COMPUTER SOFTWARE INNOVATIONS INC
Form 10-Q
August 14, 2008
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the quarterly period ended June 30, 2008**

**OR**

**¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from _____ to _____.**

**Commission file number: 000-51758**

# COMPUTER SOFTWARE INNOVATIONS, INC.

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **98-0216911** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

| **900 East Main Street, Suite T, Easley, South Carolina** | **29640** |
|---|---|
| **(Address of principal executive offices)** | **(Zip Code)** |

**(864) 855-3900**

**(Registrant s telephone number, including area code)**

**[None]**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

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

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

| **Class** | **Outstanding at August 8, 2008** |
|---|---|
| Common Stock, $0.001 par value per share | 4,908,061 shares |

**Table of Contents**

***COMPUTER SOFTWARE INNOVATIONS, INC.***

***TABLE OF CONTENTS***


| | | PAGE NUMBER |
|---|---|---|
| PART I - FINANCIAL INFORMATION | | 3 |
| Item 1. | Financial Statements | 3 |
| | Consolidated Statements of Operations for the Three Months and Six Months Ended June 30, 2008 and 2007 | 3 |
| | Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007 | 4 |
| | Consolidated Statement of Changes in Shareholders Equity for the Six Months Ended June 30, 2008 | 5 |
| | Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007 | 6 |
| | Notes to Consolidated Financial Statements | 7 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 18 |
| Item 3. | Quantitative and Qualitative Disclosures about Market Risk | 44 |
| Item 4. | Controls and Procedures | 44 |
| PART II - OTHER INFORMATION | | 45 |
| Item 1. | Legal Proceedings | 45 |
| Item 1A. | Risk Factors | 45 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 45 |
| Item 3. | Defaults Upon Senior Securities | 45 |
| Item 4. | Submission of Matters to a Vote of Security Holders | 45 |
| Item 5. | Other Information | 45 |
| Item 6. | Exhibits | 46 |
| SIGNATURES | | 47 |
| EXHIBIT INDEX | | 48 |

Table of Contents

## PART I FINANCIAL INFORMATION

**Item 1. Financial Statements.**

***COMPUTER SOFTWARE INNOVATIONS, INC.***

***CONSOLIDATED STATEMENTS OF OPERATIONS***

***(UNAUDITED)***

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | June 30, 2008 | June 30, 2007 |
| **REVENUES** | | | | |
| Software applications segment | $ 3,806,286 | $ 2,794,725 | $ 6,863,900 | $ 5,534,161 |
| Technology solutions segment | 13,744,230 | 14,306,570 | 22,749,610 | 23,218,866 |
| Net sales and service revenue | 17,550,516 | 17,101,295 | 29,613,510 | 28,753,027 |
| **COST OF SALES** | | | | |
| Software applications segment | | | | |
| Cost of sales, excluding depreciation, amortization and capitalization | 1,984,887 | 1,661,868 | 3,651,105 | 3,080,595 |
| Depreciation | 27,385 | 16,608 | 51,672 | 30,918 |
| Amortization of capitalized software costs | 314,190 | 259,125 | 598,002 | 498,322 |
| Capitalization of software costs | (203,892) | (208,880) | (499,522) | (435,853) |
| Total Software applications segment cost of sales | 2,122,570 | 1,728,721 | 3,801,257 | 3,173,982 |
| Technology solutions segment | | | | |
| Cost of sales, excluding depreciation | 10,770,911 | 11,327,634 | 18,102,643 | 18,979,240 |
| Depreciation | 30,292 | 22,270 | 58,940 | 43,734 |
| Total Technology solutions segment cost of sales | 10,801,203 | 11,349,904 | 18,161,583 | 19,022,974 |
| Total cost of sales | 12,923,773 | 13,078,625 | 21,962,840 | 22,196,956 |
| Gross profit | 4,626,743 | 4,022,670 | 7,650,670 | 6,556,071 |
| **OPERATING EXPENSES** | | | | |
| Salaries, wages and benefits | 1,804,972 | 1,390,359 | 3,123,316 | 2,457,563 |
| Stock based compensation | 4,691 | 5,027 | 9,383 | 90,813 |
| Acquisition expenses | 9,345 | 4,076 | 32,844 | 8,546 |
| Compliance related costs | 137,654 | 201,178 | 234,153 | 380,756 |
| Sales consulting fees | 55,625 | 48,000 | 118,502 | 96,000 |
| Marketing costs | 106,075 | 75,537 | 115,039 | 73,312 |
| Travel and mobile costs | 180,073 | 137,128 | 350,924 | 290,609 |
| Depreciation and amortization | 122,159 | 90,502 | 228,420 | 180,749 |
| Other selling, general and administrative expenses | 390,362 | 240,209 | 797,671 | 567,261 |
| Total operating expenses | 2,810,956 | 2,192,016 | 5,010,252 | 4,145,609 |
| Operating income | 1,815,787 | 1,830,654 | 2,640,418 | 2,410,462 |
| **OTHER INCOME (EXPENSE)** | | | | |
| Interest income | 35 | 58 | 100 | 2,763 |
| Interest expense | (130,697) | (152,036) | (263,022) | (286,055) |

| | | | | |
|---|---|---|---|---|
| Loss on disposal of property and equipment | | | | (1,218) |
| Net other income (expense) | (130,662) | (151,978) | (262,922) | (284,510) |
| Income before income taxes | 1,685,125 | 1,678,676 | 2,377,496 | 2,125,952 |
| INCOME TAX EXPENSE | 673,507 | 775,499 | 938,115 | 937,989 |
| **NET INCOME** | **$ 1,011,618** | **$ 903,177** | **$ 1,439,381** | **$ 1,187,963** |
| **BASIC EARNINGS PER SHARE** | **$ 0.21** | **$ 0.25** | **$ 0.30** | **$ 0.34** |
| **DILUTED EARNINGS PER SHARE** | **$ 0.08** | **$ 0.07** | **$ 0.12** | **$ 0.09** |
| **WEIGHTED AVERAGE SHARES OUTSTANDING:** | | | | |
| **Basic** | **4,908,061** | **3,544,385** | **4,803,516** | **3,516,853** |
| **Diluted** | **12,366,568** | **13,255,883** | **12,262,023** | **13,248,383** |

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

Table of Contents

***COMPUTER SOFTWARE INNOVATIONS, INC.***

***CONSOLIDATED BALANCE SHEETS***

| | June 30, 2008 (Unaudited) | December 31, 2007 |
|---|---|---|
| ***ASSETS*** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ | $ |
| Accounts receivable, net | 13,420,118 | 8,697,036 |
| Inventories | 2,549,374 | 470,485 |
| Prepaid expenses | 152,008 | 42,832 |
| Taxes receivable | | 177,147 |
| Total current assets | 16,121,500 | 9,387,500 |
| **PROPERTY AND EQUIPMENT,** net | 1,424,187 | 1,316,713 |
| **COMPUTER SOFTWARE COSTS,** net | 2,303,453 | 2,162,717 |
| **DEFERRED TAX ASSET** | 291,535 | 263,324 |
| **GOODWILL** | 2,430,437 | 1,480,587 |
| **OTHER INTANGIBLE ASSETS,** net | 1,970,132 | 1,574,809 |
| | **$ 24,541,244** | **$ 16,185,650** |
| ***LIABILITIES AND SHAREHOLDERS EQUITY*** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable | $ 6,553,141 | $ 4,023,936 |
| Taxes payable | 340,418 | |
| Deferred revenue | 6,565,440 | 5,323,889 |
| Deferred tax liability | 478,232 | 469,046 |
| Current portion of notes payable | 294,485 | 283,187 |
| Subordinated notes payable to shareholders | 1,950,400 | 2,250,400 |
| Total current liabilities | 16,182,116 | 12,350,458 |
| **NOTES PAYABLE,** less current portion | 614,025 | 763,717 |
| **BANK LINE OF CREDIT** | 3,533,000 | 575,000 |
| Total liabilities | **20,329,141** | **13,689,175** |
| **SHAREHOLDERS EQUITY (DEFICIT)** | | |
| Preferred stock - $0.001 par value; 15,000,000 shares authorized; 6,859,736 shares issued and outstanding | 6,860 | 6,860 |
| Common stock - $0.001 par value; 40,000,000 shares authorized; 4,908,061and 4,698,970 shares issued and outstanding, respectively | 4,908 | 4,699 |
| Additional paid-in capital | 7,649,583 | 7,400,939 |
| Accumulated deficit | (3,345,338) | (4,784,719) |
| Unearned stock compensation | (103,910) | (131,304) |
| Total shareholders equity | 4,212,103 | 2,496,475 |
| | **$ 24,541,244** | **$ 16,185,650** |

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

Table of Contents

*COMPUTER SOFTWARE INNOVATIONS, INC.*

*CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY*

*(UNAUDITED)*

| | Common Stock | Preferred Stock | Additional Paid-In Capital | Accumulated Deficit | Unearned Stock Compensation | Total |
|---|---|---|---|---|---|---|
| **Balances at December 31, 2007** | **$ 4,699** | **$ 6,860** | **$ 7,400,939** | **$ (4,784,719)** | **$ (131,304)** | **$ 2,496,475** |
| Issuance of common stock, ICS Acquisition | 209 | | 229,791 | | | 230,000 |
| Issuance of stock options | | | 18,853 | | (18,853) | |
| Stock based compensation | | | | | 46,247 | 46,247 |
| Net income for six months ended June 30, 2008 | | | | 1,439,381 | | 1,439,381 |
| **Balances at June 30, 2008** | **$ 4,908** | **$ 6,860** | **$ 7,649,583** | **$ (3,345,338)** | **$ (103,910)** | **$ 4,212,103** |

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

Table of Contents

***COMPUTER SOFTWARE INNOVATIONS, INC.***

***CONSOLIDATED STATEMENTS OF CASH FLOWS***

***(UNAUDITED)***

| | Six Months Ended | |
|---|---|---|
| | **June 30, 2008** | **June 30, 2007** |
| **OPERATING ACTIVITIES** | | |
| Net Income | $ 1,439,381 | $ 1,187,963 |
| Adjustments to reconcile net income to net cash provided by (used for) operating activities | | |
| Depreciation and amortization | 937,033 | 754,583 |
| Stock compensation expense, net | 46,247 | 90,813 |
| Deferred income tax expense | (19,024) | 150,390 |
| Loss on disposal of fixed assets | | 1,218 |
| Changes in deferred and accrued amounts net of effects from purchase of McAleer Computer Associates, Inc. and ICS Systems, Inc. | | |
| Accounts receivable | (4,723,082) | (7,799,445) |
| Inventories | (2,073,889) | 831,265 |
| Prepaid expenses and other assets | (109,176) | 53,931 |
| Accounts payable | 2,523,625 | 3,381,847 |
| Deferred revenue | 1,192,546 | 5,020,732 |
| Income taxes payable | 517,565 | 699,861 |
| Net cash provided by (used for) operating activities | (268,774) | 4,373,158 |
| **INVESTING ACTIVITIES** | | |
| Purchases of property and equipment | (327,829) | (130,069) |
| Capitalization of computer software | (574,737) | (484,623) |
| Payment for acquisitions | (1,348,266) | (4,149,472) |
| Net cash used for investing activities | (2,250,832) | (4,764,164) |
| **FINANCING ACTIVITIES** | | |
| Net borrowings under line of credit | 2,958,000 | 2,019,000 |
| Borrowings under notes payable | | 972,046 |
| Repayments of notes payable | (438,394) | (106,098) |
| Proceeds from exercise of stock options | | 6,629 |
| Net cash provided by financing activities | 2,519,606 | 2,891,577 |
| Net increase in cash and cash equivalents | | 2,500,571 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD** | | |
| **CASH AND CASH EQUIVALENTS, END OF PERIOD** | $ | $ 2,500,571 |
| **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:** | | |
| Cash paid during the period for: | | |
| Interest | $ 341,801 | $ 266,162 |
| Income Taxes | $ 439,575 | $ 87,950 |

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

Table of Contents

***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 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, our issuance of preferred stock, common stock, warrants and certain subordinated notes, and the change of our name to Computer Software Innovations, Inc.

