COMPUTER SOFTWARE INNOVATIONS INC
Form 10QSB/A
October 30, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB/A

(Amendment No. 1)

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006.

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

Commission file number 000-51758

COMPUTER SOFTWARE INNOVATIONS, INC.

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

Delaware	**98-0216911**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

900 East Main Street, Suite T

Easley, South Carolina 29640

(864) 855-3900

(Address and Telephone Number of Principal Executive Offices and Principal Place of Business)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 x No ¨

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

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: 3,405,680 as of August 10, 2006.

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

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EXPLANATORY NOTE

Restatement of Previously Issued Financial Statements

On September 12, 2006, the Audit Committee of our Board of Directors, in consultation with our Chief Financial Officer and Chief Executive Officer, concluded that the previously issued financial statements contained in our quarterly report on Form 10-QSB for the quarter and six months ended June 30, 2006 (the Form 10-QSB) should not be relied upon for the reasons set forth below, and that we should restate the financial statements to make the necessary accounting corrections. Such event was previously disclosed in our Form 8-K filed with the Securities and Exchange Commission on September 18, 2006. Pursuant to this amendment on Form 10-QSB/A, we are amending the Form 10-QSB to reflect the restatement of our financial statements for the quarter and six months ended June 30, 2006.

The decision to restate was made with the concurrence of our independent registered public accounting firm. The restatement is necessary in order to correct an error in a transactional report used to accrue sales and the associated costs of goods sold. To mitigate the risk of a similar error occurring in the future, we have implemented a policy to increase report testing.

The error had little impact on fully diluted earnings per share, but was considered material for financial disclosure, particularly with respect to the reporting of revenues and cost of sales. Following adjustment, fully diluted earnings per share remained flat for the second quarter of 2006 at $0.04 per share, as the reduction, considering rounding, was less than $0.01 per share. The impact on the six months period rounded to $0.01, reducing diluted earnings to $0.00 per share from $0.01 per share.

The adjustment in revenues reduced the reported revenues from $12,164,236 as originally reported for the second quarter of 2006, to an adjusted revenue amount of $10,701,697 and reduced the reported revenues from $17,006,639 as originally reported for the first six months of 2006, to an adjusted revenue amount of $15,544,101. With respect to gross profit and operating income, the net impact of the error for both the quarter and six month periods of 2006 was a reduction in previously reported amounts of $178,412.

The effect on net income (after tax) was to reduce net income from $507,824 for second quarter 2006 to $400,776, and for the first six months of 2006 from net income of $78,292 to a net loss of $28,754.

The error and its impact on financial reporting was identified due to recent changes to improve reporting for the analysis of data as proposed by the CFO and Board of Directors, based on their experience with reporting in other companies. These changes in reporting, although primarily operationally driven, also relate to the Company s continued focus on controls to fully implement the Sarbanes-Oxley Act of 2002 in the upcoming 2007 fiscal year.

Our CFO reviewed and discussed these issues as well as the required accounting treatment and disclosure with Elliott Davis, LLC, our independent registered public accounting firm. We have determined that the impact of correcting the errors in our financial statements for the quarter and six months ended June 30, 2006 would be material if the errors were corrected in the third quarter. As a result, we determined that it was appropriate to amend as soon as practicable the Form 10-QSB to restate our financial statements to correct the error in the period in which it originated.

All amounts in this quarterly report on Form 10-QSB/A have been updated, as appropriate, to reflect such restatement. We have not updated this quarterly report on Form 10-QSB/A for subsequent events occurring after the filing of the original Form 10-QSB on August 14, 2006.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
REVENUES				
Software applications segment	$ 1,446,005	$ 1,142,039	$ 2,550,077	$ 2,128,788
Technology solutions segment	9,255,692	6,156,389	12,994,024	9,261,944
Net sales and service revenue	10,701,697	7,298,428	15,544,101	11,390,732
COST OF SALES				
Software applications segment				
Cost of sales excluding depreciation, amortization and capitalization	691,312	499,477	1,165,567	1,005,915
Depreciation	17,885	6,689	36,285	14,715
Amortization of capitalized software costs	207,751	121,049	358,760	254,672
Capitalization of software costs	(407,816)	(125,813)	(589,591)	(327,074)
Total software applications segment cost of sales	509,132	501,402	971,021	948,228
Technology solutions segment				
Cost of sales excluding depreciation	7,967,396	4,250,616	10,822,704	6,729,104
Depreciation	28,469	8,539	50,069	17,834
Total technology solutions segment cost of sales	7,995,865	4,259,155	10,872,773	6,746,938
Total cost of sales	8,504,997	4,760,557	11,843,794	7,695,166
Gross profit	2,196,700	2,537,871	3,700,307	3,695,566
OPERATING EXPENSES				
Salaries and wages and benefits (excluding stock-based compensation)	894,324	773,474	1,665,539	1,375,865
Stock based compensation	81,258		695,212	631,174
Reverse acquisition costs				759,283
Professional and legal compliance and litigation costs	88,208	220,303	430,888	220,303
Marketing costs	59,952		149,856	
Travel and mobile costs	149,815	90,168	232,260	152,394
Depreciation	41,513	14,772	76,624	27,451
Other selling, general and administrative expenses	207,878	183,337	303,588	323,568
Total operating expenses	1,522,948	1,282,054	3,553,967	3,490,038
Operating income	673,752	1,255,817	146,340	205,528
OTHER INCOME (EXPENSE)				
Interest income	819		3,000	6,023

