

NIC INC
Form 10-Q
August 02, 2017

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, 2017

Commission file number 000-26621

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

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

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company	

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 17, 2017, the number of shares outstanding of the registrant's common stock, \$0.0001 par value per share, was 66,267,128.

PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

NIC INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

thousands except par value amount

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash	\$ 135,386	\$ 127,009
Trade accounts receivable, net	79,349	82,722
Prepaid expenses & other current assets	12,382	15,033
Total current assets	227,117	224,764
Property and equipment, net	9,653	9,726
Intangible assets, net	4,484	3,588
Deferred income taxes, net	1,511	2,307
Other assets	1,984	477
Total assets	\$ 244,749	\$ 240,862
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 58,717	\$ 73,252
Accrued expenses	22,207	23,395
Other current liabilities	3,794	3,150
Total current liabilities	84,718	99,797
Other long-term liabilities	8,172	7,162
Total liabilities	92,890	106,959
Commitments and contingencies (Notes 1 and 2)	-	-
Stockholders' equity:		
Common stock, \$0.0001 par, 200,000 shares authorized, 66,265 and 65,982 shares issued and outstanding	7	7
Additional paid-in capital	108,996	106,669
Retained earnings	42,856	27,227
Total stockholders' equity	151,859	133,903
Total liabilities and stockholders' equity	\$ 244,749	\$ 240,862

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

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Revenues:				
Portal revenues	\$79,374	\$75,513	\$156,572	\$148,710
Software & services revenues	5,952	5,297	11,931	10,490
Total revenues	85,326	80,810	168,503	159,200
Operating expenses:				
Cost of portal revenues, exclusive of depreciation & amortization	49,009	46,123	96,041	89,738
Cost of software & services revenues, exclusive of depreciation & amortization	1,779	1,445	3,542	2,858
Selling & administrative	13,131	11,165	24,791	22,507
Depreciation & amortization	1,688	1,736	3,301	3,400
Total operating expenses	65,607	60,469	127,675	118,503
Operating income before income taxes	19,719	20,341	40,828	40,697
Income tax provision (Notes 1 and 6)	6,950	7,280	14,074	14,742
Net income	\$12,769	\$13,061	\$26,754	\$25,955
Basic net income per share	\$0.19	\$0.20	\$0.40	\$0.39
Diluted net income per share	\$0.19	\$0.20	\$0.40	\$0.39
Weighted average shares outstanding:				
Basic	66,248	65,953	66,147	65,846
Diluted	66,248	65,967	66,147	65,859

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		Additional	Retained	
	Shares	Amount	Paid-in Capital	Earnings	Total
Balance, January 1, 2017 (previously reported)	65,982	\$ 7	\$ 106,669	\$27,227	\$ 133,903
Cumulative effect of adoption of new accounting standard	-	-	409	(409)	-
Balance, January 1, 2017 (as adjusted)	65,982	7	107,078	26,818	133,903
Net income	-	-	-	26,754	26,754
Restricted stock vestings	319	-	107	-	107
Dividends declared	-	-	-	(10,692)	(10,692)
Dividend equivalents on performance-based restricted stock awards	-	-	-	(55)	(55)
Dividend equivalents cancelled upon forfeiture of performance-based restricted stock awards	-	-	-	31	31
Shares issuable in lieu of dividend payments on unvested performance-based restricted stock awards	-	-	(83)	-	(83)
Shares surrendered and cancelled upon vesting of restricted stock to satisfy tax withholdings	(123)	-	(2,614)	-	(2,614)
Stock-based compensation	-	-	3,178	-	3,178
Issuance of common stock under employee stock purchase plan	87	-	1,330	-	1,330
Balance, June 30, 2017	66,265	\$ 7	\$ 108,996	\$42,856	\$ 151,859

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,	2016 (as adjusted)
	2017	
Cash flows from operating activities:		
Net income	\$ 26,754	\$ 25,955
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for losses (recoveries) on accounts receivable	379	(23)
Depreciation & amortization	3,301	3,400
Stock-based compensation expense	3,178	3,005
Deferred income taxes	796	51
Excess tax benefits from stock-based compensation	-	427
(Gain) loss on disposal of property and equipment	39	(4)
Changes in operating assets and liabilities:		
Decrease in trade accounts receivable, net	2,994	2,941
(Increase) decrease in prepaid expenses & other current assets	2,651	(2,168)
(Increase) in other assets	(1,507)	(26)
Increase (decrease) in accounts payable	(14,535)	1,599
(Decrease) in accrued expenses	(1,271)	(1,515)
Increase in other current liabilities	644	169
Increase in other long-term liabilities	1,010	746

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Net cash provided by operating activities	24,433	34,557
Cash flows from investing activities:		
Purchases of property and equipment	(2,395)	(2,748)
Proceeds from sale of property and equipment	7	6
Capitalized internal use software development costs	(1,692)	(1,142)
Net cash used in investing activities	(4,080)	(3,884)
Cash flows from financing activities:		
Cash dividends on common stock	(10,692)	-
Proceeds from employee common stock purchases	1,330	1,114
Tax withholdings related to stock-based compensation awards	(2,614)	(2,073)
Net cash used in financing activities	(11,976)	(959)
Net increase in cash	8,377	29,714
Cash, beginning of period	127,009	98,388
Cash, end of period	\$ 135,386	\$ 128,102
Other cash flow information:		
Non-cash investing activities:		
Capital expenditures accrued but not yet paid	\$ 83	\$ 27
Cash payments:		
Income taxes paid	\$ 12,405	\$ 13,941
Cash dividends on common stock previously restricted for payment of dividend	\$ -	\$ 36,456

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

NIC INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Unaudited 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 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, 2016, filed with the SEC on February 22, 2017, 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, 2016 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 Unaudited 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, 2017 are not necessarily indicative of the results to be expected for the full year ending December 31, 2017.

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

NIC is a leading provider of digital government services that help governments use technology to provide a higher level of service to businesses and citizens and increase efficiencies. 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 secure government-based transactions through multiple online channels, including mobile devices. 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. Typically 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 business model allows the Company to generate revenues by sharing in the fees the Company collects from online transactions. The Company is typically responsible for funding the up-front investments 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 digital government services, other than outsourced portal services, to state and local governments as well as federal agencies (See Note 2).