On January 2, 2007, we purchased substantially all of the assets and business operations of McAleer Computer Associates, Inc. ( McAleer ) and on April 1, 2008 we purchased substantially all of the assets and business operations of ICS Systems, Inc. ( ICS ). The total prices for the assets acquired in both these acquisitions are further discussed in Note 3 Acquisitions.

**Description of business**

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

The Company s internally developed software consists of fund accounting based financial management software and standards-based lesson planning software. The Company s primary software product, fund accounting based financial management software, is developed for those entities that track expenditures and investments by fund , or by source and purpose of the funding. The fund accounting software is used primarily by public sector and not-for-profit entities. The Company s standards-based lesson planning software is designed to allow teachers to create lesson plans that are tied to a state s curriculum standards. These lesson plans may be reviewed by administrators and a report generated to determine the standards that have been met or need to be met. The lesson plans can be stored, shared, and retrieved for collaboration, editing and future use.

In connection with its hardware-based solutions, the Company provides a wide range of technology products and services including hardware and design, engineering, installation, training and ongoing support and maintenance. Technology solutions include computers, networking, security, IP telephony, interactive whiteboard solutions and integrated accessories, distance learning and video communication. The Company currently markets its products and services primarily to a wide variety of education and local government agencies, and not-for-profit entities in the southeastern United States. The majority of the Company s business is with K-12 (kindergarten through grade 12) public education and local government entities.

**Basis of presentation**

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

**Use of estimates**

The accounting and reporting policies conform to accounting principles generally accepted in the United States of America ( generally accepted accounting principles or GAAP ). GAAP requires us to make estimates, assumptions and judgments and to rely on projections of future results of operations and cash flows. Those estimates, assumptions, judgments and

Table of Contents

projections are an integral part of the financial statements. We base our estimates and assumptions on historical data and other assumptions, which include knowledge and experience with regard to past and current events and assumptions about future events that we believe are reasonable under the circumstances. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities in our financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

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

The interim consolidated balance sheet and the related consolidated statements of operations, changes in shareholders equity and cash flows are unaudited. In our opinion, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been made. The results of the three and six month period ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the consolidated financial statements, critical accounting policies, significant accounting policies and the notes to the consolidated financial statements included in our most recent Annual Report on Form 10-K.

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

**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 May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 162, The Hierarchy of Generally Accepted Accounting Principles ( SFAS 162 ). SFAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS 162 is effective 60 days following approval by the U.S. Securities and Exchange Commission ( SEC ) of the Public Company Accounting Oversight Board s amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company does not expect SFAS 162 to have a material impact on the preparation of its financial statements.

In April 2008, the FASB issued FASB Staff Position (FSP) No. FAS 142-3, Determination of the Useful Life of Intangible Assets. The final FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, Goodwill and Other Intangible Assets. The FSP is intended to improve the consistency between the useful life of an intangible asset determined under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141 (revised 2007), Business Combinations, and other US generally accepted accounting principles. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are currently evaluating the impact FSP 142-3 will have on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161). SFAS 161 is intended to improve financial reporting of derivative instruments and hedging activities by requiring enhanced disclosures to enable financial statement users to better understand the effects of derivatives and hedging on an entity s financial position, financial performance and cash flows. The provisions of SFAS 161 are effective for interim periods and fiscal years beginning after November 15, 2008. We are currently evaluating the effect the adoption of SFAS 161 will have on our Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141R). SFAS 141R establishes principles and requirements for recognizing and measuring assets acquired, liabilities assumed and any non-controlling interests in the acquiree in a business combination. SFAS 141R also provides guidance for recognizing and measuring goodwill acquired in a business combination, requires capitalization of acquired in-process research and development assets at the time of acquisition and requires the acquirer to disclose information that users may need to evaluate and understand the financial effect of the business combination. As SFAS 141R is effective for business combination transactions for which the acquisition date is on or after December 15, 2008. The Company will assess the impact of SFAS 141R if and when a future acquisition occurs.

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.

8

Table of Contents

***NOTE 2 EARNINGS PER SHARE***

Basic earnings per share are computed by dividing net income by the weighted average number of common stock shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common and potential common shares outstanding during the period following application of the treasury stock method. The table below presents the weighted average shares outstanding for the three and six month periods ended June 30, 2008 and 2007, both prior to and after application of the treasury stock method.

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| **Weighted Average Shares Outstanding Prior to Application of the Treasury Stock Method** | | | | |
| Common stock | 4,908,061 | 3,544,385 | 4,803,516 | 3,516,853 |
| Preferred stock | 6,859,736 | 6,944,736 | 6,859,736 | 6,959,012 |
| Warrants | 6,163,936 | 7,217,736 | 6,163,936 | 7,217,736 |
| Options | 382,676 | 290,988 | 378,939 | 297,055 |
| Total Weighted Average Shares Outstanding | 18,314,409 | 17,997,845 | 18,206,127 | 17,990,656 |
| **Weighted Average Shares Outstanding After Application of the Treasury Stock Method** | | | | |
| Common stock | 4,908,061 | 3,544,385 | 4,803,516 | 3,516,853 |
| Preferred stock | 6,859,736 | 6,944,736 | 6,859,736 | 6,959,012 |
| Warrants | 407,851 | 2,533,398 | 407,851 | 2,533,398 |
| Options | 190,920 | 233,364 | 190,920 | 239,120 |
| Total Weighted Average Shares Outstanding treasury stock method | 12,366,568 | 13,255,883 | 12,262,023 | 13,248,383 |

The potential common shares were used in the calculation of diluted earnings per share for the three and six months ended June 30, 2008 and 2007.

***NOTE 3 ACQUISITIONS***

*Acquisition of McAleer Computer Associates, Inc.*

On January 2, 2007, the Company consummated its previously announced acquisition of the business operations of 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, Including Related Party Transaction 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, 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 valuations, 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 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. The allocation of the purchase price, detail of intangible assets and sources of funds used are shown in the tables below.

Table of Contents

*Acquisition of ICS Systems, Inc.*

On March 31, 2008, CSI consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS. The total purchase price was $1,348,266 in cash, plus $49,584 of assumed liabilities, and the issuance by the Company of 209,091 shares of the Company s common stock. We did not assume any material liabilities of ICS. We plan to operate ICS as a separate office from which we will continue to support the existing product and expand opportunities and sales into surrounding areas. We will also be integrating the unique features of ICS software into our products over time, and plan to use ICS personnel to assist with these efforts and future product development needs.

The acquisition was effectuated pursuant to an Asset Purchase Agreement with ICS and Michael Byers, its sole shareholder. The assets acquired included: certain account receivables; work in progress; all furniture, fixtures, machinery, equipment and supplies; and all software and intellectual property rights. The cash portion of the consideration was substantially funded by draw under the Company s revolving credit facility with RBC Bank (USA).

In connection with the asset purchase transaction described in the Asset Purchase Agreement, the Company entered into a Lease with Byers Properties, L.L.C. for the lease by the Company of the former facilities of ICS. Byers Properties is controlled by Michael Byers, who is the sole shareholder of ICS. The term of the Lease begins April 1, 2008 and runs for a period of three years through March 2011. The Lease calls for annual rent of $79,875, payable monthly. The leased property consists of a single-story brick building located on 2.57 acres in Triangle Industrial Park at 8518 Triad Drive, Colfax, North Carolina. The building comprises 7,207 square feet, with approximately 300 square feet being warehouse space.

ICS, located in Colfax, North Carolina (near Greensboro) is a developer, provider and consultant with respect to fund accounting and billing software. Its primary focus is municipalities located in North Carolina. ICS provides CSI with an immediate customer base geographically contiguous with that of CSI, and its North Carolina office provides a launching point for continued expansion into areas north along the eastern seaboard. The acquisition also provides CSI strategic advantages, including valuable market experience and deeper penetration into the local government market.

The allocation of the purchase prices for both the McAleer and ICS acquisitions, including capitalized acquisition expenses, are as follows (liabilities assumed as parts of the purchase price were not deemed material):

| | McAleer | ICS |
|---|---|---|
| Property and equipment | $ 615,000 | $ 50,000 |
| Computer software | 610,000 | 164,000 |
| Goodwill | 1,480,587 | 949,850 |
| Other intangible assets | 1,645,000 | 464,000 |
| Deferred tax liability | (33,750) | |
| Total assets purchase price | $ 4,316,837 | $ 1,627,850 |

The detail of computer software, other intangible assets and goodwill and their useful lives are as follows:

| | McAleer | | ICS | |
|---|---|---|---|---|
| Asset | Value | Effective Useful Life | Value | Effective Useful Life |
| Computer software | $ 610,000 | 4 years | $ 164,000 | 4 years |
| Trade name | 70,000 | 3 years | 19,000 | 3 years |
| Covenants not-to-compete | 75,000 | 5 years | 70,000 | 5 years |
| Customer contracts and related relationships | 1,500,000 | 20 years | 375,000 | 20 years |
| Other intangible assets | $ 1,645,000 | | $ 464,000 | |

| | | | | |
|---|---|---|---|---|
| Total computer software and other intangible assets | $ 2,255,000 | 13.3 years* | $ 628,000 | 13.3 years* |
| Goodwill | $ 1,480,587 | indefinite | $ 949,850 | indefinite |

* Weighted Average

Table of Contents

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

| | McAleer | ICS |
|---|---|---|
| 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 | 1,320,995 |
| Draw on revolving credit facility (for refinance of McAleer note) | 39,000 | |
| Payments of acquisition related expenses (funded from revolving credit facility) | 254,459 | 27,271 |
| Subtotal of funds from revolving loan | 2,064,791 | 1,348,266 |
| Issuance of 209,091 shares of CSI s common stock valued at $1.10 per share | | 230,000 |
| Assumed liabilities | | 49,584 |
| Total purchase price | $ 4,316,837 | $ 1,627,850 |

***NOTE 4 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 options granted.

In 2005, the Company assumed the stock based employee compensation plan of CSI South Carolina as a result of the reverse merger. The Company granted options to purchase 70,000 shares of common stock under the 2005 Incentive Compensation 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, and in November 2007 granted options to purchase an additional 100,000 shares to key employees. In the first quarter of 2008 the Company granted options to purchase an additional 20,000 to other employees. The fair value of stock-based compensation was estimated at the grant date for each issuance using the Black-Scholes option-pricing model. For further information and discussion related to the weighted average assumptions used in the option pricing model please see the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

*Assumptions used in calculation of fair value*

| | For the Period Ended June 30, | |
|---|---|---|
| | 2008 | 2007 |
| Expected term (in years) | 7 | 10 |
| Expected volatility | 123% | 153% |
| Expected dividend yield | 0.0% | 0.0% |
| Risk-free interest rate | 3.6% | 4.7% |

*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 |
| Options granted to key employees | 100,000 | $ 1.42 | November 9, 2017 |
| Options granted to other employees | 20,000 | $ 1.09 | May 28, 2018 |

11

**Table of Contents**

The following table summarizes option activity under the plans for the first six months of 2008:

| Stock Options | Number of Shares | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2007 | 375,203 | $ 0.60 | | |
| Granted | 20,000 | 1.09 | | |
| Cancelled | | | | |
| Exercised | | | | |
| Forfeited/expired | | | | |
| Outstanding at June 30, 2008 | 395,203 | $ 0.63 | 6.13 | $ 147,121 |
| Exercisable at June 30, 2008 | 205,203 | $ 0.12 | 4.34 | $ 180,421 |

The aggregate intrinsic value represents the difference between the Company s closing stock price of $1.00 as of June 30, 2008 and the exercise price multiplied by the number of options outstanding as of that date.

