues in the current quarter increased 12%, or approximately $5.3 million, over the prior year quarter. Of this increase, (i) 6%, or approximately $2.6 million, was attributable to an increase in same state portal revenues (portals in operation and generating revenues for two full periods); and (ii) 6%, or approximately $2.7 million, was attributable to increases from our newer portals, including Oregon ($0.3 million), which began to generate revenues in June 2012; Maryland ($1.1 million), which began to generate revenues in May 2012; Delaware ($0.3 million), which began to generate revenues in October 2011; Mississippi ($0.4 million), which began to generate revenues in May 2011; and New Jersey ($0.6 million), which began to generate revenues in April 2011.

Same state portal revenues in the current quarter increased 6% over the prior year quarter, primarily due to higher revenues from our Texas and Montana portals, among others. Same state revenue growth in the prior year quarter was 9%. Same state non-DMV transaction-based revenues increased 12% in the current quarter due to strong performance from several key services, including motor vehicle registrations, tax filings, and driver's license renewals. Our same state non-DMV transaction-based revenue growth in the current quarter was lower than the 23% growth we achieved in the prior year quarter due in part to higher prior year growth related to certain biennial licensing applications and changes in the timing of certain seasonal services, among others. Same state DMV revenues decreased 1% in the current quarter compared to flat growth in the prior year quarter. Absent DMV price increases, same state DMV revenue growth has historically ranged from 0% to 3% per year, and has generally been flat in recent years.

Portal revenues for the six-month period ended June 30, 2012 increased 13%, or approximately $10.6 million, over the prior year period. Of this increase, (i) 8%, or approximately $6.7 million, was attributable to an increase in same state portal revenues; and (ii) 5%, or approximately $3.9 million, was attributable to increases from our newer portals, including Oregon ($0.3 million), Maryland ($1.1 million), Delaware ($0.6 million), Mississippi ($1.1 million), and New Jersey ($0.8 million).

Same state portal revenues in the current year-to-date period increased 8% over the prior year period, primarily due to increased revenues from our Texas, Colorado and Montana portals, among others. Same state revenue growth in the prior year-to-date period was 9%. Same state non-DMV transaction-based revenues increased 16% in the current year-to-date period due to strong performance from several key applications, including motor vehicle registrations and tax filings, among others. Our same state non-DMV transaction-based revenue growth in the six-month period ended June 30, 2012 was lower than the 23% growth we achieved in the prior year period due in part to higher prior year growth related to certain biennial licensing applications and changes in the timing of certain seasonal services, among others. Same state DMV transaction-based revenues decreased 1% compared to growth of 1% in the prior year-to-date period.

COST OF PORTAL REVENUES. In the analysis below, we have categorized our cost of portal revenues between fixed and variable costs (in thousands), with the corresponding percentage increase or decrease from the prior year period. Fixed costs include costs such as employee compensation (including stock-based compensation), subcontractor labor costs, telecommunication, and all other costs associated with the provision of dedicated client service such as dedicated facilities. Variable costs consist of costs that vary with our level of portal revenues and primarily include bank fees required to process debit/credit card and automated clearinghouse transactions and, to a lesser extent, costs associated with revenue share arrangements with our state partners.

	Three months ended June 30,			Six months ended June 30,		
Cost of Portal Revenue Analysis	2012	% Change	2011	2012	% Change	2011
Fixed costs	$ 19,590	17 %	$ 16,693	$ 38,151	17 %	$ 32,715
Variable costs	10,960	13 %	9,669	21,150	11 %	19,068
Total	$ 30,550	16 %	$ 26,362	$ 59,301	15 %	$ 51,783

Cost of portal revenues for the current quarter increased 16%, or approximately $4.2 million, over the prior year quarter. Of this increase, (i) 6%, or approximately $1.6 million, was attributable to an increase in same state cost of portal revenues; and (ii) 10%, or approximately $2.6 million, was attributable to our newer portals in Oregon, Maryland, Delaware, Mississippi, and New Jersey.