Interest expense	(96,592)	(77,198)	(188,977)	(90,202)
Amortization of loan fees			(17,458)	(24,442)
Gain (loss) on disposal of property and equipment				100
Unrealized loss on warrants		(108,267)		(3,193,188)
Net other income (expense)	(95,773)	(185,465)	(203,435)	(3,301,709)
Income (loss) before income taxes	577,979	1,070,352	(57,095)	(3,096,181)
INCOME TAX EXPENSE (BENEFIT)	177,203	481,762	(28,341)	(1,235,328)
NET INCOME (LOSS)	**$ 400,776**	**$ 588,590**	**$ (28,754)**	**$ (1,860,853)**
BASIC EARNINGS (LOSS) PER SHARE	**$ 0.12**	**$ 0.22**	**$ (0.01)**	**$ (0.71)**
DILUTED EARNINGS (LOSS) PER SHARE	**$ 0.04**	**$ 0.05**	**$ (0.01)**	**$ (0.71)**
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	**3,340,004**	**2,631,786**	**3,119,657**	**2,631,786**
Diluted	**11,362,728**	**12,474,658**	**11,262,792**	**2,631,786**

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
CURRENT ASSETS		
Cash	$ 334,310	$
Accounts receivable, net	8,263,867	5,891,950
Inventories	15,197	
Prepaid expenses	97,700	70,962
Taxes receivable	343,896	192,918
Total current assets	9,054,970	6,155,830
PROPERTY AND EQUIPMENT, net	718,671	411,835
COMPUTER SOFTWARE COSTS, net	1,254,485	983,654
OTHER ASSETS	55,737	22,475
	$ 11,083,863	**$ 7,573,794**
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable	$ 3,538,639	$ 2,349,785
Deferred revenue	2,530,429	1,498,418
Deferred tax liability	415,082	298,764
Bank line of credit	1,842,000	1,701,000
Current portion of note payable	100,000	
Subordinated notes payable to shareholders	2,250,400	2,250,400
Total current liabilities	10,676,550	8,098,367
NOTE PAYABLE, less current portion	265,428	
	$ 10,941,978	**$ 8,098,367**
SHAREHOLDERS EQUITY (DEFICIT)		
Common stock - $0.001 par value; 40,000,000 shares authorized; 3,369,030 shares issued and outstanding	3,369	2,632
Preferred stock - $0.001 par value; 15,000,000 shares authorized; 7,012,736 shares issued and outstanding	7,013	7,218
Additional paid-in capital	6,005,049	5,111,736
Retained earnings (deficit)	(5,674,913)	(5,646,159)
Unearned stock compensation	(198,633)	
Total shareholders equity (deficit)	141,885	(524,573)
	$ 11,083,863	**$ 7,573,794**

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY (DEFICIT)

(UNAUDITED)

	Common Stock	Preferred Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Unearned Stock Compensation	Total
Balances at December 31, 2005	$ 2,632	$ 7,218	$ 5,111,736	$ (5,646,159)	$	$ (524,573)
Barron s conversion of preferred stock into common stock	205	(205)				
Stock based compensation	532		893,313		(198,633)	695,212
Net loss for six months ended June 30, 2006				(28,754)		(28,754)
Balances at June 30, 2006	**$ 3,369**	**$ 7,013**	**$ 6,005,049**	**$ (5,674,913)**	**$ (198,633)**	**$ 141,885**

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Six Months Ended	
	June 30,	**June 30,**
	2006	**2005**
OPERATING ACTIVITIES		
Net loss	$ (28,754)	$ (1,860,853)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities		
Depreciation and amortization	539,196	314,672
Stock compensation expense, net	695,212	631,174
Deferred income taxes	116,318	(1,209,508)
Gain on disposal of fixed assets		(100)
Unrealized loss on financial instrument		3,193,188
Changes in deferred and accrued amounts		
Accounts receivable	(2,371,917)	(3,465,393)
Inventories	(15,197)	(168,729)
Prepaid expenses and other assets	(44,196)	(28,043)
Accounts payable	1,188,854	810,892
Deferred revenue	1,032,011	885,947
Taxes payable (receivable)	(150,978)	(325,054)
Net cash provided by (used for) operating activities	960,549	(1,221,807)
INVESTING ACTIVITIES		
Purchase of property and equipment	(469,814)	(93,278)
Capitalization of computer software	(589,591)	(327,074)
Purchase of computer software	(40,000)	
Trademarks	(33,262)	
Net cash used for investing activities	(1,132,667)	(420,352)
FINANCING ACTIVITIES		
Net borrowings under line of credit	141,000	1,051,000
Borrowings under note payable	400,000	
Repayments of note payable	(34,572)	
Payment of debt issuance costs		(83,800)
Proceeds from notes payable to shareholders		1,875,200
Repayments under notes payable to shareholders		(1,500,000)
Dividends paid		(3,460,000)
Redemption of stock options		(899,144)
Purchase of VerticalBuyer shell		(415,024)
Payments for purchase of stock from shareholders		(3,624,800)
Proceeds from issuance of preferred stock and related warrants		5,042,250
Net cash provided by (used for) financing activities	506,428	(2,014,318)
Net increase (decrease) in cash and cash equivalents	334,310	(3,656,477)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		3,656,477