As of June 30, 2008 there remained $103,910 of unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of approximately two years.

No non-employee based stock awards were granted in the first six months of 2008.

Total stock based compensation for the first six months of 2008 was $46,247, of which $9,383 related to the stock options granted as a result of the McAleer acquisition, and $36,864 related to employee stock compensation.

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

In 2005, in order to support the activities of the reverse acquisition, the Company entered into a line of credit facility with a bank whereby the Company could 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 and in January 2007, the facility was renewed and the limit increased to $3.5 million and $5.5 million, respectively. The primary purpose of these 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 in early 2007. In May 2007, the Company extended the maturity date of the facility until September 15, 2007.

On September 14, 2007, the Company entered into agreements with the bank renewing the line of credit facility. The terms of the agreements previously entered into were amended as follows:

- the principal amount of the facility was increased from $5.5 million to $7.0 million;
- the maturity date was extended from September 15, 2007 until June 30, 2009;
- permissible purposes of the funds borrowed under the revolving facility were expanded to include funding short-term working capital and general corporate purposes of the Company; and

the definition of the borrowing base was expanded to include 50% of eligible inventory (with a maximum borrowing ability against eligible inventory of $1,000,000), in addition to 80% of eligible accounts receivable.

On June 30, 2008, the Company entered into agreements to once again extend the maturity date of the line of credit facility from June 30, 2009 to June 30, 2010.

Other than the amendments noted above, the material obligations and provisions of the facility remain unchanged. 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.

Under our bank facility, eligible accounts receivable balances essentially include all of our trade accounts receivable except, in most cases, those accounts which are more than 90 days past due. Certain other accounts are excluded from eligibility for borrowing including: (i) accounts due from affiliates; (ii) accounts which we have determined to be of doubtful 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 bore interest at LIBOR plus 2.50% (4.96%) at June 30, 2008, and LIBOR plus 2.50% (7.73%) at December 31, 2007, payable monthly.

**Table of Contents**

On February 14, 2006 the Company entered into an agreement with a bank for a 42 month equipment term loan of $400,000 at a fixed interest rate of 7.5% per year. 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 a modification of the equipment loan. Pursuant to the modification, the equipment loan was increased to $800,000, and bears interest at 7.85% per annum. Principal and interest are payable in 36 consecutive monthly payments of principal and interest of $25,015 continuing until January 1, 2010.

The loans under the revolving credit facility and the equipment facility, as well as all other obligations owed by the Company to the bank, are secured by a first priority security interest in substantially all of the Company s assets. Also, the Company is required to comply with certain covenants, including: providing periodic financial statements to the bank, compliance with SEC reporting requirements, allowing the bank to inspect its secured assets, and the Company maintaining its assets in good operating condition and maintaining sufficient insurance. Also, the Company is required to comply with certain financial covenants. The first financial covenant is a Debt Service Coverage Ratio, which is measured at the end of each year beginning December 31, 2007. This ratio is calculated by adding certain nonrecurring special items to EBITDA ( Adjusted EBITDA ), and then dividing by current maturities of long term debt plus interest expense. For the purposes of the amended loan agreement, EBITDA means the total of (i) net income from continuing operations (excluding extraordinary gains or losses), and to the extent deducted in determining net income (ii) interest expense, (iii) income taxes, and (iv) depreciation, depletion and amortization expenses. The Company is required to maintain a Debt Service Coverage Ratio of not less than 1.2 to 1.0. The second financial ratio is Funded Debt to EBITDA, which is also measured annually beginning December 31, 2007. A ratio of not greater than 2.5 to 1.0 is required. For the purposes of the ratio, Funded Debt generally means all obligations for borrowed money or for the deferred purchase price of property, and all capitalized lease obligations. Management believes the Company complied with these current covenants at June 30, 2008, and December 31, 2007.

The amended loan agreement also contains certain restrictive covenants. These include general prohibitions on: (i) disposing of property other than in the ordinary course of business; the Company changing its business; a change in control of the Company; mergers, acquisitions and the creation of new subsidiaries; the incurring of new indebtedness; the creation of new encumbrances or liens; investments, other than certain permitted investments in liquid investment grade paper; and the Company making loans, including loans to officers. Also, the amended loan agreement prohibits the Company from making any distributions (including any dividends on its common stock), or making any repurchases or redemptions of its capital stock, except to the extent there is no event of default either before or after any such distribution, repurchase or redemption. The bank may accelerate the Company s obligations under the amended loan agreement and the related promissory notes upon an event of default under the amended loan agreement. Events of default generally include the Company failing to make payments of principal or interest when due; defaults under loan covenants, subject to periods during which the Company may cure in certain cases; the Company becoming insolvent or being subject to certain bankruptcy proceedings, subject to certain time periods; and the occurrence of a material adverse change in the Company s business or financial condition. Upon an acceleration of the bank s loans to the Company, the bank, among other remedies, would have recourse to substantially all of the Company s assets through its security interest. There was $3,533,000 and $575,000 of outstanding draws under the facility as of June 30, 2008 and December 31, 2007, respectively.

The Company has subordinated notes payable to shareholders with amounts outstanding totaling $1,950,400 at June 30, 2008. 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 drawdown would not be sufficient to fund ongoing working capital needs. The Company also anticipated that such a refunding of the subordinated notes with bank debt would have caused the Company to fail to comply with equity related covenants with the bank, given that the subordinated notes are treated as equity for such ratios. Accordingly, after consultation with the bank and the holders of the subordinated notes, we determined it was not in the best interest of all stakeholders to pay the notes at maturity. Following the original maturity date, the Company paid a default interest rate of 15%, both on the principal balance and any interest not paid quarterly. From time to time the Company has also deferred the payment of interest to preserve working capital. Specifically, the Company took this action in the first and second quarters of 2007 as a precautionary measure considering the cash requirement needed for the acquisition of the McAleer operations. Subsequently, the Company paid this and other interest due and no interest was in arrears as of June 30, 2008.

On April 23, 2008, we and each of the holders of the subordinated notes entered into a letter agreement which extended the maturity date of such notes until March 31, 2009. Each noteholder also waived existing and past payment defaults and the notes will continue to bear interest at the default rate of 15%. In exchange for the extension and waiver, the Company made principal payments on the subordinated notes totaling $300,000, paid pro-rata among the noteholders.

Table of Contents

The amount outstanding on the notes payable to the bank was $908,510 at June 30, 2008 and $1,046,904 at December 31, 2007.

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

| | |
|---|---|
| 2008 | $ 144,363 |
| 2009 | 306,235 |
| 2010 | 457,912 |
| Total Principal Payments | $ 908,510 |

*Off Balance Sheet Instruments*

As of June 30, 2008, 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.

*Related Party Transactions*

During the first and second quarter of 2008 the Company made interest payments to the five former shareholders of CSI South Carolina, all of whom are significant shareholders of the Company, and four of which are executive officers, and Barron, who owns all of the Company s preferred shares. These interest payments were made on the subordinated notes payable associated with the reverse merger transaction which occurred in 2005, and represented an annual interest rate of 15% as of June 30, 2008. In 2008, interest payments to the five original shareholders of CSI South Carolina totaled $122,632 and interest payments to Barron totaled $122,632.

***NOTE 6 PREFERRED STOCK AND RELATED WARRANTS AND RETAINED EARNINGS***

**Warrants**

On February 11, 2005, pursuant to the terms of a Preferred Stock Purchase Agreement with Barron, 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. The first 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 9, 2008.

Activity related to the common stock purchase warrants for the six month period ended June 30, 2008 and outstanding balances is as follows:

*Common Stock Purchase Warrants*

| | Warrant A1 | Warrant A2 | Warrant B1 | Warrant B2 |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Exercise Price | $ 1.3972 | $ 0.70 | $ 2.0958 | $ 0.85 |
| Expiration Date | 2/10/2010 | 2/10/2010 | 2/10/2010 | 2/10/2010 |

Table of Contents

*Warrant related activity for the six months*

*ended June 30, 2008*

| | Warrant A1 | Warrant A2 | Warrant B1 | Warrant B2 |
|---|---|---|---|---|
| Outstanding at December 31, 2007 | 2,000,000 | 555,068 | 2,000,000 | 1,608,868 |
| Exercised first six months 2008 | | | | |
| Outstanding at June 30, 2008 | 2,000,000 | 555,068 | 2,000,000 | 1,608,868 |

**Registration Rights Agreement**

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

***NOTE 7 COMMITMENTS AND CONTINGENCIES***

**Operating Leases**

The Company leases certain facilities and equipment under various operating leases. At June 30, 2008, future minimum lease payments under non-cancelable leases were:

| | |
|---|---|
| 2008 | $ 133,178 |
| 2009 | 235,008 |
| 2010 | 226,431 |
| 2011 | 56,764 |
| Total | $ 651,381 |

The Company entered into an operating lease on November 30, 2005 related to the lease of its office facility. The term of this lease is five years, beginning on April 1, 2006 and ending on March 31, 2011. The original commitment under this lease totaled $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 its expiration.

On June 20, 2007, the Company and Chuck Yeager Real Estate amended the operating lease agreement, originally entered into on November 30, 2005, to include an additional 12,544 square feet of warehouse space. The lease of the additional warehouse space was the result of carrying additional inventory and increased monthly rent by approximately $2,400. While the lease on the additional space was scheduled to expire on August 31, 2007, the Company extended the lease until December 31, 2007. On April 1, 2008 the Company terminated the lease of this additional warehouse space, and entered into a one year lease with Edge Developments, LLC for 18,000 square feet of warehouse space located at 903B East Main Street, Easley, SC. The terms of this lease require monthly payments of $3,900, which are included in the schedule above, and are scheduled to expire on March 31, 2009, at which time the Company may chose to extend the lease.

On April 1, 2008, in connection with the acquisition of ICS (Note 3), the Company entered into a lease with Byers Properties, L.L.C. for the lease by the Company of the former facilities of ICS. Byers Properties is controlled by Michael Byers, who is the sole shareholder of ICS. The term of the Lease begins April 1, 2008 and runs for a period of three years through March 2011. The lease calls for annual rent of $79,875, payable monthly. The leased property consists of a single-story brick building located on 2.57 acres in Triangle Industrial Park at 8518 Triad Drive, Colfax, North Carolina. The building comprises 7,207 square feet, with approximately 300 square feet being warehouse space. The future minimum lease payments under this lease are included in the schedule above. For further details on the acquisition of ICS please see Note 3 Acquisitions.

Table of Contents

**Purchase Commitments**

The majority of our purchase commitments are based on firm purchase orders. However, from time to time we commit to purchase product in advance of customer commitments and as inventory to obtain volume pricing discounts or operational efficiencies. Currently we have purchase order commitments to Promethean, one of our major suppliers, for interactive whiteboard inventory of $12.3 million in 2008. As of June 30, 2008, we had satisfied approximately $6.4 million of these purchase order commitments. We have no other significant purchase commitments based on estimates of customer demand that significantly exceed customer commitments. 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.

**Executive Officer Employment Agreements**

The Company entered into separate employment agreements with each of the four most highly compensated executive officers on February 11, 2005, in conjunction with the closing of the reverse merger. The term of all the employment agreements was three years, expiring on February 10, 2008. The agreements renewed for a one year term automatically upon the expiration of the initial term. Such agreements provide for minimum salary levels adjusted for performance based on review by the Board of Directors. The aggregate commitment for future salaries at June 30, 2008, excluding bonuses, was approximately $518,000.