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 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 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 and depreciation & amortization. Cost of portal revenues consists of all direct costs associated with operating government portals on an outsourced basis including employee compensation and benefits (including stock-based compensation), fees required to process credit/debit card and automated clearinghouse transactions, subcontractor labor costs, telecommunications, provision for losses on accounts receivable, 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 and benefits (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 expenses consist primarily of corporate-level expenses relating to human resource management, administration, information technology, security, legal, finance and accounting, internal audit and all non-customer service related costs from the Company's software & services businesses, including compensation and benefits, information systems and office rent. Selling & administrative expenses also consist of management incentive compensation, including stock-based compensation, and corporate-level expenses for market development and public relations.

Certain amounts included in the unaudited consolidated statement of cash flows for the six-month period ended June 30, 2016 were reclassified to conform to the current year presentation. The reclassifications had no effect on total cash flows or the income statement for the three- and six-month periods ended June 30, 2016.

Adoption of accounting standard

In March 2016, the Financial Accounting Standards Board ("FASB") issued new authoritative literature, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"), which simplifies several aspects of accounting for employee share-based payment transactions, including accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The Company adopted the standard on January 1, 2017, which is effective for the annual reporting period beginning January 1, 2017, including interim periods within that reporting period. Adoption of the standard resulted in a decrease in retained earnings of approximately \$0.4 million and a corresponding increase in additional paid-in capital in the Company's unaudited consolidated balance sheet at January 1, 2017, reflecting a cumulative-effect adjustment associated with the Company's policy election to account for forfeitures of awards as they occur. Previously, the Company estimated and excluded compensation cost related to awards not expected to vest based on estimated forfeitures. Furthermore, changes in presentation as a result of the adoption of ASU 2016-09 increased both cash provided by operating activities and cash used in financing activities by approximately \$2.5 million in the Company's unaudited consolidated statement of cash flows for the six-month period ended June 30, 2016.

Upon adoption of ASU 2016-09, excess tax benefits or deficiencies from share-based award activity are reflected in the consolidated statement of income prospectively as a component of the provision for income taxes, whereas previously such benefits or deficiencies were recognized in additional paid-in capital in the consolidated balance sheet. Excess tax benefits resulted in a reduction of the Company's provision for income taxes of approximately \$0.1 million and \$0.5 million, respectively, for the three- and six-month periods ended June 30, 2017.

Earnings per share

Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are 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 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 0.6 million for each of the periods ended June 30, 2017 and 2016. 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,	
	2017	2016	2017	2016
Numerator:				
Net income	\$12,769	\$13,061	\$26,754	\$25,955
Less: Income allocated to participating securities	(117)	(114)	(245)	(234)
Net income available to common stockholders	\$12,652	\$12,947	\$26,509	\$25,721
Denominator:				
Weighted average shares - basic	66,248	65,953	66,147	65,846
Performance-based restricted stock awards	-	14	-	13
Weighted average shares - diluted	66,248	65,967	66,147	65,859
Basic net income per share:				
Net income	\$0.19	\$0.20	\$0.40	\$0.39
Diluted net income per share:				
Net income	\$0.19	\$0.20	\$0.40	\$0.39

Concentration of credit risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and accounts receivable. The Company limits its exposure to credit loss by depositing its cash with high credit quality financial institutions and monitoring the financial stability of those institutions. The Federal Deposit Insurance Corporation ("FDIC") provides deposit insurance coverage up to \$250,000 per depositor for deposit accounts at each FDIC-insured depository institution. At June 30, 2017, the amount of cash covered by FDIC deposit insurance was approximately \$8.2 million, and approximately \$127.2 million of cash was above the FDIC deposit insurance limit. The Company performs ongoing credit evaluations of its customers and generally requires no collateral to secure accounts receivable.

Recently issued accounting pronouncements

Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For trade and other receivables, the Company will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses which reflects losses that are probable. The new standard will be effective for the Company beginning January 1, 2020, with early adoption permitted beginning January 1, 2019. Application of the amendments is through a cumulative-effect adjustment to retained earnings as of the effective date. The Company is currently evaluating the new standard and the estimated impact it will have on the Company's financial statements.

Leases

In February 2016, the FASB issued a new standard related to leases to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet. Most prominent

among the amendments is the recognition of assets and liabilities by lessees for those leases classified as operating leases under current U.S. GAAP. Under the new standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

The standard is effective for the annual reporting period beginning January 1, 2019, including interim periods within that reporting period. The Company will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. Early application is permitted. The Company is currently evaluating the effects that the standard will have on its consolidated financial statements, which the Company anticipates could be significant, due mainly to its non-cancellable leases for office space. As further described in Note 7, Commitments and Contingencies, of the Company's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the SEC on February 22, 2017, as of December 31, 2016, the Company had minimum lease commitments under non-cancellable operating leases totaling \$17.9 million.

8

Revenue from Contracts with Customers

In May 2014, the FASB issued a new standard related to revenue recognition. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. In addition, the standard requires expanded disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The FASB has issued several amendments to the standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective approach). The standard is effective for the annual reporting period beginning January 1, 2018, including interim periods within that reporting period. The Company currently expects it will adopt the standard using the modified retrospective approach during the first quarter of 2018.

The Company has established an implementation team that has completed a preliminary impact assessment of the new standard and a scoping of its revenue sources by type of service provided under its contracts with customers. The Company continues to assess the standard and is currently evaluating a sample of customer contracts for each revenue source to determine the estimated impact the standard will have on the Company's sources of revenue and financial statements.

2. OUTSOURCED GOVERNMENT 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 statements of work with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These statements of work preliminarily establish the pricing of the online 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.

The Company is typically responsible for funding the up-front investments and ongoing operations and maintenance costs of the government portals, and generally owns all of the intellectual property in connection with the applications developed under these contracts. After completion of a defined contract term, the government partner typically receives a perpetual, royalty-free license to use the applications and digital government services built by the Company only in its own state. However, certain proprietary 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 a number of government partners on a software-as-a-service ("SaaS") basis, and thus would not be included in any royalty-free license. If the Company's contract expires after a defined term or if its contract is terminated by a government partner for cause, the government agency would be entitled to take over the portal in place, and NIC would have no future revenue from, or obligation to, such former government partner, except as otherwise provided in the contract.

