Computer Software Innovations, Inc.
Form 10-Q
May 14, 2010
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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 March 31, 2010

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 **(State or other jurisdiction of** **incorporation or organization)**	**98-0216911** **(I.R.S. Employer** **Identification No.)**
900 East Main Street, Suite T, Easley, South Carolina **(Address of principal executive offices)**	**29640** **(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 ¨ 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 May 10, 2010**
Common Stock, $0.001 par value per share	6,973,343 shares

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COMPUTER SOFTWARE INNOVATIONS, INC.

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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 March 31, 2010	March 31, 2009
REVENUES		
Software Applications Segment	$ 3,835	$ 3,321
Technology Solutions Segment	6,558	5,556
Net sales and service revenue	10,393	8,877
COST OF SALES		
Software Applications Segment		
Cost of sales, excluding depreciation, amortization and capitalization	2,349	2,124
Depreciation	34	29
Amortization of capitalized software costs	339	358
Capitalization of software costs	(440)	(248)
Total Software Applications Segment cost of sales	2,282	2,263
Technology Solutions Segment		
Cost of sales, excluding depreciation	5,739	4,805
Depreciation	23	27
Total Technology Solutions Segment cost of sales	5,762	4,832
Total cost of sales	8,044	7,095
Gross profit	2,349	1,782
OPERATING EXPENSES		
Research and development	39	91
Selling costs	1,058	1,233
Marketing costs	161	155
Stock based compensation	21	2
Acquisition costs		1
Professional, legal compliance and litigation costs	163	95
Depreciation and amortization	149	164
Other general and administrative expenses	907	927
Total operating expenses	2,498	2,668
Operating income (loss)	(149)	(886)
OTHER INCOME (EXPENSE)		
Interest expense	(72)	(113)
Loss on disposal of property and equipment	(1)	(4)

Net other income (expense)		(73)		(117)
(Loss) income before income tax (benefit) expense		(222)		(1,003)
INCOME TAX (BENEFIT) EXPENSE		(53)		(353)
NET INCOME (LOSS)	**$**	**(169)**	**$**	**(650)**
BASIC EARNINGS (LOSS) PER SHARE	**$**	**(0.03)**	**$**	**(0.10)**
DILUTED EARNINGS (LOSS) PER SHARE	**$**	**(0.03)**	**$**	**(0.10)**
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic		**6,461**		**6,381**
Diluted		**6,461**		**6,381**

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)	March 31, 2010 (Unaudited)	December 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 618	$
Accounts receivable, net	7,229	7,587
Inventories	2,150	2,628
Prepaid expenses	179	140
Income taxes receivable	117	32
Total current assets	10,293	10,387
PROPERTY AND EQUIPMENT, net	710	732
COMPUTER SOFTWARE COSTS, net	2,677	2,573
GOODWILL	2,431	2,431
OTHER INTANGIBLE ASSETS, net	2,563	2,647
Total assets	**$ 18,674**	**$ 18,770**
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 2,597	$ 2,229
Deferred revenue	7,566	7,790
Deferred tax liability	511	445
Current portion of notes payable	388	505
Subordinated notes payable to shareholders	1,750	1,750
Total current liabilities	12,812	12,719
LONG-TERM DEFERRED TAX LIABILITY, net	93	144
BANK LINE OF CREDIT		
Total liabilities	12,905	12,863
SHAREHOLDERS EQUITY		
Preferred stock - $0.001 par value; 15,000 shares authorized; 6,740 shares issued and outstanding	7	7
Common stock - $0.001 par value; 40,000 shares authorized; 6,473 and 6,448 shares issued and outstanding, respectively	6	6
Additional paid-in capital	9,093	9,075
Accumulated deficit	(3,322)	(3,153)
Unearned stock compensation	(15)	(28)
Total shareholders equity	5,769	5,907
Total liabilities and shareholders equity	**$ 18,674**	**$ 18,770**

The accompanying notes are an integral part of these 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, 2009	**$ 6**	**$ 7**	**$ 9,075**	**$ (3,153)**	**$ (28)**	**$ 5,907**
Issuance of common stock			18			18
Stock based compensation					13	13
Net income (loss) for the three months ended March 31, 2010				(169)		(169)
Balances at March 31, 2010	**$ 6**	**$ 7**	**$ 9,093**	**$ (3,322)**	**$ (15)**	**$ 5,769**