The increase in same state cost of portal revenues in the current quarter was partially attributable to an increase in fixed costs primarily due to higher employee compensation and benefit costs and an increase in marketing expenses. In addition, the increase was partially attributable to higher variable costs to process debit/credit card transactions, due mainly to higher transaction volumes from our portals in Texas and Montana, among others. A significant percentage of our non-DMV transaction-based revenues are generated from online applications whereby users pay for information or transactions via debit/credit cards. We typically earn a percentage of the debit/credit card transaction amount, but also must pay an associated interchange fee to the bank that processes the debit/credit card transaction. We earn a lower gross profit percentage on these transactions as compared to our other non-DMV applications. However, we plan to continue to implement these services as they contribute favorably to our operating income growth. Although we did experience lower debit interchange fees as a percentage of portal non-DMV revenues in the current quarter as a result of the Durbin Amendment under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which places limits on debit card interchange rates that card issuing banks may charge, and which became effective on October 1, 2011, we are unable to predict whether such limits going forward will result in an increase in other fees that banks charge us to process credit card and other electronic transactions.

Our portal gross profit percentage was 38% in the current quarter, down from 40% in the prior year quarter due mainly to higher start-up costs related to newer state portals. We carefully monitor our portal gross profit percentage to strike the balance between generating a solid return for our stockholders and delivering value to our government partners through reinvestment in our portal operations (which we believe also benefits our stockholders).

Cost of portal revenues for the six-month period ended June 30, 2012 increased 15%, or approximately $7.5 million, over the prior year period. Of this increase, (i) 5%, or approximately $2.5 million, was attributable to an increase in same state cost of portal revenues; and (ii) 10%, or approximately $5.0 million, was attributable to our newer portals in Oregon, Maryland, Delaware, Mississippi, and New Jersey. The increase in same state cost of portal revenues in the current year-to-date period was partially attributable to an increase in fixed costs primarily due to higher employee compensation and benefit costs. The increase was also attributable to an increase in variable merchant fees to process credit card transactions, particularly from our portals in Montana and Texas, among others, which was offset partially by lower debit interchange fees as a result of the Durbin Amendment, as further discussed above.

Our portal gross profit percentage was 37% for the six-month period ended June 30, 2012, down from 38% in the prior year period due mainly to higher start-up costs related to newer portals.

SOFTWARE & SERVICES REVENUES. In the analysis below, we have categorized our software & services revenues by business (in thousands), with the corresponding percentage increase or decrease from the prior year period.

	Three months ended June 30,			Six months ended June 30,		
Software & Services Revenue Analysis	2012	% Change	2011	2012	% Change	2011
NIC Technologies	$ 2,519	11 %	$ 2,275	$ 5,134	19 %	$ 4,321
Other	421	15 %	365	837	20 %	698
Total	$ 2,940	11 %	$ 2,640	$ 5,971	19 %	$ 5,019

Software & services revenues in the current quarter and year-to-date periods increased 11% and 19%, or approximately $0.3 million and $1.0 million, respectively, over the prior year periods. This increase was primarily due to higher revenues in the current quarter and year-to-date periods from our contract with the FMCSA ($0.4 million and $0.9 million, respectively), as a result of increased adoption of the PSP compared to the prior year periods.

COST OF SOFTWARE & SERVICES REVENUES. Cost of software & services revenues in the current quarter was flat compared to the prior year quarter and decreased 2% in the current year-to-date period from the prior year period. Our software & services gross profit percentage in the current quarter and year-to-date periods was 66% and 67%, respectively, compared to 62% and 60%, respectively, in the prior year periods. The increases in 2012 were primarily due to higher revenues from the PSP, as further discussed above.

SELLING & ADMINISTRATIVE. As compared to the prior year periods, selling & administrative expenses were relatively flat in the current quarter and increased 8%, or approximately $1.2 million, in the current year-to-date period. Selling & administrative expenses for the three-month period ended June 30, 2012 include approximately $1.5 million of legal fees and other third-party costs related to the previously disclosed SEC matter. These expenses were reduced by approximately $1.4 million of reimbursement from our directors' and officers' liability insurance carrier, resulting in a net increase in expense of approximately $0.1 million in the current quarter. The $1.4 million reimbursement was approved for payment during the second quarter of 2012 and was subsequently collected during the third quarter of 2012. Selling & administrative expenses for the six-month period ended June 30, 2012 include approximately $2.3 million of legal fees and other third party costs related to the SEC matter, net of approximately $2.1 million of insurance reimbursement, resulting in a net increase in expense of approximately $0.2 million in the current year-to-date period.

Selling & administrative expenses for the three- and six-month periods ended June 30, 2011 include approximately $1.1 million and $1.9 million, respectively, of legal fees and other third party costs related to the SEC matter and the previously disclosed derivative action that was concluded in the fourth quarter of 2011. These expenses were reduced by approximately $0.6 million and $1.8 million, respectively, of insurance reimbursement, resulting in a net increase in expense of approximately $0.5 million and $0.1 million, respectively, for the three- and six-month periods ended June 30, 2011.