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 if the Company breaches a material contractual obligation and fails to cure such

breach within a specified period or upon the occurrence of other events or circumstances specified in the contract. In addition, 14 contracts under which the Company provides enterprise-wide outsourced portal and digital government services, as well as the Company's contract with the Federal Motor Carrier Safety Administration ("FMCSA"), can be terminated by the other party without cause on a specified period of notice. Collectively, revenues generated from these contracts represented approximately 62% and 61% of the Company's total consolidated revenues for the three- and six-month periods ended June 30, 2017, respectively. In the event that any of these contracts is terminated without cause, the terms of the respective contract may require the government to pay the Company a fee in order to continue to use the Company's applications in its portal.

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. At June 30, 2017, the Company was bound by performance bond commitments totaling approximately \$5.8 million on certain outsourced portal contracts.

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The following is a list of the contracts in each state through which the Company has the ability to provide enterprise-wide outsourced digital government services to multiple government agencies:

<u>NIC Enterprise Contract</u>	<u>State</u>	<u>Year Services Commenced</u>	<u>Contract Expiration Date (Renewal Options Through)</u>
NICUSA, IL Division	Illinois	2017	6/29/2023 (6/29/2027)
Louisiana Interactive, LLC	Louisiana	2015	1/28/2020
Connecticut Interactive, LLC	Connecticut	2014	1/9/2020
Wisconsin Interactive Network, LLC	Wisconsin	2013	5/13/2018 (5/13/2023)
Pennsylvania Interactive, LLC	Pennsylvania	2012	11/30/2019 (11/30/2022)
NICUSA, OR Division	Oregon	2011	11/22/2021
NICUSA, MD Division	Maryland	2011	8/10/2018 (8/10/2019)
Mississippi Interactive, LLC	Mississippi	2011	12/31/2017 (12/31/2021)
New Jersey Interactive, LLC	New Jersey	2009	5/1/2020 (5/1/2022)
Texas NICUSA, LLC	Texas	2009	8/31/2018
West Virginia Interactive, LLC	West Virginia	2007	6/30/2021 (6/30/2024)
Vermont Information Consortium, LLC	Vermont	2006	6/8/2019
Colorado Interactive, LLC	Colorado	2005	4/30/2019 (4/30/2023)
South Carolina Interactive, LLC	South Carolina	2005	7/15/2019 (7/15/2021)
Kentucky Interactive, LLC	Kentucky	2003	8/31/2018
Alabama Interactive, LLC	Alabama	2002	3/19/2020 (3/19/2022)
Rhode Island Interactive, LLC	Rhode Island	2001	7/1/2018 (7/1/2019)
Oklahoma Interactive, LLC	Oklahoma	2001	3/31/2018 (3/31/2020)
Montana Interactive, LLC	Montana	2001	12/31/2019 (12/31/2020)
Hawaii Information Consortium, LLC	Hawaii	2000	1/3/2019 (3-year renewal options)
Idaho Information Consortium, LLC	Idaho	2000	6/30/2018
Utah Interactive, LLC	Utah	1999	6/5/2019
Maine Information Network, LLC	Maine	1999	7/1/2018
Arkansas Information Consortium, LLC	Arkansas	1997	6/30/2018
Indiana Interactive, LLC	Indiana	1995	7/31/2017 (7/31/2018)
Nebraska Interactive, LLC	Nebraska	1995	4/1/2019 (4/1/2021)
Kansas Information Consortium, LLC	Kansas	1992	12/31/2022 (annual 1-year renewal options)

Outsourced federal contract

The Company's subsidiary NIC Federal, LLC has a contract with the FMCSA to develop and manage the FMCSA's Pre-Employment Screening Program ("PSP") for motor carriers nationwide, using a transaction-based business model. During the third quarter of 2017, the FMCSA exercised the second of its two one-year renewal options, extending the current contract through August 31, 2018.

Any renewal of the contract with the FMCSA beyond the current term is at the option of the FMCSA and the contract can be terminated by the FMCSA without cause on a specified period of notice.

Expiring contracts

There are currently 4 contracts under which the Company provides enterprise-wide outsourced portal and digital government services that have expiration dates within the 12-month period following June 30, 2017. Collectively, revenues generated from these contracts represented approximately 10% and 9% of the Company's total consolidated

revenues for the three- and six-month periods ended June 30, 2017, respectively. Although certain of these contracts have renewal provisions, any renewal is at the option of the Company's government partner. 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, and NIC would have no future revenue from, or obligation to, such former government partner, except as otherwise provided in the contract.

The contract under which the Company's subsidiary, NICUSA Inc. ("NICUSA"), managed digital government services for the state of Tennessee expired on March 31, 2017. For the six-month period ended June 30, 2017 revenues from the Tennessee portal contract were approximately \$1.8 million, compared to \$2.0 million and \$4.3 million in the three- and six- month periods ended June 30, 2016, respectively.

The contract under which the Company's subsidiary, Iowa Interactive, LLC managed digital government services for the state of Iowa expired on November 30, 2016. For the three- and six-month periods ended June 30, 2016, revenues from the Iowa portal contract were approximately \$0.5 million and \$0.9 million, respectively.

10

3. STOCK BASED COMPENSATION

During the three- and six-month periods ended June 30, 2017, the Compensation Committee of the Board of Directors of the Company granted to certain management-level employees and executive officers, service-based restricted stock awards totaling 2,152 shares and 230,847 shares, respectively, with a grant-date fair value totaling approximately \$0.1 million and \$5.1 million, respectively. Such restricted stock awards vest beginning one year from the date of grant in annual installments of 25%. In addition, during the three-month period ended June 30, 2017, non-employee directors of the Company were granted service-based restricted stock awards totaling 37,464 shares with a grant-date fair value totaling approximately \$0.8 million. Such restricted stock awards vest one year from the date of grant. 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 (generally the vesting period of the award). The Company records forfeitures when they occur.

During the first quarter of 2017, the Compensation Committee of the Board of Directors of the Company also granted to certain executive officers performance-based restricted stock awards pursuant to the terms of the Company's executive compensation program totaling 110,678 shares with a grant-date fair value totaling approximately \$2.4 million, which represents the maximum number of shares the executive officers can earn at the end of a three-year performance period ending December 31, 2019.

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); and
Return on invested capital (three-year average).

