

COMPUTER SOFTWARE INNOVATIONS INC  
Form 10QSB  
May 15, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-QSB**

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(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2007.

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number \_\_\_\_\_

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**COMPUTER SOFTWARE INNOVATIONS, INC.**

(Exact Name of Small Business Issuer as Specified in Its Charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**900 East Main Street, Suite T**  
**Easley, South Carolina 29640**

**(864) 855-3900**

**98-0216911**  
(I.R.S. Employer  
Identification No.)

(Address and Telephone Number of Principal Executive Offices)

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Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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  No

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 3,497,030 as of May 9, 2007.

Transitional Small Business Disclosure Format (Check one): Yes  No

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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)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
<b>REVENUES</b>		
Software applications segment	\$ 2,739,436	\$ 1,104,072
Technology solutions segment	8,912,296	3,738,332
Net sales and service revenue	11,651,732	4,842,404
<b>COST OF SALES</b>		
Software applications segment:		
Cost of sales, excluding depreciation, amortization and capitalization	1,418,727	474,255
Depreciation	14,310	18,400
Amortization of capitalized software costs	239,197	151,009
Capitalization of software costs	(226,973)	(181,775)
Total software applications segment cost of sales	1,445,261	461,889
Technology solutions segment:		
Cost of sales, excluding depreciation	7,651,606	2,855,308
Depreciation	21,464	21,600
Total technology solutions segment cost of sales	7,673,070	2,876,908
Total cost of sales	9,118,331	3,338,797
Gross profit	2,533,401	1,503,607
<b>OPERATING EXPENSES</b>		
Salaries and wages and benefits (excluding stock-based compensation)	1,072,307	771,215
Stock based compensation	85,786	613,954
Acquisition expenses	69,655	
Professional and legal compliance related costs	219,871	342,680
Marketing costs	43,649	89,904
Travel and mobile costs	153,421	82,445
Depreciation and amortization	90,247	35,111
Other selling, general and administrative expenses	218,660	95,710
Total operating expenses	1,953,596	2,031,019
Operating income (loss)	579,805	(527,412)
<b>OTHER INCOME (EXPENSE)</b>		
Interest income	2,705	2,181
Interest expense	(134,019)	(92,385)
Amortization of loan fees		(17,458)
Loss on disposal of property and equipment	(1,218)	
Net other income (expense)	(132,532)	(107,662)

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Income (loss) before income taxes	447,273	(635,074)
<b>INCOME TAX EXPENSE (BENEFIT)</b>	162,490	(205,544)
Net income (loss)	<b>\$ 284,783</b>	<b>\$ (429,530)</b>
<b>BASIC EARNINGS (LOSS) PER SHARE</b>	<b>\$ 0.08</b>	<b>\$ (0.15)</b>
<b>DILUTED EARNINGS (LOSS) PER SHARE</b>	<b>\$ 0.02</b>	<b>\$ (0.15)</b>
<b>WEIGHTED AVERAGE SHARES OUTSTANDING Basic</b>	<b>3,489,015</b>	<b>2,891,556</b>
<b>WEIGHTED AVERAGE SHARES OUTSTANDING Diluted</b>	<b>13,675,910</b>	<b>2,891,556</b>

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

**COMPUTER SOFTWARE INNOVATIONS, INC.****CONSOLIDATED BALANCE SHEETS**

	March 31, 2007 (Unaudited)	December 31, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and equivalents	\$	\$
Accounts receivable, net	5,493,438	3,828,190
Inventory	52,160	2,569,382
Prepaid expenses	107,965	56,174
Income taxes receivable	43,651	43,651
Total current assets	5,697,214	6,497,397
<b>PROPERTY AND EQUIPMENT, net</b>	1,372,345	771,472
<b>COMPUTER SOFTWARE COSTS, net</b>	2,124,835	1,505,458
<b>DEFERRED TAX ASSET</b>	205,125	366,476
<b>GOODWILL</b>	1,480,587	
<b>OTHER ASSETS</b>	1,662,308	318,884
	<b>\$ 12,542,414</b>	<b>\$ 9,459,687</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 3,176,868	\$ 3,995,021
Deferred revenue	3,847,621	2,079,492
Deferred tax liability	407,500	373,960
Bank line of credit	1,341,000	551,000
Current portion of notes payable	238,007	109,274
Subordinated notes payable to shareholders	2,250,400	2,250,400
Total current liabilities	11,261,396	9,359,147
<b>NOTES PAYABLE, less current portion</b>	1,007,960	204,680
Total liabilities	<b>12,269,356</b>	<b>9,563,827</b>
<b>SHAREHOLDERS EQUITY (DEFICIT)</b>		
Preferred stock - \$0.001 par value; 15,000,000 shares authorized; 6,944,736 and 7,012,736 shares issued and outstanding, respectively	6,945	7,013
Common stock - \$0.001 par value; 40,000,000 shares authorized; 3,544,385 and 3,429,030 shares issued and outstanding, respectively	3,544	3,429
Additional paid-in capital	6,634,624	6,473,342
Accumulated deficit	(6,240,990)	(6,525,773)
Unearned stock compensation	(131,065)	(62,151)
Total shareholders equity (deficit)	273,058	(104,140)
	<b>\$ 12,542,414</b>	<b>\$ 9,459,687</b>

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



*COMPUTER SOFTWARE INNOVATIONS, INC.*

*CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)*

*(UNAUDITED)*

	Common Stock	Preferred Stock	Additional Paid-In Capital	Accumulated Deficit	Unearned Stock Compensation	Total
<b>Balances at December 31, 2006</b>	\$ 3,429	\$ 7,013	\$ 6,473,342	\$ (6,525,773)	\$ (62,151)	\$ (104,140)
Barron's conversion of preferred stock into common stock	68	(68)				
Exercise of stock options	47		6,582			6,629
Stock-based compensation			154,700		(68,914)	85,786
Net income for three months ended March 31, 2007				284,783		284,783
<b>Balances at March 31, 2007</b>	<b>\$ 3,544</b>	<b>\$ 6,945</b>	<b>\$ 6,634,624</b>	<b>\$ (6,240,990)</b>	<b>\$ (131,065)</b>	<b>\$ 273,058</b>

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



**COMPUTER SOFTWARE INNOVATIONS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	<b>March 31,</b>
	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$ 284,783	\$ (429,530)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	365,218	243,578
Stock compensation expense, net	85,786	613,954
Deferred income taxes	161,141	13,705
Loss on disposal of fixed assets	1,218	
Changes in deferred and accrued amounts		
Accounts receivable	(1,665,248)	2,422,825
Inventories	2,517,222	(14,506)
Prepaid expenses and other assets	51,994	(24,621)
Accounts payable	(818,153)	173,876
Deferred revenue	1,768,129	(273,730)
Taxes payable (receivable)		(225,568)
<b>Net cash provided by operating activities</b>	<b>2,752,090</b>	<b>2,499,983</b>
<b>INVESTING ACTIVITIES</b>		
Purchases of property and equipment	(82,639)	(351,484)
Capitalization of computer software	(226,973)	(181,775)
Purchase of computer software	(21,601)	(10,000)
Trademarks		(4,354)
Purchase of McAleer Computer Associates, Inc.	(4,149,519)	
<b>Net cash used for investing activities</b>	<b>(4,480,732)</b>	<b>(547,613)</b>
<b>FINANCING ACTIVITIES</b>		
Net borrowings (repayments) under line of credit	790,000	(1,701,000)
Borrowings under long term notes payable	972,046	400,000
Repayments of long term notes payable	(40,033)	(8,245)
Exercise of stock options	6,629	
<b>Net cash provided by (used for) financing activities</b>	<b>1,728,642</b>	<b>(1,309,245)</b>
<b>Net change in cash and cash equivalents</b>		<b>643,125</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>		
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$</b>	<b>\$ 643,125</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$ 47,636	\$ 222,882
Income taxes	\$ 1,350	\$ 6,318

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



**COMPUTER SOFTWARE INNOVATIONS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**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. On January 31, 2005, a change in control of the Company occurred as a result of the purchase of a majority of our common stock by Computer Software Innovations, Inc., a South Carolina corporation (CSI South Carolina). On February 11, 2005, CSI South Carolina merged into us, and we issued preferred stock, common stock, warrants and certain subordinated notes. In connection with the merger, we changed our name to Computer Software Innovations, Inc. We refer to the Company prior to the merger as VerticalBuyer.

The merger of CSI South Carolina into us was accounted for as a reverse acquisition, with CSI South Carolina being designated for accounting purposes as the acquirer, and the surviving corporation, VerticalBuyer, Inc., being designated for accounting purposes as the acquiree. Under reverse acquisition accounting, the financial statements of the surviving corporation (VerticalBuyer) are the financial statements of the acquirer (CSI South Carolina). The activities of VerticalBuyer are included only from the date of the transaction forward. Shareholders' equity of CSI-South Carolina, after giving effect for differences in par value, has been carried forward after the acquisition.

The reverse merger and related transactions are described in further detail in our Annual Report on Form 10-KSB for the year ended December 31, 2006.

In accordance with our business strategy, on January 2, 2007, we purchased substantially all of the assets and business operations of McAleer Computer Associates, Inc. (McAleer). The total price for the assets acquired was \$4,050,000. Details on the acquisition are described in Note 3 McAleer Acquisition, below.

**Description of business**

The Company is engaged in the business of development and sales of internally developed software, sales and distribution of computers and accessories, as well as interactive collaborative classroom and other hardware solutions. The Company is also engaged in providing a wide range of technology consulting services, including network and systems integration, along with providing computer support and maintenance services. The Company currently markets its products and services to a wide variety of governmental and not-for-profit entities in the southeastern United States. The majority of the Company's business is with local governmental agencies.

**Basis of presentation**

Our consolidated financial statements include CSI Technology Resources, Inc., a wholly-owned subsidiary. Intercompany balances and transactions have been eliminated. We use the accrual basis of accounting.

We employ accounting principles generally accepted in the United States (generally accepted accounting principles or GAAP). GAAP requires us to make estimates, assumptions and judgments and 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 and 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.



Certain accounting policies, methods and estimates are particularly sensitive because of their significance to the financial statements and of the possibility that future events affecting them may differ markedly from management's current judgments.

The consolidated balance sheet and the related consolidated statements of operations, changes in shareholders' equity (deficit) 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 month period ended March 31, 2007 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-KSB.

Certain amounts have been reclassified to conform to the current presentation.

**NOTE 2 EARNINGS (LOSS) PER SHARE**

Basic earnings (loss) per share is 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 during the period. The weighted average number of common stock shares outstanding was 3,489,015 and 2,891,556 for the quarters ended March 31, 2007 and 2006, respectively. The weighted average number of common and potential common shares outstanding for the quarter ended March 31, 2007 was 13,675,910 (consisting of 3,489,015 shares outstanding and shares underlying our preferred stock, warrants and options of 6,973,447, 2,947,581 and 265,868, respectively); and 12,696,145 for the quarter ended March 31, 2006 (consisting of 2,891,556 shares outstanding, and shares underlying our preferred stock, warrants and options of 7,087,736, 2,460,839 and 256,014, respectively). The actual number of shares underlying outstanding warrants and options were 7,217,736 and 290,988; and 7,217,736 and 268,343, respectively, for the quarters ended March 31, 2007 and 2006. These shares are reduced by application of the treasury stock method, which assumes that the proceeds from the exercise of the warrants and options are used to buy back shares off the market, thereby reducing the number of outstanding shares for the earnings (loss) per share calculation.

GAAP requires that in the case of thinly traded stock, management assess, among other factors, whether the market quoted price is representative of the price that would be effective were all shares issued in connection with various transactions, which would include the issuance of significant additional shares in dilutive transactions. Following consultation with accounting and valuation experts and applying the principle of conservatism, which is a basis of the dilution calculation under GAAP, management uses the higher of an income statement performance and cash flow indicator based stock value computation based on comparisons to peer public companies, or the quoted market price, on a weighted average basis, for the repurchase of shares in the diluted earnings (loss) per share calculation. Once management, in consultation with its accounting and financial experts, considers the stock no longer thinly traded, management will use the quoted market price exclusively.

The potential common shares were not used in the calculation of diluted earnings per share for the quarter ended March 31, 2006, as the effect is anti-dilutive due to the net loss reported for the period.

**NOTE 3 MCALEER ACQUISITION**

On January 2, 2007, the Company consummated its previously announced acquisition of the business operations of McAleer Computer Associates, Inc ( McAleer ). The transaction was structured as a purchase of substantially all of the assets of McAleer.

The total price for the purchased assets was \$4,050,000, of which \$3,525,000 was paid in cash at closing. The balance of \$525,000 was to be paid pursuant to a promissory note to the owner, William McAleer, in twenty quarterly installments of principal in the amount of \$26,250, plus interest in arrears at the LIBOR rate, beginning March 31, 2007. The note was secured by a first mortgage on the real property of McAleer conveyed in the acquisition, consisting of the office building located in Mobile, Alabama from which the Mobile personnel operate. The Company assumed no liabilities of McAleer, other than certain operating leases and obligations under ongoing customer contracts. On February 8, 2007, the Company repaid the note to William McAleer by financing the real estate through a mortgage note with its bank in the amount of \$486,000 (the terms of which are discussed below under Note 5 Long-term and Short-term Debt and Off-Balance Sheet Instruments) and a draw against its revolving credit facility for the remaining balance. Expenses for the acquisition, in the amount of \$266,837, of which \$167,318 was expended in 2006, consisted of legal and professional fees, travel costs, stock compensation costs and various other expenses related to the acquisition transaction. These expenses have been capitalized and allocated to goodwill. The Company engaged an independent party to provide assistance with customary evaluations, analysis and allocation of the

purchase price, which resulted in an allocation to goodwill. For the purposes of recording assets by segment, the acquired assets, including goodwill, are reported under the Software applications segment. The Company expects all goodwill will be deductible for tax purposes, and has an indefinite life for book purposes. The deferred tax liability arises from a difference in the agreed to price for the building asset (tax basis) and the purchase price allocation (book basis included in property and equipment and based on appraisal). Research and development assets acquired in the purchase were not material.

The allocation of the purchase price, including capitalized acquisition expense is as follows (liabilities assumed as a part of the purchase price were not deemed material):

Property and equipment	\$ 615,000
Computer software	610,000
Goodwill	1,480,587
Intangible assets	1,645,000
Deferred tax liability	(33,750)

Total assets purchase and purchase price	\$ 4,316,837
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The detail of computer software, other intangible assets and goodwill over their useful lives are as follows:

Asset	Value	Effective Useful Life
Computer software	\$ 610,000	4 years
Trade name	70,000	3 years
Covenants not-to-compete	75,000	5 years
Customer contracts and related relationships	1,500,000	20 years
<b>Total</b>	<b>\$ 2,255,000</b>	<b>13.3 years *</b>
 Goodwill	 \$ 1,480,587	 indefinite

\* weighted average

The Company funded the acquisition in part with advances of approximately \$2.1 million under its credit facilities with its bank. The Company also utilized approximately \$1.3 million in cash from McAleer as, pursuant to the asset purchase agreement, service contract revenue with respect to 2007 services which was received by McAleer in 2006 prior to the closing was segregated for the Company's account. Initially the owner assumed a \$525,000 note secured by the real estate for the remainder of the purchase price, which was subsequently refinanced, and the Company incurred expenses which were capitalized as a part of the transaction.

Sources of funds used in the transaction (net of subsequent refinancing activities) are as follows:

Proceeds from increase in long-term note payable secured by property and equipment (at time of purchase)	\$ 486,046
Proceeds from long-term note payable secured by real estate (for refinance of McAleer note)	486,000
Receipts on billings for McAleer 2007 support agreements earmarked for CSI	1,280,000
Draw on revolving credit facility (escrow payment at time of signing of definitive agreement)	100,000
Draw on revolving credit facility (at time of purchase (including \$12,378 for acquisition related expenses)	1,671,332
Draw on revolving credit facility (for refinance of McAleer note)	39,000
Payments of acquisition related expenses (funded from revolving credit facility)	254,459
 Subtotal of funds from revolving loan	 2,064,791
 Total purchase price	 \$ 4,316,837



Under SFAS No. 141, Business Combinations, acquisition expenses incurred as of the initiation date by the acquiring company that are direct costs of the acquisition, as determined by the principles of accounting for the acquisition of an asset, should be allocated to identified assets acquired and liabilities assumed, with unallocated amounts being recorded as goodwill. The guidance further defines the initiation date as the earlier of (1) the date that the major terms of a plan, including the ratio of exchange of stock, are announced publicly or otherwise formally made known to the stockholders of any one of the combining companies or (2) the date that stockholders of a combining company are notified in writing of an exchange offer. In addition, direct costs are further defined as out-of-pocket or incremental costs directly related to a business combination such as a finder's fee and fees paid to outside consultants for accounting, legal, or engineering investigations or for appraisals. Guidance further dictates that internal costs associated with a business combination (whether one-time costs or recurring in nature) should be expensed as incurred. Under this guidance, the initiation date of this acquisition was September 20, 2006, the date the Company filed the Form 8-K with the SEC setting forth our intent to acquire McAleer and formally communicating to our shareholders the major terms of the potential acquisition agreement.

In consideration of the requirements of SFAS No. 141, the Company identified expenses incurred that were directly related to the acquisition of McAleer, and capitalized those expenses as appropriate. Upon completion of the acquisition, the purchase price and other direct costs were allocated to identifiable assets or liabilities, with all unallocated amounts classified as goodwill, subject to SFAS No. 142, Goodwill and Other Intangible Assets. As of March 31, 2007, the Company has incurred approximately \$300,000 in acquisition related costs, of which approximately \$267,000 were direct costs of the acquisition of McAleer and were therefore capitalized.

### **Pro Forma Financial Information**

The following unaudited pro forma statement of operations data for the three months ended March 31, 2006 gives effect to our acquisition of McAleer as if the acquisition had occurred on January 1, 2006. Our historical financial information has been derived from our unaudited financial statements included in this report. Historical financial information for McAleer has been derived from the unaudited financial statements of McAleer as of March 31, 2006.

The following unaudited pro forma financial information reflects our accounting for the acquisition of McAleer using the purchase method of accounting. Under the purchase method of accounting, the purchase price that we paid is allocated to the assets acquired, both tangible and intangible, and liabilities that we assumed based upon fair values. Any excess in the purchase price over the fair values of assets and liabilities is recorded as goodwill, which does not require amortization, but is periodically evaluated for impairments. The following unaudited pro forma financial statements data reflects our best estimates of the impact had the transaction occurred on January 1, 2006 based on the best available data, including the final allocation of purchase price using external third-party valuation experts as noted above.

The unaudited pro forma financial information is not necessarily indicative of the financial condition or results of operations that we would have achieved had the acquisition occurred on the dates referred to above. In addition, unaudited pro forma operating information is not necessarily indicative of the results of operations that we may achieve following the consummation of the acquisition.

We have not disclosed pro forma results for the first quarter of 2007 as actual results reported on our income statement are the same as those that would be reported on a pro forma basis. Since the acquisition was agreed to close effective January 1, 2007, and was only closed on January 2, 2007 to accommodate the bank's holiday, the financial statements for the period ended March 31, 2007 as disclosed on the income statement are indicative of the pro forma results for that period and no further disclosure is necessary.



	CSI	McAleer	Adjustments	Pro Forma Combined
<b>Pro Forma Income Statement Data</b>				
<b>Three months ended March 31, 2006</b>				
Revenues	\$ 4,842,404	\$ 1,113,946		\$ 5,956,350
Net income (loss)	(429,530)	202,779 <sup>(1)</sup>	(54,132) <sup>(1)(2)</sup>	(280,883)
Earnings (loss) per share (basic and diluted)	(0.15)			(0.10)
Weighted average shares outstanding	2,891,556			2,891,556

(1) Net income is net of pro forma adjustment for C-corporation taxes.

(2) Net income is adjusted for the pro forma additional depreciation of property and equipment and the amortization of intangibles over the useful lives noted above following the write-up of the assets to their fair values (in accordance with the purchase price allocation detailed above) and the pro forma additional interest expense related to financing used to fund the acquisition.

