

COMPUTER SOFTWARE INNOVATIONS INC

Form 10KSB

March 30, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-KSB

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

For the fiscal year ended December 31, 2005

OR

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

For the transition period from to

Commission file number: **000-51758**

COMPUTER SOFTWARE INNOVATIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1661 East Main Street, Easley, SC
(Address of principal executive offices)

(864) 855-3900

(Registrant's telephone number, including area code)

None

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

Securities registered pursuant to Section 12(b) of the Act:

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

29640
(Zip Code)

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None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$0.001 per share

Check whether the issuer is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes [] No [**x**]

Check whether the issuer (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 []

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [**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**]

State issuer's revenues for its most recent fiscal year. \$24,286,724

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. \$748,865, based on the average bid and asked price of \$2.98 on March 17, 2006.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at March 17, 2006
Common Stock, \$0.001 par value per share	3,270,680 shares

DOCUMENTS INCORPORATED BY REFERENCE

None

Transitional Small Business Disclosure Format (check one): Yes [] No [**x**]

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PART I

Item 1. Description of Business.

A. Introduction

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

We develop software and provide hardware-based technology solutions. Our internally developed software consists of fund accounting based financial management software and standards-based lesson planning software. Our primary software product, fund accounting based financial management software, is developed for those entities that track expenditures and investments by fund, or by source and purpose of the funding. Our fund accounting software is used primarily by public sector and not-for-profit entities. In September 2005, we acquired a standards-based lesson planning software product that we have since named curriculator. The 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. We also provide a wide range of technology solutions, including hardware and design, engineering, installation, training and ongoing support and maintenance. Our solutions include computers, networking, security, IP telephony and distance learning and video communication.

Our operations are those of our predecessor, Computer Software Innovations, Inc., a South Carolina corporation organized in 1990. The history and development of CSI South Carolina is described in C. History and Development of CSI South Carolina. Our current business operations are described in B. Overview and elsewhere in this Description of Business.

Prior to February 10, 2005, the Company was known as VerticalBuyer, Inc. Prior to our merger with CSI South Carolina on February 11, 2005, we were a public shell corporation, having conducted no business operations since September 2001. A brief history of VerticalBuyer, Inc. is presented in Q. VerticalBuyer, Inc.

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

The merger of CSI South Carolina into us is accounted for as a reverse acquisition, with CSI South Carolina being designated for accounting purposes as the acquirer, and the surviving corporation, VerticalBuyer, Inc., being designated for accounting purposes as the acquiree. Under reverse acquisition accounting, the financial statements of the surviving corporation (VerticalBuyer) are the financial statements of the acquirer (CSI South Carolina). Accordingly, reported prior year financial results are those of CSI South Carolina, not VerticalBuyer. The activities of VerticalBuyer are included only from the date of the transaction forward. Shareholders' equity of CSI South Carolina, after giving effect for differences in par value, has been carried forward after the acquisition, and prior year per share amounts have been restated to account for the additional stock issued as a result of the merger.

The merger and related transactions are described in E. The Merger and Recapitalization, and under Item 6 Management's Discussion and Analysis or Plan of Operation B. Reverse Merger and Investment by Barron Partners LP.

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Our principal executive offices are located at 1661 East Main Street, Easley, South Carolina 29640. Our telephone number at that location is (864) 855-3900.

We maintain an Internet website at www.csi-plus.com. Certain pertinent information about our business, products and services and recent developments is posted on our website. The information on our website does not constitute a part of this report.

We are subject to the information requirements of the Securities Exchange Act of 1934, as amended, and we file annual, quarterly and current reports and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy any document that we file at the SEC's public reference room facility located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains an Internet site at <http://www.sec.gov> that contains reports and other information regarding issuers, including us, that file documents with the SEC electronically through the SEC's electronic data gathering, analysis and retrieval system known as EDGAR.

Our common stock is traded in the over-the-counter market under the symbol "CSWI.OB". Trade information is reported on the OTC Bulletin Board.

B. Overview

We develop software and provide hardware-based technology solutions. Our internally developed software is sold and supported through our software applications segment. We monitor our business as two segments, but take advantage of cross-selling and integration opportunities. We provide hardware-based technology solutions through our technology solutions segment. By strategically combining our fund accounting software with our ability to integrate computer and other hardware, we have been successful in providing a variety of technological solutions to over 300 clients located in South Carolina, North Carolina and Georgia. We are pursuing a national presence with a primary, initial focus on the southeast region of the United States.