At the end of the three-year period, the executive officers are eligible to receive up to a specified number of shares based upon the Company's performance relative to these performance criteria over the performance period. In addition, the executive officers will accrue dividend equivalents for any cash dividends declared during the performance period, payable in the form of additional 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, 2016, the three-year performance period related to the performance-based restricted stock awards granted to certain executive officers on February 24, 2014 ended. Based on the Company's actual financial results from 2014 through 2016, 59,437 of the shares subject to the awards and 4,945 dividend shares were earned. The remaining 21,503 shares subject to the awards were forfeited in the first quarter of 2017.

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 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,	
	2017	2016	2017	2016
Cost of portal revenues, exclusive of depreciation & amortization	\$345	\$327	\$657	\$782
Cost of software & services revenues, exclusive of depreciation & amortization	27	15	44	32
Selling & administrative	1,332	1,041	2,477	2,191
Stock-based compensation expense before income taxes	1,704	1,383	3,178	3,005
Income tax benefit	(601)	(495)	(1,096)	(1,089)
Net stock-based compensation expense	\$1,103	\$888	\$2,082	\$1,916

4. STOCKHOLDERS' EQUITY

Dividends

On July 31, 2017, the Company's Board of Directors declared a regular quarterly cash dividend of \$0.08 per share, payable to stockholders of record as of September 6, 2017. The dividend, which is expected to total approximately \$5.4 million, will be paid on September 20, 2017 out of the Company's available cash. A dividend equivalent of \$0.08 per share will also be paid simultaneously on the unvested shares of service-based restricted stock.

On May 2, 2017, the Company's Board of Directors declared a regular quarterly cash dividend of \$0.08 per share, payable to stockholders of record as of June 6, 2017. The dividend, totaling approximately \$5.4 million, was paid on June 20, 2017 on 66,264,853 outstanding shares of common stock. A dividend equivalent of \$0.08 per share was also paid simultaneously on 613,524 unvested shares of service-based restricted stock. This dividend was paid out of the Company's available cash.

On January 30, 2017, the Company's Board of Directors declared a regular quarterly cash dividend of \$0.08 per share, payable to stockholders of record as of March 7, 2017. The dividend, totaling approximately \$5.3 million, was paid on March 21, 2017 on 66,131,192 outstanding shares of common stock. A dividend equivalent of \$0.08 per share was also paid simultaneously on 643,339 unvested shares of service-based restricted stock. This dividend was paid out of the Company's available cash.

5. DEBT OBLIGATIONS AND COLLATERAL REQUIREMENTS

On April 28, 2017, NIC Inc. (the "Company") entered into Amendment No. 3 to Amended and Restated Credit Agreement (the "Amendment"), which amends the Amended and Restated Credit Agreement, dated as of August 6, 2014, by and between the Company and Bank of America, N.A. (the "Credit Agreement"). The Amendment extended the maturity date to May 1, 2019. The other material terms of the Credit Agreement remain unchanged, including customary representations and warranties, affirmative and negative covenants and events of default.

6. INCOME TAXES

The Company's effective tax rate was approximately 35% and 34%, respectively, for the three- and six-month periods ended June 30, 2017 compared to 36% for each of the three- and six-month periods ended June 30, 2016. The

Company's effective tax rate in the current quarter and year-to-date periods was lower than the prior year quarter and year-to-date periods mainly due to favorable benefits related to the domestic production activities deduction, which the Company began recognizing in the third quarter of 2016, and favorable benefits related to excess tax deductions for the vesting of restricted stock awards, which the Company began recognizing in the provision for income taxes in the first quarter of 2017 upon the adoption of ASU 2016-09 (See Note 1).

The Company's reserve for unrecognized income tax benefits, including interest and penalties, included in other long-term liabilities in the unaudited consolidated balance sheet at June 30, 2017 and the consolidated balance sheet at December 31, 2016 were approximately \$7.7 million and \$6.6 million, respectively. The increase was mainly due to a reserve for unrecognized income tax benefits related to the domestic production activities deduction recorded during the six-month period ended June 30, 2017.

7. REPORTABLE SEGMENT AND RELATED INFORMATION

The Outsourced Portals segment is the Company's only reportable segment and generally includes the Company's subsidiaries operating outsourced state and local government portals. The Other Software & Services category primarily includes the Company's subsidiaries that provide software development and digital government services, other than 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. There have been no significant intersegment transactions for the periods reported. The summary of significant accounting policies applies to all operating segments.

12

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) before income taxes. Segment assets 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-month period ended June 30 (in thousands):

	Outsourced Portals	Other Software & Services	Other Reconciling Items	Consolidated Total
2017				
Revenues	\$ 79,374	\$ 5,952	\$ -	\$ 85,326
Costs & expenses	49,009	1,779	13,131	63,919
Depreciation & amortization	668	23	997	1,688
Operating income (loss) before income taxes	\$ 29,697	\$ 4,150	\$ (14,128)	) \$ 19,719
2016				
Revenues	\$ 75,513	\$ 5,297	\$ -	\$ 80,810
Costs & expenses	46,123	1,445	11,165	58,733
Depreciation & amortization	856	18	862	1,736
Operating income (loss) before income taxes	\$ 28,534	\$ 3,834	\$ (12,027)	) \$ 20,341

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

	Outsourced Portals	Other Software & Services	Other Reconciling Items	Consolidated Total
2017				
Revenues	\$ 156,572	\$ 11,931	\$ -	\$ 168,503
Costs & expenses	96,041	3,542	24,791	124,374
Depreciation & amortization	1,353	46	1,902	3,301
Operating income (loss) before income taxes	\$ 59,178	\$ 8,343	\$ (26,693)	) \$ 40,828
2016				
Revenues	\$ 148,710	\$ 10,490	\$ -	\$ 159,200
Costs & expenses	89,738	2,858	22,507	115,103
Depreciation & amortization	1,706	31	1,663	3,400
Operating income (loss) before income taxes	\$ 57,266	\$ 7,601	\$ (24,170)	) \$ 40,697

The Company's Texas portal contract accounted for approximately 20% of the Company's total consolidated revenues for the three- and six-month periods ended June 30, 2017 and approximately 19% and 20% of the Company's total consolidated revenues in each of for the three- and six-month periods ended June 30, 2016, respectively. No other state portal contract accounted for more than 10% of the Company's total consolidated revenues.