#### **NOTE 4 STOCK-BASED COMPENSATION**

The Company has a stock based compensation plan, the 2005 Incentive Compensation Plan ( the Plan ). The Company accounts for stock based compensation using the fair value method prescribed in SFAS No. 123R, Share-Based Payment, and related interpretations, which the Company adopted in 2006 using the modified prospective method. The Company utilizes the Black-Scholes model to estimate the fair value of the shares granted.

In 2005, the Company assumed the stock based employee compensation plan of CSI- South Carolina as a result of the reverse merger. In addition, the Company granted 70,000 of new options under the Plan in the first quarter of 2007 at an exercise price of \$0.85 per share, as a result of the McAleer acquisition which closed on January 2, 2007. The fair value of stock-based compensation was estimated at the grant date for each issuance using the Black-Scholes option-pricing model with the following weighted-average assumptions. The assumptions in 2007 relate to the options issued in 2007, reflected in the tables below. The assumptions in 2006 relate to the non-employee compensation issued in 2006, which is discussed under Non-employee Compensation below.

#### *Assumptions used in calculation of fair value*

	For the Period Ended March 31,	
	2007	2006
Expected term (in years)	10	10
Expected volatility	153%	35%
Expected dividend yield	0.0%	0.0%
Risk-free interest rate	4.7%	4.8%

#### *Stock options*

Detail	Number of Options	Weighted Average Exercise Price	Expiration
Options assumed in reverse merger	268,343	\$ 0.12	November 1, 2012
Options granted in McAleer acquisition	70,000	\$ 0.85	January 2, 2017

The following table summarizes option activity under the plans for the first quarter of 2007:

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2006	268,343	\$ 0.12		
Granted	70,000	0.85		
Cancelled				

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Exercised	(47,355)		0.14		
Forfeited/expired					
Outstanding at March 31, 2007	290,988	\$	0.29	6.6	\$ 193,803
Exercisable at March 31, 2007	220,988	\$	0.12	5.6	\$ 186,103

The aggregate intrinsic value represents the difference between the Company's closing stock price of \$0.96 as of March 31, 2007 and the exercise price multiplied by the number of options outstanding as of that date.

As of March 31, 2007 there remained \$79,469 of unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of approximately 5.6 years.

### **Non-employee Compensation**

On February 21, 2006, the Compensation Committee of the Board of Directors and the full Board of Directors approved awards of Company common stock for the Company's outside directors under the Company's 2005 Incentive Compensation Plan (the "Plan"). Directors receiving awards under the Plan were Anthony H. Sobel, Chairman; Shaya Phillips; and Thomas V. Butta. Mr. Sobel was granted 98,496 shares, while Messrs. Phillips and Butta were granted 49,248 shares each. One-third of the awards vested immediately upon approval. An additional one-third vested on February 28, 2006, with the final one-third to vesting on February 28, 2007. Except in the event of a change in control of the Company, the directors could not sell any shares awarded to them prior to March 1, 2007. If a director's service terminated prior to a vesting date, all unvested shares would be forfeited, subject to exception in the discretion of the Board. As a result of his subsequent resignation as a director discussed below, Mr. Butta forfeited 32,832 shares.

Thomas V. Butta resigned from the Company's Board of Directors effective February 22, 2006. His resignation was not the result of any disagreement relating to the Company's operations, policies or practices. Rather, Mr. Butta resigned in order to devote his full attention to his responsibilities with an unaffiliated company of which he is the Chief Executive Officer. Mr. Butta served on the Board's Audit and Compensation Committees.

On March 2, 2006, the Company entered into a Letter of Engagement dated February 27, 2006 and individual restricted stock agreements with Robert F. Steel and Kenneth A. Steel, Jr. (the "Consultants"). The purpose of the agreements was to formally set forth the terms and conditions under which the Consultants had been providing and will continue to provide consulting services to the Company through February 10, 2008. Under the terms of the Letter of Engagement, the Consultants are to advise the Company on the development and implementation of strategic business plans, to assist management in developing marketing and growth strategies, and to assist management in seeking out and analyzing potential acquisition opportunities. The agreement requires the Consultants to provide such consulting services until February 10, 2008. In return, the Company agreed to issue 172,367 shares of its common stock to each of the Consultants. The stock awards were granted pursuant to the Company's 2005 Incentive Compensation Plan. The Company will also reimburse the Consultants for reasonable travel and other expenses incurred by the Consultants in furtherance of the objectives of the agreements. The agreements contain customary confidentiality and non-competition provisions. The agreements also required the Consultants, if they were terminated for cause prior to the earlier to occur of February 28, 2007 or a change in control of the Company, to return one-third of the Stock Awards at the time of termination.

On June 20, 2006, the Board elected Jeffery A. Bryson to fill the vacancy on the Board created by the February 22, 2006 resignation of Mr. Butta. Mr. Bryson serves on the Company's Audit and Compensation Committees and he is Chairman of the Audit Committee. In connection with his election to the Board of Directors on June 20, 2006, the Board approved the award to Mr. Bryson of 23,350 shares of common stock under the Company's 2005 Incentive Compensation Plan. Under the terms of the award, 11,675 shares vested immediately upon Mr. Bryson's election to the Board and the remaining shares will vest at the conclusion of the 2007 Annual Meeting of Stockholders of the Company when Mr. Bryson was reelected to the Board for a successive term at such meeting.

On July 10, 2006, the Company entered into an Investor Relations Consulting Agreement (the "Agreement") with Alliance Advisors, LLC ("Alliance"). The purpose of the Agreement is for Alliance to assist the Company in the development of the Company's investor relations and corporate communications program. Under the terms of the Agreement, Alliance will assist the Company for up to a period of twelve months in developing and implementing an investor relations and corporate communications strategy. In exchange for Alliance's services, the Company paid Alliance \$6,500 per month for the first six months of the Agreement. At the end of six months, either party to the Agreement had the option of terminating the Agreement. The Agreement continues for an additional six months, with a monthly payment of \$7,250. In addition to the cash compensation just described, the Company issued to Alliance sixty thousand (60,000) shares of restricted common stock in the third quarter of 2006. If Alliance does not complete the full one-year term of the Agreement, a pro rata portion of fifty-four thousand (54,000) shares must be returned to the Company. In addition to the cash compensation, it is anticipated that the Company will record non-cash stock-based compensation of approximately \$40,000 per quarter over the subsequent four quarters related to the Agreement.

No additional non-employee based stock awards were granted in the first quarter of 2007.

Total stock based compensation in the first quarter of 2007 was \$85,786, of which approximately \$14,331 related to the stock options granted as a result of the McAleer acquisition, and \$71,455 related to non-employee stock compensation discussed above. As of March 31, 2007 there was \$131,065 of unearned stock compensation.

**NOTE 5 LONG-TERM AND SHORT-TERM DEBT, INCLUDING RELATED PARTY TRANSACTIONS, AND OFF-BALANCE SHEET INSTRUMENTS**

During the first quarter of 2005, in order to support the activities of the reverse acquisition, the Company entered into a \$3.0 million line of credit facility with a bank whereby the Company can borrow up to 80% of accounts receivable balances, not to exceed the total facility limit of \$3.0 million. In the first quarter of 2006, this facility was renewed with an increased limit of \$3.5 million to support increasing working capital requirements of the Company. On January 2, 2007, the principal amount of the facility was increased again to \$5.5 million to support funding and increased working capital in connection with the McAleer acquisition. 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 collectibility; and (iii) accounts due from any one of our customers if such accounts constitute more than 20% of the total eligible accounts. The loans bear interest at Libor plus 2.5% (Libor plus 2.75% in prior year and quarter) (7.72% and 7.38% at March 31, 2007 and 2006, respectively), payable monthly. There were \$1,341,000 and \$551,000 of outstanding draws under the facility as of March 31, 2007 and December 31, 2006, respectively. Following several extensions from the original maturity of July 15, 2006 in connection with the increase to support the McAleer acquisition the maturity was set at May 30, 2007.

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, 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 beginning December 31, 2006. This ratio is calculated by adding certain nonrecurring special items to 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 1.20 to 1.0. The second financial ratio is Funded Debt to EBITDA, which is also measured annually beginning December 31, 2006. 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. The Company complied with these covenants at December 31, 2006 and anticipates continued compliance.

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.

On February 14, 2006 the Company entered into an agreement with its bank for a 42 month term loan of \$400,000 at a fixed interest rate of 7.5% per annum. The facility is collateralized by substantially all of the assets of the Company. The purpose of the term loan was to finance 2005 capital expenditures and improve its availability under its bank credit facility for working capital purposes.

On January 2, 2007, the Company entered into agreements with the bank modifying its credit facilities. Specifically, availability under its revolving facility was increased from \$3.5 million to \$5.5 million, and its equipment facility was increased from \$400,000 to \$800,000. The maturity date for the revolving facility is May 30, 2007, prior to which date the Company anticipates renewing the facility. The equipment note matures January 1, 2010. The primary purpose of the modifications was to increase the amount of the credit facilities to provide for expanding working capital and other credit needs, including funding the acquisition of substantially all of the assets and business operations of McAleer (see Note 3). The 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 the acquisition of McAleer, including the use of bank credit facility advances to fund such acquisition, and incurring mortgage indebtedness to McAleer as a part of the purchase of McAleer's real estate. The bank also waived any cross-default relating to the subordinated notes payable to certain stockholders, which the Company did not repay at their May 2006 maturity.

The Company had subordinated notes payable to shareholders with amounts outstanding totaling \$2,250,400 at both March 31, 2007 and December 31, 2006. Although the Company possessed adequate availability on the May 9, 2006 due date to repay the subordinated notes, management believed that cash flow from operations and remaining availability under the bank facility following such a draw 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 remain due and payable.

Since the Company failed to pay the subordinated notes at maturity such notes are in default. Interest not paid quarterly and any principal not paid by the due date accrue interest at 15% until paid. Any potential cross-default under our bank credit facilities relating to the nonpayment of the subordinated notes has been waived by our bank lender. Pursuant to the terms of our bank credit facilities, we have also agreed to obtain the consent of the bank to any modification of the terms of the subordinated notes.

The Company's subordinated noteholders have cooperated with us in the deferral of payment on the subordinated notes. After discussion with the subordinated noteholders, we did not pay the quarterly interest payments that were due on January 1, 2007 and April 1, 2007. We made the decision to defer these payments in a conservative effort to preserve cash flow anticipating the potential impact on liquidity of borrowings as a result of the McAleer acquisition. Due to the large billings and related cash inflow from the Company's annual billing of support agreements in other quarters of the year, the Company plans to bring such payments current by the third quarter of 2007. Depending on cash flow and liquidity, management will also consider and may make some payments toward reduction of the principal.

The Company anticipates the continued cooperation of the noteholders and the ultimate successful negotiation of a maturity date extension or other restructuring of its subordinated debt with the holders. The subordinated notes may, for example, be refinanced as part of the financing of future acquisitions, or repaid from the proceeds of the exercise of warrants by Barron. However, the Company can give no assurance that it will be able to successfully restructure, extend or refund the subordinated notes, and that the noteholders will continue to cooperate. The notes are subordinated to the Company's senior bank debt, and management believes the ability of the noteholders to have direct recourse against us is limited. However, the Company can give no assurances as to what adverse collection actions the subordinated noteholders might take, and the impact such actions and default might otherwise have on its other creditors and its financial condition. The Company does not anticipate any of the noteholders taking any action which would be detrimental. It should be noted that five of the subordinated noteholders are currently significant stockholders of the Company, and four of these are executive officers. The sixth noteholder, Barron, holds all of the Company's preferred stock.

The amount outstanding on the notes payable at March 31, 2007 was \$1,245,967. Scheduled principal payments under the Company's notes payable for the years ended are presented below:

2007	\$ 198,314
2008	283,187
2009	306,235
2010	458,231
<b>Total Principal Payments</b>	<b>\$ 1,245,967</b>

As of March 31, 2007, for the prior reporting periods, and through the filing date, CSI had no off-balance sheet instruments except for certain operating leases discussed in Note 7.

**NOTE 6 PREFERRED STOCK AND RELATED WARRANTS AND RETAINED EARNINGS (ACCUMULATED DEFICIT)**

On February 11, 2005, pursuant to the terms of a Preferred Stock Purchase Agreement with Barron Partners LP, we issued to Barron two common stock purchase warrants to purchase a total of 7,217,736 shares of our common stock. The respective exercise prices of the warrants were \$1.3972 and \$2.0958 per share, with each warrant exercisable for 3,608,868 shares. On December 29, 2006, we agreed to a re-pricing of a portion of the warrants in a Warrant Amendment and Exchange Agreement between the Company and Barron. One warrant was amended and divided into two warrants, one for 1,608,868 shares of common stock at an exercise price of \$0.70 per share and another for 2,000,000 shares of common stock at the original exercise price of \$1.3972 per share. The second warrant was likewise amended and divided into two warrants, one for 1,608,868 shares of common stock at an exercise price of \$0.85 per share and another for 2,000,000 shares of common stock at the original exercise price of \$2.0958 per share.

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 warrants are identical except with respect to the exercise price.

The warrants may be exercised on a cashless basis. In such event, the Company would receive no proceeds from their exercise. However, a warrant holder (including Barron) could not effect a cashless exercise prior to February 11, 2006. Also, so long as the Company maintains an effective registration statement for the shares underlying the warrants, a 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 14, 2007.

GAAP requires that in the case of thinly traded stock, management assess, among other factors, whether the market quoted price is representative of the price which would be effective were all shares issued in connection with various transactions, which would include having significant additional shares and liquidity in the market. Following consultation with accounting and valuation experts, management used the higher of an income statement performance and cash flow indicator based stock value computation based on comparisons to peer public companies and the market value of their shares near the date of the Company's preferred stock and warrant transaction. The Company used these comparables to calculate a per share market value of its shares as a public company with significant stock liquidity (the Adjusted Market Value).

The Adjusted Market Value of the shares has been used in the Black-Scholes calculation for valuing the warrants, as appropriate. Because the registration rights agreement contained a clause whereby liquidated damages were payable in cash, the warrants were initially considered a liability under derivative accounting (see further discussion below). The principles used under SFAS No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity require that the proceeds be allocated first to the liability portion of an instrument based on its fair market value and the remaining proceeds assigned to the equity portion. As the fair market value of the warrants exceeded the proceeds from the preferred shares and warrants offering, no proceeds, except for the par value of \$7,218, were allocated to the preferred stock.

**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 carveback 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 and, prior to February 11, 2007, was liable for liquidated damages in the event the registration of shares did not remain effective pursuant to the Registration Rights Agreement.



On December 29, 2006, the Registration Rights Agreement was amended to, among other things, eliminate liquidated damages. The Company's obligation to maintain an effective registration statement was also extended by one year until February 11, 2009.

### **Warrants**

As a result of the Registration Rights Agreement containing a clause whereby liquidated damages were payable in cash, the Company was required to follow EITF 00-19. In light of the required accounting treatment under EITF 00-19, the amount of proceeds allocated to the issuance of warrants (\$5,035,032, representing all the proceeds with the exception of the \$7,218 par value allocated to preferred stock) was recorded as a liability as of the date of the transaction. In addition, the difference between the amount allocated to the issuance of warrants and the fair market value of the warrants based on the Black-Scholes valuation method at reporting dates was recorded in the statement of operations as an unrealized gain (loss) on financial instrument-warrant liability and as an adjustment to the financial instrument-warrant liability on the Company's balance sheet, to restate the warrants to fair market value as of that date. In each period up to November 7, 2005, the date of the amendment to the Registration Rights Agreement, whereby the cash liquidated damages provision was converted to damages payable by the issuance of a set number of preferred shares, the financial instrument was marked to market and changes in the value were recorded as adjustments in the statement of operations. These adjustments resulted in the Company reporting a significant accumulated deficit where otherwise it would have reported retained earnings.

It was not the intent of either CSI or Barron that the Registration Rights Agreement result in the majority of the proceeds from the preferred stock and warrant issuance being recorded as a liability rather than equity. In response, on November 7, 2005, CSI and Barron entered into an amendment to the Registration Rights Agreement that eliminated cash liquidated damages and replaced them with liquidated damages in the form of additional shares of Series A Convertible Preferred Stock. Pursuant to the amendment, 2,472 shares of preferred stock would have been issued to Barron for each day when liquidated damages were triggered until February 11, 2007, when this damages provision expired. Because the amendment to the Registration Rights Agreement changed the liquidated damages penalty from settlement in cash to settlement in a set number of shares which is unaffected by changes in the share market price, in accordance with EITF 00-19, as of the amendment date, the fair value of the warrants was reclassified from a liability to permanent equity as additional paid-in capital rather than as a potential offset to the accumulated deficit which would not have existed if the initial accounting for the warrants had been as paid in capital instead of as a liability. The fair value at that date, based on the Black-Scholes valuation method, was \$5,449,392. The difference between this fair value and the amount allocated to the warrants at issuance (\$5,035,032), or \$414,360, was recorded as an unrealized loss on warrants to purchase common stock in the accompanying statement of operations for the year ended December 31, 2005.

Prior to the execution of the amendment to the Registration Rights Agreement, Barron agreed to waive any liquidated damages through November 30, 2005 pursuant to a waiver dated September 30, 2005. Barron had also waived liquidated damages on three prior occasions. In exchange, during the fourth quarter of 2005 the Company paid Barron \$50,000, which was expensed, and agreed to cause the registration statement to become effective under the Registration Rights Agreement on or before November 30, 2005. After that date, the Company entered into two additional waivers extending the required effectiveness date initially until January 31, 2006 and finally, February 28, 2006. The Company's registration statement was declared effective on February 14, 2006.

On September 11, 2006, the Company notified Barron of the need to refrain from selling under the Company's then effective registration statement, and accordingly, to refrain from utilizing the prospectus relating to the primary registration statement until amendments could be filed with the SEC and declared effective. This notification was the result of the proposed acquisition by the Company of substantially all of the assets of McAleer.

The Company filed a post-effective amendment with the SEC on January 29, 2007. We filed another such amendment on March 14, 2007, which was declared effective on that date. However, absent an amendment or waiver of the Registration Rights Agreement, the Company would have been required to issue to Barron 2,472 shares of preferred stock for each day the liquidated damages are triggered until February 11, 2007, when the damages provision expired. As a part of the agreement on December 29, 2006 to re-price the warrants, Barron waived liquidated damages through February 11, 2007, when the liquidated provisions of the Registration Rights Agreement expired. Also, Barron and the Company agreed to extend the effective term of the Registration Rights Agreement by one year.



**NOTE 7 COMMITMENTS AND CONTINGENCIES****Operating Leases**

The Company leases certain facilities and equipment under various operating leases. At March 31, 2007, future minimum lease payments under non-cancelable leases were:

2007	\$ 101,016
2008	138,432
2009	143,433
2010	146,556
2011	36,795
Total	\$ 566,232

The Company entered into a new operating lease with Chuck Yeager Real Estate on November 30, 2005, related to the lease of premises at 900 Block, 900 East Main Street, Easley, SC, Suite T. The term of this lease is five years, beginning on April 1, 2006 and ending on March 31, 2011. Total rent due under this lease is \$700,920, 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 proximately 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.

**Purchase Commitment**

On April 18, 2006, we entered into a Reseller Agreement with Promethean, Inc., pursuant to which we were granted the exclusive right to market and resell certain Promethean products in North Carolina and South Carolina. The Reseller Agreement expired in accordance with its terms on December 31, 2006. Subsequently, the parties continued operating under the terms of the expired Reseller Agreement. In March of 2007, the parties engaged in negotiations for a new agreement.

On or about May 4, 2007, the parties were successful in agreeing on the terms of an interim agreement to be effective beginning May 1, 2007. In exchange for purchasing an initial minimum amount of Promethean product aggregating approximately \$2.3 million, we will receive standardized pricing for the products. We believe that the arrangement preserves our previous exclusive reseller status in the North and South Carolina markets. The terms of the agreement have not been memorialized in a formal written contract.

