Computer Software Innovations, Inc.
Form 10-Q
November 14, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from to

Commission file number: 000-51758

COMPUTER SOFTWARE INNOVATIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**98-0216911**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
900 East Main Street, Suite T, Easley, South Carolina	**29640**
(Address of principal executive offices)	**(Zip Code)**

(864) 855-3900

(Registrant s telephone number, including area code)

[None]

(Former name, former address and former fiscal year, if changed since last report)

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 (§232.405 of this chapter) 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, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at November 9, 2011
Common Stock, $0.001 par value per share	6,584,191 shares

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(Amounts in thousands, except per share data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
REVENUES				
Financial Management Applications Segment	$ 3,526	$ 3,381	$ 10,184	$ 10,472
Cloud Services Segment	277	214	866	698
Technology Solutions Segment	13,471	10,871	29,787	30,121
Net sales and service revenue	17,274	14,466	40,837	41,291
COST OF SALES				
Financial Management Applications Segment				
Cost of sales, excluding depreciation, amortization and capitalization	2,116	1,887	6,053	5,633
Depreciation	31	30	86	88
Amortization of capitalized software costs	289	306	787	843
Capitalization of software costs	(320)	(302)	(914)	(783)
Total Financial Management Applications Segment cost of sales	2,116	1,921	6,012	5,781
Cloud Services Segment				
Cost of sales, excluding depreciation, amortization and capitalization	672	433	1,846	1,418
Depreciation	75	19	180	38
Amortization of capitalized software costs	116	81	252	242
Capitalization of software costs	(189)	(113)	(522)	(487)
Total Cloud Services Segment cost of sales	674	420	1,756	1,211
Technology Solutions Segment				
Cost of sales, excluding depreciation	11,055	9,081	24,935	25,826
Depreciation	24	28	71	76
Total Technology Solutions Segment cost of sales	11,079	9,109	25,006	25,902
Total cost of sales	13,869	11,450	32,774	32,894
Gross profit	3,405	3,016	8,063	8,397
OPERATING EXPENSES				
Research and development	17	45	69	122
Selling costs	1,324	1,154	3,763	3,363
Marketing costs	137	118	440	387
Stock based (non-employee wage) compensation	7	8	22	49
Professional and legal public company compliance costs	157	66	386	385
Depreciation and amortization	100	134	308	434
Other general and administrative expenses	864	755	2,596	2,496
Total operating expenses	2,606	2,280	7,584	7,236

Operating income		799		736		479		1,161
OTHER EXPENSE								
Interest expense		(49)		(54)		(137)		(201)
Loss on disposal of property and equipment								(2)
Other expense		(49)		(54)		(137)		(203)
Income before income taxes		750		682		342		958
INCOME TAX EXPENSE (BENEFIT)		(44)		295		(82)		443
NET INCOME	**$**	**794**	**$**	**387**	**$**	**424**	**$**	**515**
BASIC EARNINGS PER SHARE	**$**	**0.12**	**$**	**0.06**	**$**	**0.06**	**$**	**0.08**
DILUTED EARNINGS PER SHARE	**$**	**0.06**	**$**	**0.03**	**$**	**0.03**	**$**	**0.04**
WEIGHTED AVERAGE SHARES OUTSTANDING:								
Basic		**6,577**		**6,522**		**6,565**		**6,490**
Diluted		**13,641**		**13,912**		**13,629**		**13,889**

The accompanying notes are an integral part of these consolidated financial statements.

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)	September 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$	$ 1,578
Accounts receivable, net	11,266	8,681
Inventories	2,283	558
Prepaid expenses	261	159
Income taxes receivable	313	284
Total current assets	14,123	11,260
PROPERTY AND EQUIPMENT, net	1,381	1,033
COMPUTER SOFTWARE COSTS, net	3,243	2,844
GOODWILL	2,431	2,431
OTHER INTANGIBLE ASSETS, net	2,206	2,359
DEFERRED TAX ASSET	26	
Total assets	**$ 23,410**	**$ 19,927**
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 4,155	$ 2,600
Deferred revenue	6,674	8,014
Deferred tax liability	886	693
Bank line of credit	3,187	
Current portion of notes payable	466	456
Current portion of subordinated notes payable to shareholders	64	58
Total current liabilities	15,432	11,821
LONG-TERM DEFERRED TAX LIABILITY, net		226
NOTES PAYABLE, less current portion	268	618
SUBORDINATED NOTES PAYABLE TO SHAREHOLDERS, less current portion	719	783
Total liabilities	16,419	13,448
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY		
Preferred stock - $0.001 par value; 15,000 shares authorized; 6,740 shares issued and outstanding	7	7
Common stock - $0.001 par value; 40,000 shares authorized; 6,584 and 6,541 shares issued and outstanding, respectively	7	7
Additional paid-in capital	9,373	9,249
Accumulated deficit	(2,276)	(2,700)
Unearned stock compensation	(120)	(84)
Total shareholders equity	6,991	6,479
Total liabilities and shareholders equity	**$ 23,410**	**$ 19,927**

The accompanying notes are an integral part of these consolidated financial statements.