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 (referred to herein as “the Company”, “NIC”, “we”, “our” 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 new projects under existing portal contracts, statements relating to possible future dividends, statements of assumptions underlying such statements, and statements of our 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 2016 Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on February 22, 2017.

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, our success in renewing existing contracts and in signing contracts with new states and with federal and state government agencies; our ability to successfully increase the adoption and use of digital government services; the possibility of security breaches or disruptions through cyber-attacks or other events and any resulting liability; our ability to implement new contracts and any related technology enhancements in a timely and cost-effective manner; the possibility of reductions in fees or revenues as a result of budget deficits, government shutdowns, or changes in government policy; continued favorable government legislation; acceptance of digital government services by businesses and citizens; competition; 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 2016 Annual Report on Form 10-K filed on February 22, 2017 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. Except as may be required by applicable law, we will not 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 digital government services that help governments use technology to provide a higher level of service to businesses and citizens and increase efficiencies. We accomplish this currently through two channels: our primary outsourced portal businesses and our software & services businesses.

In our primary outsourced portal business, 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 through multiple online channels, including mobile, and complete secure transactions. These transactions include 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 the up-front investments and ongoing operations and maintenance costs of the government portals. Our unique business model allows us to generate revenues by sharing in the fees collected from online transactions. Our partners benefit because they reduce their financial and technological 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.

14

On behalf of our government partners, we enter into statements of work with various agencies and divisions of the government to provide specific services and to conduct specific transactions. These statements of work preliminarily establish the pricing of the online transactions and data access services we provide and the division of revenues between us 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. We typically own all the intellectual property in connection with the applications developed under these contracts. After completion of a defined contract term, the government partner typically receives a perpetual, royalty-free license to use the applications and digital government services we built only in its own state. However, certain proprietary 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 a number of our government partners on a SaaS basis, and thus would not be included in any royalty-free license. If our contract expires after a defined term or if our contract is terminated by our government partner for cause, the government agency would be entitled to take over the portal in place, and NIC would have no future revenue from, or obligation to, such former government partner, except as otherwise provided in the contract. We also provide certain payment processing services on a SaaS basis to a few private sector entities and to state and local agencies in states where we do not maintain an enterprise-wide outsourced portal contract, and may continue to market these services to other entities in the future. Historically, revenues from these services have not been significant, but have grown in recent years. 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 these contracts beyond the initial term by the government is optional and a government may terminate its contract prior to the expiration date if we breach a material contractual obligation and fail to cure such breach within a specified period or upon the occurrence of other events or circumstances specified in the contract. In addition, 14 contracts under which we provide enterprise-wide outsourced portal and digital government services, as well as our contract with the FMCSA, can be terminated by the other party without cause on a specified period of notice. Collectively, revenues generated from these contracts represented approximately 62% and 61% of our total consolidated revenues for the current quarter and year-to-date periods, respectively. In the event that any of these contracts are terminated without cause, the terms of the respective contract may require the government to pay us a fee in order to continue to use our applications in its portal.

Our subsidiary, NIC Federal, LLC (“NIC Federal”) has a contract with the FMCSA to develop and manage the FMCSA’s PSP for motor carriers nationwide, using the Company’s transaction-based business model. During the third quarter of 2017, the FMCSA exercised the second of its two one-year renewal options, extending the current contract through August 31, 2018.

Any renewal of the contract with the FMCSA beyond the current term is at the option of the FMCSA and the contract can be terminated by the FMCSA without cause on a specified period of notice. The loss of the contract 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.

We currently have four contracts under which we provide enterprise-wide outsourced portal and digital government services that have expiration dates within the 12-month period following June 30, 2017. Although certain of these contracts have renewal provisions, any renewal is at the option of our government partners, who may choose to not renew the contract, to re-open bidding for the services, to take over the portal in place and provide services internally, or to allow individual government agencies to retain the services of their own providers. Collectively, revenues generated from these contracts represented approximately 10% and 9% of our total consolidated revenues for the current quarter and year-to-date periods, respectively. As described above, if a contract expires after a defined term,

the government partner would be entitled to take over the portal in place, and NIC would have no future revenue from, or obligation to, such former government partner, except as otherwise provided in the contract.

The contract under which our subsidiary, NICUSA Inc. (“NICUSA”), managed digital government services for the state of Tennessee expired on March 31, 2017. For the six-month period ended June 30, 2017, revenues from the Tennessee portal contract were approximately \$1.8 million, compared to approximately \$2.0 million and \$4.3 million for the three- and six- month periods ended June 30, 2016, respectively.

The contract under which our subsidiary Iowa Interactive, LLC managed digital government services for the state of Iowa expired on November 30, 2016. For the three and six-month periods ended June 30, 2016, revenues from the Iowa portal contract were approximately \$0.5 million and \$0.9 million, respectively.

OVERVIEW OF BUSINESS MODELS AND 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 outsourced basis. The software & services category primarily includes revenues and cost of revenues from our subsidiaries that provide software development and digital government services, other than outsourced portal services, to state and local governments as well as federal agencies. We currently earn 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.

15

Our outsourced portal businesses

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

IGS: mainly consists of transaction fees from interactive government services, referred to as IGS, from sources other than digital access to motor vehicle driver history records, for transactions conducted by business users and consumer users through our portals and which are generally recurring. For a representative listing of the IGS applications 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, 2016, filed with the SEC on February 22, 2017.

DHR: mainly consists of transaction fees from driver history records, referred to as DHR, for providing digital access to motor vehicle driver history records from our state portals to data resellers, insurance companies, and other pre-authorized customers on behalf of our state partners, and which are generally recurring.

Portal software development and services: 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 and are not generally recurring. 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 current government partner in the state of Indiana and are generally recurring.

Our software & services businesses

NIC Federal currently earns a significant portion of its revenues from its contract with the FMCSA to develop and manage the PSP for motor carriers nationwide, using a transaction-based business model. NIC Federal recognizes revenues from this contract (primarily transaction-based information access fees) when the services are provided at the time of the transactions. NIC Federal also earns a portion of its revenues from fixed fee and time and materials application development and outsourced maintenance contracts with other government agencies and recognizes revenues as services are provided.