**NOTE 8 SEGMENT INFORMATION**

CSI is organized into 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, deployment and provision of ongoing support of our software applications, fund accounting based financial management software, and standards based lesson planning software.

*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 a wide range of technology consulting services, including network and systems integration and computer support and maintenance services.

**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 sales and investment decisions made to evaluate existing or potential new products. Through its software

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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 service.

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 Income Statements. Operating expenses are allocated to segment income based on estimates of sales and administrative time spent on each segment. None of the income or loss items following operating income (loss) in our Consolidated Statements of Operations is allocated to our segments, since they are reviewed separately by management. Certain non-recurring items (generally those items occurring for reasons that have not occurred in the prior two years and are not likely to reoccur in two succeeding years) and compliance and governance costs are generally excluded from management's analysis of profitability by segment and the Company's segment presentation. Accordingly, the total of segment income from all segments, less certain non-recurring and compliance and governance items, if any, is equal to operating income (loss) as reported in our Consolidated Statements of Operations.

The total of segment assets for all segments is equal to total assets as reported in our Consolidated Balance Sheets. The Company allocates shared assets related to liquidity (e.g. cash, accounts receivable and inventory) based on each segment's percent of revenues to total consolidated revenues. Capitalized computer software costs are allocated to the software segment. Fixed assets, net, are allocated on the same basis as operating expenses (or by time spent on each segment, as discussed above), because support equipment usage is generally tied to time utilized. All other assets are generally allocated on the same basis.

The following tables summarize information about segment income for the quarters ended March 31, 2007 and 2006; and assets allocated to segments as of March 31, 2007 and 2006.

	Software Applications	Technology Solutions	Total Company
<b>Quarter ended March 31, 2007:</b>			
Net sales and service revenue	\$ 2,739,436	\$ 8,912,296	\$ 11,651,732
Gross profit	1,294,175	1,239,226	2,533,401
Segment income	457,273	497,844	(*)
Segment assets	7,737,587	4,804,827	12,542,414
<b>Quarter ended March 31, 2006:</b>			
Net sales and service revenue	\$ 1,104,072	\$ 3,738,332	\$ 4,842,404
Gross profit	642,183	861,424	1,503,607
Segment income	169,454	259,768	(*)
Segment assets	2,467,902	3,894,922	6,362,824

\* See reconciliation below

**Reconciliation of Segment income (non-GAAP measure) to operating income (loss) per consolidated Statements of Operations (GAAP measure):**

	Quarter Ended	
	March 31, 2007	March 31, 2006
<b>Segment income:</b>		
<b>Software applications segment</b>	\$ 457,273	\$ 169,454
<b>Technology solutions segment</b>	497,844	259,768
<b>TOTAL SEGMENT INCOME</b>	955,117	429,222
<b>Less: Merger and compliance costs</b>		
Stock based compensation	(85,786)	(613,954)
Professional and legal compliance and litigation related costs	(219,871)	(342,680)
Acquisition costs	(69,655)	
<b>OPERATING INCOME (Loss) Per consolidated Statements of Operations</b>	<b>\$ 579,805</b>	<b>\$ (527,412)</b>



**Item 2. Management's Discussion and Analysis or Plan of Operation.**

**A. Overview Introduction**

Unless the context requires otherwise, (1) Computer Software Innovations, Inc., CSI, we, our, us and the Company refer to the consolidated combined business of Computer Software Innovations, Inc., a Delaware corporation formerly known as VerticalBuyer, Inc., and its subsidiary, CSI Technology Resources, Inc., a South Carolina corporation; (2) VerticalBuyer refers to the Company prior to its merger with CSI South Carolina on February 11, 2005; and (3) CSI South Carolina refers to Computer Software Innovations, Inc., a South Carolina corporation, prior to the merger.

We develop software applications and provide technology solutions, focused primarily on the needs of organizations that employ fund accounting. Fund accounting is used by those entities that track expenditures and investments by fund, or by source and purpose of the funding (e.g. funds provide by government or grant sources), and is utilized primarily by public sector and not-for-profit entities. Our client base consists principally of municipalities, school districts and local government organizations. Our clients also include public libraries, disabilities boards and other non-governmental clients.

**Segment reporting**

We monitor our business results as two segments, the software applications segment and the technology solutions segment. Our results of operations related to our internally developed software, including an allocation of overheads, are reported through our software applications segment. Our internally developed software consists of fund accounting based financial management software and standards-based lesson planning software. Our primary software, fund accounting based financial management software, is developed for those entities that track expenditures and investments by fund, or by source and purpose of funding. Our fund accounting software is used primarily by public sector and not-for-profit entities. Through our software applications segment, we also provide standards based lesson planning software. The software is designed to allow education professionals to create, monitor, and document lesson plans and their compliance with a state's curriculum standards including what standards have been met or need to be met. These applications are offered principally to our municipality, school, school district and local government clients. Our software clients also include public libraries, disabilities boards and other non-governmental clients.

Our results of operations related to our hardware-based technology solutions, including an allocation of overheads, are reported through our technology solutions segment. Our hardware-based technology solutions include design, engineering, project planning, installation, training, management and ongoing support and maintenance of hardware and hardware-based operating systems and application software. Our solutions include hardware and hardware-based operating systems and application software for computers, networking, firewall (internet and network access security) and email solutions, IP telephony, wireless networking, video conferencing, video surveillance, monitoring and interactive distance and in-classroom teaching tools. We have established associations with some of the largest vendors in the industry and others whom we believe offer innovative products. These technology solutions are offered to our primary customer base, users of fund accounting. Some solutions, such as IP telephony and video conferencing, are also offered to for-profit entities as opportunities arise.

The wide variety of software and hardware based solutions and related support and maintenance services we offer are discussed in more detail under Organization below.

**Strategy**

While we report the business as two segments and use such information for analysis and decision making purposes, we also operate the business collectively, taking advantage of cross-selling opportunities. As a part of our software applications and technology solutions sales efforts we provide systems and software networking and integration services. These services also generate a significant amount of revenue by increasing demand for the computer hardware equipment we sell.

Our marketing strategy is to provide a suite of software products coupled with full service integration of the hardware solutions that support those products and other back-office functions, and to provide ongoing technical support, monitoring and maintenance services to support the clients' continuing needs. We also market our hardware solutions and ability to provide a wide level of services and support independent from our software solutions, which when marketed to a fund accounting based organization may also lead to future software sales and integration services. By providing a client the ability to call one solution provider and circumvent the difficulties that often arise when dealing with multiple vendors, we believe we are able to achieve high long-term client satisfaction and a competitive advantage in the marketplace. Repeat business from and increased account penetration through added products and services within our existing customer base has been key to our success and we expect it will continue to play a vital role in our growth. Our focus is on nurturing

long-standing relationships with existing customers while establishing relationships with new customers. Over the past ten years we have retained more than 90% of our financial management software customers, and many have become technology solutions customers. Some of our customers who first purchased technology solutions and services have subsequently become financial management software customers.

Our long-term strategy is to pursue a national presence. Our primary, initial focus has been on the southeast region of the United States. As a result of our recent acquisition of McAleer Computer Associates, Inc. ( McAleer ) discussed below, we have expanded our reach into the southeastern states significantly and are beginning to look at other areas of the United States as well.

By strategically combining our internally developed software applications with our ability to integrate computer, networking and other hardware solutions, we have been successful in providing software and hardware solutions to over 400 clients located in the tri-state area of South Carolina, North Carolina and Georgia.

Prior to January 2, 2007, we supported our operations principally out of our physical location in Easley, South Carolina. On January 2, 2007, we acquired the operations, in an asset purchase acquisition, of McAleer. McAleer, an Alabama corporation based in Mobile, Alabama, is primarily a provider of financial management software to the K-12 education market. It has been in operation for over twenty-five years. The acquisition of McAleer strengthens CSI's current operations with the addition of an office in Mobile, Alabama, from which CSI will be able to deliver expanded software, technology and service offerings to a broader geographic area and the local government (city and county) markets. The addition of McAleer brings on more than 160 additional fund accounting customers in the K-12 education sector, with a geographic presence in five states not previously served by CSI: Alabama, Mississippi, Louisiana, Tennessee and Florida. Like CSI, McAleer also has customers in Georgia and South Carolina. In contrast to CSI, McAleer has not historically focused on the local government market or provided as broad a range of technology solutions. CSI has the opportunity to increase sales to those specific markets and the new regions that McAleer serves. McAleer and the acquisition is discussed in more detail below under B. Recent Developments Acquisition of McAleer Computer Associates, Inc.

The products and services previously offered by McAleer are now products and services of CSI. However, in order to differentiate, we will refer to the products and services offered by McAleer prior to the acquisition, and from which continued service and support will be offered from the Mobile, Alabama office subsequent to the acquisition, as McAleer products and services. All other products and services of CSI referred to are those offered by CSI prior to the acquisition of McAleer, and for which CSI continues to provide the development, support and services primarily out of its Easley, South Carolina headquarters.

For more information on our strategy, see our latest annual report filed on Form 10-KSB.

#### **2005 Reverse merger**

We were previously known as VerticalBuyer, Inc. until entering into a merger transaction with CSI South Carolina in February 2005. Incorporated in Delaware on September 24, 1999, VerticalBuyer ceased business operations of any kind in September 2001. Prior to assuming the business operations of CSI South Carolina in the February 2005 merger, VerticalBuyer was a shell corporation without material assets or liabilities.

In the first quarter of 2005, we completed 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 culminated on February 11, 2005 with the merger of CSI South Carolina into the Company, and our issuance of preferred stock, common stock, common stock warrants and certain subordinated notes, and the change of our name to Computer Software Innovations, Inc. ( CSI. ) We refer to the Company prior to such merger as VerticalBuyer, and Computer Software Innovations, Inc. prior to such merger as CSI South Carolina. As we were a shell corporation with virtually no assets or operations and due to other considerations under reverse merger accounting, CSI South Carolina was considered the acquirer and VerticalBuyer the acquiree. As a result, our prior operations for reporting purposes became those of CSI South Carolina. The reverse merger and recapitalization was consummated in consideration that it would allow CSI South Carolina potential access to funds through the capital markets. This potential might assist CSI South Carolina in providing resources to support its long-term growth strategy. The reverse merger resulted in the commencement of the public reporting of CSI South Carolina's operations through us (as the new CSI). The recapitalization transactions, along with further discussion regarding merger accounting and merger summary are discussed in Note 1 herein, and are also discussed in further detail in our most recent filing of our audited financial statements on Form 10-KSB.

## Organization

Our business efforts are focused on two key operating segments: internally developed software applications and related service and support (our Software applications segment ), and other technology solutions and related service and support (our Technology solutions segment ).

### *Software Applications Segment*

Our Software applications segment develops accounting and administrative software applications that are designed for organizations that employ fund accounting. These organizations are primarily municipalities, school districts and local governments. Specific software modules include:

General (or Fund ) Ledger;

Accounts Payable;

Purchasing;

Payroll;

Personnel;

Employee Absence/Substitutes;

Inventory;

Utility Billing; and

Other specialty modules designed for government markets.

Our Software applications segment includes a staff of software developers, implementers, trainers, sales personnel and applications support specialists focused primarily on the development, sales, deployment and support of our in-house software products. From time-to-time they also provide support for the Technology solutions segment.

As in other competitive software businesses, the sales and support of software products developed for resale, coupled with few related hardware sales, support higher margins in the Software applications segment (also referenced as software and related services ). The sales of the Technology solutions segment (also referenced as hardware sales and related services ) are typically at lower margins, due to the amount of hardware, a traditionally low margin product, included in these sales.

### *Technology Solutions Segment*

Our Technology solutions segment has a staff of certified engineers capable of providing a broad range of technology solutions to our client base, including, but not limited to:

Technology planning (developing plans to purchase or upgrade computers, telephone equipment, cabling and software);

Hardware/software installations;

Cabling (installation of wiring and wireless devices to link computer networks and telephones);

System integration (installation of computers and configuration of software to enable systems to communicate with and understand each other);

Wide area networking (linking a group of two or more computer systems over a large geographic area, usually by telephone lines or the internet);

Wireless networking (linking a group of two or more computer systems by radio waves);

IP telephony and IP surveillance (sending voice calls and surveillance across the internet using internet protocol ( IP ), a standard method for capturing information in packets);

Project management (overseeing installation of computers, telephone equipment, cabling and software);

Support and maintenance (using Novell, Microsoft, Cisco and Citrix certified engineers and other personnel to fix problems);

System monitoring (proactively monitoring computers and software to detect problems);

Education technologies, including distance learning and classroom learning tools such as interactive white boards.



In addition to our engineers, our Technology solutions segment includes a staff of sales persons, project managers and product specialists. Our Technology solutions segment also purchases and resells products from a variety of manufacturers including but not limited to Hewlett Packard, Cisco, Microsoft, Novell, Promethean, Tandberg and DIVR, and supports the Software applications segment, as needed.

The combination of traditionally low margin sales of hardware with the sales of services results in a much lower margin for the Technology solutions segment when compared to the Software applications segment. Margins for the Software applications segment were 53.1% for the 2006 fiscal year, while margins for the Technology solutions segment were 15.8% for the same period. Margins for the Software applications segment were 47.2% for the first quarter of 2007, while margins for our Technology solutions segment were 13.9% for the same period. Margins for the Software applications segment were 58.2% for the first quarter of 2006, while margins for the Technology solutions segment were 23.0% in the first quarter of 2006.

We believe the combined efforts of our Technology solutions segment with that of our Software applications segment provide CSI with a competitive advantage in the education and government markets.

For a discussion of the results of the reported segments, see I. Financial Performance Results of Operations Segment Information below.

### **Subsidiary**

Our financial statements continue to include CSI Technology Resources, Inc. as a wholly-owned subsidiary. However, this subsidiary no longer has any significant operations or separate accounting. Its former operations are now accounted for within CSI, except that CSI Technology Resources, Inc. is still named in certain contracts. At a future date, these contracts may be transferred to the parent and the subsidiary deactivated, subject to a review of any tax and legal consequences. 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.

### **Acquisitions**

We believe that to remain competitive, we need to take advantage of acquisition opportunities that arise which may help us achieve greater geographic presence and economies of scale. We may also utilize acquisitions to, when appropriate, expand our technological capabilities and product offerings. While we may use a portion of any cash proceeds generated by operations or obtained from capital sources to pay down debt on an interim basis, we intend to use any additional liquidity and/or availability from those sources or related paydown to fund acquisitions. Additionally, we have engaged a consultant to assist us with acquisitions, including identifying potential acquisition opportunities. We believe our markets contain a number of attractive acquisition candidates. We foresee expanding through acquisitions of one or more of the following types of software and technology organizations:

Developers and resellers of complementary software, such as time and attendance, workflow management, tax appraisals and assessment, education, court and law enforcement related products.

Consulting firms providing high level professional services. We believe this type of acquisition would enhance our offering of technology planning and project management.

Cabling and infrastructure contractors. We currently outsource cabling services.

Our business strategy provides that we will examine the potential acquisition of companies and businesses within our industry. In determining a suitable acquisition candidate, we will carefully analyze a target's potential to add to and complement our product mix, expand our existing revenue base, improve our margins, expand our geographic coverage, strengthen our management team and, above all, improve stockholder returns.

As previously disclosed, on January 2, 2007 we acquired the business operations of McAleer. We believe the acquisition of this leading provider of fund accounting based financial management software in Alabama fits within our acquisition strategy. McAleer and the acquisition transaction are discussed in more detail below under B. Recent Developments Acquisition of McAleer Computer Associates, Inc.

We are unable to predict the nature, size or timing of any acquisition. We can give no assurance that we will reach agreement or procure the financial resources necessary to fund any acquisition, or that we will be able to successfully integrate or improve returns as a result of any such

acquisition. We continue to pursue and enter into preliminary discussions with various acquisition candidates. However, except for the McAleer acquisition, the Company has not entered into agreements or understandings for any other acquisitions which management deems material.

**B. Recent Developments****Acquisition of McAleer Computer Associates, Inc.**

On January 2, 2007, we consummated our previously announced acquisition of the business operations of McAleer. The transaction was structured as a purchase of substantially all of the assets of McAleer.

McAleer is the leading provider of fund accounting based financial management software, its major product, for the K-12 sector of the education market in the state of Alabama and has a presence in five other states. The acquisition expands our reach from our three primary state markets to an eight-state footprint in the southeast. We believe the acquisition constitutes a major move in implementing our strategy of geographic expansion, with the ultimate goal of achieving a national presence. We also believe McAleer has a strong management team and a reputation for delivering quality customer service from its location in Mobile, Alabama. We plan to utilize the existing McAleer staff to continue to service McAleer's existing clients from the offices in Mobile. We anticipate that we will be able to capitalize on the new Mobile location by delivering expanded technology and service offerings to the broader geographic area and the local government (city and county) markets. In contrast to our strategy, McAleer has not historically focused on the local government market or provided as broad a range of technology solutions.

The total price for the purchased assets was \$4,050,000, of which \$3,525,000 was paid in cash at closing. The balance of \$525,000 was paid pursuant to a promissory note payable in twenty quarterly installments of principal in the amount of \$26,250, plus interest in arrears at the LIBOR rate, beginning March 31, 2007. In February 2007, we refinanced the \$525,000 note payable with \$486,000 in proceeds from a new real estate note with our bank and a draw on our revolver for the remaining amount. The new note is payable monthly based on a 7.85% interest rate and a 15 year amortization with a balloon payment due at the end of year three. The original \$525,000 note was and the new \$486,000 note is secured by a first mortgage on the real property of McAleer conveyed in the acquisition, consisting of the office building located in Mobile, Alabama from which our Mobile personnel operate. We assumed no liabilities of McAleer, other than certain leases and obligations of McAleer under ongoing customer contracts.

Expenses for the acquisition, in the amount of \$266,837, consisted of legal and professional fees and travel costs and various other expenses related to the acquisition transaction. These expenses have been capitalized and allocated to goodwill. We engaged an independent party to provide assistance with customary evaluations, analysis and allocation of the purchase price, which resulted in an allocation to goodwill. For the purposes of recording assets by segment, the acquired assets, including goodwill will be reported under the software applications segment. The Company expects all goodwill will be deductible for tax purposes, and has an indefinite life for book purposes. The Deferred tax liability arises from a difference in the agreed to price for the building asset (tax basis) and the purchase price allocation (book basis included in Property and equipment and based on appraisal). Research and development assets acquired in the purchase were not material.

The allocation of the purchase price, including capitalized acquisition expenses, is as follows (other liabilities assumed as a part of the purchase were not deemed material):

Property and equipment	\$ 615,000
Computer software	610,000
Goodwill	1,480,587
Intangible assets	1,645,000
Deferred tax liability	(33,750)
 Total purchase price	 \$ 4,316,837

The detail of Computer software, other Intangible assets and Goodwill and their useful lives are as follows:

Asset	Value	Effective Useful Life
Computer software	\$ 610,000	4 years
Trade name	70,000	3 years
Covenants not-to-compete	75,000	5 years
Customer contracts and related relationships	1,500,000	20 years

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Total	\$ 2,255,000	13.3 years *
Goodwill	\$ 1,480,587	indefinite

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\* weighted average

We funded the acquisition in part with advances of approximately \$2.1 million under our modified credit facilities with our bank. We also utilized approximately \$1.3 million in cash from McAleer as, pursuant to the asset purchase agreement, service contract revenue with respect to 2007 for which cash was received by McAleer in 2006 prior to the closing was segregated for our account. Initially the owner assumed a \$525,000 note secured by the real estate for the remainder of the purchase price, which was subsequently refinanced, and the Company incurred expenses which were capitalized as a part of the transaction.