CASH AND CASH EQUIVALENTS, END OF PERIOD	$	334,310	$	
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest	$	304,554	$	12,512
Income Taxes	$	6,318	$	308,500

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

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COMPUTER SOFTWARE INNOVATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACTIVITIES

Description of business and disclosure regarding segments

Computer Software Innovations, Inc. (CSI, Company, we or us) develops software and provides hardware-based technology solutions. We monitor our business results as two segments, the software applications segment and the technology solutions segment, but operate the business collectively, taking advantage of cross-selling and integration opportunities. By strategically combining our internally developed software with our ability to integrate computer and other hardware, we have been successful in providing a variety of technological solutions to over 400 clients located in South Carolina, North Carolina and Georgia. We are pursuing a national presence with a primary, initial focus on the southeast region of the United States. Our client base consists primarily of municipalities, school districts and local governments, although we continue to expand the products and services we can provide to corporate and other non-governmental entities.

Our internally developed software consists of fund accounting based financial management software and standards based lesson planning software. Our primary software product, fund accounting based financial management software, is developed for those entities which 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. In September 2005, we acquired a 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. Our results of operations related to our internally developed software, including an allocation of overheads are reported through our software applications segment.

Our technology solutions are provided to more than 200 organizations. These solutions include, among other capabilities, planning, installation and management of computer, telephone, wireless, video conference, security monitoring and distance and classroom learning projects. The technology solutions segment also provides subsequent support, monitoring and maintenance of equipment and systems. We have established associations with some of the largest vendors in the industry and others whom we believe offer innovative products. The results of operations related to our technology solutions, including an allocation of overheads, are reported under technology solutions segment.

Organization

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

In the first quarter of 2005, we concluded a series of recapitalization transactions which began January 31, 2005 with a change in control due to the purchase of a majority of our common stock by Computer Software Innovations, Inc., a South Carolina corporation since 1989 (CSI South Carolina). These transactions culminated on February 11, 2005 with the merger of CSI South Carolina into us, our issuance of preferred stock, common stock, warrants and certain subordinated notes, and the change of our name to Computer Software Innovations, Inc. We refer to the Company prior to such merger as VerticalBuyer.

The series of transactions was accounted for as a reverse acquisition, in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations, 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. The assets of CSI South Carolina as the accounting acquirer were recorded at their historical costs. The assets and liabilities of VerticalBuyer as the acquiree would have been recorded at fair value, but no assets or liabilities existed at the date of acquisition; accordingly, no goodwill was recorded in connection with the reverse acquisition. Costs associated with the reverse merger were expensed as incurred. Shares issued in the transaction are shown as outstanding for all periods presented and our activities 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 transaction.

Basis of presentation

The consolidated financial statements include the accounts of Computer Software Innovations, Inc., and CSI Technology Resources, Inc., a wholly-owned subsidiary. CSI Technology Resources, Inc. was acquired by CSI on May 1, 2000 and became the technology services division of CSI through which its activities were reported for approximately one year. This subsidiary no longer has any significant operations or separate accounting, as all activities are now accounted for within CSI, except that certain vendor contracts are still in the name of CSI Technology Resources, Inc. At a future date, the name on these contracts may be converted and the subsidiary deactivated, subject to a review of any tax or legal implications. The consolidated balance sheet and the related consolidated statements of operations, changes in shareholders equity (deficit) and cash flows are unaudited. Intercompany balances and transactions have been eliminated. The Company uses the accrual basis of accounting. 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 six month period ended June 30, 2006 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.