We expect to continue to incur obligations to advance legal fees and other expenses to our Chief Financial Officer in connection with the previously disclosed civil action by the SEC against him. We are not a party to the civil action, but are obligated to provide indemnification in certain circumstances (including advancing certain defense costs) to our Chief Financial Officer in accordance with our certificate of incorporation and bylaws and our indemnification agreement with him. In addition, we expect to incur costs responding to subpoenas and other discovery requests relating to the civil action. Our directors' and officers' liability insurance carrier has agreed to reimburse us for certain reasonable costs of defense advanced by us to our Chief Financial Officer in the SEC civil action. We are not able to estimate or predict the extent of any indemnification obligation to our Chief Financial Officer or other costs resulting from the civil action, the amount or timing of and eligibility for reimbursements from our directors' and officers' liability insurance carrier associated with the civil action, any possible loss or possible range of loss associated with the civil action, or any potential effect on our business, results of operations, cash flows, or financial condition. We promptly submit any invoices potentially reimbursable under our directors' and officers' liability insurance policies to our insurance carrier for reimbursement. For expenses that are subject to reimbursement, we do not generally receive reimbursement for 90 to 120 days. To the extent our directors' and officers' liability insurance carrier reimburses us for expenses previously recorded in selling & administrative expenses, we will treat any such reimbursement as a reduction of selling & administrative expenses in the period such reimbursement is determined to be estimable and probable.

In the current quarter, legal fees and other third-party costs related to the SEC matter, net of insurance reimbursement, decreased approximately $0.4 million from the prior year period, while other selling & administrative expenses increased by approximately $0.4 million, due mainly to higher personnel and software and maintenance costs to support and enhance corporate-wide information technology, security and portal operations. In the current year-to-date period, legal fees and other third-party costs and penalties related to the SEC matter, net of insurance reimbursement, increased approximately $0.1 million from the prior year period, while other selling & administrative expenses increased by approximately $1.1 million, due mainly to higher personnel and software and maintenance costs to support and enhance corporate-wide information technology, security and portal operations, in addition to higher incentive compensation and benefit costs.

As a percentage of total consolidated revenues, selling & administrative expenses were 16% in both the current quarter and year-to-date periods, compared to 18% and 17%, respectively, in the prior year periods. The decrease in selling & administrative expenses as a percentage of total revenues in the current quarter primarily reflects lower costs related to the SEC matter, net of insurance reimbursement, and higher total revenues in the current quarter. The decrease in selling & administrative expenses as a percentage of total revenues in the current year-to-date period primarily reflects higher total revenues in the current year-to-date period, as further discussed above.

DEPRECIATION & AMORTIZATION. Depreciation & amortization expense in the current quarter and year-to-date periods increased 19% and 20%, or approximately $0.2 million and $0.4 million, respectively, over the prior year periods. These increases were primarily attributable to capital expenditures for our centralized hosting environment to support and enhance corporate-wide information technology and security and for new state portal contracts. As a percentage of total consolidated revenues, depreciation & amortization was 3% in both the current quarter and year-to-date periods, compared to 2% in the prior year periods.

INCOME TAXES. Our effective tax rate in the current quarter and year-to-date periods was approximately 43% and 42%, respectively, compared to 41% in each of the prior year periods. The increase in the current quarter and year-to-date effective tax rates was primarily due to an increase in nondeductible compensation-related expenses compared to the prior year periods.

Liquidity and Capital Resources

Operating Activities

Net cash provided by operating activities was $10.0 million in the current year-to-date period as compared to $6.4 million in the prior year period. The increase in cash flow from operations in the current period was primarily the result of (i) the period-over-period increase in operating income, excluding non-cash charges for depreciation & amortization and stock-based compensation; (ii) an increase in the current period in accounts payable from our newer state portals; and (iii) a reduction in accounts payable in the prior year period due to the timing of payments to our government partners, which were partially offset by an increase in accounts receivable from our newer state portals in the current period.