Sources of funds used in the transaction, including subsequent refinance activities and related expenses are as follows:

Proceeds from increase in long-term note payable secured by property and equipment (at time of purchase)	\$ 486,046
Proceeds from long-term note payable secured by real estate (for refinance of McAleer note)	486,000
Receipts on billings for McAleer 2007 support agreements earmarked for CSI	1,280,000
Draw on revolving credit facility (escrow payment at time of signing of definitive agreement)	100,000
Draw on revolving credit facility (at time of purchase (including \$12,378 for acquisition related expenses)	1,671,332
Draw on revolving credit facility (for refinance of McAleer note)	39,000
Payments of acquisition related expenses (funded from revolving credit facility)	254,459
Subtotal of funds from revolving loan	2,064,791
Total purchase price	\$ 4,316,837

It is anticipated that McAleer will add additional revenues of approximately \$5.0 million to our software applications segment. McAleer is in the process of upgrading approximately 60% of its customers to the latest major release of the McAleer fund accounting system. These increases provide additional revenue due to the increased pricing structure to reflect the enhancements in the latest major release. Accordingly, while not estimable, we anticipate an ongoing improvement in our recurring revenues through this upgrade process.

Due to the increased depreciation and amortization of intangible assets based on the purchase price allocation, and financing costs of the transaction, it is not anticipated that McAleer will add a significant amount to earnings in 2007. However, it is anticipated the McAleer acquisition will be cash flow positive.

For results of operations for the period of this filing, see G. Overview of Financial Performance Three months ended March 31, 2007, versus three months ended March 31, 2006 pro forma combined and Note 3 to our unaudited consolidated financial statements dated March 31, 2007 included in this report.

#### **Modification of Bank Credit Facilities**

On January 2, 2007, the Company and RBC Centura Bank entered into an amended and restated loan agreement. The amended loan agreement restated and amended various agreements between the Company and the bank. The primary purpose of the amended loan agreement was to increase the amount of the Company's credit facilities to provide for its expanding working capital and other credit needs, including the funding of a substantial portion of the purchase price in the Company's acquisition of McAleer. Specifically, the Company's revolving facility was increased from \$3.5 million to \$5.5 million, and the Company's equipment facility was increased from \$400,000 to \$800,000.

Borrowings under the revolving credit facility bear interest at one month LIBOR plus 2.5%, payable monthly in arrears beginning February 1, 2007. The facility expires on May 30, 2007, at which time all principal and other amounts are due and payable. The facility may be prepaid in whole or in part at any time without penalty. Upon nonpayment of interest, or the Company's failure to repay the facility at maturity, whether by acceleration or otherwise, interest may be charged at a default rate of 5% plus the pre-default rate of interest otherwise applicable.

Draws under the revolving facility are generally determined pursuant to a borrowing base equal to 80% of the Company's eligible accounts. Eligible accounts essentially include all of the Company's trade accounts receivable less than 90-days old. Certain other accounts are excluded from eligibility, including: (i) accounts subject to any security interest or incumbrances ranking in priority to the security interest of the bank; (ii) accounts due from affiliates; (iii) accounts which have been determined to be of doubtful collectability; and (iv) accounts due from any one of the Company's customers if such accounts constitute more than 20% of total eligible accounts. Total advances under the facility are limited to the lesser of the borrowing base or \$5.5 million. Advances can be borrowed, repaid and reborrowed under the revolving facility. On January 2, 2007, immediately prior to the parties entering into the amended loan agreement, advances totaling \$569,000 were outstanding under the revolving facility. Upon entering into the amended loan agreement, the Company drew down \$1.7 million, which was used to fund a portion of the purchase price in the McAleer acquisition. Following such advance, borrowings under the revolving facility totaled \$2.2 million, with \$400,000 available for further advances. As of May 9, 2007, \$2.0 million was outstanding under the facility and \$1.6 million was available for additional draws.

On February 14, 2006, the Company entered into a 42-month term loan totaling \$400,000 with the Bank, at a fixed interest rate of 7.5% per annum. The purpose of the loan was to finance capital expenditures long term and improve availability under the revolving facility. The amended loan agreement modified the February 2006 equipment loan, increasing it to \$800,000. The equipment note bears interest at 7.85% per annum. Principal and interest are payable in 36 consecutive monthly payments of \$25,015 commencing February 1, 2007 and continuing until January 1, 2010, when all amounts under the equipment loan will be due and payable. The term note may be prepaid in whole or in part at any time without penalty. Upon nonpayment of any payment of interest under the equipment note, or after maturity of the note whether by acceleration or otherwise, interest accrues at a default rate equal to the pre-default interest rate plus 5%. Payments past due for 15 or more days are also subject to a late charge of up to 4% of the amount of the payment past due. The new equipment note refunded the February 2006 equipment loan balance of \$313,954, with an additional \$486,046 being advanced at the January 2, 2007 closing. The additional proceeds represented a reimbursement to the Company for capital expenditures incurred during 2006, and were used to help fund the McAleer acquisition.

In the amended loan agreement, the bank also committed to extend to the Company mortgage financing, discussed above, to refund indebtedness incurred by the Company in the acquisition of real estate in Mobile, Alabama as a part of the McAleer acquisition. The commitment limited the amount of such financing to the lesser of 90% of the appraised value of the improved real estate or \$500,000.

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, 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 beginning December 31, 2006. This ratio is calculated by adding certain nonrecurring special items to 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. EBITDA, as adjusted for certain non-recurring special items, is referred to elsewhere in this prospectus as Adjusted EBITDA or Financing EBITDA. It is a non-GAAP financial measure, which is discussed and reconciled to appropriate GAAP measures at H. Liquidity and Capital Resources Non-GAAP Financial Measures: EBITDA and Adjusted EBITDA.

The Company is required to maintain a Debt Service Coverage Ratio of not less than 1.20 to 1.0. The second financial ratio is Funded Debt to EBITDA, which is also measured annually beginning December 31, 2006. A ratio of not greater than 2.5 to 1 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. At December 31, 2006, we complied with these covenants.

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 incumbrances 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.

The amended loan agreement also memorializes certain previously granted waivers to the requirements of the continuing credit facilities with the bank. Such waivers from default and the operation of the covenants contained in the amended loan agreement include: waivers permitting the Company to enter into the acquisition of McAleer, including the use of bank credit facility advances to fund such acquisition and the Company's incurring mortgage indebtedness to McAleer as a part of the purchase of McAleer's real estate; and a waiver with respect to any cross-default relating to the Company's subordinated debt to certain stockholders, which debt was not paid at the May 2006 maturity.

### **C. Current Challenges and Opportunities of our Business, and Forward-Looking Information**

#### **Bid and Sales Processes and Procedures**

Because of our focus on the public sector, many sales opportunities are subject to our having to comply with government bid requirements and other formal proposal processes. Complying with such requirements and processes can result in a significant investment of time and effort that may or may not result in a sale. We have been implementing procedures to make the bid and sales process more efficient and believe these types of improvements will aid in our ability to maintain competitiveness in the marketplace. We will also look for additional process improvement opportunities as we move through the process of documenting controls and procedures in order to comply with the Sarbanes-Oxley Act legislation. However, this process is primarily compliance-driven, will be costly, and cost-saving opportunities as a result of this process, if any, may be limited.

#### **Sarbanes-Oxley Compliance**

Prior to February 11, 2005, we were a public shell with virtually no operations and CSI - South Carolina was a private company with limited complex accounting issues. As a result neither we nor CSI - South Carolina had need for staff with technical accounting and public reporting expertise. In the first quarter of 2005, we entered into a complex merger and began public reporting of significant operations. It was some time before we hired personnel with public reporting experience and began updating our procedures to comply with the Sarbanes-Oxley Act. In the process of reviewing and improving our controls and processes, we have identified and reported errors in our financial reporting.

One error in 2006 was the identification of an isolated computer-generated report calculation error (due to a unit of measure issue) which resulted in the overaccrual of sales in the second quarter of 2006 which was detected when the overaccrual was reversed in the subsequent quarter. Also, prior to the release of our 2006 Form 10-KSB: (i) we detected a typographical error which was not caught in a Form 8-K submission due to failure to clerically check the report after it was Edgarized and before submitted electronically by a third party service provider, and (ii) we detected a typographical error in our September 30, 2006 Form 10-QSB with respect to our net loss for the prior year nine months period ended September 30, 2005. All of these have been properly corrected and disclosed in previously filed reports.

In connection with these errors, we identified a deficiency related to the review of calculations for significant transactions and during certain points in the regulatory filing cycle review a deficiency as a result of insufficient personnel time and resources. While we implemented the internal control improvements with a policy whereby transactions of significant size are recalculated, we have adopted procedures and are increasing our resources to expand our review and validation process to identify and correct typographical and related errors, and we plan to take the following additional actions to improve internal controls in 2007. In the third quarter of 2006 we purchased software for approximately \$50,000 which will allow us to automate our monitoring of our controls to assure they are executed as designed. We believe this will provide the most cost effective solution to meet the requirements of the Sarbanes-Oxley Act. This system was installed and training begun, but no improvements implemented in fourth quarter 2006. The entering of controls into the system and the monitoring of those controls will be occurring in the second quarter and throughout the remainder of 2007. In fourth quarter 2006, for an





undisclosed amount (due to agreement with the vendor), we also purchased a financial reporting, planning and consolidation system which was not installed until first quarter 2007, and is not yet fully implemented. This system will eliminate the use of complex spreadsheets used in the roll-up of financial information for both internal and external reporting and improve the timeliness of our financial close and reporting cycle. It will also provide more time for personnel to focus on analysis and review of financial information and controls surrounding those activities which must be performed late in the financial closing and regulatory filing cycles. The system also establishes a framework to automate the consolidation of acquired entities, which the Company believes is critical to support the acquisition portion of its growth strategy. This system has been installed and will be implemented throughout the remainder of 2007.

Our accounting system also interfaces with an automated forms routing and approval system which includes the ability to attach and retain supporting documentation. In first quarter 2007, this system was implemented and we identified certain forms and other documents to be integrated into the automated system to improve the consistency and documentation of compliance with controls already in place. We plan to expand the number of forms being used in the system and anticipate that this system will improve the effectiveness of controls across various business process cycles, including the financial reporting cycle. We anticipate more wide-spread implementation and use of this system throughout 2007. As a technical company, and based on training in fourth quarter 2006 and first quarter 2007, we believe we will be able to provide much of the work related to the implementation of these systems with limited external resources and have budgeted \$200,000 in 2007 for this and other Sarbanes-Oxley Act compliance related work.

Even with these changes, due to the increasing number and complexity of pronouncements, emerging issues and releases, we expect there will continue to be some risk related to financial disclosures. We anticipate that such risks will be mitigated following full implementation of the Sarbanes-Oxley Act requirements in 2007, which, based on our plans includes the implementation of the systems and automation of controls monitoring described above. The process of identifying risk areas and implementing financial disclosure controls and internal controls over financial reporting required under the Sarbanes-Oxley Act may result in the identification of areas where we may need additional resources. Accordingly, we have also determined until such time as we complete this process, we may be unable to declare our controls effective. This process has begun and we anticipate it will be completed in 2007. This process may also result in the identification and possible reporting of additional deficiencies.

We have moved forward with our initial work surrounding the implementation of the Sarbanes-Oxley Act. This has included an assessment of risk in financial reporting and the creation of a documentation and evaluation framework for a significant portion of our business, under consultation with an independent public accounting firm. We budgeted \$200,000 for compliance work by external parties related to the Sarbanes-Oxley Act for the fiscal year 2006 and to thereafter complete a portion of testing. We anticipate spending a similar amount in 2007. In 2006, we spent approximately \$120,000 on external resources and approximately \$80,000 in capital expenditures (for systems described above) to support this initial effort. We used the framework established with the assistance of external resources to perform much of the documentation and initial evaluation effort with internal staff in the third and fourth quarters of 2006 and plan to continue the use of primarily internal staff over the first and second quarters of 2007, in an effort to minimize our third party costs, while still moving forward in our effort to improve our internal controls. In the third and fourth quarters of 2006, we used external resources to help with the implementation of software and related training that will assist us in maintaining controls compliance. We will likely also use some external resources in 2007 for implementation and training efforts. We may also use external resources for further documentation and assistance with controls implementation and compliance in 2007, if deemed necessary to meet the 2007 implementation deadline.

#### **Establishment of a Telesales Department and Expanded Marketing Department**

We believe telesales will be beneficial in promoting and providing leads for potential sales of our products and services. We have not previously had a formal telesales department, and the establishment of this area has entailed some up front investment. We have used existing personnel to manage the telesales department, and have also hired two additional employees to focus primarily on telesales and are looking to hire one or two additional telesales employees. The telesales department has been used to assist in the identification and qualifying of additional sales opportunities for the fund accounting software. We have also expanded our marketing department to include individuals who are focused on specific product areas or business lines. Previously we have not had a more defined focus within this group. We expect, but can give no assurances, that these efforts will generate sufficient revenues to avoid a negative impact on profitability. We will likely hire additional marketing, sales and support staff as we identify geographic territories with good potential for telesales efforts.

#### **Software Modifications Required by Geographic Expansion**

We have achieved the most significant penetration in the tri-state area of South Carolina, North Carolina and Georgia. We are now accelerating our efforts to move into surrounding states. To do so, we may have to modify our existing fund accounting

programs to accommodate differences in state laws, regulations and taxation. We anticipate needing to make additional investment in software development to accomplish this. However, we plan to make the changes when we have firm orders in an area in an attempt to maximize return on investment as quickly as possible. We are currently converting our programs to the Microsoft .Net programming and SQL database language, but do not yet have all modules ready for release. As a result, some jurisdictional related changes may be required to be made in both our current and .Net platforms through 2007, when we anticipate the large majority, if not all modules will be converted. The costs of such changes may offset somewhat the positive impact from expanding our geographic reach significantly beginning in early 2007 with the acquisition of McAleer.

#### **Conversion of our Accounting+Plus software to Microsoft .Net Programming and SQL Database Language**

We have already completed the conversion of the majority of our core accounting modules, with the personnel module still in progress. The completed modules are in formal beta installations. However, the changes we are having to make as a result of the formal beta use have been limited. We are prepared to install and have installed some of the completed modules in select entities which do not have an immediate need for other integrated modules not yet converted. In addition, the completed modules have the functionality necessary to handle school activity funds, such as student clubs, organizations and athletics. Typically payroll is not needed to support school activity funds. Many school activity personnel use packages independent of the school's accounting packages, which may be cumbersome, or lack functionality. Accordingly, we are beginning to look for sales opportunities of the completed modules now, marketed as our School Activity solution. If the school later adopts our full accounting suite, the process of integration will be relatively seamless. We anticipate completing the personnel and certain additional modules adequate to support such installations early in 2007. As previously noted under Software Modifications Required by Geographic Expansion above, we anticipate completing most if not all of the remaining modules throughout 2007.

#### **Maintaining Margins**

In 2005, we continued to experience a significant increase in IP telephony sales, historically one of our higher margin product lines in the technology segment. Among these transactions were continued sales of IP Telephony products to one of our largest customers, Greenville County Schools, which encompasses all schools in a fairly large school district. IP telephony sales increased sales to that customer to 14% of our revenues in 2005, and represented more than 90% of the revenues from this customer in that year. The challenge going forward will be to match large opportunities or increase the number of smaller opportunities. We have increased and reorganized our sales force in an effort to achieve consistent and enhanced performance in this product niche in future periods. In 2006, IP Telephony hardware sales did not keep up with prior year levels, with an insufficient number of opportunities of adequate size found in 2006 to exceed the large opportunity in 2005.

In 2006, we experienced a significant increase in sales of interactive whiteboard solutions and to a lesser degree the amount we charge for related engineering services. Both product lines, IP Telephony and interactive whiteboard solutions, have become subject to increased competition as more product manufacturers have recognized product potential and have entered these markets. In order to maintain and improve our margins, we need to continue to search for new and innovative, and initially higher margin, products to augment those that become mature. We also intend to continue our focus on higher margin engineering services and software. While we cannot predict success in achieving these goals, we have taken and are taking actions to do so. These include expanding our geographic reach, increasing the size of and reorganizing our sales force to focus on more products backed by product specialists, adding telemarketing efforts, improving our sales tools, and identifying additional product and service areas. We are focused on increasing margins, but ultimately we are looking to increase profits by leveraging existing and an increasing number of customer relationships by taking advantage of cross-sell opportunities with a variety of products and services. We will work to focus primarily on those customers for whom we can provide ongoing support and higher margin integration and other engineering services.

#### **Continued Improvement of Support Solutions**

Historically, our Software applications segment has been the most effective in providing support solutions. Going forward, we are increasing the level of support offerings available through our Technology solutions segment. Previously, these primarily consisted of warranty-based services. Additional support offerings may include additional telephone-based troubleshooting and support, real time monitoring and other proactive service offerings and guaranteed response times for customer needs. We have begun introducing additional services, including support for our interactive whiteboard solutions. However, increases in revenues have not yet exceeded our investment in increased technology support offerings. These efforts are discussed further under Investment in Support and Telesales Efforts below.

#### **Investment in Support and Telesales Efforts**

In 2006, we originally estimated making an investment of as much as \$500,000 to bolster our technical support services and telesales efforts. The investment consisted primarily of increased salaries and wages, and less than \$180,000 was spent in



2006. We plan to continue this investment in 2007; however, we do not expect the investment to exceed the amount actually spent in 2006. Based on our past experience with prospecting and technical support agreements, we expect the additional revenue generated from the sales of technical support contracts and additional sales opportunities uncovered by telesales efforts for the fund accounting software and the new curriculum standards based lesson planner software will be sufficient to offset our investment within approximately one year. However, we can give no assurances such additional services will be profitable collectively, particularly in the short-term.

#### **Developing Customer Relationships in New Regions**

As we move forward with our growth strategy, we anticipate expanding into new geographic regions. We have achieved the most significant penetration in the tri-state area of South Carolina, North Carolina and Georgia. We are now accelerating our efforts to move into surrounding states. While expanding geographic markets provides a good opportunity to extend existing customer bases and increase revenue, breaking into a new market can prove difficult. There are obstacles to successfully entering new geographic markets, including limited market knowledge and relationships, little brand awareness, and no established presence or regional client references. We anticipate that initial penetration will be slow but will accelerate over time. We cannot predict the time required to build customer relationships and the rate at which new market penetration can be accomplished.

To support the expansion process, we plan to hire additional sales personnel to help penetrate new geographic regions, which could represent a \$200,000 to \$300,000 investment. Thus far, we have reassigned tasks of current employees to focus on telesales efforts to obtain market data and sales efforts to develop higher level relationships with state-wide associations in new areas where opportunities are identified. We have not yet hired new employees for specific areas. Our focus in hiring personnel will move along into 2007, focused on the states added as a result of the McAleer acquisition. While management believes hiring additional sales personnel is a prudent investment which should result in significant long-term increases in revenue, there may be an initial short-term negative impact on earnings. Due to the length of our typical software sales closing cycle, six to twelve months, and the obstacles to market penetration discussed above, we cannot predict the time to recovery on this investment.

#### **Reorganization of Sales Force**

In 2006 we reorganized our sales force, with representatives selling both software and technology. The purpose of this reorganization was to take advantage of cross-sell opportunities within customer accounts. Previously, our sales personnel had focused on selling either software or technology. While the reorganization was not entirely ineffective, we found that our sales personnel gravitated to either software or technology. Moreover, our market analysis confirmed that fewer personnel in a geographic area are needed to sell software than technology products and services. Accordingly, market expansion for software sales can be effected more quickly than for technology. Therefore, we found it beneficial to maintain separate sales forces for software and technology. We will continue to encourage our sales personnel to cross-sell all of our products and services, emphasizing our ability to handle all of a client's needs. We are implementing this new sales approach in 2007.

#### **Technology and Software Budgets**

While federal, state and local funding was slightly decreased in 2006 from 2005, and technology and software budgets have been challenged during the last few years, we have sensed a steady improvement in the discretionary funds that are available to our potential clients. These discretionary funds, coupled with our clients' desire to utilize those funds to improve or implement technology and software tools into their individual environments, have provided growth for our business. We recognize that changes in funding could improve or strain technology budgets even further.