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Amounts in thousands)	**Three Months Ended March 31, 2010**	**March 31, 2009**
OPERATING ACTIVITIES		
Net income (loss)	$ (169)	$ (650)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	545	578
Stock compensation expense, net	31	12
Deferred income taxes	16	(44)
Loss on disposal of property and equipment	1	4
Changes in deferred and accrued amounts		
Accounts receivable	358	6,432
Inventories	478	(999)
Prepaid expenses	(39)	(72)
Accounts payable	368	907
Deferred revenue	(224)	(1,167)
Income taxes receivable/payable	(85)	(415)
Net cash provided by operating activities	1,280	4,586
INVESTING ACTIVITIES		
Purchases of property and equipment	(102)	(162)
Capitalization of computer software	(443)	(265)
Net cash used for investing activities	(545)	(427)
FINANCING ACTIVITIES		
Net repayments under line of credit		(4,047)
Repayments of notes payable	(117)	(112)
Net cash used for financing activities	(117)	(4,159)
Net change in cash and cash equivalents	618	
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 618	$
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 72	$ 211
Income Taxes	$ 18	$ 107

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

COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(Amounts in thousands, except where specifically stated)

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, we concluded a series of recapitalization transactions which began January 31, 2005 with a change in control due to the purchase of a majority of our 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 us (reverse merger), our issuance of preferred stock, common stock, warrants and certain subordinated notes, and the change of our name to Computer Software Innovations, Inc.

Description of business and disclosure regarding segments

The Company is engaged in the business of development and sales of internally developed software, which is reported through its Software Applications Segment, and sales and distribution of computers, network and communications hardware and accessories, as well as interactive collaborative classroom technologies and other hardware based solutions, accompanied by integration and management services, which activities are reported through its Technology Solutions Segment.

Software Applications Segment

The Company s internally developed software consists of fund accounting based financial management software, standards-based lesson planning software and solutions that facilitate single sign-on application access management provisioning based on Microsoft s Identity Lifecycle Management, referred to as our identity and access management solutions, cloud-based communications and collaboration solutions and Microsoft SharePoint deployments. 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 solution for communication and collaboration, CSI@K12 are instructional communications management solution providing tools to manage the regulatory compliance and security standards required within a kindergarten through grade 12 (K-12) education environment and are based on Microsoft s Live@edu hosted email solution. CSI@K12 also provides an integrated portal experience for school administrators, teachers, students and parents providing email, homework and class task, network file access and a rich set of collaboration tools. These include class sites and social media tools, delivered in a browser and native Microsoft Outlook access and views.

Technology Solutions Segment

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. Technology solutions include computers, networking, security, internet protocol (IP) telephony, interactive whiteboard solutions and integrated accessories, distance learning and video communication.

Market

The Company markets its financial management and technology solutions and its services primarily to a wide variety of education and local government agencies, and not-for-profit entities in the southeastern United States, with a focus on future geographic expansion nationally. Its identity and access management solutions are installed in additional states, with a few

COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(Amounts in thousands, except where specifically stated)

installations internationally, and its CSI@K12 product is targeted to K12 school districts throughout the US. The majority of the Company s business is with K-12 (kindergarten through grade 12) public education entities, with local government entities one of its fastest growing segments and non-for-profits and some corporations also included in its client mix.

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.

Use of estimates and interim adjustments

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 us 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 financial statements. We base our 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 we believe 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 our financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

Our judgments are based on our 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 our 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, changes in shareholders equity and cash flows are unaudited. In our 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 months ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year. These 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 our most recent Annual Report on Form 10-K.

Reclassification

Certain prior period amounts have been reclassified to conform to the current presentation. Such reclassifications had no impact on previously reported Net income or Shareholders equity.

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 April 2010, The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-17, concerning the milestone method of revenue recognition. The ASU codified the consensus reached in EITF Issue No. 08-9, Milestone Method of Revenue Recognition. The amendments to the Codification provide guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. The Company is currently evaluating the impact of the adoption of this guidance but does not anticipate it will have a material impact on our results of operations or financial condition.

In April 2010, The FASB issued ASU No. 2010-13, concerning stock compensation awarded in the currency of which the underlying equity security trades. The ASU codified the consensus reached in EITF Issue No. 09-J. The amendments to the Codification clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity s equity shares trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. The Company is currently evaluating the impact of the adoption of this guidance but does not anticipate it will have a material impact on our results of operations or financial condition.