***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 services.

There are no significant transactions between reportable segments. The total of Segment net sales and service revenue from all segments is equal to Net sales as reported in our Consolidated Statements of Operations. Sales and Cost of sales are included in each segment s income as reported in our Consolidated Statements of Operations. Accordingly, the total of the segments Gross profit is equal to Gross profit in our Consolidated Statements of Operations. Operating expenses are allocated to segment income based on estimate 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 are allocated to our segments, since they are reviewed separately by management. Certain non-recurring items (those items occurring for reasons which have not occurred in the prior 2 years and are not likely to reoccur in 2 years) and compliance 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 non-recurring and compliance items, if any, is equal to Operating income (loss) as reported in our Consolidated Statements of Operations.

16

Table of Contents

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 applications segment. Fixed assets, net, are allocated on the same basis as operating expenses (or by time spent on each segment as discussed above), since 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 (loss) for the three and six month periods ended June 30, 2008 and 2007; and assets allocated to segments as of June 30, 2008 and 2007.

***Amounts in thousands***

| | Software Applications | Technology Solutions | Total Company |
|---|---|---|---|
| Three months ended June 30, 2008: | | | |
| Net sales and service revenue | $ 3,806 | $ 13,745 | $ 17,551 |
| Gross profit | 1,683 | 2,944 | 4,627 |
| Segment income | 332 | 1,636 | (*) |
| Segment assets | 10,929 | 13,612 | 24,541 |
| Three months ended June 30, 2007: | | | |
| Net sales and service revenue | $ 2,795 | $ 14,306 | $ 17,101 |
| Gross profit | 1,066 | 2,957 | 4,023 |
| Segment income (loss) | (19) | 2,060 | (*) |
| Segment assets | 7,797 | 14,811 | 22,608 |

| | Software Applications | Technology Solutions | Total Company |
|---|---|---|---|
| Six months ended June 30, 2008: | | | |
| Net sales and service revenue | $ 6,864 | $ 22,750 | $ 29,614 |
| Gross profit | 3,063 | 4,588 | 7,651 |
| Segment income | 708 | 2,208 | (*) |
| Segment assets | 10,929 | 13,612 | 24,541 |
| Six months ended June 30, 2007: | | | |
| Net sales and service revenue | $ 5,534 | $ 23,219 | $ 28,753 |
| Gross profit | 2,360 | 4,196 | 6,556 |
| Segment income | 340 | 2,551 | (*) |
| Segment assets | 7,797 | 14,811 | 22,608 |

* See reconciliation below

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

***Amounts in thousands***

| | Three Months Ended | |
|---|---|---|
| | June 30, 2008 | June 30, 2007 |
| **Segment income (loss):** | | |
| **Software applications segment** | $ 332 | $ (19) |

| | | |
|---|---|---|
| **Technology solutions segment** | 1,636 | 2,060 |
| | | |
| **TOTAL SEGMENT INCOME** | 1,968 | 2,041 |
| **Less: Merger and compliance costs** | | |
| Stock based compensation | (5) | (5) |
| Acquisition expenses | (9) | (4) |
| Professional and legal compliance and litigation related costs | (138) | (201) |
| | | |
| **OPERATING INCOME Per consolidated Statements of Operations** | $ 1,816 | $ 1,831 |

Table of Contents

*Amounts in thousands*

| | Six Months Ended | |
|---|---|---|
| | June 30, 2008 | June 30, 2007 |
| **Segment income:** | | |
| **Software applications segment** | $ 708 | $ 340 |
| **Technology solutions segment** | 2,208 | 2,551 |
| **TOTAL SEGMENT INCOME** | 2,916 | 2,891 |
| **Less: Merger and compliance related costs** | | |
| Stock based compensation | (9) | (91) |
| Acquisition expenses | (33) | (9) |
| Professional and legal compliance costs | (234) | (381) |
| **OPERATING INCOME Per Statement of Operations** | $ 2,640 | $ 2,410 |

**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.**

**A. Introduction**

Unless the context requires otherwise, 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, and its subsidiary, CSI Technology Resources, Inc., a South Carolina corporation.

Table of Contents

**Products and Services**

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 provided 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.

We monitor our business results as two segments, the Software applications segment and the Technology solutions segment.

Through our Software applications segment, we report the results of operations related to our internally developed software, including an allocation of overheads. 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. Our client base for our financial management software consists principally of K-12 (kindergarten through grade 12) public education and local government organizations, including counties and municipalities. Our clients also include public libraries, disabilities boards, higher education and other non-governmental clients. 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 education clients. Additionally, we rebrand and resell other software applications and services including application delivery, data recovery, warmsite and other applications focused solutions and report the results through our Software applications segment.

We report the results of operations related to our hardware-based technology solutions, including an allocation of overheads, through our Technology solutions segment. Our hardware-based technology solutions include a wide range of technology products and services including hardware and related design, engineering, project planning, installation, training, management and ongoing support and maintenance of hardware and hardware-based operating systems and application software. Our technology solutions include hardware and software for hardware-based operating systems and application software for computers, networking (wireless and wired), 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, including interactive whiteboard solutions and integrated accessories. 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.

**Organization**

Our business efforts are focused on our 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.

Table of Contents

*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, (distance learning and classroom learning tools such as interactive white boards and integrated accessories, such as hand held voting devices and audio systems).

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 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. Gross margins for the Software applications segment were 44.2% and 44.6% for the three and six month periods ended June 30, 2008, while margins for our Technology solutions segment were 21.4% and 20.2% for the same periods. Gross margins for the Software applications segment were 38.1% and 42.6% for the three and six month periods ended June 30, 2007, while margins for the Technology solutions segment were 20.7% and 18.1% for the same periods.

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 F. Financial Performance 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.

Table of Contents

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 January 2007 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, was primarily a provider of financial management software to the K-12 education market. It had 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 in our latest Annual Report filed on Form 10-K.

The products and services previously offered by McAleer are now products and services of CSI. However, where appropriate, in order to differentiate, we 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 or CSI-Mobile products and services. All other products and services of CSI referred to, and the software applications products and services referred to specifically as CSI-Easley, 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 Acquisitions below and our latest annual report filed on Form 10-K.

**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 pay-downs to fund acquisitions. 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.

Table of Contents

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, based in Alabama. We believe the acquisition of this leading provider of fund accounting based financial management software to the K-12 education sector in seven southeastern states fits within our acquisition strategy. McAleer and the acquisition transaction are discussed in more detail in our latest Annual Report filed on Form 10-K and Note 3 to our financial statements included in this Form 10-Q filing.

Also as previously disclosed, in furtherance of our acquisition strategy, on March 31, 2008, we consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS Systems, Inc. ( ICS ), located in Colfax, North Carolina (near Greensboro), was a developer, provider and consultant with respect to fund accounting and billing software for the local government market space in that state. We sometimes refer to the former ICS operations as CSI-Greensboro. The ICS transaction is discussed in more detail in Note 3 to our unaudited consolidated financial statements included in this Form 10-Q.

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.

Table of Contents

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

*Sarbanes-Oxley Compliance*

As a public company we are required to maintain internal controls and processes related to addressing risks which are inherent in financial reporting, in compliance with the Sarbanes-Oxley Act ( SOX ). These controls must also be executed consistently and reviewed and tested for effectiveness on a periodic basis. The implementation, monitoring, testing and remediation of internal controls are a complex and costly endeavor. Our costs to support Sarbanes-Oxley are estimated to be under $500,000 per year, including both outsourced efforts and internal personnel costs, and our spending on capitalizable items specifically related to Sarbanes-Oxley is under $100,000 per year.

We have incurred costs to implement, and will incur additional costs to support ongoing efforts to comply with the Sarbanes-Oxley Act legislation. Due to the ongoing changes in our business, our acquisition strategy and the increasing complexity of reporting requirements and regulations, we can give no assurances that our costs for continuing Sarbanes-Oxley compliance will not increase. Also, we cannot guarantee that we will not in the future identify internal control deficiencies, or that we will be able to remediate any such deficiencies in a timely fashion.

*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 have been made in 2007 and may be required to be made in both our current and .Net platforms through 2008, 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 begun 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 to Microsoft.Net Programming and SQL database language, with the personnel module still in progress. The completed modules are in formal beta installations. However, the changes resulting from 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 the personnel (payroll) module 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 most of the remaining modules throughout 2008, with the remainder completed in 2009.

Table of Contents

*Maintaining Margins and Volume*

In 2007, we experienced a significant increase in sales of interactive whiteboard solutions and to a lesser degree sales of IP Telephony solutions, as well as increased sales of engineering services related to both product solutions. 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. Favorably, our margins have fluctuated by only a few (typically less than five, and often less than one) percentage points on a quarterly and annual basis. 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, or we need to increase our revenues or our personnel utilization to achieve greater economies of scale. We also intend to continue our focus on existing higher margin areas such as engineering services and sales of software solutions and related services. While we cannot predict success in achieving these goals, as opportunities arise we take actions to maintain and improve our margins. These include expanding our geographic reach, increasing the size of and reorganizing our sales force to focus on more products backed by product specialists, increasing 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.

Additionally in 2007, a considerable percentage of the significant increase in sales of interactive whiteboard solutions related to a select number of large projects, initiated by school districts, involving their implementation of the new technology. Due to the size and nature of these projects, we were able to achieve certain economies of scale that resulted in substantially improved margins and increased gross profits. The challenge in 2008 and future periods will be to secure similar large opportunities or a greater number of smaller implementations. We have therefore developed a strategy focused on both large opportunities and a greater number of smaller opportunities. This strategy includes focusing certain members of our sales team s efforts specifically on the interactive whiteboard solution product line in an effort to increase market penetration and continue the growth of interactive whiteboard sales. We are also making efforts to take advantage of opportunities which may arise to expand our geographic reach with this product line. Prior to 2007, we were authorized to sell interactive whiteboard products by our partner on an exclusive basis in two states, South Carolina and North Carolina. In early 2008, we entered into an affiliate relationship with another vendor whereby we would participate in the opportunity to sell these solutions in certain counties within the state of Alabama. Also, in the first half of 2008 our revenues have increased only slightly from increases in the number of smaller dollar sales from all segments combined, to offset the very large orders in the prior year. However, with fewer projects of similar size to those very large ones in the prior year, revenues have been up, but not to the level we would prefer. We continue to invest in efforts to improve our top line performance, including recruiting sales talent and increasing marketing efforts, and expect these efforts to pay off in future periods. We also continue to look to acquisitions to enhance our growth.

*Technology and Software Budgets*

While federal, state and local funding can vary from year to year, 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 improve or implement technology and software tools into their individual environments, have provided growth for our business. We recognize that future changes in funding could improve or strain technology budgets. For example, a recession could result in a decline in spending by our educational and local government client base. However, since such spending is generally based on tax revenues which do not always correlate immediately or directly with changes in the economy, the impact is generally reduced when compared to the impact on those vendors whose client base consists primarily of private sector businesses. In the current year, we have experienced some delays in orders due to budget constraints. While we are cautiously optimistic about continued spending, we cannot predict the impact changes in funding may have on our business.

*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.

Table of Contents

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 seek to successfully execute our corporate acquisition growth strategy and thereby provide positive operating results and increased return on investment to our stockholders.

**Forward-Looking Statements**

This report 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, pla 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 of our Annual Report on Form 10-K for the year ended December 31, 2007. 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.

**C. 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

Table of Contents

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 to the audited financial statements as of and for the year ended December 31, 2007 filed with our Form 10-K and Note 1 contained in the explanatory notes to our unaudited consolidated financial statements as of and for the period ended June 30, 2008 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 (e.g., 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

Table of Contents

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 have 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.

27

Table of Contents

**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 resulting from 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 No. 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.