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

(UNAUDITED)

(Amounts in thousands)	Common Stock	Preferred Stock	Additional Paid-In Capital	Accumulated Deficit	Unearned Stock Compensation	Total
Balances at December 31, 2010	**$ 7**	**$ 7**	**$ 9,249**	**$ (2,700)**	**$ (84)**	**$ 6,479**
Common stock based compensation			22			22
Issuance of stock options			102		(102)	
Stock option based compensation					66	66
Net income for the nine months ended September 30, 2011				424		424
Balances at September 30, 2011	**$ 7**	**$ 7**	**$ 9,373**	**$ (2,276)**	**$ (120)**	**$ 6,991**

The accompanying notes are an integral part of these consolidated financial statements.

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Amounts in thousands)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
OPERATING ACTIVITIES		
Net income	$ 424	$ 515
Adjustments to reconcile net income to net cash (used for) provided by operating activities		
Depreciation and amortization	1,684	1,721
Stock compensation expense, net	88	93
Deferred income taxes	(59)	168
Loss on disposal of property and equipment		2
Changes in deferred and accrued amounts		
Accounts receivable	(2,585)	(1,107)
Inventories	(1,725)	1,711
Prepaid expenses	(102)	(51)
Accounts payable	1,555	1,077
Deferred revenue	(1,340)	(2,230)
Income taxes receivable/payable	(29)	(11)
Net cash (used for) provided by operating activities	(2,089)	1,888
INVESTING ACTIVITIES		
Purchases of property and equipment	(842)	(604)
Capitalization of computer software	(1,436)	(1,285)
Net cash used for investing activities	(2,278)	(1,889)
FINANCING ACTIVITIES		
Net borrowings under line of credit	3,187	1,241
Repayments of notes payable	(398)	(1,245)
Proceeds from exercise of stock options and warrants		5
Net cash provided by financing activities	2,789	1
Net change in cash and cash equivalents	(1,578)	
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,578	
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	$
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 134	$ 199
Income Taxes	$ 7	$ 287

The accompanying notes are an integral part of these consolidated financial statements.

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NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES

Organization

Computer Software Innovations, Inc. (formerly VerticalBuyer, Inc.) (the Company , CSI or we), a Delaware corporation, was incorporated on September 24, 1999. The Company currently trades in the over the counter market and is reported on the OTC Bulletin Board under the symbol CSWI.OB.

In the first quarter of 2005, the Company concluded a series of recapitalization transactions which began January 31, 2005 with a change in control due to the purchase of a majority of the Company s common stock by Computer Software Innovations, Inc., a South Carolina corporation (CSI South Carolina). These transactions culminated on February 11, 2005 with the merger of CSI South Carolina into the Company (reverse merger), the Company s issuance of preferred stock, common stock, warrants and certain subordinated notes, and the change of the Company s name to Computer Software Innovations, Inc. At the time, VerticalBuyer was a public shell, having disposed of all prior operations, and CSI South Carolina merged into the shell in a reverse merger transaction, which is a transaction whereby the historical records of Vertical Buyer prior to the merger, for future reporting purposes become those of acquirer, in this case CSI South Carolina, as the prior operations of VerticalBuyer are not comparable to its future operations, which are those carried over from CSI South Carolina. The Company s historical references are now to operations reported under CSI South Carolina since its start in late 1989 and formal organization in 1990. Thus CSI s operations have existed for more than 20 years, 10 years beyond its new corporate organization s (VerticalBuyer s) incorporation which occurred in 1999.

Description of business

The Company is engaged in the business of development and sales of internally developed software, sales and distribution of computers, network and communications hardware and accessories, as well as interactive collaborative classroom technologies and other hardware based solutions.