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COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(Amounts in thousands, except where specifically stated)

In February 2010, the FASB issued ASU No. 2010-09, concerning the recognition and disclosure requirements of certain subsequent events. The amendments in the ASU remove the requirement for an SEC filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. The FASB believes these amendments remove potential conflicts with the SEC s literature. The Company is currently evaluating the impact of the adoption of this guidance but does not anticipate it will have a material impact on our results of operations or financial condition.

In January 2010, The FASB issued ASU No. 2010-06, concerning disclosures about fair value measurements. The ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification. The FASB s objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, ASU 2010-06 amends the Codification to now require (1) A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and (2) in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. In addition, ASU 2010-06 clarifies the requirements of the following existing disclosures (1) For purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and (2) A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009. The Company is currently evaluating the impact of the adoption of this guidance but does not anticipate it will have a material impact on our results of operations or financial condition.

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 (LOSS) PER SHARE

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of common stock shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) 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 months ended March 31, 2010 and 2009, both prior to and after application of the treasury stock method.

	For the Three Months Ended March 31,	
	2010	**2009**
Weighted Average Shares Outstanding Prior to Application of the Treasury Stock Method		
Common stock (excluding shares held in escrow)	6,473	6,381
Common stock held in escrow	500	800
Preferred stock	6,740	6,740
Warrants	6,464	6,164
Options	465	385
Total Weighted Average Shares Outstanding	20,642	20,470

Weighted Average Shares Outstanding After Application of the Treasury Stock Method		
Common stock (excluding shares held in escrow)	6,461	6,381
Common stock held in escrow	500	800
Preferred stock	6,740	6,740
Warrants		
Options	164	160
Total Weighted Average Shares Outstanding treasury stock method	13,865	14,081

The potential common shares were not used in the calculation of diluted loss per share for the three months ended March 31, 2010 and 2009, as the effect is anti-dilutive due to the net loss reported for the period.

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COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(Amounts in thousands, except where specifically stated)

NOTE 3 STOCK-BASED COMPENSATION

The Company has a stock based compensation plan, 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 Standard 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 granted options to purchase 70 shares of common stock in the first quarter of 2007, as a result of the McAleer acquisition which closed on January 2, 2007, and an additional 30 shares of common stock subsequently related to this acquisition. In November 2007, the Company granted options to purchase an additional 100 shares to key employees. In the first quarter of 2008 the Company granted options to purchase an additional 20 to other employees. In April 2009 the Company granted options to purchase an additional 50 shares to its Chief Executive Officer, (in lieu of a portion of a salary adjustment in connection with the renewal of her executive employment agreement. Commitments under executive agreements are discussed further under Executive Officer Employment Agreements in *NOTE 6 COMMITMENTS AND CONTINGENCIES*). 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, 2009.

Assumptions used in calculation of fair value

	For the Three Months Ended March 31,	
	2010	**2009**
Expected term (in years)	7	7
Expected volatility	142%	123%
Expected dividend yield	0.0%	0.0%
Risk-free interest rate	2.5%	3.6%

Stock options

Detail	Number of Options	Weighted Average Exercise Price	Expiration
Options assumed in reverse merger	205	$ 0.12	November 1, 2012
Options granted in McAleer acquisition	100	$ 0.87	January 2, 2017
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

The following table summarizes option activity under the plans for the first three months of 2010:

Stock Options	Number of Shares	Weighted Average Exercise	Weighted Average Remaining	Aggregate Intrinsic Value

		Price per Share	Contractual Term	
Outstanding at December 31, 2009	465	$ 0.64	5.74	$ (21)
Granted				
Cancelled				
Exercised				
Forfeited/expired				
Outstanding at March 31, 2010	465	$ 0.64	5.50	$ (21)
Exercisable at March 31, 2010	410	$ 0.57	5.16	$ 14

The aggregate intrinsic value represents the difference between the Company s closing stock price of $0.60 as of March 31, 2010 and the exercise price multiplied by the number of options outstanding as of that date.

As of March 31, 2010 there remained $15 of unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of approximately two years.

The Company issued 11 shares of common stock to outside Board of Directors under the plan in the first three months of 2010. Outside of the plan, the Company issued non-employee based stock awards of 15 shares of common stock as compensation for investor relations services pursuant to the terms of a Consulting Agreement with its investor relations firm (see also *NOTE 5 PREFERRED STOCK AND RELATED WARRANTS*).