Software Applications Segment

Our software applications segment develops accounting and administrative software applications that are designed for organizations that employ fund accounting. These organizations include our primary target market: municipalities, school districts and local governments. Our software provides a wide range of functionality to handle public sector and not-for-profit accounting requirements including receipt and tracking of funds, application of purchases, payables, investments and expenditures by fund, and production of financial and informational reports. The software is written in modules which can be sold separately or as a fully-integrated package so that information keyed in one module will be updated electronically into other modules to minimize keying and improve productivity. In addition to the modules covering general accounting functions, specialty modules are also available. The 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.

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More detailed information concerning the modules noted above and additional specialty modules is presented in G. Product and Services.

We also provide standards-based lesson planning software that we have recently renamed *curriculator*. This software is designed to allow teachers to create lesson plans that tie to a state's curriculum standards. Lesson plans may then be reviewed by school administrators and reports generated to determine if standards have been met. Additional information concerning the standards based learning planning software is presented in G. Product and Services.

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, our applications support specialists also provide support for the technology solutions segment.

Typically, sales of software and related services generate significantly higher margins than sales of hardware. Because revenues in our software applications segment result from sales and support of software products developed for resale, and are coupled with a relatively small volume of related hardware sales, (also referred to as *software and related services*), our software applications segment produces higher margins than our technology solutions segment. Conversely, revenues in our technology solutions segment result primarily from hardware sales, and a relatively smaller amount of integration services (also referred to as *hardware sales and related services*). Accordingly, our technology solutions segment produces lower margins than our software applications segment.

Technology Solutions Segment

Our technology solutions segment has a staff of certified systems engineers capable of providing a broad range of technology solutions to our clients. Certified systems engineers are computer professionals who have passed a test indicating specialized knowledge in the design, planning and implementation of specific computer based technology. These solutions can include, among other capabilities, planning, installation and management of computer, telephone, wireless, video conference, security monitoring and distance and classroom learning projects. Through this segment we also provide subsequent support and maintenance of equipment and systems.

In addition, we provide network integration solutions as a value added reseller (selling equipment purchased from vendors to which we have added our engineering services) of computer hardware and engineering services. These technologies include, but are not limited to:

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

hardware/software sales and installation;

system and network integration (combining different computer programs, processes and hardware such that they operate and communicate seamlessly as a tight-knit system.);

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);

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

education technologies, including distance learning and classroom learning tools.

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 such as Hewlett Packard, Cisco, Microsoft, Novell, Promethean, Tandberg and DIVR, and supports the software applications segment.

Currently our business efforts are focused on the 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).

The chart below shows revenues by business segment for the years ended December 31, 2005 and 2004.

	Year Ended December 31, 2005	Year Ended December 31, 2004
<i>(\$ in thousands)</i>		
Revenues		
Software applications segment	\$ 4,148	\$ 4,676
Technology solutions segment	20,139	17,805
Revenues	\$ 24,287	\$ 22,481
Gross Profit		
Software applications segment	\$ 2,367	\$ 3,063
Technology solutions segment	4,179	4,006
Gross Profit	\$ 6,546	\$ 7,069
Gross Margin		
Software applications segment	57.1%	65.5%
Technology solutions segment	20.8%	22.5%
Gross Margin	27.0%	31.4%

C. History and Development of CSI - South Carolina**Initial Development**

Our current business operations are those of CSI - South Carolina. CSI - South Carolina was incorporated under the name of Compu-Software, Inc. as a South Carolina corporation on January 12, 1990, and founded by Joe G. Black, our former interim Chief Financial Officer; Nancy K. Hedrick, our Chief Executive Officer and Director; and Beverly N. Hawkins, our Secretary and Vice President of Product Development. Ms. Hedrick and Ms. Hawkins previously worked for Data Management, Inc. (DMI), and while employed by DMI, they developed a software program for an accounting system designed for the local government and the kindergarten through high school (K-12) education sector. Ms. Hedrick and Ms. Hawkins left DMI to work for Holliday Business Service, Inc. (HBS) and shortly thereafter, in February of 1989, DMI sold the accounting system software to HBS. HBS created a division of the company for this accounting system named CompuSoft. In January of 1990, Ms. Hawkins and Ms. Hedrick left HBS to create CSI - South Carolina under the name of Compu-Software, Inc. In connection with the establishment of the new company, HSB sold the rights to the CompuSoft software to CSI - South Carolina (Compu-Software, Inc., which subsequently changed its name to Computer Software Innovations, Inc.).