The Company began as an internal developer of software in 1989. The Company s internally developed software consists of its original product line, fund accounting based financial management software (the results of which are reported through its Financial Management Applications Segment), which is now accompanied by other internal applications development, including standards-based lesson planning software, solutions that facilitate single sign-on application access management provisioning based on Microsoft s Identity Lifecycle Management, referred to as its identity and access management solutions, cloud-based communications and collaboration solutions, including both hosted email and hosted voice-over-internet, using internet protocol (VoIP) services, and Microsoft SharePoint deployments (the results of which are all reported through its Cloud Services Segment). The Company s primary software product, fund accounting based financial management software, is developed for those entities that track expenditures and investments by fund , or by source and purpose of the funding. The fund accounting software is used primarily by public sector and not-for-profit entities. The Company s standards-based lesson planning software is designed to allow teachers to create lesson plans that are tied to a state s curriculum standards. These lesson plans may be reviewed by administrators and a report generated to determine the standards that have been met or need to be met. The lesson plans can be stored, shared, and retrieved for collaboration, editing and future use. The Company s solutions for single sign-on application access management provide the ability to eliminate the need for users to sign on to every application separately (thereby allowing single sign-on) and provides for other efficiencies related to setting-up and controlling user access. The Company s hosted email solutions and hosted VoIP solutions focus on making security and administration of email and VoIP telecommunications more efficient and up-front cost of adoption of the technology lower for its primary kindergarten through grade 12 (K-12) market space.

In connection with its hardware-based solutions, the Company provides a wide range of technology products and services including hardware and design, engineering, installation, training and ongoing support and maintenance (the results of which are reported through its Technology Solutions Segment). The Company added its Technology solutions segment in 1999 to meet the needs of customers to have infrastructure adequate to run its software applications. Its Technology solutions include computers, networking, security, internet protocol (IP) telephony, interactive whiteboard solutions and integrated accessories, distance learning and video communication.

The Company currently markets its products and services primarily to a wide variety of education and local government agencies, and not-for-profit entities. The Company also markets to other verticals such as mid- and larger-sized commercial businesses and healthcare businesses. The majority of the Company s business is with K-12 public education and local government entities, although many of its solutions are also applicable to the commercial market space. The majority of the Company s customers are located in the southeastern United States (US) but, primarily with its cloud products, the Company is adding customers in other US regions.

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Disclosure regarding segments

The Company reports its operations under three operating segments: the Financial Management Applications Segment, the Cloud Services Segment and the Technology Solutions Segment.

Financial Management Applications Segment

Through the Financial Management Applications Segment, the Company reports the results of the development, sales, and deployment and provision of ongoing support of its fund accounting based financial management software. Through this segment, the Company also reports the results of operations related to complimentary third-party applications and services and supplies the Company resells supporting or complementing the use of its Financial Management Applications.

Cloud Services Segment

Through the Cloud Services Segment, the Company reports the results of the development, integration, sales and deployment of its proprietary standards based lesson planning software, solutions that facilitate single sign-on application access management provisioning based on Microsoft s Identity Lifecycle Management, cloud-based communication and collaboration solutions, based on Microsoft s Live@edu hosted exchange and SharePoint environments and Microsoft SharePoint deployments, and for Hosted VoIP (voice calls over Internet protocol via off premises hosting). Through this segment the Company also reports the results of operations related to complimentary third-party applications and services which are an integral part of its Cloud Services solutions.

Technology Solutions Segment

Through the Technology Solutions Segment, the Company reports the results of the technology solutions products through the sales and distribution of computers, infrastructure and physical security hardware and accessories and the wide range of technology consulting services, including network and systems integration and computer support and maintenance services, that the Company provides.

Basis of presentation

The consolidated financial statements include CSI Technology Resources, Inc., a wholly-owned subsidiary. CSI Technology Resources, Inc. was acquired by CSI on May 1, 2000 and became the Technology Solutions Segment of CSI. This subsidiary no longer has any significant operations or separate accounting, as all activities are now accounted for within CSI, except that certain vendor contracts are still in the name of CSI Technology Resources, Inc. At a future date, the name on these contracts may be converted and the subsidiary deactivated, subject to a review of any tax or legal implications. As the Company files a consolidated tax return and has been accounting for all activities through the parent, there should be no financial or tax implications related to the formal procedures which would be undertaken to deactivate the subsidiary. Intercompany balances and transactions have been eliminated. The Company uses the accrual basis of accounting.

Reclassification

Certain prior period amounts have been reclassified to the current presentation. Such reclassifications had no impact on previously reported net income, or shareholders equity.