Table of Contents

**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 and payments described in Note 5 to our unaudited financial statements for the period ended June 30, 2008 and under E. 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.

**D. Financial Performance**

**Overview**

Our revenues increased $0.4 million or 2.6% to $17.6 million for the second quarter of 2008 compared to the same period of the prior year. The revenue increase was due to 36.2% growth in new software sales, service and support, substantially offset by a 3.9% decline in technology sales consisting primarily of interactive whiteboard solutions. Of the 36.2% increase in software sales for the second quarter 2008, the new addition of the CSI-Greensboro operations added 8.4%, with the organic growth from our CSI-Easley and Mobile software operations (operations ongoing before the CSI-Greensboro acquisition) contributing the remaining 27.8%. Interactive whiteboard technology solutions declined primarily from our delivery of smaller orders in 2008 being insufficient to match two large, multi-million dollar orders delivered in the same period of 2007. Revenues for the six month period ended June 30, 2008 of $29.6 million increased $0.9 million or 3.0% compared with the same period in the prior year primarily due to the increased revenue generated from the software segment (up 24.0%), partially offset by a decline (2.0%) in technology primarily from lower interactive whiteboard solutions sales. Of the 24.0% increase in software segment revenues for the six months, the CSI-Greensboro operations added 4.2%, with the remaining 19.8% coming from increased CSI-Easley and Mobile software revenues.

Gross profit for the second quarter of 2008 improved by $0.6 million, or 15.0%, to $4.6 million. The improvement was primarily due to the increased volume and margin from the Software applications segment (which experienced an increase in gross profit of 57.9%) including the addition of software profits generated by the acquired CSI-Greensboro operations (which improved software segment gross profit by 6.5%). These improvements were partially offset by a decrease in Technology solutions gross profit (-0.5%) primarily from the reduced product sales. Increases were also partially offset by increased amortization related to increased capitalization of costs associated with the .Net Microsoft SQL (application programming language and database) conversion effort for the CSI-Easley software operations. The decrease in gross profit from product sales of the technology division was partially offset by an improvement in the technology margin. Gross profit for the six month period ended June 30, 2008 increased by $1.1 million or 16.7% to $7.7 million. This increase was primarily related to the increased volume in the Software applications segment (which experienced an increase in gross profit of 29.8%) including the addition of CSI-Greensboro (which improved software segment gross profit by 3.0%). An improvement in Technology solutions gross profit (9.3%) added to the increase.

Operating income for the second quarter of 2008 was relatively flat over the same period in the prior year, declining by less than $15,000 or 0.8%. The slight decline came primarily from second quarter increased investment in sales and marketing efforts in our extended geographic region, which was expanded by the CSI-Mobile acquisition in the prior year, increased sales commissions, and increased travel and mobile costs. The decline also reflects increased IT personnel costs to support SOX and a larger organization, and increased franchise and business license taxes and other miscellaneous costs related to the significant increase in operations and growth in revenues in the prior year. The addition of selling, general and administrative costs from the acquired CSI-Greensboro operations also added to the increase. Operating income for the first six months of 2008 improved $0.2 million, or 9.5%, over the same period in the prior year, to $2.6 million. This increase resulted from the increases in gross profits and decrease in operating expenses as a percent of sales in the first quarter, partially offset by the second quarter s modest decline. Further analysis of financial performance, including additional segment information, is discussed below in subsequent sections of this report.

Table of Contents

**Consolidated Results of Operations for the Three Months Ended June 30, 2008 and 2007**

*Amounts in 000 s*

| | Three Months Ended | | |
|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | Increase (Decrease) |
| **NET SALES AND SERVICE REVENUE** | $ 17,551 | $ 17,101 | $ 450 |
| **GROSS PROFIT** | 4,627 | 4,023 | 604 |
| **OPERATING INCOME** | 1,816 | 1,831 | (15) |
| | | | |
| **SIGNIFICANT ITEMS THAT INCREASED (DECREASED) OPERATING INCOME** | | | |
| Gross Profit: | | | |
| Sales | | | $ 450 |
| Cost of sales excluding depreciation, amortization and capitalization | | | 232 |
| Depreciation and amortization | | | (73) |
| Capitalization of software costs | | | (5) |
| | | | 604 |
| Operating Expenses: | | | |
| Salaries, wages and benefits | | | (415) |
| Stock based compensation | | | |
| Acquisition expenses | | | (5) |
| Professional and legal compliance related costs | | | 63 |
| Sales consulting fees | | | (8) |
| Marketing expenses | | | (30) |
| Travel and mobile costs | | | (43) |
| Depreciation and amortization | | | (31) |
| Other SG&A expenses | | | (150) |
| | | | $ (15) |

**Revenues**

Total revenues in the second quarter of 2008 increased $0.4 million or 2.6% in comparison with the second quarter of 2007 to $17.6 million. This net increase included a $1.0 million increase in software sales and services partially offset by a $0.6 million decline in hardware sales and services through the Technology solutions segment, primarily from reduced sales of interactive whiteboard solutions with a higher volume of lower dollar sales transactions in the current year quarter being insufficient to surpass the impact of a very large deal in the prior year s second quarter. Included in the software segment results were increased sales of $0.2 million from the CSI-Greensboro acquisition. The remaining $0.8 million increase in that segment was from organic growth.

**Gross Profit**

Gross profit in the second quarter of 2008 increased $0.6 million or 15.0% in comparison with the second quarter of 2007 to $4.6 million. The increase was driven by increased sales in the software segment, partially offset by a decline in hardware gross profits primarily from decreased sales of interactive whiteboard solutions. Increased margin in the software segment added to the improvement from sales volume while increased margin in the technology segment partially offset the reduction from the impact of reduced technology sales volume. Increases were also partially offset by increased amortization related to increased capitalization of costs associated with the .Net Microsoft SQL (application programming language and database) conversion effort for the CSI-Easley software operations.

**Operating Expenses**

Operating expenses increased approximately $0.6 million, or 28.2%, in the second quarter of 2008 compared to the second quarter of 2007. The above table analyzes the major items that account for this increase. The majority of the increase came primarily from increased salaries, wages

and benefits, marketing and travel and mobile costs. In the second quarter of 2008, we increased investment in sales and marketing efforts in our extended geographic region, which was expanded by the CSI-Mobile acquisition in the prior year. We also experienced increased sales commissions, and increased travel to support expansion efforts. Increased IT personnel costs to support SOX and a larger organization, in addition to the expansion efforts, contributed to the increase in salaries and wages, compared to the same period of the prior year. Other selling, general and administrative costs increased due to increased franchise and business license taxes and other miscellaneous costs related to

Table of Contents

the significant increase in operations and growth in revenues in the prior year. These increases were partially offset by a decrease in professional and legal compliance costs due to reduced registration related activities. The addition of selling, general and administrative costs from the acquired CSI-Greensboro operations contributed approximately $0.1 million spread among the major categories. The increased operating costs resulted in a relatively flat operating income result, with operating income declining only $15,000 or 0.8% compared to the prior year s second quarter, despite the investment for, in the opinion of management, improved long-term performance.

**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.

| | Three Months Ended | | |
|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | Increase (Decrease) |
| **NET SALES AND SERVICE REVENUE** | $ 3,806 | $ 2,795 | $ 1,011 |
| **GROSS PROFIT** | 1,683 | 1,066 | 617 |
| **SEGMENT INCOME (LOSS)** | 332 | (19) | 351 |
| | | | |
| **SIGNIFICANT ITEMS THAT INCREASED (DECREASED) SEGMENT INCOME** | | | |
| Gross Profit: | | | |
| Sales | | | $ 1,011 |
| Cost of sales excluding depreciation, amortization and capitalization | | | (324) |
| Depreciation and amortization | | | (65) |
| Capitalization of software costs | | | (5) |
| | | | 617 |
| Operating Expenses: | | | |
| Salaries, wages and benefits | | | (128) |
| Marketing expenses | | | (20) |
| Travel and mobile | | | (3) |
| Depreciation and amortization | | | (22) |
| Other SG&A expenses | | | (93) |
| | | | $ 351 |

Revenues improved by $1.0 million, or 36.2%, from increased sales in all major areas for the software segment: software product sales, services and support. Of the increase, the acquisition of the CSI-Greensboro operations added $0.2 million.

Just under half of the increase in cost of sales came from the addition of the CSI-Greensboro operations. Increased amortization expense and increased salaries, wages and benefits related to the support for the .Net Microsoft SQL (application programming language and database) conversion effort, and for increased installation and training efforts, also contributed to the increase in cost of sales. Increased costs from improved sales of third-party product also contributed to the increase in software cost of sales. The increased sales of additional internally developed software products and increased services related to those sales favorably impacted Software applications segment margin. The gross margin for the second quarter of 2008 was 44.2% compared to 38.1% in the prior year s second quarter.

Operating expenses increased primarily from the increased commissions related to the improved sales results and the addition of the CSI-Greensboro acquisition. The segment experienced a significant increase in operating income due to the improvements in software product sales and related services previously discussed.

*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.

Table of Contents

| | Three Months Ended | | |
|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | Increase (Decrease) |
| **NET SALES AND SERVICE REVENUE** | $ 13,745 | $ 14,306 | $ (561) |
| **GROSS PROFIT** | 2,944 | 2,957 | (13) |
| **SEGMENT INCOME (LOSS)** | 1,636 | 2,060 | (424) |
| | | | |
| **SIGNIFICANT ITEMS THAT INCREASED (DECREASED) SEGMENT INCOME** | | | |
| Gross Profit: | | | |
| Sales | | | $ (561) |
| Cost of sales excluding depreciation | | | 556 |
| Depreciation | | | (8) |
| | | | (13) |
| Operating Expenses: | | | |
| Salaries, wages and benefits | | | (287) |
| Sales consulting fees | | | (8) |
| Marketing expenses | | | (10) |
| Travel and mobile | | | (40) |
| Depreciation and amortization | | | (9) |
| Other SG&A expenses | | | (57) |
| | | | $ (424) |

Technology revenues decreased from second quarter 2007 by $0.6 million, or 3.9%. The decrease in new hardware sales was attributed to an increase in the number of smaller-dollar sales transactions of interactive whiteboard systems being insufficient to surpass the impact of a large-dollar district-wide implementation in the prior year s same quarter.

The decrease in sales was accompanied by a decrease in cost of sales for the related products. Favorable changes in product mix toward higher margin engineering services, and increases in product sales commissions for representation of products sold direct to customers and for which no cost of sales are incurred, improved the margins from 20.7% in the prior year s second quarter to 21.4% in the second quarter of 2008, partially offsetting the impact of reduced volume of interactive whiteboard solutions sales on gross profit.

The increase in salaries and wages, sales consulting fees, marketing and travel and mobile in operating expenses was related primarily to increased sales efforts across a broader geographic area. Increased franchise taxes and business license costs following the large jump in the size of the technology business in the prior year impacted other SG&A. The increased operating costs resulted in a 20.6% decrease in segment operating income compared to the prior year s second quarter.

The following tables summarize information about segment profit and loss for the quarters ended June 30, 2008 and 2007.