#### **Creating Synergies with Merger and Acquisition Activity**

Part of our strategy to remain competitive and to grow the Company involves taking advantage of acquisition opportunities. While there are many benefits to be gained from a successful acquisition, there are also many financial and operations risks that must be properly addressed in order to create operational synergy and financial benefit. While we engage outside professionals to assist us with identifying and evaluating potential acquisitions, some members of our management team have limited experience in merger and acquisition activity. Management must be cautious in their evaluation of and expectations from any acquisition target. With any acquisition, we cannot ensure that we are allocating capital to businesses that will increase growth with higher returns and will not require additional capital, or add other strain on our capital resources.

We have identified the criteria listed below, by which we evaluate potential acquisition targets in an effort to gain the synergies necessary for successful growth of the Company:

Access to new customers and new geographic markets



Protection of our current customer base from competition

Removal or reduction of market entry barriers

Opportunity to gain operating leverage and increased profit margins

Diversification of sales by customer and/or product

Improved vendor pricing from increased volume and/or existing vendor relationships

Improvements in product/service offerings

Protection of and ability to expand mature product lines

Ability to attract public capital and increased investor interest

By carefully evaluating these factors we hope to execute our corporate growth strategies through acquisitions successfully and therefore provide positive operating results and increased return on investment to stockholders.

#### **D. Financial Impact of Certain Developments**

##### **E-Rate Program**

We experienced an improvement in 2006 in our success in winning proposal awards for projects related to the E-Rate program. However, this success did not ultimately translate into increased revenues due to the reduced rate of funding approvals for projects we have won, compared to our experience in prior years.

The E-Rate program assists both schools and libraries in the United States to obtain affordable telecommunications and internet infrastructure and access. The program provides federally subsidized funding based on the level of poverty and the urban/rural status of the population served. The funding ranges from 20% to 90% of the costs of eligible services. The Company has participated in this program in the past, typically winning total contract awards in the \$4,000,000 to \$5,000,000 range during the last several years. In late 2005, as a result of our additional investments in software and personnel, we improved our ability to respond to proposals under the program. As a result, for the annual fall 2005 to spring 2006 E-Rate window, we were awarded more than \$17 million in contracts and for the annual fall 2006 and spring 2007 E-Rate window, we were awarded more than \$24 million in contracts.

Not all of these contracts become fully funded, and projects and related funding can span multiple years. Typically, we have experienced a 20% to 45% funding rate of awarded contracts. Accordingly, we cannot project the impact of our E-Rate efforts on future periods. Revenues linked to the E-Rate program ranged from 10% to nearly 25% of our total revenues from 2004 through 2005. In 2006, revenues linked to the E-Rate program constituted 9% of our total revenues. Although we saw some revenues related to E-Rate in 2006, we did not see significant funding in comparison to projects funded in 2005. We began to receive notification of funding in late 2006 and early 2007. We have received notification that approximately \$5 million or 29% of the \$17 million in projects we proposed for the fall 2005 / spring 2006 application cycle received funding. This amount represents a nice award considering the amount of E-Rate revenues have historically run between 5% and 25% of our total revenues in any given year, and could approach more than 10% in our current year, were we able to deliver on all projects. However, the completion of these projects may span multiple years and is dependent on the customers having available sufficient resources to provide their share of matching funds to receive the E-Rate program's portion. Accordingly, we cannot predict the impact of such funding awards, if any, on our 2007 revenues.

##### **Additional Investments Which May Impact Earnings in the Short Term**

In addition to the items mentioned above, we expect that our investments in expanding our telesales team, increasing our technical support offerings and hiring additional sales personnel to support our geographic expansion efforts may impact earnings negatively in the short term. While we would expect to cover these investments over no more than four to six quarters, we are unable to estimate the portion of these investments which will be covered in the short term. For further discussion, see C. Current Challenges and Opportunities of our Business, and Forward-Looking Information above.

#### **Acquisitions and Registration Rights**

Our growth strategy includes acquisitions. While certain costs related to completing a specific acquisition may be capitalized by inclusion in the allocation of purchase price to the fair value of assets or goodwill, other costs associated with an acquisition and those activities related to searching for, identifying and negotiating an acquisition and certain other costs are expensed. The Company expects to incur additional costs as it seeks to acquire other businesses to execute its growth strategy but cannot predict the amount or timing of such expenses.

An acquisition could also result in the issuance of stock to support the purchase price, or stock-based or other compensation to retain management. For further discussion see C. Current Challenges and Opportunities of our Business, and Forward-Looking Information Creating Synergies with Merger and Acquisition Activity above.

In addition, in connection with our reverse merger and commencement of public reporting in the first quarter of 2005, and our sale of preferred shares and warrants, we committed to using our best efforts to maintain an effective registration statement for the underlying shares. The McAleer acquisition was considered a material acquisition and, accordingly, we were required to amend our registration statement to disclose the impact of the acquisition. Amending our registration statement results in additional legal and professional fees, which can approach \$100,000. These costs are expensed. Subsequent acquisitions, if deemed material, may result in additional amendments and further costs.

### **Professional Fees**

We expect to incur some costs to implement the Sarbanes-Oxley Act legislation and have budgeted \$200,000 in 2007 for this work. As of December 31, 2006, we had incurred approximately \$118,000 of expenses related to Sarbanes-Oxley work and \$50,000 and an undisclosed amount (due to a confidentiality agreement with the vendor) of capital expenditures for internal controls and financial reporting software, respectively, in support of our Sarbanes-Oxley efforts. For the quarter ended March 31, 2007, we incurred approximately \$33,000 in costs related to our Sarbanes-Oxley efforts. In the first quarter of 2006, such spending was approximately \$97,000. Our professional and legal compliance related costs were approximately \$609,000 for the 2006 fiscal year, of which approximately \$228,000 was related to services relating to registration statement amendments. The remainder of professional fees related to public company reporting, other regulatory compliance and the Sarbanes-Oxley work.

### **Stock Based Compensation**

In connection with becoming a public company, we recruited independent, non-employee directors. We also engaged consultants to assist us with strategic planning and acquisitions. Definitive agreements were reached regarding the independent directors and consultants compensation in the first and second quarters of 2006. The Compensation Committee of the Board of Directors board approved stock awards, granting the non-employee directors and consultants approximately 500,000 shares. We recorded non-cash expense for directors and consultants fees in the 2006 totaling approximately \$970,000. We expect stock-based compensation, primarily that paid to consultants, to be significantly reduced in 2007 compared to 2006. See Note 4 to our unaudited consolidated financial statements dated March 31, 2007, Stock Based Compensation, for further discussion.

### **Guidance**

Going forward, the Company plans to issue earnings releases and provide general forward-looking information regarding earnings. However, we do not intend to provide specific guidance.

### **Forward-Looking Statements**

This prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Among other things, these statements relate to our financial condition, results of operations and future business plans, operations, opportunities and prospects. In addition, we and our representatives may from time to time make written or oral forward-looking statements, including statements contained in other filings with the Securities and Exchange Commission and in our reports to stockholders. These forward-looking statements are generally identified by the words or phrases may, could, should, expect, anticipate, plan, believe, seek, estimate, predict, project or words of similar import. These forward-looking statements are based upon our current knowledge, assumptions about future events and involve risks and uncertainties that could cause our actual results, performance or achievements to be materially different from any anticipated results, prospects, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are not guarantees of future performance. Many factors are beyond our ability to control or predict. You are accordingly cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date that we make them. We do not undertake to update any forward-looking statement that may be made from time to time by or on our behalf.

We have included risk factors and uncertainties that might cause differences between anticipated and actual future results in the Risk Factors section. We have attempted to identify, in context, some of the factors that we currently believe may cause actual future experience and results to differ from our current expectations regarding the relevant matter or subject area. The operations and results of our software and systems integration businesses also may be subject to the effects of other risks and uncertainties, including, but not limited to:

a reduction in anticipated sales;





an inability to perform customer contracts at anticipated cost levels;

our ability to otherwise meet the operating goals established by our business plan;

market acceptance of our new software, technology and services offerings;

an economic downturn; and

changes in the competitive marketplace and/or customer requirements.

## **E. Critical Accounting Policies and Estimates**

### **Basis of Presentation**

Our consolidated financial statements include CSI Technology Resources, Inc., a wholly-owned subsidiary. We use the accrual basis of accounting.

We employ accounting principles generally accepted in the United States ( generally accepted accounting principles or GAAP ). GAAP requires us to make estimates, assumptions and judgments and 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 and assumptions of future trends or events may have on the financial condition and results of operations reported in our financial statements. It is important that an investor understand that actual results could differ materially from these estimates, assumptions, projections and judgments.

Certain accounting policies, methods and estimates are particularly sensitive because of their significance to the financial statements and of the possibility that future events affecting them may differ markedly from management's current judgments. For a description of our significant accounting policies, see Note 1 contained in the explanatory notes to our unaudited consolidated financial statements as of and for the quarter ended March 31, 2007 included as part of this report. The most critical accounting policies that have a significant impact on the results we report in our consolidated financial statements are discussed below.

### **Disclosure Regarding Segments**

The Company reports its operations under two operating segments: the Software applications segment and the Technology solutions segment.

### **Revenue Recognition**

#### *Software License Revenues*

Software revenues consist principally of fees for licenses of our CSI Accounting+Plus software product, service and training. We recognize all software revenue using the residual method in accordance with Statement of Position ( SOP ) 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, and Software Revenue Recognition with Respect to Certain Transactions. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. If evidence of the vendor specific fair value of one or more undelivered elements does not exist, revenues are deferred and recognized when delivery of those elements occurs or when fair value can be established. Company-specific objective evidence of fair value of maintenance and other services is based on our customary pricing for such maintenance and/or services when sold separately. At the outset of the arrangement with the customer, we defer revenue for the fair value of its undelivered elements (e.g., maintenance, consulting and training) and recognize revenue for the remainder of the arrangement fee attributable to the elements initially delivered in the arrangement (i.e., software product) when the basic criteria in SOP 97-2 have been met. If such evidence of fair value for each undelivered element of the arrangement does not exist, we defer all revenue from the arrangement until such time that evidence of fair value does exist or until all elements of the arrangement are delivered.



Under SOP 97-2, revenue attributable to an element in a customer arrangement is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) the fee is fixed or determinable, (iv) collectibility is probable and (v) the arrangement does not require services that are essential to the functionality of the software.

Persuasive evidence of an arrangement exists. We determine that persuasive evidence of an arrangement exists with respect to a customer when we have a written contract, which is signed by both us and the customer, or a purchase order from the customer when the customer has previously executed a standard license arrangement with us.

Delivery has occurred. Our software may be either physically or electronically delivered to the customer. We determine that delivery has occurred upon shipment of the software pursuant to the billing terms of the agreement or when the software is made available to the customer through electronic delivery.

The fee is fixed or determinable. If at the outset of the customer engagement we determine that the fee is not fixed or determinable, we recognize revenue when the fee becomes due and payable.

Collectibility is probable. We determine whether collectibility is probable on a case-by-case basis. When assessing probability of collection, we consider the number of years in business, history of collection, and product acceptance for each customer. We typically sell to customers for whom there is a history of successful collection. However, collection cannot be assured.

We allocate revenue on software arrangements involving multiple elements to each element based on the relative fair value of each element. Our determination of the fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence ( VSOE ). We align our assessment of VSOE for each element to the price charged when the same element is sold separately. We have analyzed all of the elements included in our multiple-element arrangements and determined that we have sufficient VSOE to allocate revenue to the maintenance, support and professional services components of our perpetual license arrangements. We sell our professional services separately, and have established VSOE for professional services on that basis. VSOE for maintenance and support is determined based upon the customer's annual renewal rates for these elements. Accordingly, assuming that all other revenue recognition criteria are met, we recognize revenue from perpetual licenses upon delivery using the residual method in accordance with SOP 98-9.

Our software products are fully functional upon delivery and implementation and do not require any significant modification or alteration of products for customer use.

We expense all manufacturing, packaging and distribution costs associated with software license sales as cost of license revenues.

#### *Computer Hardware Sales Revenues*

Revenue related to hardware sales is recognized when: (a) we have a written sales agreement; (b) delivery has occurred; (c) the price is fixed or determinable; (d) collectibility is reasonably assured; (e) the product delivered is standard product with historically demonstrated acceptance; and (f) there is no unique customer acceptance provision or payment tied to acceptance or an undelivered element significant to the functionality of the system. Generally, payment terms are net 30 days from shipment. When sales to a customer involve multiple elements, revenue is recognized on the delivered element provided that (1) the undelivered element is a standard product, (2) there is a history of acceptance on the product with the customer and (3) the undelivered element is not essential to the customer's application. Revenue related to spare parts is recognized on shipment. Shipping and handling charges to customers are included in revenues. Shipping and handling costs incurred by the Company are included in cost of sales.

Technology revenues are generated primarily from the sale of hardware. In accordance with Emerging Issues Task Force ( EITF ) 99-19,

Reporting Revenue Gross as a Principal Versus Net as an Agent, we record revenues as net when we serve as an agent. In these circumstances, our supplier pays a commission to us but acts as the primary obligor in a transaction and we record only the commission in revenues. We record revenues as gross (generally cost of merchandise plus margin) when we serve as a principal whereby we act as the primary obligor in a transaction, have the latitude for establishing pricing and retain all the credit risk associated with such transaction.

#### *Long-term Payment Arrangements*

Our primary customer base consists of local government and education entities whose source of funding (local taxes and federal funding) is generally assured; accordingly the risk of uncollectibility is lower than that of businesses selling primarily to non-government entities. The Company has an ongoing practice of providing financing for certain purchases under notes receivable or long term leases typically ranging from 3 to 5 years, subject to review of its exposure under such facilities and cash flow availability or needs at the time of such purchases. Such amounts have not constituted a significant portion of its



account balances, and the Company has historically never experienced a default under such arrangements. The Company recognizes revenue under these arrangements when the criteria noted under Software License Revenues and Computer Hardware Sales Revenues above is met, in accordance with SOP 97-2, as amended by SOP 98-9.

#### *Service/Support Revenues*

Services revenues consist of professional services and maintenance fees from software and hardware maintenance agreements. Maintenance agreements are typically priced based on a percentage of the product license fee or hardware cost and has a one-year term, renewable annually. Services provided to customers under maintenance agreements may include technical product support and unspecified software upgrades. Revenue related to maintenance and service contracts is recognized ratably over the duration of the contracts. Deferred revenues from advanced payments for maintenance agreements are recognized ratably over the term of the agreement, which is typically one year.

#### *Warranties*

Our suppliers generally warrant the products distributed by us and allow returns of defective products, including those that have been returned to us by its customers. We do not independently warrant the products we distribute, but we do warrant our services with regard to products that we configure for our customers and products that we build from components purchased from other sources. Warranty expense is not material to our financial statements.

### **Long-lived Assets**

#### *Long-lived Assets*

Expenditures for major renewals or betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expenses as incurred.

We continually evaluate whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of long-lived assets may not be recoverable in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 144, Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of. When factors indicate that long-lived assets should be evaluated for possible impairment, we use an estimate of the related undiscounted future cash flows over the remaining life of the long-lived assets in measuring whether they are recoverable. If the estimated undiscounted future cash flows exceed the carrying value of the asset, a loss is recorded as the excess of the asset's carrying value over fair value.

#### *Depreciation*

Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of such property and equipment.

#### *Computer Software Costs and Amortization*

Computer software costs consist of internal software production costs and purchased software costs capitalized under the provisions of SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed.

Costs in the research and development of new software products where the technological feasibility is unknown and enhancements which do not prolong the life or otherwise increase its value are expensed as incurred. Capitalized computer software costs are amortized over the economic life of the product, generally three years, using the straight-line method. Our software development efforts focus on the implementation of known technological capabilities applied to common business processes to enhance our existing products. Historically, to date, through our software solutions segment, we have spent no material efforts on technological innovation for which the feasibility has been unknown.

### **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 SFAS No. 123R, Share-Based Payment, and related interpretations, which the Company adopted in 2006 using the modified prospective method. The Company utilizes the Black-Scholes model to estimate the fair value of the shares granted.



### **Other Intangible Assets**

The Company follows SFAS No. 142, Goodwill and Other Intangible Assets, in our accounting and reporting for other intangible assets.

SFAS No. 142 eliminates the requirement to amortize intangible assets with an indefinite life, addresses the amortization of intangible assets with a defined life, and addresses impairment testing and recognition indefinite-lived intangible assets. In accordance with SFAS No. 142, we do not amortize indefinite-lived intangible assets (e.g., corporate trademarks for which planned use is indefinite). We evaluate the remaining useful life of intangible assets that are not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, we amortize the intangible asset prospectively over its remaining estimated useful life. Amortizable intangible assets (e.g., product trademarks) are amortized on a straight-line basis over six years or the life of the product, whichever is shorter.

In addition, as required under SFAS 142, we perform annual tests for impairment of our indefinite-lived intangible assets. Our indefinite-lived intangible assets consist of values assigned to certain trademarks and other intangibles we have developed or acquired.

### **Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due or refundable plus deferred income tax assets and liabilities. Deferred income tax assets and liabilities are recorded to recognize the income tax effect of the temporary differences in the method of reporting various items of income and expenses for financial reporting purposes and income tax purposes. The deferred income tax assets and liabilities at the end of the year are determined using the statutory tax rates expected to be in effect when the taxes are actually due or refundable.

### **Related Party Transactions and Off-Balance Sheet Arrangements**

We have not entered into any significant transactions with related parties other than the issuance of subordinated debt to certain executive officers and shareholders described in Note 5 to our unaudited financial statements for the three months ended March 31, 2007 and under **H. Liquidity and Capital Resources** Credit Arrangements below. We do not use off-balance-sheet arrangements with unconsolidated related parties, nor do we use other forms of off-balance-sheet arrangements such as research and development arrangements.

### **F. 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 February 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting ( SFAS ) No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140. This Statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. FAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest only-strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after January 1, 2007. The Company has adopted the provisions of SFAS No. 155 but does not believe that the adoption will have a material impact on its financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes . FIN 48 clarifies the accounting for uncertainty in income taxes recognized in enterprises' financial statements in accordance with FASB Statement No. 109,

Accounting for Income Taxes . FIN 48 prescribes a recognition threshold and measurement attributable for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods,



disclosures and transitions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 on January 1, 2007 did not have a material impact on the Company's financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard does not require any new fair value measurements, but rather eliminates inconsistencies found in various prior pronouncements. SFAS 157 is effective for the Company on January 1, 2008 and will not impact the Company's accounting measurements but it is expected to result in some additional disclosures.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. This statement permits, but does not require, entities to measure many financial instruments at fair value. The objective is to provide entities with an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Entities electing this option will apply it when the entity first recognizes an eligible instrument and will report unrealized gains and losses on such instruments in current earnings. This statement 1) applies to all entities, 2) specifies certain election dates, 3) can be applied on an instrument-by-instrument basis with some exceptions, 4) is irrevocable and 5) applies only to entire instruments. One exception is demand deposit liabilities which are explicitly excluded as qualifying for fair value. With respect to SFAS 115, available-for-sale and held-to-maturity securities at the effective date are eligible for the fair value option at that date. If the fair value option is elected for those securities at the effective date, cumulative unrealized gains and losses at that date shall be included in the cumulative-effect adjustment and thereafter, such securities will be accounted for as trading securities. SFAS 159 is effective for the Company on January 1, 2008. The Company is currently analyzing the fair value option that is permitted, but not required, under SFAS 159.

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.

#### **G. Overview of Financial Performance**

Our revenues increased \$6.8 million or 140.5% for the first quarter of 2007 compared to the same period of the prior year due to an increase in technology sales, primarily interactive whiteboard solutions, and new software sales, and the addition of sales from the January 2, 2007 acquisition of the McAleer operations ( McAleer , or CSI-Mobile ). Of the 140.5% increase, increased technology sales contributed 106.8% and the new addition of the CSI-Mobile operations added 24.0% with the CSI-Easley software operations (operations ongoing before the acquisition and supported principally from our Easley location) adding the remaining 9.7% of the increase. The gross profit improved \$1.0 million or 68.4%, primarily due to the increased volume in technology (25.1%), CSI-Mobile (34.2%) and CSI-Easley (9.1%) software sales and a proportional reduction in software costs from the CSI-Mobile operations, partially offset by an unfavorable change in the product mix in technology and increased amortization of capitalized software costs, primarily for CSI-Easley. Operating income improved from the prior year by \$1.1 million or 209.9% from improvements in both the technology and CSI-Easley software operations and the CSI-Mobile addition (38.0%) (For more information as to the results of each segment, see Segment Information below). The increase was due to the increases in sales and gross profit, coupled with a slight decrease in our operating expenses primarily as a result of the decrease in stock-based compensation costs, professional and legal compliance costs and marketing expenses (due to the completion of rebranding efforts in the prior year). These cost reductions were partially offset by increases in salaries, wages and benefits (primarily from the addition of CSI-Mobile and increased sales activities), travel and mobile costs, and depreciation and amortization. Further analysis of financial performance is discussed below in subsequent sections of the report.