Use of estimates and interim adjustments and seasonal considerations impacting financial results

The accounting and reporting policies conform to accounting principles generally accepted in the United States of America (generally accepted accounting principles or GAAP). GAAP requires Company management (Management) to make estimates, assumptions and judgments and to rely on projections of future results of operations and cash flows. Those estimates, assumptions, judgments and projections are an integral part of the consolidated financial statements. The Company s management bases its estimates and assumptions on historical data and other assumptions, which include knowledge and experience with regard to past and current events and assumptions about future events that Company management believes are reasonable under the circumstances. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities in its consolidated financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

Management s judgments are based on its assessment as to the effect certain estimates, assumptions of future trends or events may have on the financial condition and results of operations reported in the Company s consolidated financial statements. Actual results could differ materially from these estimates, assumptions, projections and judgments.

The interim consolidated balance sheet and the related consolidated statements of operations, and the changes in shareholders equity and cash flows are unaudited. In Management s opinion, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been made. The results of the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results to be expected for the full year. The Company s operations are seasonal, being driven by its primary client base, K-12 schools being closed or having significantly reduced operations during the summer months. At such time infrastructure and systems changes are less disruptive to their operations and so during such times they prefer to have a larger number of projects completed. As a result, and with the Company s fiscal quarter corresponding to the calendar year, the results for the Company s first and fourth quarters of each fiscal year when schools are in session are typically lower than the results for its second and third quarters, which contain the summer months when schools are closed or have significantly reduced operations. These consolidated financial statements should be read in conjunction with the consolidated financial statements, critical accounting policies, significant accounting policies and the notes to the consolidated financial statements included in the Company s most recent Annual Report on Form 10-K.

Recent accounting pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting, and/or disclosure of financial information by the Company.

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-08, which is intended to simplify testing for goodwill impairment. This guidance gives an entity the option to first assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This guidance will be effective for the Company beginning January 1, 2012. Management is currently evaluating the impact of this update on the Company s financial statements, but they do not expect the adoption of this guidance to have a material impact on the Company s financial position, results of operations, or cash flows.

In May 2011, FASB issued ASU No. 2011-04, which clarifies and changes fair value measurement and disclosure requirements. This guidance expands existing disclosure requirements for fair value measurements and makes other amendments but does not require additional fair value measurements. This guidance will be effective for the Company beginning January 1, 2012. Management does not expect the adoption of this guidance to have a material impact on the Company s financial position, results of operations, or cash flows.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company s financial position, results of operations or cash flows.

NOTE 2 EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income by the weighted average number of common stock shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common and potential common shares outstanding, including common stock held in escrow, during the period following application of the treasury stock method. The table below presents the weighted average shares outstanding for the three and nine month periods ended September 30, 2011 and 2010, both prior to and after application of the treasury stock method.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Weighted Average Shares Outstanding Prior to Application of the Treasury Stock Method				
Common stock (excluding shares held in escrow)	6,577	6,522	6,565	6,490
Common stock held in escrow	200	500	200	500
Preferred stock	6,740	6,740	6,740	6,740
Warrants		300	167	1,226
Options	727	642	604	545
Total Weighted Average Shares Outstanding	14,244	14,704	14,276	15,501
Weighted Average Shares Outstanding After Application of the Treasury Stock Method				

Common stock (excluding shares held in escrow)	6,577	6,522	6,565	6,490
Common stock held in escrow	200	500	200	500
Preferred stock	6,740	6,740	6,740	6,740
Warrants				
Options	124	150	124	159
Total Weighted Average Shares Outstanding treasury stock method	13,641	13,912	13,629	13,889

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NOTE 3 STOCK-BASED COMPENSATION

The Company has a stock based compensation plan, established in 2005, (the 2005 Incentive Compensation Plan). The Company accounts for stock based compensation using the fair value method prescribed in the Stock Compensation section of the FASB s Accounting Standards Codification (ASC), which the Company adopted in 2006 using the modified prospective method. The Company utilizes the Black-Scholes model to estimate the fair value of options granted. In 2005, the Company assumed the stock based employee compensation plan of CSI South Carolina as a result of the reverse merger.