NOTE 2 EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of common stock shares outstanding during the period. Diluted earnings (loss) per share are 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 3,340,004 and 2,631,786 for the quarters ended June 30, 2006 and 2005. The weighted average number of common and potential common shares outstanding for the quarter ended June 30, 2006 was 11,362,728 (consisting of 3,340,004 shares outstanding and shares underlying the preferred stock, warrants and options of 7,012,736, 760,105, and 249,883, respectively) and 11,262,792 for the six months ended June 30, 2006 (consisting of 3,119,657 shares outstanding and shares underlying the preferred stock, warrants and options of 7,085,361, 807,584, and 250,190, respectively). The shares underlying the outstanding warrants and options of 7,217,736 and 268,343, respectively, were outstanding for the quarter and the six months ended June 30, 2006 and are reduced by application of the treasury stock method which assumes 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 per share calculation. The weighted average number of common and potential common shares outstanding for the quarter ended June 30, 2005 was 12,474,658 (consisting of 2,631,786 shares outstanding and shares underlying preferred stock, warrants and options of 7,217,736, 2,369,361, and 255,775, respectively) and 12,379,346 for the six months ended June 30, 2005 (consisting of 2,631,786 shares outstanding and shares underlying the preferred stock, warrants and options of 7,217,736, 2,274,294, and 255,530, respectively). The shares underlying the outstanding warrants and options of 7,217,736 and 268,343, respectively, were assumed outstanding for the quarter ended and six months ended June 30, 2005 and are reduced by application of the treasury stock method. Generally accepted accounting principles (GAAP) require 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 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 a cashflow 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 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 common and potential common shares are used in the calculation of diluted earnings per share for the quarters ended June 30, 2005 and 2006, respectively, while for the six months ended June 30, 2005 and 2006 they are not, as the effect is anti-dilutive due to the net loss reported for both periods.

NOTE 3 ACQUISITION AND MERGER

In the first quarter of 2005, we concluded a series of recapitalization transactions which began January 31, 2005 with a change in control due to the purchase of a majority of our common stock by Computer Software Innovations, Inc., a South Carolina corporation, (CSI South Carolina). These transactions culminated on February 11, 2005 with the merger of CSI South Carolina into us, and our issuance of preferred stock, common stock, warrants and certain subordinated notes.

The significant merger related cash activity in the order it occurred is as follows:

Purchase of VerticalBuyer shell company(1)	$ (415,024)
CSI South Carolina redemption of options for common stock	(899,144)
Initial cash payment of portion of CSI - South Carolina $3,460,000 dividends declared to shareholders	(960,000)
Proceeds from sale of warrants in merger	5,042,250
Proceeds from issuance of subordinated note to Barron Partners, LP (Barron)	1,875,200
Payment of remaining outstanding dividends declared, from preferred stock and warrant proceeds	(2,500,000)
Payment on first of the two sets of subordinated notes issued to shareholders in connection with merger	(3,624,800)

Payment of debt issuance costs for $3,000,000 revolving credit facility	(83,800)
Initial borrowings under revolving credit facility	1,500,000
Payment on second set of shareholder ($1,875,200) and Barron s ($1,875,200) notes, from loan proceeds	(1,500,000)
Net effect of merger transactions on cash, and cash used for financing activities	$ (1,565,318)

(1) The net cash purchase cost of VerticalBuyer consisted of an agreed to purchase price of $450,000 and legal costs of approximately $20,000, net of $50,000 waived reimbursement for the advisory fee previously paid by Barron to Maximum Ventures as earnest money and a $5,000 allowance from Maximum Ventures to defray a portion of the estimated costs of preparation of tax returns for 2001, 2002, 2003 and 2004 and accountant fees for the 2004 audit.

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In addition to the cash used for the purchase of Vertical Buyer and other financing activities related to the merger, the Company incurred approximately $700,000 in legal and professional fees, which were expensed.

The above transactions are described in more detail below.

Change of Control. On January 31, 2005, approximately 77% of the ownership of the Company, known then as VerticalBuyer, Inc. (VerticalBuyer or VBYR) which had been maintained as a corporate shell since it discontinued operations in September 2001, was acquired by CSI South Carolina for $415,024.

Reverse Stock Split. On January 31, 2005, the board of directors of VerticalBuyer approved a 40 to 1 consolidation of shares or reverse stock split of its common stock in contemplation of a potential merger of VBYR with CSI South Carolina. The reverse stock split was paid effective February 11, 2005 to shareholders of record as of February 10, 2005. Pursuant to the reverse stock split, every 40 shares of the VBYR s common stock issued and outstanding on the record date was converted and combined into one share of post-split shares. The par value of all shares of common stock was maintained at $0.001 per share. No fractional shares were issued, nor was any cash paid in lieu thereof. Rather, all fractional shares were rounded up to the next higher number of post-split shares and the same issued to any beneficial holder of such post-split shares which would have resulted in fractional shares. Accordingly, each beneficial holder of the common stock had the right to receive at least one post-split share.

Redemption of Options. Prior to the merger, CSI South Carolina, for $899,144, redeemed options to purchase 738,195 shares, as allowed for under a stock option plan which had provided to certain non-executive employees options to purchase 1,065,746 shares of common stock. The 738,195 non-executive employees options redeemed represented 73.34% of the 1,006,538 options outstanding at the time of the merger. Pursuant to the plan, the option holders retained the remaining portion of their options.

Declaration of Dividends. Prior to the merger, CSI South Carolina also declared dividends to its five shareholders totaling $3,460,000, of which $960,000 was paid immediately in cash and $2.5 million was recorded as subordinated dividend notes payable to each stockholder. These subordinated dividend notes payable were paid subsequent to the closing of the transaction and prior to March 31, 2005 from the proceeds of the issuance of preferred stock and warrants discussed below.