**Consolidated Results of Operations**

(In thousands)	Three Months Ended		
	March 31, 2007	March 31, 2006	Increase (Decrease)
<b>NET SALES AND SERVICE REVENUE</b>	\$ 11,652	\$ 4,842	\$ 6,810
<b>GROSS PROFIT</b>	2,533	1,504	1,029
<b>OPERATING INCOME (LOSS)</b>	580	(527)	1,107

**SIGNIFICANT ITEMS THAT INCREASED (DECREASED) OPERATING INCOME**

Gross Profit:		
Sales		\$ 6,810
Cost of sales, excluding depreciation, amortization and capitalization		(5,742)
Depreciation		4
Amortization of capitalized software costs		(88)
Capitalization of software costs		45
		1,029
Operating Expenses:		
Salaries, wages and benefits		(301)
Stock-based compensation		529
Acquisition expenses		(70)
Professional and legal compliance related costs		123
Marketing expenses		46
Travel and mobile costs		(71)
Depreciation and amortization		(55)
Other selling general and administrative expenses		(123)
		\$ 1,107

**Three months ended March 31, 2007 versus three months ended March 31, 2006****Revenues**

Total revenues in the first quarter of 2007 increased \$6.8 million in comparison with the first quarter of 2006. This net increase included a \$5.2 million increase in hardware sales and services through the technology solutions segment and a \$1.6 million increase in software sales and services through the software solutions segment. The increase in the technology solutions segment came from increases primarily in sales of interactive whiteboard solutions. A substantial portion of the increase in hardware revenues was related to a large hardware order, approximately \$3.5 million, for a number of interactive whiteboard solutions in the fourth quarter of 2006 for which component parts were backordered delaying invoicing. Additional sales of interactive whiteboard solutions in the first quarter pushed the results higher. The increase in the software solutions segment was due primarily to the acquisition of the CSI-Mobile operations, which added \$1.2 million in software sales, and increased software support agreement revenues and new client software sales from CSI-Easley contributed the remaining \$0.4 million increase.

**Gross Profit**

Gross profit in the first quarter of 2007 increased \$1.0 million in comparison with the first quarter of 2006. The increase in both software and hardware gross profits were driven by the corresponding increases in revenues of both segments, including the new addition of revenues from the first quarter 2007 acquisition of the CSI-Mobile operations. The gross margin was 21.7% in 2007 versus 31.1% in 2006. The change in margins was primarily driven by product mix with the increase in technology sales being substantially greater than that provided by the software segment. A drop in margins by about ten percentage points, also contributed to the decline. On the hardware side, the drop in margin was due to changes in product mix within that group from higher margin internet telephony sales and services in the prior year's quarter, to lower margin interactive whiteboard solutions in the current year's quarter. On the software side, the drop in margin came from increased amortization of the capitalized investment made in software, higher costs related to third party provided products and services and from the addition of the CSI-Mobile operations having somewhat lower margins than CSI-Easley.



**Operating Expenses**

Operating expenses decreased \$77,000, or 3.8%, in the first quarter of 2007 compared to the first quarter of 2006. The above table analyzes the major items that account for this decrease. The majority of the decrease, approximately \$529,000, is reflected in reduced stock-based compensation costs associated with the merger and which applied primarily to services for which compensation vested in 2006 and 2005 and for which no additional awards were granted significantly impacting 2007. This reduction was partially offset by a smaller amount of stock-based compensation issued in connection with the acquisition of CSI-Mobile. Professional and legal compliance related costs declined as a result of no work being provided by external resources related to SOX in 2007, compared to approximately \$100,000 in related fees being incurred in 2006. Marketing costs declined due to reduced activity related to the rebranding (as CSI Technology Outfitters) which was substantially completed in 2006. These decreases were partially offset by increases in salaries, wages and benefits, acquisition expenses, travel and mobile, depreciation and amortization and other selling, general and administrative expenses. These areas all increased as a result of the addition of CSI-Mobile to our operations, and depreciation and amortization and other selling, general and administrative costs also increased due to the move to an expanded headquarters location with room for growth in Easley, in the second quarter of 2006.

**Segment information**

CSI is organized into the two segments: software applications and technology solutions.

*Software applications segment*

Through our Software applications segment, we develop, sell, deploy and provide ongoing support of proprietary software applications.

(In thousands)	Three Months Ended		
	March 31, 2007	March 31, 2006	Increase (Decrease)
<b>NET SALES AND SERVICE REVENUE</b>	\$ 2,740	\$ 1,104	\$ 1,636
<b>GROSS PROFIT</b>	1,294	642	652
<b>SEGMENT INCOME (LOSS)</b>	457	169	288

**SIGNIFICANT ITEMS THAT INCREASED (DECREASED) SEGMENT INCOME**

Gross Profit:		
Sales		\$ 1,636
Cost of sales, excluding depreciation, amortization and capitalization		(945)
Depreciation		4
Amortization of capitalized software costs		(88)
Capitalization of software costs		45
		652
Operating Expenses:		
Salaries, wages and benefits		(230)
Marketing expenses		19
Travel and mobile costs		(47)
Depreciation and amortization		(29)
Other selling general and administrative expenses		(77)
		\$ 288

Revenues improved by \$1.6 million, or 148.1%, primarily due to the acquisition of the CSI-Mobile operations (105.5%) but also from a significant increase in recurring software support revenues and new software sales and related services from CSI-Easley (42.7%).

Cost of sales increased primarily from the addition of the CSI-Mobile operations and increased costs of third-party provided products and services. Cost of sales also increased from increased salaries, wages and benefits in cost of sales due increased support for the .Net Microsoft SQL (application programming language and database) conversion effort, and also in the areas of delivery, training and support to provide for the increasing number of installations. Third party software and component costs also increased due to the increase in these sales. While salary and wage costs related to development are generally capitalized, the amortization of previously capitalized costs increased from the increased development efforts previously



expended and depreciation increased from the investment in capital equipment (e.g., personal computers and related software) provided for a larger staff. Margins for the first quarter of 2007 were 47.2% compared to 58.2% in the prior year's quarter due to the increased costs discussed above. With CSI-Mobile having lower margins and increased development and third party costs for CSI-Easley, the rate of increase in gross profit was 101.5% compared to an increase in revenues of 148.1%; however, cost reductions in the operating expense area compared to the prior year and economies of scale with the McAleer acquisition helped make up the gap in the rate of increase in sales compared to that of operating income as noted below.

Operating expenses increased primarily from the increased sales efforts including increased sales personnel and related travel and mobile expenses, and increases in depreciation and amortization and other selling general and administrative costs related to the move to new facilities in the second quarter of 2006, partially offset by the reduction in marketing costs due to rebranding occurring in the prior, not current year's quarter. The increase in operating expenses was significantly lower in rate than the increase in gross profit, coming primarily from the impact of achieving economies of scale through the acquisition. Accordingly the segment experienced an 169.9% increase in segment operating income compared to a 101.5% increase in gross profit.

#### *Technology solutions segment*

Through our Technology solutions segment, we provide technology solutions through the sales and distribution of computers and accessories and offer a wide range of technology consulting services, including network and systems integration and computer support and maintenance services.

(In thousands)	Three Months Ended		
	March 31, 2007	March 31, 2006	Increase (Decrease)
<b>NET SALES AND SERVICE REVENUE</b>	\$ 8,912	\$ 3,738	\$ 5,174
<b>GROSS PROFIT</b>	1,239	862	377
<b>SEGMENT INCOME (LOSS)</b>	498	260	238

#### **SIGNIFICANT ITEMS THAT INCREASED (DECREASED) SEGMENT INCOME**

<b>Gross Profit:</b>			
Sales			\$ 5,174
Cost of sales, excluding depreciation, amortization and capitalization			(4,797)
Depreciation			
			377
<b>Operating Expenses:</b>			
Salaries, wages and benefits			(72)
Marketing expenses			28
Travel and mobile costs			(24)
Depreciation and amortization			(26)
Other selling general and administrative expenses			(45)
			\$ 238

Hardware revenues increased over first quarter 2006 by \$5.2 million, or 138.4%. The increase in new hardware sales was attributed to significant sales of interactive whiteboard systems.

The increase in sales was offset by a significant increase in cost of sales for the purchase of the related products. The shift in product mix from higher margin internet telephony products and engineering services to lower margin interactive whiteboard solutions and related services resulted in a decline in the margin from 23.0% in the prior year's first quarter to 13.9% in the first quarter of 2007. The shift also resulted in a more significant rate of increase in sales (138.4%) than gross profit (43.9%). However, cost reductions in the operating expense area compared to the prior year helped make up the gap in the rate of increase in sales compared to that of operating income as noted below.

The increase in salaries and wages, and travel and mobile costs in operating expenses was related primarily to increased sales staff. Equipment for increased sales staff and increased ongoing costs related to moving to new facilities with room for growth in the second quarter of 2006 was the primary driver of increases in depreciation and amortization and other selling, general and administrative expenses. Marketing expenses declined as the primary effort in rebranding and related costs were



incurred in the prior year. While operating costs increased, the increase was at a lower rate than sales resulting in an 84% increase in segment operating income compared to a 43.9% increase in gross profit.

The following tables summarize information about segment profit and loss for the quarters ended March 31, 2007 and 2006 and assets allocated to segments as of March 31, 2007 and 2006.

The changes in segment assets came primarily from the following:

Segment assets in the Software segment increased primarily from the asset purchase of McAleer. This included an increase in property plant and equipment, computer software, goodwill and intangible assets.

Also, capitalized software costs for the software applications segment increased from the investment in the conversion of the fund accounting software to the Microsoft .Net and SQL platform.

Segment assets in the Technology segment increased primarily in accounts receivable due to the increase in sales.

(In thousands)	Software Applications	Technology Solutions	Total Company
Quarter ended March 31, 2007:			
Net sales and service revenue	\$ 2,740	\$ 8,912	\$ 11,652
Gross profit	1,294	1,239	2,533
Segment income	457	498	(*)
Segment assets	7,737	4,805	12,542
Quarter ended March 31, 2006:			
Net sales and service revenue	\$ 1,104	\$ 3,738	\$ 4,842
Gross profit	642	862	1,504
Segment income	169	260	(*)
Segment assets	2,468	3,895	6,363

\* See reconciliation below

**Reconciliation of Segment income (non-GAAP measure) to operating income (loss) per consolidated Statements of Operations (GAAP measure):**

(In thousands)	Quarter Ended	
	March 31, 2007	March 31, 2006
<b>Segment income:</b>		
Software applications segment	\$ 457	\$ 169
Technology solutions segment	498	260
<b>TOTAL SEGMENT INCOME</b>	955	429
<b>Less: Merger and compliance costs</b>		
Stock based compensation	(86)	(614)
Acquisition expenses	(70)	
Professional and legal compliance related costs	(219)	(342)
<b>OPERATING INCOME (LOSS) Per consolidated Statements of Operations</b>	<b>\$ 580</b>	<b>\$ (527)</b>

**Interest and Other Income and Expenses**

Interest expense increased by \$42,000, or 45.1%, due to the financing of the McAleer acquisition.



**Income Taxes**

Income taxes increased by \$368,000, or 179.1%, in the first quarter of 2007 compared to the first quarter of 2006 due to the tax impact of the increase in operating income.

### **Net Income (Loss) and Earnings (Loss) per Share**

The Company reported net income in the first quarter of 2007 of \$285,000, an increase of \$714,000, or 166.3%, compared to the net loss of \$430,000 for the first quarter of 2006, as a result of the addition of the CSI-Mobile / acquired McAleer operations, increases in other software and our technology sales, and reductions in operating costs, partially offset by increases in cost of goods sold and increases in interest costs.

Basic and diluted earnings per share improved from a loss per share of \$0.15 in the first quarter 2006, to basic income per share of \$0.08 and diluted income per share of \$0.02 in the first quarter of 2007. This improvement resulted from the changes in net income discussed above. Diluted earnings per share was the same as basic earnings per share for the prior year's quarter. The additional preferred stock, warrants and employee held options issued in connection with the merger in February 2006 were not included in the calculation of diluted earnings (loss) per share for 2006, as their effect, due to losses being reported in that period being anti-dilutive.

### **Three months ended March 31, 2007, versus three months ended March 31, 2006 pro forma combined**

The following analysis presents the financial results for the first quarter of 2007, which include the operations of McAleer (CSI-Mobile) as a result of the acquisition on January 2, 2007, compared to the financial results for the first quarter of 2006, as if the Company had been acquired at the beginning of the 2006 year. Certain pro forma income statement data is presented in Note 3 to the unaudited consolidated financial statements for the quarter ended March 31, 2007.

Revenues increased by \$5.7 million or 95.6% from \$6.0 million in the first quarter of 2006 on a pro forma combined basis, to \$11.7 million in the first quarter of 2007, as a result of increases in both segments of the business. Technology was up 138.4% while software supported primarily out of Easley was up 42.7%, and the added CSI-Mobile software operations grew 4.5% on a comparable proforma basis. Technology increased due primarily to increased sales of interactive whiteboard solutions, while CSI-Easley software grew as a result of increases in recurring support revenues and new software sales and related services. CSI-Mobile revenues grew primarily as a result of upgrades of software to the latest release of CSI-Mobile's software.

Net income grew \$0.6 million or 201.4% from a net loss of \$0.3 million in the first quarter of 2006 on a pro forma combined basis, to \$0.3 million in net income in the first quarter of 2007, as a result of the increases in sales from both segments of the business. The CSI-Easley operations net income grew 136.7%, while net income from the McAleer operations declined 14.6%, primarily from the increase in interest expense related to the funding of the purchase and from the increase in depreciation and amortization on a pro forma basis from the write-up of the assets to their fair values based on the purchase price allocation (noted above).

### **H. Liquidity and Capital Resources**

Our strategic plan includes the expansion of the company both organically and through acquisitions. Due to the long-term nature of investments in acquisitions and other financial needs to support organic growth, including working capital, we expect our long-term and working capital needs to periodically exceed the short-term fluctuations in cash flow from operations. Accordingly, we use debt and equity vehicles in addition to cash flow from operations to fund our growth and working capital needs. Currently our funds for working capital are provided under our \$5.5 million revolving line of credit.

#### **Events Impacting Liquidity and Capital Resources**

##### *Increase in Bank Credit Facilities*

On January 2, 2007, we entered into agreements with our primary senior lender, RBC Centura Bank. The primary purpose was to increase the amount of our credit facilities in order to provide for our expanding working capital and other credit needs. Such funding needs included the Company's acquisition of substantially all of the business operations of McAleer. Specifically, the Company's revolving facility was increased from \$3.5 million to \$5.5 million, and our equipment facility was increased from \$400,000 to \$800,000. The revolving facility is priced at one month LIBOR plus 2.5% and expires on May 30, 2007. The equipment facility bears interest at 7.85% and is payable in 36 consecutive monthly installments of principal and interest of \$25,015, maturing January 1, 2010. Availability under the revolving facility is determined pursuant to a borrowing base equal to 80% of the Company's eligible accounts. Both the revolving facility and the equipment facility are secured by substantially all of our assets.

As a part of amended loan arrangements, the bank also committed to extend mortgage financing to be used to pay off the \$525,000 indebtedness incurred by the Company to William McAleer in the acquisition of real estate in Mobile, Alabama as a part of the McAleer acquisition. The Company utilized \$486,000 of such financing (90% of the building's appraised value)



and a \$39,000 draw on its line of credit to repay the \$525,000 note payable to William McAleer in February 2007. The new real estate loan is payable on a 15 year amortization with a balloon payment due at the end of year three.

Our credit facility with RBC Centura Bank and the recent facility amendments are discussed in more detail in the notes to the unaudited consolidated financial statements for the quarter ended March 31, 2007 and under **B. Recent Developments** **Modification of Bank Credit Facilities** above.

#### *Acquisition of McAleer*

On January 2, 2007, we consummated the acquisition of substantially all of the assets and business operations of McAleer. McAleer and the acquisition transaction is discussed in more detail under **B. Recent Developments** **Acquisition of McAleer Computer Associates, Inc.**

The purchase price was \$4,050,000, of which \$3,525,000 was paid in cash at closing. The balance of \$525,000 was to be paid pursuant to a promissory note in 20 quarterly installments of principal in the amount of \$26,250 plus interest in arrears at the LIBOR rate, beginning March 31, 2007. This amount was refinanced with a real estate note and small draw on our credit facilities in February 2007, as discussed under

**Increase in Bank Credit Facilities** above. We assumed no liabilities of McAleer, other than certain leases and obligations of McAleer under ongoing customer contracts. Expenses for the acquisition consist of legal and professional fees, travel costs, stock compensation and various other expenses related to the acquisition transaction. Expenses for the acquisition, in the amount of \$266,837, consisted of legal and professional fees and travel costs and various other expenses related to the acquisition transaction. These expenses have been capitalized and allocated to goodwill.

The acquisition was funded in part with advances of \$2.1 million under our modified bank credit facilities. We also utilized approximately \$1.3 million in cash from McAleer as, pursuant to the asset purchase agreement, service contract revenue with respect to 2007, which was received by McAleer in 2006 prior to the closing and was segregated for our account.

Our utilization of draws under our bank revolver to fund a large portion of the purchase price of the McAleer acquisition has reduced our availability under the facility. Increased working capital requirements as a result of anticipated sales growth, as well as the addition of working capital requirements associated with our McAleer operations, could put pressure on the adequacy of our bank revolving credit facility. Accordingly, we continue to evaluate other funding options, as discussed below under **Future Capital Needs and Resources**.

#### **Cash Flows**

For the three months ended March 31, 2007 cash and cash equivalents remained at \$0, due primarily to the use of available cash and additional borrowings to fund the McAleer acquisition.

#### *Cash from Operating Activities*

Cash provided by operating activities totaled \$2.8 million in the first three months of 2007 compared to cash provided by operating activities of \$2.5 million in the first three months of 2006. The increase, \$0.3 million, was due primarily to the sale of inventory on hand at year end 2006, held due to backordered components, which was moved out in the first quarter of 2007. A substantial increase occurred in deferred revenue, \$1.8 million related to cash we received from billings by the McAleer operation, where receipts for support agreement obligations for the 2007 fiscal year were earmarked for our account. This was the source for a significant portion of cash collected from operations and used in the McAleer acquisition (toward the \$4.0 million recorded in investing activities). These increases were partially offset by an increase in accounts receivable, \$1.7 million, due to the large sales in 2007 and little E-Rate receivables to collect, compared to significant collections of slower paying year-end 2005 E-Rate accounts collected in the first quarter of 2006. The increases were also offset by significant payments on accounts payable (\$0.8 million reduction) primarily related to the inventory on hand at year end 2006.

Significant changes since year end to balance sheet items related to operating activities are as follows:

Increases in the consolidated balance sheet line items for accounts receivable were a result of the substantial increase in sales in the first quarter of 2007. The decrease in inventory was due to the sales of product held at year end, for a short term, while waiting on backordered component parts. This inventory was moved out in the first quarter of 2007. Accounts payable declined due to payments in the first quarter of 2007 for inventory held at year end, and deferred revenue increased as a result of the acquisition of McAleer.