The Company has granted options to purchase shares of common stock in connection with acquisitions, certain hiring agreements and to incent and encourage the longevity of senior employees through option vesting. The issuance of options is further detailed below. The fair value of stock-based compensation was estimated at the grant date for each issuance using the Black-Scholes option-pricing model. For further information and discussion related to the weighted average assumptions used in the option pricing model please see the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

Assumptions used in calculation of fair value

	For the Nine Months Ended September 30, 2011	2010
Expected term (in years)	7	7
Expected volatility	208%	169%
Expected dividend yield	0.0%	0.0%
Risk-free interest rate	2.3%	2.8%

Stock options

Detail	Number of Options	Weighted Average Exercise Price	Expiration
Options assumed in reverse merger	158	$ 0.12	November 1, 2012
Options granted to key employees	100	$ 1.42	November 9, 2017
Options granted to other employees	10	$ 1.09	May 28, 2018
Options granted to key employees	50	$ 0.70	April 17, 2019
Options granted to a key and other employees	196	$ 0.70	June 1, 2020
Options granted to a key and other employees	213	$ 0.70	June 1, 2021

The following table summarizes option activity under the plans for the three months ended September, 30 2011.

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at June 30, 2011	727	$ 0.68	7.12	$ 236
Granted				
Cancelled				
Exercised				
Forfeited/expired				
Outstanding at September 30, 2011	727	$ 0.68	6.87	$
Exercisable at September 30, 2011	383	$ 0.65	4.49	$

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The following table summarizes option activity under the plans for the first nine months of 2011.

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2010	615	$ 0.68	6.31	$
Granted	213	0.70		
Cancelled				
Exercised				
Forfeited/expired	(101)	0.76		
Outstanding at September 30, 2011	727	$ 0.68	6.87	$
Exercisable at September 30, 2011	383	$ 0.65	4.49	$

The aggregate intrinsic value represents the difference between the Company s closing stock price of $0.50 as of September 30, 2011 and the exercise price multiplied by the number of options outstanding as of that date. Because the weighted average exercise price is higher than the market price of $0.50 per share as of September 30, 2011, the aggregate intrinsic value is reflected at $0.

As of September 30, 2011 there remained $120 of unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of approximately three years.

The Company issued 32 shares of common stock to outside Board of Directors and 213 employee stock options under the plan in the first nine months of 2011. There were no other issuances of common stock during the period.

Total stock based compensation for the three months ended September 30, 2011 was $32, of which $7 related to the stock issued to the Company s outside Directors and $25 is related to employee stock compensation (wage-related). Total stock based compensation for the three months ended September 30, 2010 was $32, of which $7 related to the stock issued to the Company s outside Board of Directors, $1 related to stock options granted from acquisition, and the remaining $24 is related to employee stock compensation (wage-related).

Total stock based compensation for the nine months ended September 30, 2011 was $88, of which $22 related to the stock issued to the Company s outside Directors and $66 is related to employee stock compensation (wage-related). Total stock based compensation for the first nine months of 2010 was $93, of which $22 related to the stock issued to the Company s investor relations firm, $22 related to the stock issued to the Company s outside Board of Directors, $5 related to stock options granted from acquisition, and the remaining $44 is related to employee stock compensation (wage-related).

Employee stock compensation (wage related) is included in the Statements of Operations categories of cost of sales or departmental operating expense categories as appropriate.

NOTE 4 LONG-TERM AND SHORT-TERM DEBT, INCLUDING RELATED PARTY TRANSACTIONS, AND OFF-BALANCE SHEET INSTRUMENTS

Bank Credit Facilities

The Company maintains a line of credit facility with its bank. The terms of the facility are as follows:

- the principal amount of the facility is $7.8 million;

- the latest renewal was on September 21, 2011, with a maturity date of July 3, 2013;
- permissible purposes of the funds borrowed under the revolving facility include funding short-term working capital and general corporate purposes of the Company; and
- the definition of the borrowing base includes 50% of eligible inventory (with a maximum borrowing ability against eligible inventory of $1.0 million), in addition to 80% of eligible accounts receivable.

On September 21, 2011, the Company entered into a modification of the line of credit facility, extending the maturity date from June 30, 2012 to July 3, 2013. Previously, on June 25, 2010, the Company entered into a modification of the line of credit facility temporarily increasing the line of credit from $7.0 million to $8.0 million and this increase will be reduced annually by $200 beginning January 31, 2011 until the balance reaches $7.0 million on January 31, 2015 (assuming the facility would be customarily renewed with no significant change in borrowing ability and working capital needs). The increase in the bank s revolving line of credit from $7.0 million to $8.0 million was for the purpose of accommodating a capital need to fund the June 2010 payments of $875, paid on and as agreed in an extension of, the Subordinated Notes (discussed below), while deferring any immediate impact on working capital line availability.