Name Change. On February 10, 2005, VBYR changed its name from VerticalBuyer, Inc to Computer Software Innovations, Inc.

Merger Agreement. On February 10, 2005, VBYR entered into an Agreement and Plan of Merger (the Merger Agreement) with CSI South Carolina. The Merger Agreement provided that, upon the terms and conditions set forth in the agreement, CSI South Carolina would merge into VerticalBuyer, with VerticalBuyer continuing as the surviving corporation. The merger and related transactions were consummated on February 11, 2005 via the surrender (and cancellation) of CSI South Carolina s shares in VerticalBuyer, representing 77% ownership of the common stock of VerticalBuyer before the merger, and an exchange by the five shareholders of CSI South Carolina of their shares in CSI South Carolina for shares in the surviving corporation representing 96% ownership in VerticalBuyer (now known as CSI) following the merger, and the issuance of notes payable to the shareholders, and cash (as detailed below).

SFAS 141 states that, In identifying the acquiring entity in a combination effected through an exchange of equity interests, all pertinent facts and circumstances should be considered, and includes the following as significant factors in the decision process: which of the combining entities owners as a group retain the larger portion of voting rights, composition of the governing body and senior management positions, and the terms of the exchange of equity securities.

Following the merger, the former majority shareholders of CSI South Carolina as a group held 96% of the voting stock of the Company, occupied two of five board seats with the remaining three seats being filled by independent directors, and retained senior management positions of the combined company. Preferred stock issued subsequent to the merger sold to assist with the payment for shares and dividends payable to the CSI South Carolina shareholders, cannot be converted to common stock in excess of 4.9% ownership, except in the event of a change in control, defined as (i) a consolidation or merger of our company with or into another company or entity in which we are not the surviving entity, or (ii) the sale of all or substantially all of the assets of our company to another company or entity not controlled by our then existing stockholders

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in a transaction or series of transactions. We are obligated to give Barron (or any subsequent holder of preferred stock) thirty days notice prior to a change in control. In addition, the preferred stock has no voting rights (except under limited circumstances under Delaware law) and generally no provisions granting rights with respect to governance of the Company. Accordingly, under SFAS No. 141 the merger of CSI South Carolina into us was considered to be a reverse acquisition, where by CSI South Carolina is considered to be the acquirer even though it is not the surviving corporation. Accordingly, the assets and liabilities of CSI South Carolina continued to be recorded at their actual cost. The assets and liabilities of VerticalBuyer would have been recorded at fair value, but no assets or liabilities existed at the time of acquisition; therefore no goodwill is recorded. Under reverse acquisition accounting, the financial statements of the surviving corporation (VerticalBuyer) are the financial statements of the acquirer (CSI South Carolina). Costs associated with the reverse acquisition are expensed as incurred. Shares issued in the transaction are shown as outstanding for all periods presented and our activities (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.

Pursuant to the Merger Agreement, in the merger and related CSI South Carolina dividend transactions, the former shareholders of CSI South Carolina received, in exchange for their shares of common stock, approximately $6.7 million of cash, subordinated notes aggregating approximately $2.3 million and 2,526,905 shares of common stock of the Company. The shares of VerticalBuyer s common stock previously held by CSI South Carolina, representing approximately 77 percent of VerticalBuyer s issued and outstanding capital stock, were cancelled, as was the common stock of CSI South Carolina. The remaining shareholders of VerticalBuyer retained their existing shares, subject to the 40 to 1 reverse stock split.

Preferred Stock Purchase Agreement. In connection with the merger, CSI entered into a Preferred Stock Purchase Agreement dated February 10, 2005 (the Preferred Stock Agreement) with Barron, whereby CSI agreed to issue 7,217,736 shares of its newly created Series A convertible, non-voting preferred stock to Barron in exchange for payment of $5,042,250. Each share of preferred stock is convertible into one share of common stock, subject to certain anti-dilution adjustments. The proceeds of the preferred stock issuance were used to pay the outstanding dividends as declared by CSI South Carolina and a portion of the subordinated notes. Barron has agreed, generally, not to convert at any time its preferred stock into shares of the Company common stock or exercise its warrants to purchase shares of common stock if and to the extent that Barron s beneficial ownership of CSI common stock would exceed 4.9%, except in the case of a change in control as discussed previously.

Warrants. Pursuant to the Preferred Stock Agreement, Barron was issued two warrants to purchase 7,217,736 shares of CSI s common stock (the Warrant Shares). The respective exercise prices of the warrants are $1.3972 and $2.0958 per share, with each warrant exercisable for half of the total Warrant Shares. The terms and conditions of the warrants are identical except with respect to exercise price. Barron has agreed, generally, not to convert at any time its preferred stock into shares of the Company common stock or exercise its warrants to purchase shares of common stock if and to the extent that Barron s beneficial ownership of CSI common stock would exceed 4. 9%, except in the case of a change in control as discussed previously.