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COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(Amounts in thousands, except where specifically stated)

Total stock based compensation for the first three months of 2010 was $31, of which $11 related to the stock issued to the Company s investor relations firm, $7 related to the stock issued to the Company s outside Board of Directors, $3 related to stock options granted from acquisition, and the remaining $10 is related to employee stock compensation (wage-related). Employee stock compensation (wage related) is included in the income statement categories of cost of sales or departmental operating expense categories as appropriate. Total stock based compensation for the first three months of 2009 was $12, of which $2 was related to the stock options granted as a result of acquisition, and $10 was related to employee stock compensation.

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 $7.0 million;
- the latest renewal was on December 21, 2009, with a maturity date of August 31, 2011;
- 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 December 21, 2009, the Company entered into a modification of the line of credit facility, extending the maturity date from June 30, 2010 to August 31, 2011.

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 our bank facility, eligible accounts receivable balances essentially include all of our 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 we have determined to be of doubtful collectability; and (iii) accounts due from any one of our customers if such accounts constitute more than 20% of the total eligible accounts. The loans bore interest at LIBOR plus 2.50%, subject to a 3% floor, payable monthly. LIBOR plus 2.50% was 2.73% at March 31, 2010 and 2.74% at December 31, 2009.

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 its 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 was November 1, 2008. Pursuant to the modification, the equipment loan was increased from $238 to $1.0 million, and bears interest at 30-day LIBOR plus 250 basis points. Principal and interest are payable in 23 consecutive monthly payments of principal and interest of $40 continuing until November 15, 2010.

The amount outstanding on the notes payable to the bank was $388 at March 31, 2010 and $505 at December 31, 2009.

Scheduled principal payments under the Company s notes payable for the years ended are presented below:

2010	388
Total Principal Payments	$ 388

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(Amounts in thousands, except where specifically stated)

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 from continuing operations (excluding extraordinary gains or losses), and to the extent deducted in determining net income (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 events of noncompliance with these annual covenants at March 31, 2010 and December 31, 2009.

The amended loan agreement also contains certain restrictive covenants. These include general prohibitions on: (i) 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 were no outstanding draws under the facility as of March 31, 2010 and December 31, 2009.

Subordinated Notes

The Company has subordinated notes payable to shareholders with amounts outstanding totaling $1,750 at March 31, 2010, and December 31, 2009. Although the Company possessed adequate availability on the initial due date of May 9, 2006 to repay the subordinated notes, management believed that cash flow from operations and remaining availability under the bank facility following such a drawdown would not be sufficient to fund ongoing working capital needs. The Company also anticipated that such a refunding of the subordinated notes with bank debt would have caused the Company to fail to comply with equity related covenants with the bank, given that the subordinated notes are treated as equity for such ratios. Accordingly, after consultation with the bank and the holders of the subordinated notes, the Company determined it was not in the best interest of all stakeholders to pay the notes at maturity, and the subordinated notes remained due and payable. We pay a default interest rate of 15%, both on the principal balance and any interest not paid quarterly. From time to time we have also deferred the payment of interest to preserve working capital. Specifically, we took this action in the first and second quarters of 2007 as a precautionary measure considering the cash requirement needed for the acquisition of the McAleer operations. Subsequently, we paid this and other interest due and no interest was in arrears as of March 31, 2010, or as of the date of this report.

On May 13, 2009, we and each of the holders of the subordinated notes entered into an agreement to extend the notes until August 30, 2009. In exchange for the extensions, we made a principal payment on the subordinated notes totaling $200, paid pro-rata among the note holders. Under this agreement, the Company sought to enter into a new and separate term loan facility with its bank lender to fund the payout of Barron, and to negotiate to restructure the notes payable to the remaining holders.

In conjunction with the Company entering into the extension with respect to the subordinated notes, it also entered into a waiver agreement (the Waiver) with the bank dated May 13, 2009. The bank had previously granted waivers with respect to cross-default and other provisions which may have been triggered by the payment default under the subordinated notes. The terms of the revolving credit facility with the bank restrict payments on the subordinated notes, and require the Company to obtain the bank s written consent prior to amending any of the terms of the subordinated notes. Accordingly, pursuant to the Waiver, the bank agreed to the terms of the extension and granted waivers of any defaults relating thereto.