CRITICAL ACCOUNTING POLICIES

There have been no material changes in our critical accounting policies from the information provided under “Critical Accounting Policies” 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, 2016, filed with the SEC on February 22, 2017.

RESULTS OF OPERATIONS

The following discussion summarizes the significant factors affecting operating results for the three- and six-month periods ended June 30, 2017 and 2016. This discussion and analysis should be read in conjunction with our Unaudited Consolidated Financial Statements and the related Notes included in this Form 10-Q.

Due to the expiration of our contract with the state of Iowa on November 30, 2016, the operating results for this portal have been removed from the same state category for the three- and six-month periods ended June 30, 2017. In addition, our Tennessee portal contract expired on March 31, 2017. Due to the ongoing transition of services back to the state throughout the first quarter of 2017, the operating results for our Tennessee portal have also been removed from the same state category for the three- and six-month periods ended June 30, 2017. Furthermore, the operating results for

our new Louisiana portal have been excluded from the same state category for all periods presented because it had not generated revenues for two full comparable periods.

	Three months ended June 30,		Six months ended June 30,	
<u>Key Financial Metrics</u>	2017	2016	2017	2016
Revenue growth - outsourced portals	5 %	6 %	5 %	9 %
Same state revenue growth - outsourced portals	7 %	6 %	6 %	9 %
Recurring portal revenue as a % of total portal revenues	97 %	96 %	97 %	96 %
Gross profit % - outsourced portals	38 %	39 %	39 %	40 %
Revenue growth - software & services	12 %	11 %	14 %	14 %
Gross profit % - software & services	70 %	73 %	70 %	73 %
Selling & administrative expenses as a % of total revenues	15 %	14 %	15 %	14 %
Operating income margin % (operating income as a % of total revenues)	23 %	25 %	24 %	26 %

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,		
		%			%	
<u>Portal Revenue Analysis</u>	2017	Change	2016	2017	Change	2016
IGS transaction-based	\$50,217	11 %	\$45,276	\$96,142	10 %	\$87,209
DHR transaction-based	25,689	(1 %)	25,830	53,858	2 %	52,956
Portal software development	2,193	(30 %)	3,132	4,022	(33 %)	5,995
Portal management	1,275	-	1,275	2,550	-	2,550
Total	\$79,374	5 %	\$75,513	\$156,572	5 %	\$148,710

Portal revenues in the current quarter increased 5%, or approximately \$3.9 million, over the prior year quarter mainly due to a 7%, or approximately \$4.9 million, increase in same state portal revenues (portals in operation and generating comparable revenues for two full periods). Revenues from our new Louisiana portal increased approximately \$1.4 million in the current quarter and were offset by a decrease in revenues from legacy Tennessee and Iowa portals (combined, approximately \$2.4 million) due to contract expirations on March 31, 2017 and November 30, 2016, respectively.

Same state portal revenues grew 7% in the current quarter compared to 6% in the prior year quarter. The same state portal revenues increase in the current quarter was primarily attributable to higher revenues from our Texas, Colorado and South Carolina portals, among others. Same state IGS revenues grew 12% in the current quarter compared to 11% in the prior year quarter. The same state IGS revenues increase in the current quarter was driven by several key services, including vehicle inspections in Texas, motor vehicle registrations in Colorado and Maryland and property tax and business registration filings in New Jersey and South Carolina. Same state DHR revenues grew 1% in both the current and prior year quarters. The increase in same state DHR revenues in the current quarter was primarily attributable to higher transaction volumes from our Utah, Colorado and Wisconsin portals, among others. Same state portal software development and services revenues decreased 22% in the current quarter, due to lower project-based revenues from our Wisconsin and Colorado portals, among others.

Portal revenues in the current year-to-date period increased 5%, or approximately \$7.9 million, over the prior year-to-date period mainly due to a 6%, or approximately \$8.4 million, increase in same state portal revenues. Revenues from our new Louisiana portal increased approximately \$2.9 million in the current year-to-date period and were offset by a decrease in revenues from legacy Tennessee and Iowa portals (combined, approximately \$3.4 million) due to contract expirations on March 31, 2017 and November 30, 2016, respectively.

Same state portal revenues grew 6% in the current year-to-date period compared to 9% in the prior year-to-date period. The same state portal revenues increase in the current year-to-date period was primarily attributable to higher revenues from our Texas, Colorado and Indiana portals, among others. Same state IGS revenues grew 11% in the current year-to-date period compared to 13% in the prior year-to-date period. The same state IGS revenues increase in the current year-to-date period was driven by several key services, including vehicle inspections in Texas, motor vehicle registrations in Colorado and property tax and business registration filings in South Carolina. Same state DHR revenues grew 1% in the current and prior year-to-date periods. The increase in same state DHR revenues in the current year-to-date period was primarily attributable to higher transaction volumes from our Utah, Wisconsin and Colorado portals, among others. Same state portal software development and services revenues decreased 26% in the current year-to-date period, due to lower project-based revenues from our Wisconsin, Indiana and Montana portals, among others.

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 from the prior year period. Fixed costs include costs such as employee compensation and benefits (including stock-based compensation), subcontractor labor costs, telecommunications, provision for losses on accounts receivable, 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 interchange fees required to process credit/debit 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,		
		%			%	
<u>Cost of Portal Revenue Analysis</u>	2017	Change	2016	2017	Change	2016
Fixed costs	\$28,135	2 %	\$27,615	\$56,015	3 %	\$54,606
Variable costs	20,874	13 %	18,508	40,026	14 %	35,132
Total	\$49,009	6 %	\$46,123	\$96,041	7 %	\$89,738

Cost of portal revenues in the current quarter increased 6%, or approximately \$2.9 million, over the prior year quarter due mainly to an increase in same state cost of portal revenues. The increase in same state cost of portal revenues in the current quarter was primarily attributable to an increase in variable fees to process credit/debit card transactions, due mainly to higher IGS transaction volumes, as further discussed above. A significant percentage of our IGS transaction-based revenues are generated from online applications whereby users pay for information or transactions via credit/debit cards. We typically earn a portion of the credit/debit card transaction amount, but also must pay an associated interchange fee to the bank that processes the credit/debit card transaction. We earn a lower incremental gross profit percentage on these transactions as compared to our DHR and other IGS transactions. However, we plan to continue to implement these services as they contribute favorably to our operating income growth. The increase in cost of portal revenues in the current quarter was also attributable to start-up development costs for our new Illinois contract to build an enterprise licensing and permitting platform (\$0.8 million), which was offset by lower costs from the legacy Tennessee and Iowa portals (combined \$1.1 million) during the quarter.