Subordinated Promissory Notes. In connection with the merger and sale of preferred stock, CSI issued six subordinated promissory notes payable, respectively, to Barron and the five former shareholders of CSI South Carolina. All such notes rank equally in right of payment in the event of bankruptcy or liquidation of CSI, or similar events, and are subordinated in right of payment to all other non-subordinated debt of CSI. Payments of principal and interest may be paid as agreed under such subordinated notes so long as, generally, CSI is not in default under any of its senior indebtedness.

The Barron note provides that CSI will pay to Barron $1,875,200, with interest accruing at the prime rate plus two percent (10.25% as of June 30, 2006). Any past due and unpaid amounts bear interest at the rate of 15% per annum until paid in full. The amount outstanding under this note totaled $1,125,200 at June 30, 2006.

The aggregate principal sum borrowed under the notes payable by CSI to the five former shareholders of CSI South Carolina is $1,875,200, or $375,040 per individual. Other than the principal amount, the terms of the notes are substantially identical to the note payable to Barron. Amounts outstanding under these notes totaled $1,125,200 at June 30, 2006.

The principal on these notes was to be paid in full on or before May 10, 2006. In consultation with its board of directors, senior debt holders, and the holders of these notes, the Company determined it was not in the best interest of all parties to pay these notes at maturity; accordingly, the Company s interest cost on the notes has increased to 15% per annum. See Item 2. Management s Discussion and Analysis or Plan of Operation under Credit Arrangements for a further discussion of the subordinated notes. From discussions with the holders of the subordinated notes, we anticipate that they will continue to cooperate with the Company in formulating a new repayment schedule, later payment date or some other resolution. Such notes are also subordinated to our senior debt, and we believe the ability of the subordinated debt holders to have direct

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recourse against the Company is currently limited. However, the holders of the subordinated notes may take actions that could adversely affect the Company, including taking legal or other adverse collection actions against the Company, or acting to accelerate the subordinated debt, thereby potentially triggering a default under our credit facility with our bank. We have received a waiver from our bank for any potential default which might have been triggered by our decision not to pay the subordinated notes on their due date.

Also in connection with the merger, CSI issued five promissory notes payable to the five former shareholders of CSI South Carolina as additional consideration related to the equity exchange totaling $3,624,800. These amounts were paid immediately following the merger from proceeds from the issuance of the preferred stock and warrants and the $1,875,200 subordinated note issued to Barron.

Merger Expenses and Other. Expenses for the merger consisted of legal and professional fees, commissions and compensation expense related to the merger. Of the $759,283 in fees paid, $275,000 was paid to a third-party broker, Liberty Company, LLC, as a commission for its assistance in the preferred stock sale and warrant issuance. No commission was paid to Barron, the investment group which purchased the preferred stock and received the warrants. The remaining fees of $484,283 consisted of merger related fees paid principally for legal and accounting services.

NOTE 4 STOCK-BASED COMPENSATION AND SUBSEQUENT EVENT

The Company has a stock based compensation plan, the 2005 Incentive Compensation Plan, as of June 30, 2006. The Company accounts for stock based compensation using the fair value method prescribed in SFAS No. 123 (revised 2004), Share-Based Payment, and related interpretations. 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 merger as described below.

At the time of the merger, the CSI South Carolina plan provided for the granting of options to purchase common stock, with a maximum term of ten years, at the option price on the date of grant. Management determined at the time of grant whether options vested immediately or at the end of a three year vesting period. Under the plan, employees had been granted options for 1,065,746 shares, of which 59,208 options were cancelled and 1,006,538 were outstanding under the plan at the time of merger.

In connection with and immediately prior to the merger with VerticalBuyer, CSI South Carolina redeemed options to purchase 797,403 shares for $899,144 pursuant to the terms of the plan. Under such plan, certain non-executive employees had been awarded options to purchase 1,065,746 shares of common stock. The 797,403 non-executive employees options redeemed represented 73.34% of the 1,006,538 options outstanding at the time of the merger. Compensation expense related to the early redemption of stock options was $631,174, consisting of the $899,144 cash payment less unearned compensation expense of $267,970 eliminated upon the redemption. Employer FICA and Medicare, and additional expenses related to this transaction totaling $47,766, were also paid by CSI South Carolina. Pursuant to the plan, the option holders retained the remaining 268,343 options. The board of directors of the surviving corporation, CSI, at its discretion, provided that the options would be assumed and exercisable for shares of CSI common stock at the exchange ratio applicable to the five CSI South Carolina shareholders in the merger. No additional options will be issued under this fixed stock option plan.

The fair value of options was estimated at the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 2003: dividend rate of zero percent for all years, risk-free interest rate of 4.8 percent, expected lives of 10 years, and volatility of 0.35 percent.

VerticalBuyer also had an option plan, with shares available for issuance at the time of the merger. However, all options under the plan had expired, and the plan was cancelled on March 24, 2005. Subsequent to the end of the first quarter 2006, our board of directors approved a new plan for the award of stock-based compensation to employees, directors and consultants as described below. The new plan provides for the award of options, restricted stock or stock appreciation rights at the discretion of the compensation committee of the board of up to an aggregate of 1,100,000 shares.