*Cash from Investing Activities*

Cash used for investing activities totaled \$4.5 million in the first three months of 2007 compared to \$0.5 million in the first three months of 2006. The increase of \$4.0 million was due primarily to the acquisition of McAleer. On the balance sheet since year end, Property and equipment, Capitalized software costs, Goodwill and Other Assets all increased most significantly as a result of the acquisition of substantially all the assets of McAleer and related purchase price allocation to the assets and recording of the additions in our financials.

*Cash from Financing Activities*

Cash provided by financing activities netted to \$1.7 million in the first three months of 2007 compared to cash used of \$1.3 million in the first three months of 2006. The increase in cash provided of \$3.0 million is due to the use of borrowings to finance the McAleer acquisition.

**Non-GAAP Financial Measures: EBITDA and Adjusted EBITDA**

*Quarters Ended March 31, 2007 and 2006*

EBITDA increased 396.1% or \$1.2 million to \$944,000 for the quarter ended March 31, 2007 compared to a Loss in EBITDA of \$319,000 reported for the same period in 2006. The EBITDA increase was primarily due to the increase in net income over the prior year. Increases in depreciation and amortization over the prior year also impacted the calculation. Adjusted (financing) EBITDA for the quarter ended March 31, 2007 increased by 248.8% or \$0.7 million to \$1.0 million compared to \$0.3 million for the prior year. The Adjusted EBITDA increase was also driven primarily by the increase in net income and depreciation and amortization over the prior year. The rate of increase in Adjusted EBITDA was lower than that of EBITDA as it excludes the non-cash item stock-based compensation, which declined \$0.5 million in the first quarter of 2007 compared to the amount incurred in the same quarter of the prior year.

*Explanation and Reconciliation of EBITDA and Adjusted EBITDA*

EBITDA is a non-GAAP financial measure used by management, lenders and certain investors as a supplemental measure in the evaluation of some aspects of a corporation's financial position and core operating performance. Investors sometimes use EBITDA as it allows for some level of comparability of profitability trends between those businesses differing as to capital structure and capital intensity by removing the impacts of depreciation and amortization. EBITDA also does not include changes in major working capital items such as receivables, inventory and payables, which can also indicate a significant need for, or source of, cash. Since decisions regarding capital investment and financing and changes in working capital components can have a significant impact on cash flow, EBITDA is not a good indicator of a business's cash flows. We use EBITDA for evaluating the relative underlying performance of the Company's core operations and for planning purposes, including a review of this indicator and discussion of potential targets in the preparation of annual operating budgets. We calculate EBITDA by adjusting net income or loss to exclude net interest expense, income tax expense or benefit, depreciation and amortization, thus the term Earnings Before Interest, Taxes, Depreciation and Amortization and the acronym EBITDA.

EBITDA is presented as additional information because management believes it to be a useful supplemental analytic measure of financial performance of our core business, and as it is frequently requested by sophisticated investors. However, management recognizes it is no substitute for GAAP measures and should not be relied upon as an indicator of financial performance separate from GAAP measures (as discussed further below).

Adjusted EBITDA or Financing EBITDA is a non-GAAP financial measure used in our calculation and determination of compliance with debt covenants related to our bank credit facilities. Adjusted EBITDA is also used as a representation as to how EBITDA might be adjusted by potential lenders for financing decisions and our ability to service debt. However, such decisions would not exclude those other items impacting cash flow which are excluded from EBITDA, as noted above. Adjusted EBITDA is defined as net income or loss adjusted for net interest expense, income tax expense or benefit, depreciation, amortization, and also certain additional items allowed to be excluded from our debt covenant calculation including other non-cash items such as operating non-cash compensation expense (such as stock-based compensation), and the Company's initial reorganization or restructuring related costs, unrealized gain or loss on financial instrument (non-cash related) and gain or loss on the disposal of fixed assets. While we evaluate the Company's performance against debt covenants on this basis, investors should not presume the excluded items to be one-time costs. If the Company were to enter into additional capital transactions, for example, in connection with a significant acquisition or merger, similar costs could reoccur. In addition, the ongoing impact of those costs would be considered in, and potential financings based on, projections of future operating performance which would include the impact of financing such costs.

We believe the presentation of Adjusted EBITDA is important as an indicator of our ability to obtain additional financing for the business, not only for working capital purposes, but particularly as acquisitions are anticipated as a part of our growth strategy. Accordingly, a significant part of our success may rely on our ability to finance acquisitions.

When evaluating EBITDA and Adjusted EBITDA, investors should consider, among other things, increasing and decreasing trends in both measures and how they compare to levels of debt and interest expense, ongoing investing activities, other financing activities and changes in working capital needs. Moreover, these measures should not be construed as alternatives to net income (as an indicator of operating performance) or cash flows (as a measure of liquidity) as determined in accordance with GAAP.

While some investors use EBITDA to compare between companies with different investment and capital structures, all companies do not calculate EBITDA or Adjusted EBITDA in the same manner. Accordingly, the EBITDA and Adjusted EBITDA measures presented below may not be comparable to similarly titled measures of other companies.

A reconciliation of Net Income reported under GAAP to EBITDA and Adjusted (Financing) EBITDA is provided below:

(In thousands)	Quarter Ended	
	2007	March 31, 2006
<b>Reconciliation of Net income (loss) per GAAP to EBITDA and Adjusted (Financing) EBITDA:</b>		
Net income (loss) per GAAP	\$ 285	\$ (430)
Adjustments:		
Income tax expense (benefit)	163	(205)
Interest expense, net	131	90
Depreciation and amortization of fixed assets and trademarks	126	75
Amortization of software development costs	239	151
EBITDA	\$ 944	\$ (319)
Adjustments to EBITDA to exclude those items excluded in loan covenant calculations:		
Stock based compensation (non-cash portion)	\$ 86	\$ 614
Adjusted (Financing) EBITDA	\$ 1,030	\$ 295

## Credit Arrangements

### Bank Credit Facilities

During the first quarter of 2005, in order to support the activities of the reverse acquisition, the Company entered into a \$3.0 million line of credit facility with a bank whereby the Company could borrow up to 80% of accounts receivables balances, not to exceed the total facility limit of \$3.0 million. Immediately upon entering into the loan agreement in 2005, the Company borrowed \$1,500,000 which was used for the paydown of a portion of the subordinated notes issued in connection with the merger. In the first quarter of 2006, this facility was renewed with an increased limit of \$3.5 million. In January 2007, this facility was amended with an increased limit of \$5.5 million to support the financing of McAleer and the growth of the Company. The bank revolving credit facility is discussed in detail under B. Recent Developments Modification of Bank Credit Facilities.

As of December 31, 2006, there was \$551,000 of outstanding draws under our bank credit facility, and \$1,781,000 was available under the facility. On January 2, 2007, immediately preceding the acquisition there was approximately \$569,000 outstanding under the facility. Subsequent to entering into the amended agreement, we drew down \$1,671,332, which was used in the funding of the McAleer acquisition. Following such advance, borrowings under the revolving facility totaled \$2,241,836, with \$412,916 available for further advances. As of May 9, 2007, \$2.0 million was outstanding under the facility and \$1.6 million was available for additional draws.

On February 14, 2006, the Company entered into a 42-month term loan totaling \$400,000 with the Bank, at a fixed interest rate of 7.5% per annum. The purpose of the loan was to finance capital expenditures long term and improve availability under the revolving facility. Pursuant to the January 2007 modification to the bank's credit facilities, the February 2006 equipment loan was modified, increasing it to \$800,000. The equipment note bears interest at 7.85% per annum. Principal and interest is



payable in 36 consecutive monthly payments of principal and interest of \$25,015 continuing until January 1, 2010. The new equipment note refunded the February 2006 equipment loan balance at December 31, 2006 of \$313,954, with an additional \$486,046 being advanced at the January 2, 2007 closing. The additional proceeds represented a reimbursement to the Company for capital expenditures incurred during 2006, and were used to help fund the McAleer acquisition. The equipment facility with our bank is discussed in more detail under the section entitled **B. Recent Developments Modification of Bank Credit Facilities.**

The credit facilities with our bank are subject to certain restrictive covenants, including financial covenants. As of December 31, 2006, we believe we had complied with all such covenants. These financial and other restrictive covenants are discussed under the section entitled **B. Recent Developments Modification of Bank Credit Facilities.**

We anticipate renewing the bank credit facility prior to its expiration date in May 2007. We do not believe that cash flow from operations will be sufficient to repay the facility at maturity and adequately fund our growing working capital needs. In the alternative, we would attempt to refinance the credit facility with another lender. Although management currently believes that our existing lender will agree to a renewal of the facility, there can be no assurance that our bank will in fact do so or that replacement financing could be procured by us on favorable terms or at all. Further, any failure to resolve our default under or otherwise restructure the subordinated notes, or to maintain the cooperation of the holders of such notes, could negatively impact our ability to renew our existing bank credit facility or procure a replacement. Without such a credit facility, we believe that our ability to fund our business operations, including providing sufficient working capital to fund sales growth, could be adversely affected.

#### *Subordinated Notes*

The Company had subordinated notes payable to shareholders with amounts outstanding totaling \$2,250,400 at both March 31, 2007 and December 31, 2006. Although the Company possessed adequate availability on the May 9, 2006 due date to repay the subordinated notes, management believed that cash flow from operations and remaining availability under the bank facility following such a draw 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 remain due and payable.

Since the Company failed to pay the subordinated notes at maturity such notes are in default. Interest not paid quarterly and any principal not paid by the due date accrue interest at 15% until paid. Any potential cross-default under our bank credit facilities relating to the nonpayment of the subordinated notes has been waived by our bank lender. Pursuant to the terms of our bank credit facilities, we have also agreed to obtain the consent of the bank to any modification of the terms of the subordinated notes.

The Company's subordinated noteholders have cooperated with us in the deferral of payment on the subordinated notes. After discussion with the subordinated noteholders, we did not pay the quarterly interest payments that were due on January 1, 2007 and April 1, 2007. We made the decision to defer these payments in a conservative effort to preserve cash flow anticipating the potential impact on liquidity of borrowings as a result of the McAleer acquisition. Due to the large billings and related cash inflow from the Company's annual billing of support agreements in other quarters of the year, the Company plans to bring such payments current by the third quarter of 2007. Depending on cash flow and liquidity, management will also consider and may make some payments toward reduction of the principal.

We anticipate the continued cooperation of the noteholders and the ultimate successful negotiation of a maturity date extension or other restructuring of our subordinated debt with the holders. Looking forward, we believe it unlikely that we will be able to generate sufficient operating cash flow so as to permit repayment of the subordinated notes with draws under the revolving credit facility. Instead, we believe the subordinated notes will be restructured or repaid from long term capital sources. The subordinated notes may, for example, be refinanced as part of the financing of future acquisitions, or repaid from the proceeds of the exercise of warrants by Barron. However, we can give no assurance that we will be able to successfully restructure, extend or refund the subordinated notes, or that the noteholders will continue to cooperate. The notes are subordinated to our senior bank debt, and we believe the ability of the noteholders to have direct recourse against us is limited. However, we can give no assurances as to what adverse collection actions the subordinated noteholders might take, and the impact such actions and default might otherwise have on our other creditors and our financial condition. We do not anticipate any of the noteholders taking any action detrimental to us. It should be noted that five of the subordinated noteholders are currently significant stockholders of the Company, and four of these are executive officers. The sixth noteholder, Barron, holds all our preferred stock.



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*Future Capital Needs and Resources*

*General*

Since inception, and prior to the merger, the Company had funded its operations through cash flow from operations. At December 31, 2004, prior to the February 2005 reverse merger, our capital resources included \$3.7 million of cash. The cash-rich status of the Company was significantly impacted by the merger and related transaction. At March 31, 2007, our cash balance was zero. Accordingly, as a result of the recapitalization in connection with the reverse merger the Company has chosen to utilize a line of credit facility and term loan to assist in the financing of future needs. Also, in order to conserve capital and borrowing capacity, we refrained from repaying the \$2.3 million in subordinated notes upon their maturity in May 2006 and making related interest payments on January 1 and April 1, 2007. On January 2, 2007, our bank revolving credit facility was increased from \$3.5 million to \$5.5 million, and our equipment facility was increased from \$400,000 to \$800,000. The increases were to provide for our expanding working capital and other credit needs, including the funding of the Company's acquisition of McAleer. The modification of the bank credit facility is described in more detail under Note 5 to our unaudited consolidated financial statements for the quarter ended March 31, 2007.

As discussed under B. Recent Developments Acquisition of McAleer Computer Associates, Inc. and Note 2 to our unaudited consolidated financial statements for the quarter ended March 31, 2007, in January 2007 we purchased substantially all of the business operations of McAleer for \$4.1 million. Of this, \$3.5 million was paid in cash at closing and the balance of \$525,000 is being financed via a five year promissory note. The acquisition was funded by advances of about \$2.2 million under our modified credit facilities with our bank. We also utilized approximately \$1.3 million in cash from McAleer.

Ongoing capital resources depend on a variety of factors, including our existing cash balance, the cash flow generated from our operations and external financial sources that may be available. During 2006, we utilized improved cash flow from operating activities and our bank line of credit in the amount of \$3.5 million to fund operations. We also utilized the \$400,000 bank term loan entered into in February 2006 to support capital expenditures. We plan to continue using our increased \$5.5 million revolving credit facility to fund operations. As of May 9, 2007, \$1.6 million was available for additional advances under the facility. Our financial projections and related forecasts of working capital needs have indicated the revolving facility would be adequate for the next year. However, our utilization of draws under the revolver to fund a large portion of the purchase price of the McAleer acquisition effectively used up a significant portion of the additional availability we gained in the January 2007 increase in the revolving credit facility from \$3.5 million to \$5.5 million. Additional billings shortly thereafter increased our borrowing base and improved this position. However, should increased working capital requirements as a result of anticipated sales growth exceed our expectations or operational cash flows be lower than anticipated without a corresponding decline in working capital requirements, coupled with the addition of working capital requirements associated with our McAleer operations, we could experience a need to increase our bank revolving credit facility or seek additional financing. Accordingly, we will continue to evaluate other funding options. These could include mezzanine financing to match the longer-term nature of our investment in McAleer with longer term debt, or the raising of additional equity. Our evaluation of potential long-term funding sources has also included exercise of the warrants. Encouraging the earlier exercise of the warrants, as well as encouraging an earlier increase in the float of our stock, entered into our decision to reduce the pricing on a portion of the warrants.

In addition to financing sources, our operating cash flow is a significant source for us to meet our future capital needs. Our ability to generate sufficient operating cash flow is dependent upon, among other things:

the amount of revenue we are able to generate and collect from our customers;

the amount of operating expenses required to provide our services;

the cost of acquiring and retaining customers; and

our ability to continue to grow our customer base.

Over the 2006 year, the Company experienced significant improvement in its cash flow from operations compared to the prior year. More than \$800,000 of expense recorded in the 2006 year related to non-cash, stock based compensation compared to only \$400,000 in non-cash expenses (related to the loss on the warrants) in the prior year, and the Company did not incur the significant costs related to the reverse merger, including litigation costs. As a result, 2006 cash flow from operations improved by more than \$2 million. This improvement placed the Company in a position to fund the purchase of McAleer with the increase in its revolving credit facility, but without significant new types of debt or equity. While not anticipated, the use of short-term funding for the acquisition could place some pressure on us in the short-term. However, we bill the

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largest portion of our annual service agreements for our software segment toward the end of the second quarter. These funds are collected primarily in the second and third quarters. The addition of the McAleer acquisition adds another large

portion of similar billings at the end of the fourth quarter, which is collected primarily in the fourth and first quarters. Additionally, our projections as to the acquisition of McAleer were that it would be cash flow positive, including the costs of financing. Our cash flow from operations improved again in the first quarter of 2007 compared to the first quarter of 2006. As a result, we see risk associated with the costs of the acquisition as being in the near-term and continuing improvements in our cash position long-term. This assessment does not take into account additional capital related to additional acquisitions, and it assumes our ongoing ability to secure asset-based financing to fund our growth. Our primary reasons for pursuing other financing and equity capital are to reduce short-term risk, if any, to fund acquisitions, and to repay our subordinated notes (potentially as part of funding an acquisition).

### ***Factors Affecting Capital Needs and Resources***

Set forth below are factors which management believes could have a significant impact on our future cash and capital needs and resources.

***Customer support billings.*** We historically bill a significant portion of our service contracts late in the second quarter of the year. In the past this amount has exceeded \$2,000,000. While revenue for service contracts is deferred over the life of the contract (typically over a year) significant cash is generated in the third quarter as a result of the service payments being billed and collected as payment for the entire future year's service. The Company borrows through its line of credit based on availability tied to its receivables. Cash collections are first used to pay down the line of credit. Thereafter, funds are available to be borrowed again based on our receivables position and line of credit limit as detailed below. Only if the line of credit were paid down and working capital needs met, would we have significant cash on our balance sheet.

A significant portion of service contracts provided by our new McAleer operations are historically billed in the fourth quarter and collected in the fourth and final quarters of each fiscal year. A large amount of expected receipts for our 2007 agreements were collected and used to fund the acquisition of McAleer, and reduced the borrowings needed to complete the acquisition. We expect that the year end collections for McAleer agreements will help offset our historically large mid-year collections in future years.

***Purchase Commitments.*** The majority of our purchase order commitments are based on customer commitments, typically backed by a firm purchase order. However, from time to time we purchase or commit to purchase product as inventory in advance of customer orders in quantities and generally with delivery schedules based on estimates of our customers' demand, which may exceed customer commitments on hand, in order to take advantage of special pricing offers. Currently we have purchase order commitments from Promethean, one of our major suppliers, for interactive whiteboard inventory of \$2.3 million. We have no other significant purchase commitments based on estimates of customer demand that may exceed customer commitments on hand. If actual customer demand were to differ significantly either in timing or volume from the purchase commitments, this could strain our available working capital resources. While management anticipates its purchase commitments will not differ significantly from its estimates of customer demand, there can be no assurance that this will in fact be the case.

***Burden of Professional and Legal Compliance Costs.*** For the quarter ended March 31, 2007, professional and legal compliance and litigation costs, excluding stock-based (non-cash) compensation, totaled \$220,000. These related primarily to compliance costs related to operating as a public company, as well as legal and accounting costs for the registration of shares pursuant to the registration rights agreement. Management anticipates that the current level of expenses should abate due to the reduced registration costs as the Company's registration statement was declared effective with the SEC on February 14, 2006 and an updating amendment was likewise declared effective on May 14, 2007. Although the Company is hopeful that costs related to supplementing the registration statement for updated financial and other information will be minimal, there can be no assurances that this will in fact be the case and cost savings realized. Also, the compliance costs associated with public company status are significant and will continue. However, management anticipates that some cost efficiencies may be realized as CSI gains experience as a reporting company and management seeks to aggressively manage compliance costs.

***Bank Credit Facility.*** Absent a significant cash inflow from the cash exercise of the warrants or otherwise, for the foreseeable future, we will rely on our line of credit facility whereby the Company can borrow up to 80% of its eligible receivables balance, not to exceed the total facility limit of \$5.5 million. As of March 31, 2006, there was \$1,341,000 of outstanding draws under our bank credit facility, and \$2,201,000 was available under the facility. On January 2, 2007, immediately preceding the acquisition there was approximately \$569,000 outstanding under the facility. Subsequent to entering into the amended agreement, we drew down \$1,671,332, which was used in the funding of the McAleer acquisition. Following such advance, borrowings under the revolving facility totaled \$2,241,836, with \$412,916 available for further advances. As of May 9, 2007, \$2.0 million was outstanding under the facility and \$1.6 million was available for additional draws.

Management believes that cash flow from operations will not be sufficient to repay both the bank credit facility in full as of such date and the subordinated promissory notes payable to shareholders in an aggregate amount of \$2.3 million, which were due May 9, 2006. Management anticipates renewing the bank credit facility prior to its expiration date. In the alternative, the Company would attempt to refinance the credit facility with another lender. Although management currently believes that its existing lender will agree to a renewal of the facility, there can be no assurance that the Company's bank will in fact agree to a renewal or that replacement financing could be procured by the Company on favorable terms. Without the existing credit facility or a replacement, management also believes that the ability of the Company to fund working capital to support additional sales growth could be adversely affected.