***Amounts in thousands***

| | Software Applications | Technology Solutions | Total Company |
|---|---|---|---|
| Three months ended June 30, 2008: | | | |
| Net sales and service revenue | $ 3,806 | $ 13,745 | $ 17,551 |
| Gross profit | 1,683 | 2,944 | 4,627 |
| Segment income (loss) | 332 | 1,636 | (*) |
| Three months ended June 30, 2007: | | | |
| Net sales and service revenue | $ 2,795 | $ 14,306 | $ 17,101 |
| Gross profit | 1,066 | 2,957 | 4,023 |
| Segment income (loss) | (19) | 2,060 | (*) |

32

Table of Contents

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

***Amounts in thousands***

| | Three Months Ended | |
|---|---|---|
| | **June 30, 2008** | **June 30, 2007** |
| **Segment income (loss):** | | |
| **Software applications segment** | $ 332 | $ (19) |
| **Technology solutions segment** | 1,636 | 2,060 |
| **TOTAL SEGMENT INCOME** | 1,968 | 2,041 |
| **Less: Merger and compliance costs** | | |
| Stock based compensation | (5) | (5) |
| Acquisition expenses | (9) | (4) |
| Professional and legal compliance and litigation related costs | (138) | (201) |
| **OPERATING INCOME Per consolidated Statements of Operations** | $ 1,816 | $ 1,831 |

**Interest and Other Income and Expenses**

Interest expense decreased in the second quarter of 2008 compared to the second quarter of 2007 by $21,000, or 14.0%, due to primarily to reductions in interest rates on borrowed funds.

**Income Taxes**

Income taxes decreased by $102,000 or 13.2%, in the second quarter of 2008 compared to the second quarter of 2007 due to the decrease in operating income, and a reduced estimated effective tax rate following the impact of South Carolina jobs tax credit which the company began taking advantage of at the end of 2007.

**Net Income and Earnings per Share**

Net income increased to $1.0 million for the second quarter of the current year, up $0.1 million or 12.0% over the same period of the prior year. The increase was primarily a result of the increased software gross profits, partially offset by the small decline in technology gross profit. The favorable Software applications segment results were also partially offset by our investment to penetrate the wider footprint of the Company through potential technology cross-sales following the CSI-Mobile acquisition in the prior year, and decreased interactive whiteboard revenue.

Basic earnings per share declined from $0.25 in the second quarter 2007 to $0.21 in the second quarter of 2008, primarily due to an increase in the number of basic shares outstanding following exercise of warrants in late 2007, partially offset by the impact of the improvement in net income. Diluted earnings per share increased from $0.07 in the second quarter of 2007 to $0.08 in the second quarter of 2008. The increase came from the improvement in net income coupled with a decrease in the weighted average number of shares outstanding, from the impact of stock prices on the application of the treasury stock method on warrants outstanding, and the reduction in outstanding warrants following exercises in late 2007.

**Consolidated Results of Operations for the Six Months Ended June 30, 2008 and 2007**

| | Six Months Ended | | |
|---|---|---|---|
| | **June 30, 2008** | **June 30, 2007** | **Increase (Decrease)** |
| **NET SALES AND SERVICE REVENUE** | $ 29,614 | $ 28,753 | $ 861 |
| **GROSS PROFIT** | 7,651 | 6,556 | 1,095 |

| | | | |
|---|---|---|---|
| **OPERATING INCOME** | 2,640 | 2,410 | 230 |

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

| | |
|---|---|
| Gross Profit: | |
| Sales | $ 861 |
| Cost of sales excluding depreciation, amortization and capitalization | 306 |
| Depreciation and amortization | (136) |
| Capitalization of software costs | 64 |
| | 1,095 |
| Operating Expenses: | |
| Salaries, wages and benefits | (665) |
| Acquisition expenses | (24) |
| Stock based compensation | 82 |
| Professional and legal compliance related costs | 147 |
| Sales consulting fees | (23) |
| Marketing expenses | (42) |
| Travel and mobile costs | (60) |
| Depreciation and amortization | (47) |
| Other SG&A expenses | (233) |
| | $ 230 |

Table of Contents

**Revenues**

Total revenues in the first six months of 2008 increased $0.9 million or 3.0% in comparison with the first six months of 2007 to $29.6 million. This net increase included a $1.3 million increase in software sales and services, partially offset by a $0.4 million decline in Technology solutions segment sales. Technology solutions segment sales decreased primarily from reduced sales of interactive whiteboard solutions, partially offset by increased sales of other products including infrastructure solutions and increased engineering services. An increased number of smaller-dollar interactive solutions sales transactions in the first six months of 2008 were not sufficient to offset the benefit carried into the first quarter of 2007 of a larger backorder at year end 2006 and an additional large dollar district-wide implementation of interactive whiteboard solutions in the second quarter of 2007. The increase in the Software applications segment was primarily due to increases in all areas including software product sales and services, and support. The acquisition of the CSI-Greensboro operations in the second quarter of 2008 added $0.2 million of software revenues, with the remaining $1.1 million the increase from organic growth.

**Gross Profit**

Gross profit in the first six months of 2008 increased $1.1 million or 16.7% in comparison with the first six months of 2007 to $7.7 million. The increase in software gross profit was driven by the corresponding increase in revenues, while the increase in hardware gross profit was driven by the shift in product mix toward more engineering services. The gross margin increased from 22.8% in 2007, to 25.8% in 2008. The change in margins was primarily due to the higher volume of software product sales and the shift in product mix in the Technology solutions segment to higher margin infrastructure products and engineering services. These increases were partially offset by increased amortization related to increased capitalization of costs associated with the .Net Microsoft SQL (application programming language and database) conversion effort for the CSI-Easley software operations.

**Operating Expenses**

Operating expenses increased approximately $0.9 million, or 20.9%, in the first six months of 2008 compared to the first six months of 2007. The above table analyzes the major items that account for this increase. The majority of the increase is reflected in salaries, wages and benefits, while sales consulting fees, marketing and travel and mobile, depreciation and amortization and other selling, general and administrative expenses added to the increase. These areas all increased as a result of growth of the business and to a greater degree, increased investment in the larger geographic region and expanded potential customer base from the addition of the CSI-Mobile operations in 2007. These increases were partially offset by the decrease in stock-based compensation costs associated with the 2005 reverse merger, which applied primarily to services for which compensation vested in 2006 and 2005 and for which no additional awards were granted significantly impacting 2007, as well as a decrease in compliance costs with less efforts expended on outsourced Sarbanes-Oxley compliance and more efficient registration work. Improvements in gross profits for both the software and technology segments for the six months sufficiently offset the increased operating costs to achieve a 9.5% increase in segment operating income compared to the first six months of the prior year.

**Segment information**

CSI is organized into the two segments: Software applications and Technology solutions.

Table of Contents

*Software applications segment*

| | Six Months Ended | | |
|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | Increase (Decrease) |
| **NET SALES AND SERVICE REVENUE** | $ 6,864 | $ 5,534 | $ 1,330 |
| **GROSS PROFIT** | 3,063 | 2,360 | 703 |
| **SEGMENT INCOME** | 708 | 340 | 368 |
| | | | |
| **SIGNIFICANT ITEMS THAT INCREASED (DECREASED) SEGMENT INCOME** | | | |
| Gross Profit: | | | |
| Sales | | | $ 1,330 |
| Cost of sales excluding depreciation, amortization and capitalization | | | (570) |
| Depreciation and Amortization | | | (121) |
| Capitalization of Software Costs | | | 64 |
| | | | 703 |
| Operating Expenses: | | | |
| Salaries, wages and benefits | | | (147) |
| Marketing expenses | | | (21) |
| Travel and mobile | | | 16 |
| Depreciation and amortization | | | (29) |
| Other SG&A expenses | | | (154) |
| | | | $ 368 |

Revenues improved by $1.3 million, or 24.0%, primarily due to increased sales of software and services and increased support revenues. The acquisition of the CSI-Greensboro operations was responsible for $0.2 million of the increase, with the remaining $1.1 million of the increase due to organic growth.

About one fourth of the increase in cost of sales came from the addition of the CSI-Greensboro operations. Increased amortization expense and increased salaries, wages and benefits related to the support for the .Net Microsoft SQL (application programming language and database) conversion effort and for increased installation and training efforts, along with increased costs associated with improved sales of third-party products, also contributed to the increase in software cost of sales. The increased sales of additional internally developed software products and increased services related to those sales favorably impacted Software applications segment margin. The margin for the first six months of 2008 was 44.6% compared to 42.7% in the first six months of the prior year.

Operating expenses increased primarily from the increased commissions related to the improved sales results and the addition of the CSI-Greensboro acquisition, increased marketing to a broader geographic area and customer base, and from increased depreciation and amortization related to acquired assets. The segment experienced an increase in operating income of 108.4% due primarily to the improvements in software product sales and related services previously discussed.

*Technology solutions segment*

| | Six Months Ended | | |
|---|---|---|---|
| | June 30, 2008 | June 30, 2007 | Increase (Decrease) |
| **NET SALES AND SERVICE REVENUE** | $ 22,750 | $ 23,219 | $ (469) |
| **GROSS PROFIT** | 4,588 | 4,196 | 392 |
| **SEGMENT INCOME** | 2,208 | 2,551 | (343) |

| **SIGNIFICANT ITEMS THAT INCREASED (DECREASED) SEGMENT INCOME** | |
|---|---|
| Gross Profit: | |
| Sales | $ (469) |
| Cost of sales excluding depreciation | 876 |
| Depreciation | (15) |
| | 392 |
| Operating Expenses: | |
| Salaries, wages and benefits | (518) |
| Sales consulting fees | (23) |
| Marketing expenses | (21) |
| Travel and mobile | (76) |
| Depreciation and amortization | (18) |
| Other SG&A expenses | (79) |
| | $ (343) |

Table of Contents

Hardware revenues in the first six months of 2008 decreased over the first six months of 2007 by $0.5 million, or 2.0% to $22.8 million. Technology solutions sales decreased primarily from reduced sales of interactive whiteboard solutions, partially offset by increased sales of other products including infrastructure solutions and increased engineering services. An increased number of smaller-dollar interactive solutions sales in the first six months of 2008 were not sufficient to offset the benefit carried into the first quarter of 2007 of a larger backorder at year end 2006 and an additional large dollar district-wide implementation of interactive whiteboard solutions in the second quarter of 2007.

The decrease in sales was accompanied by a decrease in cost of sales for the related products. The shift to inventorying interactive whiteboards to take advantage of volume pricing commitment discounts in place before the first quarter of 2008, but not in the first quarter 2007, and shifts in product mix, pushed margins higher for the full six months from 18.1% in the prior year to 20.2% in 2008.

The increase in salaries and wages, sales consulting fees, marketing and travel and mobile in operating expenses was related primarily to increased sales efforts across a broader geographic area. Increased franchise taxes and business license costs following the large jump in the size of the technology business in the prior year impacted other SG&A. The increased operating costs resulted in a 13.4% decrease in segment operating income compared to the prior year s first six months.

The following tables summarize information about segment profit and loss for the three and six months ended June 30, 2008 and 2007 and assets allocated to segments as of June 30, 2008 and 2007.

The changes in segment assets came primarily from the following:

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

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 solutions segment increased primarily in accounts receivable and inventories due to the increase in sales and a commitment to purchase interactive whiteboard solutions inventory from Promethean to secure better pricing.

| | Software Applications | Technology Solutions | Total Company |
|---|---|---|---|
| Six months ended June 30, 2008: | | | |
| Net sales and service revenue | $ 6,864 | $ 22,750 | $ 29,614 |
| Gross profit | 3,063 | 4,588 | 7,651 |
| Segment income | 708 | 2,208 | (*) |
| Segment assets | 10,929 | 13,612 | 24,541 |
| Six months ended June 30, 2007: | | | |
| Net sales and service revenue | $ 5,534 | $ 23,219 | $ 28,753 |
| Gross profit | 2,360 | 4,196 | 6,556 |
| Segment income | 340 | 2,551 | (*) |
| Segment assets | 7,797 | 14,811 | 22,608 |

Table of Contents

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

***Amounts in thousands***

| | Six Months Ended | |
|---|---|---|
| | **June 30, 2008** | **June 30, 2007** |
| **Segment income:** | | |
| **Software applications segment** | $ 708 | $ 340 |
| **Technology solutions segment** | 2,208 | 2,551 |
| **TOTAL SEGMENT INCOME** | 2,916 | 2,891 |
| **Less: Merger and compliance related costs** | | |
| Stock based compensation | (9) | (91) |
| Acquisition expenses | (33) | (9) |
| Professional and legal compliance costs | (234) | (381) |
| **OPERATING INCOME Per Statement of Operations** | $ 2,640 | $ 2,410 |

**Interest and Other Income and Expenses**

Interest expense decreased in the first six months of 2008 compared to the first six months of 2007 by $23,000, or 8.1%, due to an improved interest rate environment in the finance markets.