Investing Activities

Net cash used in investing activities was approximately $3.0 million in the current year-to-date period as compared to approximately $2.8 million in the prior year period. Investing activities in the current period primarily reflect $2.7 million of capital expenditures, which were for normal fixed asset additions in our outsourced portal businesses including additional capital expenditures in our new state portals and in our centralized hosting environment to support and enhance corporate-wide information technology security, including Web servers, purchased software, and office equipment. Investing activities in the prior year period primarily reflect $2.6 million of capital expenditures, which were for normal fixed asset additions in our outsourced portal business and in our centralized hosting environment to support and enhance corporate-wide information technology security, including Web servers, purchased software and office equipment. In addition, in the current and prior year-to-date periods we capitalized approximately $0.3 million and $0.2 million, respectively, of internal-use software development costs related to the standardization of customer management, billing and payment processing systems that support our portal operations and accounting systems.

Financing Activities

Net cash from financing activities was approximately $1.6 million in the current year-to-date period as compared to approximately $1.7 million in the prior year period. Financing activities in the current and prior year-to-date periods primarily reflect the receipt of approximately $0.8 million and $0.7 million, respectively, in proceeds from our employee stock purchase program and tax deductions of approximately $0.8 million and $1.0 million, respectively, related to stock-based compensation.

Liquidity

We recognize revenue primarily from providing outsourced government portal services net of the transaction fees due to the government when the services are provided. We recognize accounts receivable at the time these services are provided, and also accrue the related fees that we must remit to the government as accounts payable at such time. As a result, trade accounts receivable and accounts payable reflect the gross amounts outstanding at the balance sheet dates. Gross billings for the three-months ended June 30, 2012 and December 31, 2011 were approximately $1.2 billion and $772.0 million, respectively. The Company calculates days sales outstanding by dividing trade accounts receivable at the balance sheet date by gross billings for the period and multiplying the resulting quotient by the number of days in that period. Days sales outstanding for the three-month periods ended June 30, 2012 and December 31, 2011 was four and six, respectively.

We believe our working capital and current ratio are important measures of our short-term liquidity. Working capital, defined as current assets minus current liabilities, increased to $67.4 million at June 30, 2012, from $56.2 million at December 31, 2011. The increase in our working capital is primarily due to net income generated from our operations as further described above. Our current ratio, defined as current assets divided by current liabilities, was 2.0 and 1.7 at June 30, 2012 and December 31, 2011, respectively.

At June 30, 2012, our unrestricted cash and cash equivalents balance was $70.2 million compared to $61.6 million at December 31, 2011. We believe that our currently available liquid resources and cash generated from operations will be sufficient to meet our operating requirements, capital expenditure requirements, current growth initiatives, and dividend payments (if any) for at least the next 12 months without the need of additional capital. We have a $10.0 million unsecured revolving credit facility with a bank that is available to finance working capital, issue letters of credit and finance general corporate purposes. We can obtain letters of credit in an aggregate amount of $5.0 million, which reduces the maximum amount available for borrowing under the facility. In total, we had $3.2 million in available capacity to issue additional letters of credit and $8.2 million of unused borrowing capacity at June 30, 2012 under the facility. We were in compliance with all of the financial covenants under the revolving credit facility at June 30, 2012.

We issue letters of credit as collateral for certain office leases, and to a lesser extent, as collateral for performance on certain of our outsourced government portal contracts. These irrevocable letters of credit are generally in force for one year. Letters of credit may have an expiration date of up to one year beyond the May 1, 2014 expiration date of the credit agreement. We had unused outstanding letters of credit totaling approximately $1.8 million at June 30, 2012. We are not currently required to cash collateralize these letters of credit. However, even though we currently expect to be profitable in fiscal 2012, we may not be able to sustain or increase profitability on a quarterly or annual basis. We will need to generate sufficient revenues while containing costs and operating expenses if we are to achieve sustained profitability. If we are not able to sustain profitability, our cash collateral requirements may increase.

At June 30, 2012, we were bound by performance bond commitments totaling approximately $5.3 million on certain outsourced government portal contracts. We have never had any defaults resulting in draws on performance bonds. Had we been required to post 100% cash collateral at June 30, 2012 for the face value of all performance bonds, letters of credit, and our line of credit in conjunction with a corporate credit card agreement, unrestricted cash would have decreased by approximately $8.0 million and would have been classified as restricted cash.

We currently expect our capital expenditures to be approximately $13.0 million to $13.5 million in fiscal 2012, which we intend to fund from our cash flows from operations and existing cash reserves. This estimate includes capital expenditures for normal fixed asset additions and capital expenditures to implement our new portal contracts and to implement RSA 2.0 for the Texas Department of Public Safety, as described in our 2011 Annual Report on Form 10-K filed with the SEC on February 24, 2012. At June 30, 2012, the Company accrued approximately $3.0 million related to equipment currently being configured for the Texas RSA 2.0 project.