Other than the amendments noted above, the material obligations and provisions of the facility remain unchanged. Previous modifications also memorialized certain previously granted waivers to the restrictive covenants and requirements contained in the agreements with the bank. The bank granted waivers permitting us to enter into acquisitions, including the use of bank credit facility advances to fund such acquisitions, and incurring related mortgage indebtedness for acquired real estate subsequently sold. The bank also waived any cross-default relating to the subordinated notes payable to certain shareholders, which the Company did not repay at their May 2006 maturity. Such waivers and prior modifications have been disclosed in the Company s previous filings on Forms 10-K, 10-Q and 8-K.

Under the Company s bank facility, eligible accounts receivable balances essentially include all of the Company s trade accounts receivable except, in most cases, those accounts which are more than 90 days past due. Certain other accounts are excluded from eligibility for borrowing including: (i) accounts due from affiliates; (ii) accounts which the Company s management have determined to be of doubtful collectability; and (iii) accounts due from any one of the Company s customers if such accounts constitute more than 20% of the total eligible accounts. The loans bear interest at LIBOR plus 2.50%, subject to a 3% floor, payable monthly. LIBOR plus 2.50% was 2.72% at September 30, 2011 and 2.76% at December 31, 2010.

The Company s domestic asset-based lending agreement was negotiated to exceed one year with the intent that borrowings on the revolving credit facility would be classified as long-term debt. However, pursuant to the Debt-Classification of Revolving Credit Agreements Subject to Lock-Box Arrangement and Subjective Acceleration Clauses subtopic of the FASB s ASC (the Revolving Credit Subtopic), a revolving credit facility which includes both a subjective acceleration clause and a lock-box arrangement should be classified as a current liability. The Company s revolving credit facility provides for a lock-box arrangement, whereby cash received is used to reduce the balance on a daily basis. Also, the Company s revolver includes a subjective acceleration clause, providing for acceleration upon a material change in the Company s business or financial condition. This is a customary provision for revolving credit agreements. In accordance with the Revolving Credit Subtopic, the balance outstanding under the Company s revolving credit facility has been classified as a current liability.

The Company maintains an equipment term loan which has been modified and increased from time to time with a term of three to four years. The term loan is used periodically to refinance the Company s capital expenditures initially financed through its bank credit facility and improve its availability under its bank credit facility for working capital purposes. The latest modification prior to September 30, 2011 was November 5, 2010. Pursuant to the modification, the equipment loan was increased from $113 to $1.1 million, and bore interest at 30-day LIBOR plus 250 basis points. Principal and interest are payable in thirty consecutive monthly payments of principal and interest of $40 continuing until April 30, 2013.

The amount outstanding on the equipment notes payable to the bank was $734 at September 30, 2011 and $1,074 at December 31, 2010.

Scheduled principal payments under the Company s bank notes payable for the years ending December 31 are presented below:

2011	$ 115
2012	469
2013	150
Total Principal Payments	$ 734

The loans under the revolving credit facility and the equipment facility, as well as all other obligations owed by the Company to the bank, are secured by a first priority security interest in substantially all of the Company s assets. Also, the Company is required to comply with certain covenants, including: providing periodic financial statements to the bank, compliance with SEC reporting requirements, allowing the bank to inspect its secured assets, and the Company maintaining its assets in good operating condition and maintaining sufficient insurance. Also, the Company is required to comply with certain financial covenants. The first financial covenant is a Debt Service Coverage Ratio, which is measured at the end of each year. This ratio is calculated by adding certain nonrecurring special items to EBITDA (Adjusted EBITDA), and then dividing by current maturities of long term debt plus interest expense. For the purposes of the amended loan agreement, EBITDA means the total of (i) net income or loss from continuing operations (excluding extraordinary gains or losses), and to the extent deducted in determining net income or loss (ii) interest expense, (iii) income taxes, and (iv) depreciation, depletion and amortization expenses. The Company is required to maintain a Debt Service Coverage Ratio of not less than 1.2 to 1.0. The second financial ratio is Funded Debt to EBITDA, which is also measured annually. A ratio of not greater than 2.5 to 1.0 is required. For the purposes of the ratio, Funded Debt generally means all obligations for borrowed money or for the deferred purchase price of property, and all capitalized lease obligations. Management is not aware of any debt covenant violations at September 30, 2011 and December 31, 2010.