Our portal gross profit percentage was 38% in the current quarter, slightly down from 39% in the prior year quarter. The decrease in portal gross profit percentage was driven largely by costs incurred for our new Illinois contract and a decrease in the profit contribution from the legacy Tennessee, as further discussed above. 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 ongoing investment in our portal operations (which we believe also benefits our stockholders).

Cost of portal revenues in the current year-to-date period increased 7%, or approximately \$6.3 million, over the prior year-to-date period due mainly to an increase in same state cost of portal revenues. The increase in same state cost of portal revenues in the current year-to-date period was primarily attributable to an increase in variable fees to process credit/debit card transactions, due mainly to higher IGS transaction volumes, as further discussed above, and, to a lesser extent, higher employee compensation and benefit costs. Additionally, as discussed above, the increase in the cost of portal revenues for the new Illinois contract in the current year-to-date period was offset by lower costs from the legacy Tennessee and Iowa portals.

Our portal gross profit percentage was 39% in the current year-to-date period, slightly down from 40% in the prior year-to-date period. The decrease in portal gross profit percentage was driven largely by costs incurred for our new Illinois contract and a decrease in profit contribution from the legacy Tennessee portal, as discussed above.

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

	Three months ended June 30,			Six months ended June 30,		
	2017	Change %	2016	2017	Change %	2016
<u>Software & Services Revenue Analysis</u>						
NIC Federal	\$4,278	17 %	\$3,651	\$8,202	14 %	\$7,205
Other	1,674	2 %	1,646	3,729	14 %	3,285
Total	\$5,952	12 %	\$5,297	\$11,931	14 %	\$10,490

Software & services revenues in the current quarter and year-to-date periods increased 12% and 14%, or approximately \$0.7 million and \$1.4 million, respectively, over the corresponding prior year periods. The increase was primarily due to higher revenues in the current quarter and year-to-date periods from our contract with the FMCSA (\$0.2 million and \$0.5 million, respectively) as a result of increased adoption of the PSP and higher revenues in the current quarter and year-to-date periods from our new federal contract with the Library of Congress (\$0.4 million and \$0.5 million, respectively).

COST OF SOFTWARE & SERVICES REVENUES. Cost of software & services revenues in the current quarter and year-to-date periods increased 23% and 24%, or approximately \$0.3 million and \$0.7 million, respectively, over the corresponding prior year periods due mainly to higher employee compensation and benefit costs. Our software & services gross profit percentage was 70% in both the current quarter and year-to-date periods, down from 73% in the corresponding prior year periods.

SELLING & ADMINISTRATIVE. As a percentage of total consolidated revenues, selling & administrative expenses were 15% in each of the current quarter and year-to-date periods, compared to 14%, in each of the corresponding prior year periods. Selling & administrative expenses in the current quarter and year-to-date periods increased 18% and 10%, or approximately \$2.0 million and \$2.3 million, respectively, over the corresponding prior year periods mainly due to higher personnel-related costs and costs to support and enhance corporate-wide information technology, security and portal operations, including development of the citizen-centric Gov2Go enterprise platform.

DEPRECIATION & AMORTIZATION. As a percentage of total consolidated revenues, depreciation & amortization expense was 2% for all periods presented. Depreciation and amortization expense was down slightly in the current quarter and year-to-date periods from the corresponding prior year periods as depreciation on newer capital expenditures was more than offset by assets that became fully depreciated.

INCOME TAXES. Our effective tax rate was approximately 35% and 34%, respectively, for the current quarter and year-to-date periods compared to 36% for both the current quarter and year-to-date periods in the corresponding prior year. Our effective tax rate in the current quarter and year-to-date periods was lower than in the corresponding prior periods mainly due to favorable benefits related to the domestic production activities deduction, which we began recognizing in the third quarter of 2016, and favorable benefits related to excess tax deductions for the vesting of restricted stock awards, which we began recognizing in the provision for income taxes in the first quarter of 2017 upon the adoption of ASU 2016-09 (See Note 1 in the Notes to the Unaudited Consolidated Financial Statements in this Form 10-Q).

Liquidity and Capital Resources

Operating Activities

Net cash provided by operating activities was \$24.4 million in the current year-to-date period compared to \$34.6 million in the prior year-to-date period, as adjusted. The decrease in net cash provided by operating activities in the current period was mainly the result of (i) the timing of payments in current and prior year periods to our government partners in Colorado and Montana, among others, and (ii) a \$1.5 million collateral deposit made with one of our third-party merchant processors in the current period. These decreases were partially offset by an increase in net income in the current period and a decrease in prepaid income taxes in the current period due to the receipt of federal income tax refunds of approximately \$3.0 million related to the amendment of our 2014 and 2013 federal income tax returns for the domestic production activities deduction, which we began recognizing in the third quarter of 2016.

Investing Activities

Net cash used in investing activities was approximately \$4.1 million in the current year-to-date period compared to \$3.9 million in the prior year period. Investing activities in the current and prior year periods primarily reflect \$2.4 million and \$2.7 million, respectively, of capital expenditures, which were for fixed asset additions in our outsourced portal businesses and in our centralized hosting environment to support and enhance corporate-wide information technology and security infrastructure, including Web servers, purchased software and office equipment. Furthermore, in the current and prior year periods we capitalized approximately \$1.7 million and \$1.1 million, respectively, of internal-use software development costs primarily related to the enhancement of centralized customer management, billing and payment processing systems that support our portal operations and accounting systems.

Financing Activities

Net cash used in financing activities was approximately \$12.0 million and \$1.0 million in the current and prior year-to-date periods, respectively. The increase in net cash used in financing activities in the current year-to-date period was primarily attributable to cash dividends paid in the current year period of approximately \$10.7 million. Financing activities in the current and prior year periods also reflect the payment of approximately \$2.6 million and \$2.0 million, respectively, in tax withholdings related to the vesting of stock-based compensation awards and the receipt of approximately \$1.3 million and \$1.1 million, respectively, in proceeds from our employee stock purchase program.