On January 3, 2012, we paid a $0.25 per share special cash dividend totaling approximately $16.2 million out of available cash. We do not believe that this dividend will have a significant effect on our future liquidity. Our future liquidity may be adversely affected to the extent we incur obligations to advance or pay significant legal fees and other expenses that are not covered by our directors' and officers' liability insurance in connection with the civil action by the SEC against our Chief Financial Officer. Our directors' and officers' liability insurance carrier has agreed to reimburse the Company for certain reasonable costs of defense advanced by the Company to our Chief Financial Officer in the SEC civil action, as further discussed above and in Note 5 in the Notes to Unaudited Consolidated Financial Statements included in this Form 10-Q. We may need to raise additional capital within the next 12 months to further:

- fund operations if unforeseen costs arise;
- support our expansion into other states and government agencies beyond what is contemplated if unforeseen opportunities arise;
- expand our product and service offerings beyond what is contemplated if unforeseen opportunities arise;
- respond to unforeseen competitive pressures; and
- acquire technologies beyond what is contemplated.

Any projections of future earnings and cash flows are subject to substantial uncertainty. If our cash generated from operations and the unused portion of our line of credit are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity securities or issue debt securities. The sale of additional equity securities could result in dilution to the Company's stockholders. In recent years, credit and capital markets have experienced unusual volatility and disruption. There can be no assurance that financing will be available in amounts or on terms acceptable to the Company, if at all.

Off-Balance Sheet Arrangements and Contractual Obligations

We do not have off-balance sheet arrangements that are not recorded or disclosed in our financial statements. While we have significant operating lease commitments for office space, except for our headquarters those commitments are generally tied to the period of performance under related portal contracts. We have income tax uncertainties of approximately $0.6 million at June 30, 2012. These obligations are classified as non-current on our consolidated balance sheet, as resolution is expected to take more than a year. We estimate that these matters could be resolved in one to three years. However, the ultimate timing of resolution is uncertain.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK. Our cash and cash equivalents are held entirely in domestic non-interest bearing transaction accounts.

Borrowings under our line of credit bear interest at a floating rate. Interest on amounts borrowed is payable at a base rate equal to the higher of the Federal Funds Rate plus 0.5% or the bank's prime rate. We currently have no principal amounts of indebtedness outstanding under our line of credit.

We do not use derivative financial instruments.

ITEM 4. CONTROLS AND PROCEDURES

a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) that are designed to ensure that material information required to be disclosed in its filings under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of such date.

b) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

In June 2012, the Company hired a Vice President of Internal Audit who will report directly to the Audit Committee of the Board of Directors. An Internal Audit function was created in response to our continued growth. The Vice President of Internal Audit will be responsible, along with Company management, for the ongoing evaluation of the adequacy and effectiveness of the Company's governance and risk management processes and internal control structure, as well as identifying potential improvements to the Company's operations.

There have been no changes in our internal control over financial reporting that occurred during our second fiscal quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) During the second quarter of 2012, the Company acquired shares of common stock surrendered by employees to pay income taxes due upon the vesting of restricted stock as follows:

Period	Total Number of Shares Purchased	Average Price Paid per share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
May 3, 2012	1,331	$ 11.43	N/A	N/A
May 4, 2012	1,393	$ 11.14	N/A	N/A
May 5, 2012	506	$ 11.14	N/A	N/A
May 6, 2012	1,282	$ 11.14	N/A	N/A

ITEM 6. EXHIBITS

10.1 NIC Inc. Executive Incentive Plan (incorporated by reference to Exhibit 10.1 to the Form 8-K filed with the SEC on May 2, 2012)

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Section 906 Certifications of Chief Executive Officer and Chief Financial Officer

101 The following financial information from NIC's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, formatted in XBRL (Extensible Business Reporting Language) includes (i) Unaudited Consolidated Balance Sheets at June 30, 2012 and December 31, 2011, (ii) Unaudited Consolidated Statements of Income for the three and six months ended June 30, 2012 and 2011, (iii) Unaudited Consolidated Statement of Changes in Stockholders' Equity for the six months ended June 30, 2012, (iv) Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011, and (v)

the Notes to Unaudited Consolidated Financial Statements (submitted electronically herewith).

SIGNATURES

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

NIC Inc.

Dated: August 2, 2012

/s/ Stephen M. Kovzan
Stephen M. Kovzan
Chief Financial Officer

NIC Inc.
EXHIBIT INDEX

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