The amended loan agreement also contains certain restrictive covenants. These include general prohibitions on: disposing of property other than in the ordinary course of business; the Company changing its business; a change in control of the Company; mergers, acquisitions and the creation of new subsidiaries; the incurring of new indebtedness; the creation of new encumbrances or liens; investments, other than certain permitted investments in liquid investment grade paper; and the Company making loans, including loans to officers. Also, the amended loan agreement prohibits the Company from making any distributions (including any dividends on its common stock), or making any repurchases or redemptions of its capital stock, except to the extent there is no event of default either before or after any such distribution, repurchase or redemption. The bank may accelerate the Company s obligations under the amended loan agreement and the related promissory notes upon an event of default under the amended loan agreement. Events of default generally include the Company failing to make payments of principal or interest when due; defaults under loan covenants, subject to periods during which the Company may cure in certain cases; the Company becoming insolvent or being subject to certain bankruptcy proceedings, subject to certain time periods; and the occurrence of a material adverse change in the Company s business or financial condition. Upon an acceleration of the bank s loans to the Company, the bank, among other remedies, would have recourse to substantially all of the Company s assets through its security interest. There was $3,187 of draws outstanding as of September 30, 2011 and no draws as of December 31, 2010.

Subordinated Notes

The Company has subordinated notes payable to shareholders with amounts outstanding totaling $783 at September 30, 2011, and $841 at December 31, 2010. On June 25, 2010, the Company and each of the holders of certain Subordinated Promissory Notes dated February 11, 2005 (the Subordinated Notes) entered into an Extension of Subordinated Notes and Waiver dated June 24, 2010 (the Extension). Pursuant to the Extension:

- the Company agreed to make, within five days of the date of approval of the Extension, principal payments on the notes totaling $875, $438 in the case of the Subordinated Note held by Barron Partners LP (Barron) and $88 each in the case of the other five note holders. These payments were made on June 29, 2010.

- the maturity date of each Subordinated Note was extended from August 30, 2009 until no later than January 1, 2018, on which date all principal and accrued interest will be due and payable in full, if not earlier paid.

- the Company, beginning October 1, 2010, will make quarterly payments on the Subordinated Notes of principal and accrued interest in the amount of $50 in the aggregate to be applied pro-rata among the note holders, $25 on the Barron Subordinated Note and $5 each on the other Subordinated Notes.

- the Company expressed its intention to consider subsequent to each fiscal year end during the term of the Subordinated Notes whether it can make principal payments in addition to those expressly set forth in the Extension. Any such determination by the management and board of directors of the Company is in their sole discretion, and shall be based on factors they deem relevant, including but not limited to the financial performance of the Company during such fiscal year.

- at the discretion of management and the board of directors of the Company, the remaining balance on the Subordinated Notes can be repaid in full at any time without penalty.

- the Subordinated Notes will no longer be in default, and each note holder waived any existing or past default based upon the Company failing to make any payment of interest or principal when due.

- despite the Subordinated Notes not being in default, they will continue to bear interest at the Default Rate of 15% until repaid.

except as modified by the Extension, all other terms and conditions of the Subordinated Notes were confirmed and shall remain in full force and effect.

The Subordinated Notes were issued on February 11, 2005 as a part of our reverse merger and recapitalization. The Subordinated Notes are unsecured and are subordinated to the Company s senior debt, including its revolving credit and term debt with its bank lender. The original principal of all of the Subordinated Notes aggregated $3,750. At June 25, 2010, immediately prior to the Extension, principal on the Subordinated Notes totaled $1,750 and accrued interest totaled $62. The Company has paid interest at the default rate of 15% per annum since the original maturity date of May 9, 2006, when the Company, with the support of its management, board of directors and the Bank elected to defer the payment and pay the default interest rate to use the funds to support working capital needs and investments in acquisitions. The Subordinated Notes were extended several times, the latest being June 25, 2010, as described above, when the maturity date was extended to January 1, 2018. The history of the Subordinated Notes has been previously disclosed in the Company s Form 8-K dated September 3, 2009, as well as in its prior Forms 10-Q and Forms 10-K.

In addition to Barron, which owns all of our preferred stock, the Subordinated Notes are held by the five shareholders of our predecessor, Computer Software Innovations, Inc., a South Carolina corporation. Four of these note holders are currently

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executive officers of the Company, and include: Nancy K. Hedrick, President and Chief Executive Officer; Thomas P. Clinton, Senior Vice President of Strategic Relationships; Beverly N. Hawkins, Senior Vice President of Software Development; and William J. Buchanan, Senior Vice President of Technical Delivery and Support. The fifth holder, Joe G. Black, formerly served as chief financial officer of the Company. The Extension and the related restructuring of the Subordinated Notes were approved by the Company s three outside directors, none of whom have any interest in the Subordinated Notes.