Liquidity

We recognize revenues primarily from providing outsourced digital government 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. We typically collect a majority of our accounts receivable prior to remitting amounts payable to our government

partners.

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 \$142.4 million at June 30, 2017, from \$125.0 million at December 31, 2016. The increase in our working capital was primarily due to cash generated from operations in the period. Our current ratio, defined as current assets divided by current liabilities, was 2.7 and 2.3 at June 30, 2017 and December 31, 2016, respectively.

At June 30, 2017, our cash balance was \$135.4 million, compared to \$127.0 million at December 31, 2016. We believe that our currently available liquid resources and cash generated from operations will be sufficient to meet our operating requirements, capital expenditure requirements and dividend payments (if any) for at least the next 12 months without the need for additional capital. We have a \$10 million unsecured revolving credit facility (the "Credit Agreement") with a bank that is available to finance working capital, issue letters of credit and finance general corporate purposes. The Credit Agreement also includes an accordion feature that will allow us to increase the available capacity under the Credit Agreement to \$50 million, subject to securing additional commitments from the bank. We can obtain letters of credit in an aggregate amount of \$5 million, which reduces the maximum amount available for borrowing under the Credit Agreement. In total, we had \$4.3 million in available capacity to issue additional letters of credit and \$9.3 million of unused borrowing capacity at June 30, 2017 under the Credit Agreement. We were in compliance with all of the financial covenants under the Credit Agreement at June 30, 2017.

19

We have issued letters of credit as collateral for office leases, and to a much lesser extent, as collateral for performance on 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 expiration date of the Credit Agreement. We had unused outstanding letters of credit totaling approximately \$0.7 million at June 30, 2017, consisting of one letter of credit issued as collateral for an office lease and one letter of credit issued as collateral for performance on one of our outsourced government portal contracts. We are not currently required to cash collateralize these letters of credit. As further discussed in Note 5 in the Notes to Unaudited Consolidated Financial Statements in this Form 10-Q, on April 28, 2017, we entered into an amendment to our Credit Agreement to extend our credit facility to May 1, 2019.

At June 30, 2017, we were bound by performance bond commitments totaling approximately \$5.8 million on certain outsourced government portal contracts. Had we been required to post 100% cash collateral at June 30, 2017 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 \$7.5 million and would have been classified as restricted cash.

We currently expect our capital expenditures to range from \$6.0 million to \$7.0 million in fiscal 2017, 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 in our outsourced portal businesses including equipment upgrades and enhancements in our Texas portal, and in our centralized hosting environment to support and enhance corporate-wide information technology and security infrastructure, including Web servers, purchased software, and office equipment. We currently expect our capitalized internal-use software development costs to range from \$3.0 million to \$4.0 million. This estimate includes costs related to the enhancement of centralized customer management, billing and payment processing systems that support our business operations and accounting systems.

On July 31, 2017, our Board of Directors declared a regular quarterly cash dividend of \$0.08 per share, payable to stockholders of record as of September 6, 2017. The dividend, which is expected to total approximately \$5.4 million, will be paid on September 20, 2017, out of the Company's available cash. On May 2, 2017, our Board of Directors declared a \$0.08 per share regular quarterly cash dividend totaling approximately \$5.3 million that was paid out of our available cash on June 20, 2017. On January 30, 2017, our Board of Directors declared a \$0.08 per share regular quarterly cash dividend totaling approximately \$5.3 million that was paid out of our available cash on March 21, 2017. We do not believe these dividends will have a significant effect on our future liquidity needs.

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 federal, state and local government agencies beyond what is contemplated if unforeseen opportunities arise;

expand our product and service offerings beyond what is contemplated if unforeseen opportunities arise;

fund acquisitions;

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. If we need to obtain new debt or equity financing in the future, the terms and availability of such financing may be impacted by economic and financial market conditions, as well as our financial condition and results of operations at the time we seek additional financing. The sale of additional equity securities could result in dilution to our stockholders. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all.

Off-Balance Sheet Arrangements and Contractual Obligations

We had unused outstanding letters of credit totaling approximately \$0.7 million at June 30, 2017.

20

As of June 30, 2017, there have been no material changes outside the ordinary course of business from the disclosures relating to contractual obligations contained under “Off-Balance Sheet Arrangements and Contractual Obligations” 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, 2016, filed with the SEC on February 22, 2017. 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 \$7.7 million at June 30, 2017. 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 is held entirely in domestic non-interest bearing transaction bank accounts. 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

There have been no changes in our internal control over financial reporting that occurred during our second fiscal quarter of 2017 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

Share Repurchases

During the second quarter of 2017, we acquired and cancelled 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
April 20, 2017	264	\$ 21.20	N/A	N/A
May 5, 2017	797	21.45	N/A	N/A
May 6, 2017	686	21.45	N/A	N/A
May 7, 2017	55	21.45	N/A	N/A
Total	1,802		N/A	N/A

ITEM 5. OTHER INFORMATION

Frequency of Future Advisory Votes on Executive Compensation

As previously disclosed, at the May 2, 2017, Annual Meeting of Stockholders of the Company, a plurality of stockholders eligible to vote on the proposal recommended, on a non-binding advisory basis, that future advisory votes on the compensation paid to the Company's named executive officers should occur every year. Consistent with the plurality's indicated preference, the Company's Board of Directors has determined that the Company will include a non-binding advisory vote on executive compensation at each Annual Meeting of Stockholders until the Board of Directors otherwise determines. The Board of Directors shall make a determination on the frequency of advisory votes on executive compensation no less frequently than every six years.

ITEM 6. EXHIBITS

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

The following financial information from NIC's Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (Extensible Business Reporting Language) includes (i) Unaudited Consolidated Balance Sheets at June 30, 2017 and December 31, 2016, (ii) Unaudited Consolidated Statements of Income for the three and six months ended June 30, 2017 and 2016, (iii) Unaudited Consolidated Statement of Changes in Stockholders' Equity for the six months ended June 30, 2017, (iv) Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and 2016, 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, 2017 /s/ Stephen M. Kovzan
Stephen M. Kovzan
Chief Financial Officer

NIC Inc.
EXHIBIT INDEX

Exhibit Number	Description of Exhibit
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32.1	Section 906 Certifications of Chief Executive Officer and Chief Financial Officer
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