We project that the revolving credit facility with our bank will be sufficient to fund our operations in the next twelve months. Our utilization of draws under the revolver to fund a large portion of the purchase price of the McAleer acquisition effectively used up a significant portion of the additional availability we gained in the January 2007 increase in the revolving credit facility from \$3.5 million to \$5.5 million. However, subsequent billings have supported additional availability. The Company expects improvement with the billing of and collection on the next largest round of its annual support agreements which are billed and collected on in the second and third quarters. Increased working capital requirements as a result of anticipated sales growth, as well as the addition of working capital requirements associated with our McAleer operations, could put pressure on the adequacy of the bank revolving credit facility. Accordingly, we monitor our availability closely and continue to evaluate other funding options, as discussed above.

*Subordinated Promissory Notes.* At March 31, 2007, subordinated promissory notes payable to shareholders totaled approximately \$2.3 million. As discussed above, we declined to repay the subordinated promissory notes upon their maturity on May 9, 2006 and related interest payments on January 1, and April 1, 2007. From discussions with the holders of the subordinated notes, we anticipate that they will cooperate with the Company in formulating a new repayment schedule or other resolution. Our bank lender has likewise consented with respect to the subordinated notes and has granted a waiver relating to their nonpayment. Such notes are also subordinated to our senior debt, and we believe the ability of the subordinated debt holders to have direct recourse against the Company is currently limited. However, the holders of the subordinated notes may take actions that could adversely affect the Company, including acting to accelerate the subordinated debt, thereby potentially triggering a default under our credit facility with our bank. Such noteholders also may take legal or other adverse collection actions against the Company. For further discussion regarding the subordinated notes, please see *Credit Arrangements* above.

*Short Term Capital Requirements.* We currently anticipate that our capital needs for 2007 will principally consist of \$1.2 million for software development and \$600,000 for capital expenditures. We plan to fund these amounts through cashflow from operations, our line of credit or other financing options discussed above.

*Acquisitions.* We are examining the potential acquisition of companies and businesses within our industry. We are unable to predict the nature, size or timing of any such acquisition, and accordingly are unable to estimate the capital resources which may be required. Any acquisition would be subject to our utilizing sources in addition to those described above. These alternative sources could include the issuance of our common stock or other securities in an acquisition, seller financing, and bank and other third party financing, among other things. We can give no assurance that, should the opportunity for a suitable acquisition arise, we will be able to procure the financial resources necessary to fund any such acquisition or that we will otherwise be able to conclude and successfully integrate any acquisition.

As previously discussed, we acquired McAleer on January 2, 2007. We believe the acquisition of this leading provider of fund accounting based financial management software in Alabama fits within our acquisition strategy. We anticipate that the acquisition of McAleer will provide several benefits as discussed in *B. Recent Developments Acquisition of McAleer Computer Associates, Inc.* A large portion of the cash consideration for the acquisition was funded by draws under our bank revolving credit facility, thereby reducing our availability under the facility to support working capital needs. Also, it is expected that the acquisition of McAleer, like most acquisitions by the Company of other operating businesses, will increase the working capital needs of the Company. While our line of credit may be sufficient, its adequacy may be strained by our increased working capital and other needs as a result of acquisition activity. We continue to pursue other opportunities for increasing funds available to us in light of the potentially greater capital needs of a larger organization. A number of options, as discussed above, are under consideration, and could provide longer-term financing to match the longer-term nature of an acquisition related investment.

*Potential Capital Inflow from Warrants Exercise.* A significant amount of cash and capital for the Company would be generated by the exercise by Barron of its common stock warrants. The exercise of our warrants with an exercise price of \$0.70 would generate approximately \$1.1 million. The exercise of our warrants priced at \$0.85 would generate approximately \$1.3 million. The exercise of our warrants priced at \$1.3972 would generate approximately \$2.8 million. And the exercise of our warrants with a price of \$2.0958 would generate approximately \$4.2 million. The complete exercise of the warrants is in the sole discretion of Barron, subject to the restrictions in the preferred stock and the warrants prohibiting Barron from

beneficially holding greater than 4.9% of our outstanding common stock, at any time. Although we presume any decision by Barron to exercise the warrants or any portion would depend upon our stock price, results of operations and the long term outlook for the development of our business, among other things, we cannot predict if and when Barron may exercise the warrants. Accordingly, there can be no assurance that Barron will exercise the warrants and that we will receive any resulting capital.

The warrants may be exercised on a cashless basis, in which case the Company would receive no cash proceeds. However, Barron is prohibited from electing a cashless exercise so long as there is an effective registration statement with respect to the shares underlying the warrants. Accordingly, it will be important for us to maintain the effectiveness of the registration statement covering the warrant shares in order to assure the receipt of equity capital from the exercise of the warrants. Our registration statement was declared effective on February 14, 2006 and an updating amendment was likewise declared effective on May 14, 2007. Barron has not invoked the cashless exercise provision.

*Long Term Debt Financing.* On February 14, 2006, the Company entered into an agreement with RBC for a 42 month term loan of \$400,000 at a fixed interest rate 7.5% per annum. The purpose of the loan was to finance capital expenditures long term and improve availability under our bank credit facility for working capital purposes. On January 2, 2007, the equipment facility was increased to \$800,000 and the proceeds used to help fund the acquisition of McAleer. As of March 31, 2007, the Company had paid \$12,515 of interest and \$40,033 of principal related to the loan. The equipment facility is discussed further in Note 5 to our unaudited consolidated financial statements for the quarter ended March 31, 2007.

*Adequacy of Liquidity and Capital Resources.* Based on the foregoing, our management anticipates that our cash flow from operations and our existing bank credit facility will be adequate to fund our short term liquidity and capital needs, so long as we are able to successfully continue to receive cooperation as to the deferral of payment on our subordinated debt. Although we believe our \$5.5 million bank credit facility will be sufficient to fund our operations in the next twelve months, additional availability under the facility from the January 2007 modification was used to fund a large portion of the cash consideration in the acquisition of McAleer. Further, increased working capital requirements as a result of anticipated sales growth, as well as the addition of working capital requirements associated with our McAleer operations, could put pressure on the adequacy of our bank revolving credit facility. We are pursuing other financing alternatives which could include mezzanine financing or other capitalization alternatives. These options are under consideration, and could provide longer-term financing to match our long-term capital needs. Such needs would include providing longer term financing for the recent acquisition of McAleer, potentially supporting additional acquisition activities, and increased working capital. Depending on cash flow from current operations, should we find longer-term funding unnecessary, we may not take advantage of such options, thereby paying down debt and minimizing any potential for dilution from any additional capital raised.

In making our assessments of a fully-funded business plan, we have considered:

cash and cash equivalents on hand or available to our operations under credit facilities of \$1.6 million at March 31, 2007;

expected cash flow from operations;

inventory purchase commitment of \$2.3 million;

the anticipated level of capital expenditures of \$600,000;

software development costs of \$1.2 million;

our scheduled debt service; and

the McAleer acquisition

If our business plans change, including as a result of changes in our products or technology; or if we decide to expand into additional markets; or if economic conditions in any of our markets generally arise and have a material effect on the cash flow or profitability of our business; or if we

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have a negative outcome related to the debt covenants and are unable to obtain a waiver; or are unable to successfully restructure our subordinated debt; or if our working capital needs outstrip availability under our \$5.5 million revolving credit facility; then, the anticipated cash needs of our business as well as the conclusions presented herein as to the adequacy of available sources of cash and timing of our ability to generate net income could change significantly. A decision by Barron not to exercise warrants or to utilize a cashless exercise could result in the necessity to pursue other funding.

Any of these events or circumstances could involve significant additional funding needs in excess of the identified current available sources, and could require us to raise additional capital to meet these needs. However, our ability to seek additional capital, if necessary, is subject to a variety of additional factors that we cannot presently predict with certainty, including:

the commercial success of our operations;

the volatility and demand of the capital markets; and

the future market prices of our securities.

There is no guarantee CSI could obtain access to additional funding or at reasonable rates. The failure of CSI to meet covenant requirements, raise capital through the exercise of the warrants or find or obtain other funding at reasonable rates, could have a negative impact on the business.

### **Item 3. Controls and Procedures.**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 (the Exchange Act), as amended, is recorded, processed, summarized and reported within the time periods required by the Securities and Exchange Commission, including, without limitation, those controls and procedures designed to insure that such information is accumulated, and communication to our management allows timely decisions regarding required disclosures.

Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures (as such item is defined in Rules 13a-13e and 15-d-15e under the Exchange Act) as of the end of the period covered by this report. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of such period, the Company's disclosure controls and procedures were ineffective due to a significant deficiency related to financial reporting. The significant deficiency in our controls related to financial reporting was determined to exist on August 16, 2005, at which time the CFO in consultation with the CEO and the audit committee of the board of directors determined the Company still lacked sufficient internal resources to ensure compliance with new emerging issues, or to fully review its compliance in all areas of financial disclosure on a timely basis, following its inception of reporting as a public company and hiring its first CFO with SEC reporting experience. Accordingly, it was also determined until such time as we had sufficient resources and potentially until we completed our work related to meeting the requirements of the Sarbanes-Oxley Act, no later than the fiscal year ended 2007, we would be unable to declare our disclosure controls with regard to public reporting effective.

In March 2005, the Public Company Accounting Oversight Board, or PCAOB, defined a significant deficiency as a deficiency that results in a more than remote likelihood that a misstatement of the financial statements that is more than inconsequential will not be prevented or detected, or that a company will be unable to comply with laws and regulations, which includes the timely filing of required reports with the Securities Exchange Commission. As a result of this new standard, our management noted in our most recent review a significant deficiency. Prior to February 11, 2005, we were a public shell with virtually no operations and CSI South Carolina was a private company with limited complex accounting issues. As a result neither we nor CSI South Carolina had need for staff with technical accounting and public reporting expertise. In the first quarter of 2005, we entered into a complex merger and began public reporting of significant operations. It was some time before we hired personnel with public reporting experience and began updating our procedures to comply with the Sarbanes-Oxley Act. In the process of reviewing and improving our controls and processes, we have identified and reported errors in our financial reporting. One error in 2006 was the identification of an isolated computer-generated report calculation error (due to a unit of measure issue) which resulted in the overaccrual of sales in the second quarter of 2006 which was detected when the overaccrual was reversed in the subsequent quarter. Also, prior to the release of our 2006 Form 10-KSB on April 2, 2007: (i) we detected a typographical error which was not caught in a Form 8-K submission due to failure to clerically check the report after it was Edgarized and before being submitted electronically by a third party service provider, and (ii) we detected a typographical error in our September 30, 2006 Form 10-QSB with respect to our net loss for the prior year nine months period ended September 30, 2005. All of these have been properly corrected and disclosed in the previously filed reports.

In connection with the above errors, we implemented internal control improvements with a policy whereby transactions of significant size are recalculated, and we have adopted procedures and are increasing our resources to expand our review and validation process to identify and correct typographical and related errors. Additionally, we are working with the CFO to enlist the resources necessary to assist in the handling of complex non-routine accounting issues and to meet public disclosure requirements in a timely fashion. We plan to take the following additional actions to improve internal controls by the fiscal year end 2007.





In the third quarter of 2006 we purchased software for approximately \$50,000 which will allow us to automate our monitoring of our controls to assure they are executed as designed. We believe this will provide the most cost effective solution to meet the requirements of the Sarbanes-Oxley Act. This system was installed and training begun, but no improvements implemented in fourth quarter 2006 or the first quarter of 2007. The entering of controls into the system and the monitoring of those controls will be occurring in the second quarter and throughout the remainder of 2007. In fourth quarter 2006, for an undisclosed amount (due to agreement with the vendor), we also purchased a financial reporting, planning and consolidation system which was not installed until first quarter 2007, and is not yet fully implemented. This system will eliminate the use of complex spreadsheets used in the roll-up of financial information for both internal and external reporting and improve the timeliness of our financial close and reporting cycle. It will also provide more time for personnel to focus on analysis and review of financial information and controls surrounding those activities which must be performed late in the financial closing and regulatory filing cycles. The system also establishes a framework to automate the consolidation of acquired entities, which the Company believes is critical to support the acquisition portion of its growth strategy. This system has been installed and will be implemented throughout the remainder of 2007.

Our accounting system also interfaces with an automated forms routing and approval system which includes the ability to attach and retain supporting documentation. In first quarter 2007, this system was implemented and we identified certain forms and other documents to be integrated into the automated system to improve the consistency and documentation of compliance with controls already in place. We plan to expand the number of forms being used in the system and anticipate that this system will improve the effectiveness of controls across various business process cycles, including the financial reporting cycle. We anticipate more wide-spread implementation and use of this system throughout 2007. As a technical company, and based on training in the fourth quarter of 2006 and first quarter 2007, we believe we will be able to provide much of the work related to the implementation of these systems with limited external resources and have budgeted \$200,000 in 2007 for this and other Sarbanes-Oxley Act compliance related work.

Even with these changes, due to the increasing number and complexity of pronouncements, emerging issues and releases, we expect there will continue to be some risk related to financial disclosures. We anticipate that such risks will be mitigated following full implementation of the Sarbanes-Oxley Act requirements in 2007 which, based on our plans includes the implementation of the systems and automation of controls monitoring described above. The process of identifying risk areas and implementing financial disclosure controls and internal controls over financial reporting required under the Sarbanes-Oxley Act may result in the identification of areas where we may need additional resources. Accordingly, we have also determined until such time as we complete this process, we may be unable to declare our controls effective. This process has begun and we anticipate it will be completed in 2007. This process may also result in the identification and possible reporting of additional deficiencies.

As discussed above, we also maintain a system of internal accounting controls that is designed to provide assurance that assets are safeguarded and the transactions are executed in accordance with management's authorization and properly recorded. Other than the implementation of systems to improve the consistency and documentation of controls already in place and expansion of our review and validation processes related to identifying and correcting typographical and related errors, as described above in this item, there were no changes in the Company's internal control over financial reporting identified in connection with the evaluation of it that occurred during the quarter ended March 31, 2007 that materially or are reasonably likely to materially affect the Company's internal control over financial reporting.

## PART II OTHER INFORMATION

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On February 8, 2007, Barron Partners LP converted 68,000 shares of our Series A Convertible Preferred Stock into a like number of shares of our common stock. The conversion transaction was effectuated pursuant to an exemption from registration under the Securities Act of 1933, as amended, pursuant to Section 3(a)(9) of such act.

On February 6, 2007, and March 19, 2007, non-executive employees exercised options to purchase 31,570 and 15,785 shares, respectively, of our common stock. The aggregate price paid for the shares was \$5,367 and \$1,262, respectively. The options were issued under the option plan of CSI - South Carolina, our predecessor. The issuances were exempt from registration under the Securities Act of 1933, as amended, pursuant to an exemption provided by Rule 701 under such act.

**Item 3. Defaults Under Senior Securities**

From the Company's February 11, 2005 reverse acquisition and recapitalization, \$2,250,400 in principal amount of subordinated notes remain outstanding. Half of such amount is payable in a note to Barron Partners LP, and the other half is payable in five equal notes to the five former shareholders of CSI - South Carolina. Four of these former shareholders are executive officers or directors of the Company: Nancy K. Hedrick, President, CEO and director; Thomas P. Clinton, Senior Vice President of Strategic Relationships and director; Beverly N. Hawkins, Secretary and Senior Vice President of Product Development; and William J. Buchanan, our Senior Vice President of Delivery and Support. One of the former CSI - South Carolina shareholders, Joe Black, is the former interim chief financial officer of the Company. All of such shareholders are substantial stockholders of the Company.

The subordinated notes were due and payable on May 10, 2006. The Company declined to pay the subordinated notes at maturity, putting such notes in default, as previously reported. Interest not paid quarterly and any principal not paid by the due date accrues interest at 15% until paid. Although we possessed adequate availability on the May 10, 2006 due date 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 at that time. We also anticipated that such a refunding of the subordinated notes with bank debt would have caused us 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, we determined that it was not in the best interest of all stakeholders to pay the notes at maturity, and the subordinated notes remain due and payable.

Payments of accrued interest are due on a quarterly basis. After discussion with the noteholders, we did not pay the quarterly interest payments that were due on January 1, 2007 and April 1, 2007 in the amounts of \$85,083 and \$87,431, respectively. As of April 15, 2007, accrued and unpaid interest totaled \$216,232. We made the decision to defer these payments in a conservative effort to preserve cash flow anticipating the potential impact on liquidity of borrowings as a result of the McAleer acquisition.

We plan to bring the interest payments current by the third quarter of 2007. Depending on our cash flow and liquidity, we will also consider and may make some payments toward reduction of the principal. We anticipate the continued cooperation of the noteholders and the ultimate successful negotiation of a maturity date extension or other restructuring of our subordinated debt with the holders. Looking forward, we believe it unlikely that we will be able to generate sufficient operating cash flow so as to permit repayment of the subordinated notes with draws under the revolving credit facility. Instead, we believe the subordinated notes will be restructured or repaid from long term capital sources. The subordinated notes may, for example, be refinanced as part of the financing of future acquisitions, or repaid from the proceeds of the exercise of warrants by Barron. However, we can give no assurance that we will be able to successfully restructure, extend or refund the subordinated notes, or that the noteholders will continue to cooperate. The notes are subordinated to our senior bank debt, and we believe the ability of the noteholders to have direct recourse against us is limited. However, we can give no assurances as to what adverse collection actions the subordinated noteholders might take, and the impact such actions and default might otherwise have on our other creditors and our financial condition. We do not anticipate any of the noteholders taking any action detrimental to us. As noted above, five of the subordinated noteholders are currently significant stockholders of the Company, and four are executive officers. The sixth noteholder, Barron, holds all our preferred stock.

**Item 5. Other Information.**

**Unregistered Sales of Equity Securities**

The disclosure contained above in Item 2. Unregistered Sales of Equity Securities and Use of Proceeds, is incorporated herein by reference.

**Entry into a Material Definitive Agreement**

On April 18, 2006, we entered into a Reseller Agreement with Promethean, Inc., pursuant to which we were granted the exclusive right to market and resell certain Promethean products in North Carolina and South Carolina. The Reseller Agreement expired in accordance with its terms on December 31, 2006. Subsequently, the parties continued operating under the terms of the expired Reseller Agreement. In March of 2007, the parties engaged in negotiations for a new agreement.

On or about May 4, 2007, the parties were successful in agreeing on the terms of an interim agreement to be effective beginning May 1, 2007. In exchange for purchasing an initial minimum amount of Promethean product aggregating approximately \$2.3 million, we will receive standardized pricing for the products. We believe that the arrangement preserves our previous exclusive reseller status in the North and South Carolina markets. The terms of the agreement have not been memorialized in a formal written contract.



**Creation of a Direct Financial Obligation or an Obligation Under an Off-Balance Sheet Arrangement of a Registrant**

Our revolving credit arrangement with RBC Centura Bank is a facility under which we may borrow, repay and then reborrow. Advances and repayment under the credit facility occur daily, reflecting cash receipts and the Company's working capital needs. Set forth below is the outstanding balance as of specific dates through May 9, 2007. The balances presented reflect aggregate advances and paydowns which the Company deems material, or significant. Such information through March 16, 2007 was previously disclosed in our 2006 Form 10-KSB.

<b>Date</b>	<b>Loan Balance</b>
January 2, 2007	\$ 2,230,332
February 2, 2007	0
February 7, 2007	1,219,000
February 21, 2007	349,000
March 7, 2007	919,000
March 28, 2007	1,245,000
April 3, 2007	767,000
April 13, 2007	1,057,000
April 30, 2007	1,803,000
May 9, 2007	1,941,000

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
10.1	Description of Oral Reseller Agreement Between the Company and Promethean, Inc. (May 2007)
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COMPUTER SOFTWARE INNOVATIONS, INC.

Date: May 15, 2007

By: /s/ Nancy K. Hedrick  
Nancy K. Hedrick

President and Chief Executive Officer

Date: May 15, 2007

By: /s/ David B. Dechant  
David B. Dechant

Chief Financial Officer

**EXHIBIT INDEX**

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