Stock options assumed in reverse merger

Detail	Number of Options	Weighted Average	Expiration

		Exercise Price	
Options assumed in reverse merger	268,343	$ 0.12	November 1, 2012

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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 award vested immediately upon approval. An additional one-third vested on February 28, 2006, with the final one-third to vest on February 28, 2007. Except in the event of a change in control of the Company, the directors may not sell any shares awarded to them prior to March 1, 2007. If a director s service terminates prior to a vesting date, all unvested shares will 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 at 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 have 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 require the Consultants, if they are 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.

In addition, 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. Such shares are registered pursuant to the Company s Form S-8 registration statement filed with the Securities and Exchange Commission on January 27, 2006. 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 if Mr. Bryson is reelected to the Board for a successive term at such meeting.

Total stock compensation issued in 2006 was $893,845, of which $613,954 was recorded in the first quarter 2006 upon issuing of the stock awards following the reaching of a definitive agreement as to the terms of compensation for the services performed to date and to be performed, and $81,258 was earned in second quarter 2006, leaving $198,633 as unearned stock compensation at June 30, 2006.

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 a period of twelve months in developing and implementing an investor relations and corporate communications strategy. In exchange for Alliance s services, the Company will pay Alliance $6,500 a month in cash for the first six months of the Agreement. At the end of six months, either party to the Agreement will have the option of terminating the Agreement. If the Agreement continues for an additional six months, then the monthly payment will increase to $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 this agreement.

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NOTE 5 LONG-TERM AND SHORT-TERM DEBT AND OFF-BALANCE SHEET INSTRUMENTS

On February 14, 2006, the Company entered into an agreement with RBC Centura Bank (RBC) for a 42 month term loan of $400,000 at a fixed interest rate 7.5% per annum. The facility is collateralized by substantially all of the assets of the Company. The purpose of the loan was to finance capital expenditures long term and improve its availability under its bank credit facility for working capital purposes. Upon any default by the Company on the promissory note, the bank may accrue interest on the promissory note at a rate of 18% per annum, subject to any maximum rate imposed by applicable law. Further, upon default by the Company, the bank may declare the entire unpaid principal balance on the promissory note and all accrued unpaid interest on the promissory note immediately due. For the quarter ended June 30, 2006, the Company paid $9,609 of interest and $26,327 of principal on the loan. The Company paid $12,130 of interest and $34,572 of principal on the loan for the six months ended June 30, 2006.

On March 17, 2005, CSI entered into a revolving credit facility with RBC. Fees for the transaction were $83,800. The facility allows the Company to borrow up to 80% of accounts receivable balances. The total balance borrowed may not exceed the facility limit. Outstanding amounts under the facility bear interest at Libor rate plus 0.275% (7.86% at June 30, 2006), payable monthly and originally matured on May 1, 2006. The maturity date was extended several times. Most recently, on July 14, 2006, the Company and RBC Centura Bank executed a modification agreement extending the maturity date of the facility from July 15, 2006 to July 15, 2007. The modification agreement increased the principal amount of the facility from the original $3.0 million to $3.5 million. The reason for the increase in principal was to support increasing working capital requirements of the Company. Please see Item 2. Management s Discussion and Analysis or Plan of Operation under Credit Arrangements for further discussion of the revolving credit facility.

The facility is collateralized by substantially all the assets of the Company. Immediately upon entering into the loan agreement, 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. There was $1,842,000 outstanding and $1,658,000 available under the facility as of June 30, 2006. Under the facility, CSI is subject to restrictive covenants, the primary terms of which restrict incurring debt, making loans, changing approved executive compensation arrangements or making distributions or investments which would violate the restrictive covenants in the loan agreement. The agreement with our lender also requires the achievement of a debt to EBITDA (Earnings Before Interest Taxes, Depreciation and Amortization a non-GAAP, financial measure which takes GAAP net income and adds back in interest, taxes, depreciation and amortization), as defined, ratio of not more than 2.5:1 measured as of fiscal year end; a debt service coverage of 1.2:1.0 as measured at fiscal year end (EBITDA, as defined, divided by current maturities of long-term debt plus interest payments); EBITDA, as defined, of not less than $2,000,000 by year-end 2005; and a minimum tangible net worth, as defined, of $1,500,000 including subordinated debt by year-end 2005. Pursuant to our agreements with the bank, upon an event of default, it may accelerate and require the repayment of all amounts under the credit facility. It may also decline to make further advance. As of June 30, 2006, management believes the Company is in compliance with all such covenants.

The Company also has subordinated notes payable to shareholders related to the reverse merger (See Note 3).

As of June 30, 2006, for the prior reporting periods, and through the filing date, CSI had no off-balance sheet instruments.