Once again, prior to the new maturity at August 30, 2009, and consistent with past actions, the Company attempted to negotiate with Barron for an additional extension of its subordinated debt accompanied by a partial payment. However, we

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have been unable to reach an agreement for an extension and on September 4, 2009 received an invoice from Barron demanding full payment of the Barron subordinated note, including interest accrued through August 31, 2009. The invoice was accompanied by correspondence indicating that if payment were not received within ten days, actions (not specified) would be taken by Barron. Thereafter, continued discussions have occurred between the Company and Barron, although no agreement as to payment or extension has been reached. The remaining subordinated notes are separately and independently held by other note holders, and have not been accelerated. These other five note holders are founders of the Company and four remain in senior management positions. These note holders have cooperated with the Company with regard to past events of default, partial payments and extensions, and management expects continued cooperation and does not anticipate any acceleration by these other note holders.

The notes were due and payable in May of 2006 and have been in default and extended several times. For all quarterly periods due, following May 2006, including during periods when the notes have been under an extension and not considered in default, the Company has paid the default interest rate of 15%. As in past instances, the Company s operations have not been negatively impacted by the event of default. (See also *NOTE 6 COMMITMENTS AND CONTINGENCIES*).

Off Balance Sheet Instruments

As of March 31, 2010, for the periods reported, and through the filing date, CSI had no off-balance sheet instruments except for certain operating leases discussed in Note 6.

Related Party Transactions

During the first three months of 2010 the Company made 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 interest payments were made on the subordinated notes payable associated with the reverse merger transaction which occurred in 2005, and represented an annual interest rate of 15% as of March 31, 2010. In 2010, interest payments to the five original shareholders of CSI South Carolina totaled $32 and interest payments to Barron totaled $32.

NOTE 5 PREFERRED STOCK AND RELATED WARRANTS

Warrants

On February 11, 2005, pursuant to the terms of a Preferred Stock Purchase Agreement with Barron, we issued to Barron common stock purchase warrants to purchase a total of 7,218 shares of our common stock (Barron warrants).

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

The Barron warrants may be exercised on a cashless basis. In such event, the Company would receive no proceeds from their exercise. So long as the Company maintains an effective registration statement for the shares underlying the Barron warrants, a Barron warrant holder is prohibited from utilizing a cashless exercise. The Company s registration statement was declared effective on February 14, 2006 and an updating amendment was declared effective on May 12, 2009.

On May 13, 2009, pursuant to the terms of a Consulting Agreement with DC Consulting, LLC whereby DC Consulting will provide investor relations services, we 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. Also, unlike the Barron warrants, there is no allowance for an exercise on a cashless basis.

Activity related to the common stock purchase warrants for the three months ended March 31, 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

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Warrant related activity for the three months ended March 31, 2010

	Warrant A1	Warrant A2	Warrant B1	Warrant B2	DC Consulting Warrant	DC Consulting Warrant	DC Consulting Warrant
Outstanding at December 31, 2009	2,000	555	2,000	1,609	100	100	100
Issued three months ended March 31, 2010							
Exercised three months ended March 31, 2010							
Expired three months ended March 31, 2010	(2,000)	(555)	(2,000)	(1,609)			
Outstanding at March 31, 2010					100	100	100

Registration Rights Agreement

In conjunction with the Preferred Stock Purchase Agreement, the Company entered into a Registration Rights Agreement with Barron on February 10, 2005, whereby the Company agreed to register the shares of common stock underlying the preferred stock and warrants to be sold to Barron. Barron may also demand the registration of all or part of such shares on a one-time basis and, pursuant to piggy-back rights, may require the Company (subject to carve back by a managing underwriter) to include such shares in certain registration statements it may file. The Company is obligated to pay all expenses in connection with the registration of the shares. The Company s registration rights obligation ended with the expiration of the warrants held by Barron on February 10, 2010.

NOTE 6 COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases certain facilities and equipment under various operating leases. At March 31, 2010, future minimum lease payments under non-cancelable leases were:

2010	$ 819
2011	798
2012	79
Total	$ 1,696

Rent expense for the three months ended March 31, 2010 and 2009 was $272 and $267, respectively.