**Income Taxes**

Income taxes decreased by less than $1,000 and 0.1%, in the first six months of 2008 compared to the first six months of 2007 due to a reduced estimated effective tax rate following the impact of South Carolina jobs tax credit which the Company began taking advantage of at the end of 2007.

**Net Income and Earnings per Share**

The Company reported net income in the first six months of 2008 of $1.4 million, an increase of $0.2 million, or 21.2%, compared to net income of $1.2 million for the first six months of 2007, as a result of the improvement in operating income, and reduced interest costs and taxes.

Basic earnings per share declined from $0.34 in the second quarter 2007 to $0.30 in the second quarter of 2008, primarily due to an increase in the number of basic shares outstanding following exercise of warrants in late 2007, partially offset by the impact of the improvement in net income. Diluted earnings per share increased from $0.09 in the second quarter of 2007 to $0.12 in the second quarter of 2008. The increase came from the improvement in net income coupled with a decrease in the weighted average number of shares outstanding, from the impact of stock prices on the application of the treasury stock method on warrants outstanding, and the reduction in outstanding warrants following exercises in late 2007.

**E. 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 $7.0 million revolving line of credit.

**Events Impacting Liquidity and Capital Resources**

*Acquisition of ICS Systems, Inc.*

On March 31, 2008, CSI consummated the acquisition, effective April 1, 2008, of substantially all the assets and business operations of ICS. The total purchase price was $1,370,000 in cash, and the issuance by the Company of 209,091 shares of the Company s common stock. We did not assume any material liabilities of ICS. The cash portion of the purchase price was paid at closing with a draw on our line of credit facility.

Our utilization of draws under our bank revolver to fund the cash portion of the purchase price of the ICS acquisition has reduced our availability under the facility. Increased working capital requirements as a result of anticipated sales growth could put pressure on the adequacy of our bank revolving credit facility. Accordingly, we continue to evaluate other funding options, as discussed below under Credit Arrangements Factors Affecting Capital Needs and Resources.

Table of Contents

**Cash Flows**

For the six months ended June 30, 2008 the Company had no significant increase in cash and cash equivalents with no significant cash on hand, compared to an increase in cash and cash equivalents of $2.5 million to a cash balance of $2.5 million in the first six months of the prior year. In the prior year, the Company received a substantial prepayment for a large implementation. No such large prepayment occurred in the first six months of 2007.

*Cash from Operating Activities*

Cash used for operating activities totaled $0.3 million in the first six months of 2008 compared to cash provided by operating activities of $4.3 million in the first six months of 2007. The decrease, $4.6 million, was due primarily to slower collections due to the lack of prepayment in 2008 as occurred in the prior year and increased work in connection with the E-Rate program of the Schools and Libraries Division of the Federal Government (which typically has a longer collection cycle). Increased investment in inventories for volume purchase discounts also resulted in reduced cash flow from operating activities. Also, there was a substantial increase in deferred revenue, which was collected in July 2008 rather than June of the prior year. As a significant portion of our customers have fiscal years ending June 30, a shift in payments can be only a few days before or after this period depending on their budgets and cash management goals. Deferred revenue generally relates to software support agreements, which we collect annually but for which revenue is recognized over a twelve month period, as well as billings and early payments related to a select number of projects that are begun in the second quarter of 2008 but not yet completed as of June 30, 2008. Accounts payable and inventories increased primarily as a result of receiving products to take advantage of volume purchasing discounts.

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 lack of prepayment volume compared to the prior year, substantial increases in billings for deferred revenue items in the first six months of 2008, as well as slower collections. The increase in inventory was due to the increased commitment for interactive whiteboard products to take advantage of volume purchase discounts. Accounts payable increased due to receiving inventory for volume purchase discounts. Deferred revenue increased as a result billings related to software support agreements and a select number of large technology projects which were begun in the first six months of 2008, but a portion of which was pre-billed as the project had not been fully delivered as of June 30, 2008.

*Cash from Investing Activities*

Cash used for investing activities totaled $2.3 million in the first six months of 2008 compared to $4.8 million in the first six months of 2007. The decrease of $2.5 million was due primarily to the acquisition of ICS in the second quarter of 2008 requiring significantly less cash then the acquisition of McAleer funded in the first quarter of 2007. On the balance sheet, since year end 2007, 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 ICS and related purchase price allocation to the assets and recording of the additions in our financials, in addition to increases in property and equipment to support a larger organization (including improvements driven in part by our efforts to maintain compliance with Sarbanes-Oxley legislation).

*Cash from Financing Activities*

Cash provided by financing activities netted to $2.5 million in the first six months of 2008 compared to $2.9 million in the first six months of 2007. The decrease in cash provided of $0.4 million is due to the reduced borrowings needed to support working capital needs and the ICS acquisition in 2008 compared to that used to finance the McAleer acquisition in 2007.

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

*Three and Six Month Periods Ended June 30, 2008 and 2007*

EBITDA increased 4.1% or $0.1 million to $2.3 million for the three months ended June 30, 2008 compared to EBITDA of $2.2 million reported for the same period in 2007. The increase in EBITDA was primarily due to the increase in net income over the prior year after adding back the related tax effects of those increases in net income. Adjusted (financing) EBITDA for the quarter ended June 30, 2008 also increased by 4.1%, or $0.1 million, to $2.3 million compared to $2.2 million for the prior year for the same reason as the change in EBITDA.

EBITDA increased 13.1% or $0.4 million to $3.6 million for the three months ended June 30, 2008 compared to EBITDA of $3.2 million reported for the same period in 2007. The EBITDA increase was primarily due to the increase in net income

Table of Contents

over the prior year after adding back the related tax effects of those increases in net income. Increases in depreciation and amortization over the prior year also impacted the calculation. Adjusted (financing) EBITDA for the six months ended June 30, 2008 increased by 10.2%, or $0.3 million, to $3.6 million compared to $3.3 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 $0.1 million in the first six months of 2008 compared to the amount incurred in the same period 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.

Table of Contents

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

| *Amounts in thousands* | Three Months Ended June 30, 2008 | Three Months Ended June 30, 2007 | Six Months Ended June 30, 2008 | Six Months Ended June 30, 2007 |
|---|---|---|---|---|
| **Reconciliation of Net income per GAAP to EBITDA and Adjusted (Financing) EBITDA:** | | | | |
| Net income per GAAP | $ 1,012 | $ 903 | $ 1,439 | $ 1,188 |
| *Adjustments:* | | | | |
| Income tax expense (benefit) | 674 | 775 | 938 | 938 |
| Interest expense, net | 131 | 152 | 263 | 283 |
| Depreciation and amortization of fixed assets and trademarks | 180 | 129 | 339 | 255 |
| Amortization of software development costs | 314 | 259 | 598 | 498 |
| EBITDA | $ 2,311 | $ 2,218 | $ 3,577 | $ 3,162 |
| *Adjustments to EBITDA to exclude those items in loan covenant calculations:* | | | | |
| Stock based compensation (non-cash portion) | 5 | 5 | 9 | 91 |
| Adjusted (Financing) EBITDA | $ 2,316 | $ 2,223 | $ 3,586 | $ 3,253 |

**Credit Arrangements**

*Credit Facilities*

Prior to our going public through the reverse merger, we funded operations through cash flow from operations. In the reverse merger, substantially all of our cash was distributed to the founders in exchange for distributing ownership. Due to continued acquisition activity and the recapitalization of the Company in connection with going public through reverse merger, the Company frequently has no excess cash and relies on its $7.0 million line of credit facility with its bank to fund its working capital and other funding needs. Accordingly, we now use primarily our working capital facility and term loans to fund our operations. We also use other debt to finance our needs, as described below. See Note 5 to our unaudited consolidated financial statements included herein for more details.

Our current credit facilities consist of:

$7.0 million revolving line of credit, of which $3.5 million was drawn and $3.4 million available at June 30, 2008, which bears interest at LIBOR plus 2.5% and matures June 30, 2010;

$800,000 equipment note, of which approximately $0.4 million was outstanding at June 30, 2008, which bears interest at 7.85%, and has a three year amortization maturing in January 2010;

$486,000 real estate note, of which approximately $0.5 million was outstanding at June 30, 2008, which bears interest at 7.85%, and has a payment based on a 15 year amortization with a balloon payment due in January 2010; and

$2.3 million in subordinated notes to Barron Partners LP ( Barron ) and the five founding shareholders, of which $2.0 million remained outstanding at June 30, 2008, which bear interest at 15% and mature March 31, 2009. (In order to conserve capital and borrowing capacity, we refrained from repaying the $2.3 million in subordinated notes upon their initial maturity in May 2006. The noteholders have cooperated with our deferral of repayment, which, along with details of subsequent payment activity, is discussed further below under Factors Affecting Capital Needs and Resources Subordinated Promissory Notes. )

*Future Capital Needs*

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

Ongoing capital resources depend on a variety of factors, including:

- $3.4 million available to our operations at June 30, 2008, under our $7.0 million line of credit;
- inventory purchase commitments of $6.0 million remaining in 2008;
- burden of professional and legal compliance costs;
- the anticipated level of capital expenditures for 2008 of $800,000;
- software development costs of approximately $1.1 million;
- our scheduled debt service;
- continued cooperation as to the deferral of payment on our subordinated debt;

Table of Contents

potential future acquisitions; and

potential capital inflow from warrant exercises and the possibility that warrant exercises and related proceeds may not be fully realized.

The above items are described in more detail below.

*Factors Affecting Capital Needs and Resources*

*Credit Facilities.* Absent a significant cash inflow from the cash exercise of the warrants or otherwise, and in light of our growth and acquisition strategy, for the foreseeable future we will rely on a line of credit and borrowing facilities.

While we have drawn on our line significantly and paid it down from time to time, we cannot guarantee that cash flow from operations will be sufficient to repay our line of credit facility at the time it is due 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 repay or 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.

*Expected cash flow from operations.* 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.

In 2007, the Company experienced significant improvement in its cash flow from operations, increasing $1.1 million to $4.1 million compared to the prior year s $3.0 million. Net of needs for other financing activities and scheduled debt retirement, this placed the Company in the position of repaying the short-term portion of borrowings used in connection with the McAleer acquisition, in part or $1.1 million, from cash provided by operations, while the remaining $0.7 million was provided from the exercise of warrants. This improvement was also made possible from the acquisition of McAleer which historically bills the largest portion of its annual support agreements in the fourth quarter of each year and receives some additional cash by year end, with the remainder collected in the first quarter. Our projections as to the acquisition of McAleer were that it would be cash flow positive, that is it would fund its own debt service, and in fact it has done so. We were also able to easily absorb the cash need for the purchase of ICS following collections of McAleer support agreements and other collections of cash provided by operations. As a result, we see risk associated with the cost of the McAleer and ICS acquisitions as substantially behind us and continuing improvements in our cash position long-term. This assessment does not take into account additional capital needs due to additional acquisitions, and it assumes growth does not significantly outpace our expectations. It also assumes we are able to effectively and timely control our costs if impacted significantly by an economic downturn, and that we retain 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 economic risk relating to past and future acquisitions, and to repay our subordinated notes (potentially as part of funding an acquisition).