NOTE 6 PREFERRED STOCK AND RELATED WARRANTS

On February 10, 2005, the Company entered into the Preferred Stock Purchase Agreement with Barron. Pursuant to the agreement, on February 11, 2005, immediately following the consummation of the merger, the Company issued to Barron 7,217,736 shares of its newly created Series A Convertible Preferred Stock in exchange for the payment of $5,042,250. Barron was also issued two warrants to purchase in the aggregate 7,217,736 shares of the Company s common stock. The preferred stock is convertible into common stock on a one-for-one basis. The warrants are exercisable for 3,608,868 shares at a price of $1.3972 per share and 3,608,868 shares at a price of $2.0958 per share. The terms and conditions of the warrants are identical, including the expiration date of February 11, 2010, except with respect to exercise price.

Both the conversion of the preferred stock and the exercise of the warrants are subject to restrictions on ownership that limit Barron s beneficial ownership of common stock. Initially, Barron was generally prohibited from beneficially owning greater than 4.9% of common stock, and such restriction could be waived by Barron upon 61 days prior notice. It was the intention of the Company and Barron that the preferred stockholder never acquire greater than 4.9% of the Company s common stock and never be deemed an affiliate or control person under federal securities laws. For avoidance of doubt, Barron and the Company agreed to remove the 61 day waiver provision and to impose a non-waiveable beneficial ownership cap of 4.9%. These agreements were implemented on November 7, 2005.

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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) may 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 considered effective on February 14, 2006. Barron did not invoke a cashless exercise.

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 a cash flow 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. 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 also 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. Under the initial terms of the Registration Rights Agreement, the Company was obligated to file, within 45 days following the execution of the Registration Rights Agreement, a registration statement covering the resale of the shares. The agreement also obligated the Company to use its best efforts to cause the registration statement to be declared effective by the SEC within 120 days following the closing date of the registration rights agreement (February 11, 2005) or generally such earlier date as permitted by the SEC. 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 may be liable for liquidated damages in the event the registration of shares does not remain effective pursuant to the agreement.

Under the terms of the initial Registration Rights Agreement, liquidated damages were triggered if the Company failed (i) to file the registration statement within 45 days from February 11, 2005, (ii) to cause such registration statement to become effective within 120 days from February 10, 2005, or (iii) to maintain the effectiveness of the registration statement. These requirements were subject to certain allowances: 45 Amendment Days during any 12-month period to allow the Company to file post-effective amendments to reflect a fundamental change in the information set forth in the registration statement, and Black-out Periods of not more than ten trading days per year in the Company s discretion, during which liquidated damages would not be paid.

Under the initial terms of the Registration Rights Agreement with Barron, the liquidated damages were payable in cash at a rate of 25% per annum on Barron s initial preferred stock and warrant investment of $5,042,250. Because the liquidated damages were payable in cash, under Emerging Issues Task Force (EITF) 00-19 Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company s Own Stock a potential obligation (referred to under EITF 00-19 as a derivative financial instrument) existed until the registration became effective. On November 7, 2005 the Registration Rights Agreement was amended to eliminate the treatment of the warrants as a derivative financial instrument (see further discussion below).

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

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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.

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 will be issued to Barron for each day when liquidated damages are triggered until February 11, 2007, when this damages agreement expires. The maximum number of shares that could be issued was 561,144 as of June 30, 2006. Because the amendment to the Registration Rights Agreement changes 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. 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) totaling $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. Please see the table below for the complete fluctuations of gains and losses associated with the warrants in 2005.

	Ending Market Value @			
	Warrant Group 1 3,608,868 shares	Warrant Group 2 3,608,868 shares	Total Value	Quarterly (Loss) / Gain
Book Value at Grant Date	$ 2,761,147	$ 2,273,885	$ 5,035,032	
March 31, 2005	4,511,085	3,608,868	8,119,953	$ (3,084,921)
June 30, 2005	4,619,352	3,608,868	8,228,220	(108,267)
September 30, 2005	3,969,756	3,067,538	7,037,294	1,190,926
November 7, 2005	3,356,249	2,093,143	5,449,392	1,587,902
2005 Fiscal Year (Loss) / Gain				$ (414,360)

Prior to the execution of the amendment, 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 considered effective on February 14, 2006.

NOTE 7 COMMITMENTS AND CONTINGENCIES

Operating leases

The Company leases certain facilities and equipment under various operating leases. At June 30, 2006, future minimum lease payments under non-cancelable leases were:

2006	$ 67,344
2007	134,688

2008	138,432
2009	143,433
2010	146,556
Thereafter	36,795
Total	$ 667,248

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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 approximately resulting from the termination, including the cost of recovering the premises and the worth of the balance of the lease over the reasonable rental value of the premises for the remainder of the lease term, which shall be due immediately. The Company does not anticipate terminating the lease at any time prior to the natural termination of the lease.

NOTE 8 SEGMENT INFORMATION

CSI is organized into the two reportable segments: software applications and technology solutions. Below is a description of the types of products and services from which each reportable segment derives its revenues.

Software applications segment

Through our software applications segment, we report the results of the development, sales, and deployment and provision of ongoing support of our software applications, fund accounting based financial management software 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 the wide range of technology consulting services, including network and systems integration and computer support and maintenance services, that we provide.

Factors management used to identify our segments:

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