The Company entered into an operating lease on November 30, 2005 related to the lease of its office facility. The term of this lease is five years, beginning on April 1, 2006 and ending on March 31, 2011. The original commitment under this lease totaled $701, due on the first of each month in escalating monthly payments. The commitments under this lease are included in the future payments in the table above. If at any time the Company terminates the lease, the lessor may recover from the Company all damages approximately resulting from the termination, including the cost of recovering the premises and the worth of the balance of the lease over the reasonable rental value of the premises for the remainder of the lease term, which shall be due immediately. The Company does not anticipate terminating the lease at any time prior to its expiration.

On June 20, 2007, the Company and Chuck Yeager Real Estate amended the operating lease agreement, originally entered into on November 30, 2005, to include an additional 12,544 square feet of warehouse space. The lease of the additional warehouse space was the result of carrying additional inventory and increased monthly rent by approximately $2. While the lease on the additional space was scheduled to expire on August 31, 2007, the Company extended the lease until December 31, 2007. On April 1, 2008 the Company terminated the lease of this additional warehouse space, and entered into a one year lease with Edge Developments, LLC for 18,000 square feet of warehouse space located at 903B East Main Street, Easley, SC. The terms of this lease required monthly payments of $4, which are included in the schedule above, and expired on March 31, 2010. On March 23, 2010, the Company entered into a one year lease with Edge Developments, LLC for 30,000 square feet of warehouse space at 903A East Main Street, Easley, SC. The terms of this lease require monthly payments of $5, which are included in the schedule above, and are scheduled to expire on March 31, 2011.

On April 1, 2008, in connection with the acquisition of ICS Systems, Inc. (ICS) (Note 3), the Company entered into a lease with Byers Properties, LLC for the lease by the Company of the former facilities of ICS. Byers Properties is controlled by Michael Byers, who is the sole shareholder of ICS. The term of the Lease begins April 1, 2008 and runs for a period of three

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years through March 2011. The lease calls for annual rent of $80, payable monthly. The leased property consists of a single-story brick building located on 2.57 acres in Triangle Industrial Park at 8518 Triad Drive, Colfax, North Carolina. The building comprises 7,207 square feet, with approximately 300 square feet being warehouse space. The future minimum lease payments under this lease are included in the schedule above. For further details on the acquisition of ICS, see Note 3 Acquisitions.

In August 2008, the Company entered into a corporate fleet lease program with Enterprise Fleet Services, for which individual vehicle leases are signed that may amount to a total commitment of $2.0 million over a weighted-average lease term of approximately three years. The future minimum lease payment for leases executed under the program as of March 31, 2010 is included in the schedule above.

Executive Officer Employment Agreements

The Company entered into new, separate employment agreements with each of the four most highly compensated executive officers on March 1, 2009, with terms similar to their prior agreements. The term of all the employment agreements is three years, expiring on February 28, 2012. The agreements renew for a one year term automatically upon the expiration of the initial term or any renewal periods unless sooner terminated by any one of the parties. Such agreements provide for minimum salary levels adjusted for performance based on review by the Board of Directors. The aggregate commitment for future salaries at March 31, 2010, excluding bonuses, is approximately $1,662.

NOTE 7 SEGMENT INFORMATION

CSI is organized into the two reportable segments: Software Applications and Technology Solutions. Below is a description of the types of products and services from which each reportable segment derives its revenues.

Software Applications Segment

Through our Software Applications Segment, we report the results of the development, sales, and deployment and provision of ongoing support of our software applications, fund accounting based financial management software, 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. Through this segment we also report the results of operations related to complimentary third-party applications and services we resell.

Technology Solutions Segment

Through our Technology Solutions Segment, we report the results of the technology solutions products through the sales and distribution of computers and accessories and the wide range of technology consulting services, including network and systems integration and computer support and maintenance services, that we provide.

Factors management used to identify our segments:

CSI s reportable segments are analyzed separately because of the differences in margin routinely generated by the major products within each group, and the differences in which sales and investment decisions may be made to evaluate existing or potential new products. Through its Software Applications Segment, the Company develops, sells, deploys and provides ongoing support of software applications. Through its Technology Solutions Segment, the Company provides technology solutions through the sale and distribution of computers and accessories and offers a wide range of technology consulting services, including network and systems integration and computer support and maintenance services.

There are no significant transactions between reportable segments. The total of Segment net sales and service revenue from all segments is equal to Net sales as reported in our Consolidated Statements of Operations. Sales and Cost of sales are included in each segment s income as reported in our Consolidated Statements of Operations. Accordingly, the total of the segments Gross profit is equal to Gross profit in our Consolidated Statements of Operations. Operating expenses are allocated t