The restructuring of the Subordinated Notes permits the Company to repay the remaining principal over the approximate seven-year period following the restructure. Although the Company may choose to repay the Subordinated Notes earlier, particularly as a result of superior financial performance, the arrangement removes a default and gives the Company flexibility in managing its future liquidity and capital needs. Such future needs might include future acquisitions, and increased working capital relating to significant sales growth as a result of a turnaround in the general economy or increased Federal funding of technology expenditures for education.

The Extension was formulated in cooperation with the Company s primary lender, RBC Bank (USA) (the Bank), which had previously waived any cross default under the Bank s revolving and other credit facilities as a result of the previous default under the Subordinated Notes. In conjunction with the Company entering into the Extension, it also entered into a related modification of its credit facilities with the Bank.

Scheduled principal payments under the Company s subordinated notes payable for the years ending December 31 are presented below:

2012	$ 87
2013	101
2014	117
2015	136
Thereafter	342
Total Principal Payments	$ 783

Off Balance Sheet Instruments

As of September 30, 2011, and for the periods reported, and through the filing date, CSI had no off-balance sheet instruments except for certain operating leases discussed in Note 7.

Related Party Transactions

During the first nine months of 2011 the Company made principal and interest payments to the five former shareholders of CSI South Carolina, all of whom are significant shareholders of the Company, and four of whom are executive officers, and Barron, who owns all of the Company s preferred shares. These payments were made on the subordinated notes payable which were associated with the reverse merger transaction which occurred in 2005, and represented an annual interest rate of 15% as of September 30, 2011. In 2011, principal and interest payments to the five original shareholders of CSI South Carolina totaled $75 and principal and interest payments to Barron also totaled $75.

NOTE 5 PREFERRED STOCK AND RELATED WARRANTS

Warrants

On February 11, 2005, pursuant to the terms of a Preferred Stock Purchase Agreement with Barron, the Company issued to Barron common stock purchase warrants to purchase a total of 7,218 shares of our common stock (Barron warrants). The unexercised portion of these warrants, detailed below, expired on February 11, 2010.

Barron warrant exercises could have been accomplished in one or a series of transactions, subject to a 4.9% beneficial ownership restriction. The terms and conditions of the Barron warrants were identical except with respect to the exercise price.

On May 13, 2009, pursuant to the terms of a Consulting Agreement with DC Consulting, LLC whereby DC Consulting provided investor relations services, the Company issued to DC Consulting common stock purchase warrants to purchase a total of 300 shares of our common stock. Under the agreement, if at any time prior to their stated expiration date (noted below) the market price for the Company s common stock equals or exceeds the warrant exercise price for a period of 30 days, and the warrants are not exercised, they expire.

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Activity related to the common stock purchase warrants for the three and nine month periods ended September 30, 2011 and 2010 and outstanding balances are as follows:

Common Stock Purchase Warrants

	Warrant A1	Warrant A2	Warrant B1	Warrant B2	DC Consulting Warrant	DC Consulting Warrant	DC Consulting Warrant
Exercise Price	$ 1.3972	$ 0.70	$ 2.0958	$ 0.85	$ 0.70	$ 1.00	$ 1.20
Expiration Date	2/10/2010	2/10/2010	2/10/2010	2/10/2010	6/1/2011	6/1/2011	6/1/2011

Warrant related activity for the three months ended September 30, 2011

	Warrant A1	Warrant A2	Warrant B1	Warrant B2	DC Consulting Warrant	DC Consulting Warrant	DC Consulting Warrant
Outstanding at June 30, 2011					100	100	100
Issued three months ended September 30, 2011							
Exercised three months ended September 30, 2011							
Expired three months ended September 30, 2011					(100)	(100)	(100)
Outstanding at September 30, 2011							

Warrant related activity for the three months ended September 30, 2010

	Warrant A1	Warrant A2	Warrant B1	Warrant B2	DC Consulting Warrant	DC Consulting Warrant	DC Consulting Warrant
Outstanding at June 30, 2010					100	100	100
Issued three months ended September 30, 2010							
Exercised three months ended September 30, 2010							
Expired three months ended September 30, 2010							
Outstanding at September 30, 2010					100	100	100

Warrant related activity for the nine months ended September 30, 2011

	Warrant A1	Warrant A2	Warrant B1	Warrant B2	DC Consulting Warrant	DC Consulting Warrant	DC Consulting Warrant
Outstanding at December 31, 2010					100	100	100
Issued nine months ended September 30, 2011							
Exercised nine months ended September 30, 2011							
Expired nine months ended September 30, 2011					(100)	(100)	(100)
Outstanding at September 30, 2011							