*Purchase Commitments.* The majority of our purchase commitments are based on firm purchase orders. However, from time to time we commit to purchase product in advance of customer commitments and as inventory to obtain volume pricing discounts or operational efficiencies. Currently we have purchase order commitments to Promethean, one of our major suppliers, for interactive whiteboard inventory of $12.3 million in 2008. As of June 30, 2008, we had satisfied approximately $6.4 million of the purchase commitments. We have no other significant purchase

commitments based on estimates of customer demand that significantly exceed customer commitments. 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 year ended December 31, 2007, professional and legal compliance costs, excluding stock-based (non-cash) compensation, totaled $694,000. In the first six months of 2008 we spent $234,000. These related primarily to compliance costs of operating as a public company, as well as legal and accounting

Table of Contents

costs for the registration of shares pursuant to the registration rights agreement. Management anticipates that the current level of expenses should continue and could increase somewhat, particularly as the Company grows or acquires other businesses. The Company will continue to incur expenses to test and monitor controls related to the Sarbanes-Oxley Act, and to maintain the registration of shares through 2009 as required by its commitment to Barron. 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. Management anticipates that some cost efficiencies may be realized as CSI gains experience as a reporting company and management seeks to manage compliance costs, and believes economies of scale will be achieved particularly with regard to these costs as the Company grows.

*Short Term Capital Requirements.* We currently anticipate that our capital needs for 2008 will principally consist of $1.1 million for software development and $800,000 for capital expenditures. In the first six months of 2008 we capitalized approximately $500,000 of software development costs and $328,000 in capital expenditures. We plan to fund 2008 needs for these items through cash flow from operations, our line of credit or other financing options discussed above.

*Subordinated Promissory Notes.* At June 30, 2008, subordinated promissory notes payable to shareholders totaled approximately $2.0 million. Although we 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 drawdown would not be sufficient to fund ongoing working capital needs. 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 it was not in the best interest of all stakeholders to pay the notes at maturity. Following the original maturity date, the Company paid a default interest rate of 15%, both on the principal balance and any interest not paid quarterly. From time to time we have also deferred the payment of interest to preserve working capital. Specifically, we took this action in the first and second quarters of 2007 as a precautionary measure considering the cash requirement needed for the acquisition of the McAleer operations. Subsequently we paid this and other interest due and no interest was in arrears as of June 30, 2008 or as of the date of this report.

On April 23, 2008, we and each of the holders of the subordinated notes entered into a letter agreement which extended the maturity date of such notes until March 31, 2009. Each noteholder also waived existing and past payment defaults and the notes will continue to bear interest at the default rate of 15%. In exchange for the extension and waiver, we made principal payments on the subordinated notes totaling $300,000, paid pro-rata among the noteholders.

Looking forward, considering our growth and acquisition strategy, we do not know if we will be able to generate operating cash flow sufficient repay the subordinated notes in March 2009, either from cash or with draws under the revolving credit facility. Our ability to utilize our credit facility to repay the subordinated notes would be limited not only by availability under the asset based facility, but also by equity-related financial covenants. Under these covenants in our credit agreement, the subordinated notes are counted as equity. Accordingly, we believe that it is possible that we will not be able to utilize our revolving credit facility to repay the subordinated notes, and that the subordinated notes will need to 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 repay the subordinated notes, or that the noteholders will continue to cooperate. Our bank lender in the past has consented with respect to the subordinated notes and has granted waivers relating to their prior nonpayment. 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, if we fail to repay the subordinated notes at the new March 31, 2009 maturity date, 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 might take legal or other adverse collection actions against the Company. We can therefore 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. However, 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.

*McAleer, ICS, and Potential 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 capital 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.

Table of Contents

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 A. Introduction Strategy. Also, on March 31, 2008, we consummated the acquisition, effective April 1, 2008, of substantially all of the assets and business operations of ICS. We believe that the acquisition of ICS will, likewise, provide a number of strategic benefits as discussed in A. Introduction Strategy. A large portion of the cash consideration for the McAleer and ICS acquisitions was funded by draws under our bank revolving credit facility, thereby reducing our availability under the facility to support working capital needs. Also, the acquisition of McAleer and ICS, like most acquisitions by the Company of other operating businesses, has increased working capital needs of the Company from time to time, primarily due to differences in the timing of collections, typically once a year, and ongoing labor costs for product implementations and the provision of support services. 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 the remaining warrants with an exercise price of $0.70 would generate approximately $0.4 million. The exercise of our warrants priced at $0.85 would generate approximately $1.4 million. The exercise of our warrants priced at $1.3972 would generate approximately $2.8 million. The exercise of our warrants with a price of $2.0958 would generate approximately $4.2 million.

In September 2007, Barron exercised warrants priced at $0.70 per share for 120,000 shares of common stock, for which the Company received proceeds of $84,000. Additionally, subsequent to September 30, 2007 and through October 25, 2007, Barron exercised additional warrants priced at $0.70 for 933,800 shares of common stock, the proceeds from which amounted to an additional $654,000. This leaves warrants for approximately 0.5 million shares of common stock representing proceeds of approximately $400,000 remaining of those priced at $0.70 per share. Among other alternatives, we may repay a portion of the subordinated notes with a portion of such proceeds while retaining a portion for working capital or other expansion opportunities.

The 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 further 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 additional 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 updating amendments were likewise declared effective on May 14, 2007 and May 9, 2008. Barron has not invoked the cashless exercise provision.

**Adequacy of Liquidity and Capital Resources.**

Based on management s assessment giving consideration to the above items, including the availability under our line of credit facility, management anticipates that our cash flow from operations and our existing bank credit facilities will be adequate to fund our short term liquidity and capital needs for operations over the next twelve months. Accordingly, (i) further increased working capital requirements as a result of anticipated sales growth significantly beyond our expectations, (ii) cash flows lower than anticipated without a corresponding decline in working capital requirements and (iii) either of the above in combination with the addition of funding needs and working capital requirements associated with any other acquisition, could put pressure on the adequacy of our bank revolving and other credit facilities.

We continuously consider and pursue other financing options which could include mezzanine financing or other capitalization alternatives. These options could provide longer-term financing to match our long-term capital needs. Such

Table of Contents

needs would include providing longer term financing for the recent acquisitions of McAleer and ICS, potentially supporting additional acquisition activities, and increased working capital. Our evaluation of potential long-term funding sources has also included exercise of the warrants held by Barron. Encouraging the earlier exercise of the warrants and an earlier increase in the float of our stock entered into our decision to reduce the pricing on a portion of the warrants in the fourth quarter 2006. In late 2007 Barron exercised for approximately 1.0 million warrant shares providing capital proceeds of approximately $0.7 million. While we are optimistic about the future exercises, there is no guarantee additional warrant exercises will occur or when. Depending on cash flow from current operations or warrant exercises, should we find longer-term funding unnecessary, we may not take advantage of such additional funding options, thereby paying down debt and minimizing any potential for dilution from any additional raise of capital.

Any of the aforementioned 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 our business.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Not applicable.

**Item 4. Controls and Procedures.**

**Evaluation of Disclosure 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, 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 ensure that such information is accumulated and communicated to our management to allow timely decisions regarding required disclosures.

Our management, under the direction of our chief executive officer and chief financial officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2008. Based upon this evaluation our management, including our chief executive officer and chief financial officer, has concluded that our disclosure controls were effective as of June 30, 2008.

**Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of published financial statements in accordance with generally accepted accounting principles.

However, because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or the degree of compliance with policies may deteriorate.

There have been 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 June 30, 2008 that materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting.

Table of Contents

## PART II OTHER INFORMATION

**Item 1. Legal Proceedings.**
The Company is involved in various claims and legal actions arising in the normal course of business. Management believes that these proceedings will not result in a material loss to the Company.

**Item 1A. Risk Factors.**
Information regarding risk factors appears in Management s Discussion and Analysis of Financial Condition and Results of Operations Forward-looking and Cautionary Statements, in Part I-Item 2 of this Form 10-Q. More detailed information concerning our risk factors may be found in Part I-Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the Form 10-K ).

There have been no material changes in the risk factors previously disclosed in Part I-Item 1A of our Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**
Not applicable.

**Item 3. Defaults Upon Senior Securities.**
Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders.**
(a) Our Annual Meeting of stockholders was held on Wednesday, May 7, 2008. The common stockholders voted for the election of five (5) directors to serve for terms of one (1) year each, expiring on the date of the 2009 Annual Meeting of stockholders or until their successors have been duly elected and qualified. The results of the voting in these elections are set forth below.

| Nominee | Votes For | Votes Withheld | Broker Non-Votes |
|---|---|---|---|
| Anthony H. Sobel | 3,418,867 | 8,723 | |
| Shaya Phillips | 3,418,867 | 8,723 | |
| Jeffrey A. Bryson | 3,418,867 | 8,723 | |
| Nancy K. Hedrick | 3,418,862 | 8,723 | |
| Thomas P. Clinton | 3,418,862 | 8,723 | |

The five directors elected above constituted the entire Board prior to the election. Therefore, there were no additional directors whose terms continued after the meeting.

(b) At the Annual Meeting, our stockholders also considered an amendment to our 2005 Incentive Compensation Plan to increase the number of shares of common stock available for awards under the plan from 1,100,000 to 1,750,000. The amendment was approved by the stockholders, with the results of the voting as follows:

| | |
|---|---|
| Votes For | 2,194,415 |

| | |
|---|---|
| Votes Against | 1,946 |
| Abstain | 1 |
| Broker Non-Votes | 1,231,227 |

**Item 5. Other Information.**

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

Our revolving credit arrangement with RBC Bank (USA) is a facility under which we may borrow, repay and then re-borrow. Advances and repayments occur daily under the credit facility, reflecting cash receipts and the Company s working capital needs. Set forth below is the outstanding balance as of specific dates through July 22, 2008. The balances presented reflect aggregate advances and pay downs which the Company deems material, or significant. Such information through May 6, 2008, was previously disclosed in our Form 10-Q filed with the Securities and Exchange Commission on May 13, 2008.

Table of Contents

| Date | Loan Balance |
|---|---|
| May 09, 2008 | $ 3,172,000 |
| May 20, 2008 | 2,668,000 |
| May 23, 2008 | 3,071,000 |
| May 27, 2008 | 3,554,000 |
| May 28, 2008 | 3,138,000 |
| June 03, 2008 | 2,845,000 |
| June 06, 2008 | 3,415,000 |
| June 16, 2008 | 3,888,000 |
| June 24, 2008 | 3,184,000 |
| June 30, 2008 | 3,533,000 |
| July 01, 2008 | 2,751,000 |
| July 08, 2008 | 1,809,000 |
| July 09, 2008 | 2,356,000 |
| July 15, 2008 | 1,754,000 |
| July 17, 2008 | 2,512,000 |
| July 22, 2008 | 1,913,000 |
| July 28, 2008 | 1,413,000 |
| August 1, 2008 | 1,836,000 |
| August 6, 2008 | 2,766,000 |
| August 11, 2008 | 3,048,000 |

**Item 6. Exhibits.**

| Exhibit Number | Description |
|---|---|
| 10.1 | Modification to Revolving Facility dated June 30, 2008 between the Company and RBC Bank (USA), incorporated by reference to Exhibit 10.01 to the Company s Form 8-K/A filed July 16, 2008. |
| 10.2 | 2008 Executive Bonus Plan of the Company adopted effective July 11, 2008, incorporated by reference to Exhibit 99.1 to the Company s Form 8-K filed July 17, 2008. |
| *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. |

* Filed herewith.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMPUTER SOFTWARE INNOVATIONS, INC.

Date: August 14, 2008

By: /s/ Nancy K. Hedrick
Nancy K. Hedrick
President and Chief Executive Officer

Date: August 14, 2008

By: /s/ David B. Dechant
David B. Dechant
Chief Financial Officer

Table of Contents

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