Mr. Black, a former partner with HBS, recognized the value of the software targeted at a potentially attractive niche market, and teamed up with Ms. Hedrick and Ms. Hawkins in their formation of Compu-

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Software, Inc. The marketing of the accounting software and supporting the developing client base was the core business of CSI South Carolina from its incorporation until 1999. Beginning with a small, established client base, CSI South Carolina was profitable near inception. During this nine year period, it grew from the original two employees (Ms. Hedrick and Ms. Hawkins), fifteen clients and modest revenues to approximately thirteen employees, a client base of more than 70 customers, and revenues of more than a million dollars.

In early 1999, the original principals were joined by Thomas P. Clinton, our Vice President of Sales and Director; and William J. Buchanan, our Treasurer and Vice President of Delivery and Support. Messrs. Buchanan and Clinton had been employees of another value added reseller and for many years had worked closely with CSI South Carolina to provide hardware network support to its clients. When their former employer began to de-emphasize the K-12 education market, Messrs. Buchanan and Clinton elected to join CSI South Carolina. CSI Technology Resources, Inc. was formed as a wholly-owned subsidiary of CSI South Carolina to be a value added reseller of computer hardware and network integration services. A value added reseller is a business that resells computers and other technology hardware or software coupled with value adding solutions such as installation services, software, customization and project management.

The addition of the technology sector provided an additional revenue source from the existing client base and new contacts. The result was an increase in revenues from approximately \$2 million in 1999 to revenues of approximately \$24 million for the fiscal year ended 2005.

By 2000, CSI Technology Resources, Inc. ceased to operate or be accounted for as a separate organization. Accordingly, Ms. Hedrick, Ms. Hawkins and Messrs. Black, Clinton and Buchanan became equal shareholders in CSI South Carolina. Each principal managed a specific area of the business (i.e., sales, technical support services, product development, engineering and administration-finance). The business has continued to operate in a similar manner following its reverse merger with VerticalBuyer.

Events Leading Up to 2005 Restructuring

In 2001, Joe Black, one of the owners and the Chief Financial Officer of CSI South Carolina at the time, announced to the other four owners that he expected to retire within three years. He also indicated that he might want to cash out all or a portion of his interest in CSI South Carolina at the time of his retirement. The five owners of CSI South Carolina began to plan for the approaching retirement of Mr. Black and for the possible disposition of his shares of stock in connection with his retirement. The owners decided to look for financing and considered the possibility of selling stock from each owner in CSI South Carolina to an investor, as well as positioning CSI South Carolina for growth. CSI South Carolina interviewed a few investment banking firms in 2001 and 2002, including The Geneva Companies, Inc. (Geneva), an affiliate of Citigroup, Inc. Management selected Geneva and engaged it to advise CSI South Carolina and the five principals on valuation and financing strategies. Geneva directed the process of locating potential strategic or financial partners for CSI South Carolina.

CSI South Carolina spoke with several interested parties from 2003 into 2004, but no firm prospects emerged until early 2004. Ultimately, CSI South Carolina and its owners signed a letter of intent on May 10, 2004 to sell the stock of CSI South Carolina to Yasup, LLC of New York, New York, which CSI South Carolina management believed to be affiliated with a larger company in CSI South Carolina's industry. Pursuant to the letter of intent, CSI South Carolina began providing information and materials concerning its business to Yasup, LLC. Subsequently, on July 19, 2004, CSI South Carolina and its owners signed a revised letter of intent with Yasup, LLC for the sale of CSI South Carolina. This letter of intent provided that it would terminate if a definitive agreement was not executed within 90 days, or by October 17, 2004.

Over the next several months, the owners of CSI South Carolina negotiated with Yasup, LLC concerning the acquisition. During these negotiations, Yasup, LLC indicated that several companies had evaluated possible financing for the acquisition, but none committed funds. Ultimately, the parties could not come to terms by the termination date of the letter of intent or afterwards, and the proposed acquisition was abandoned.

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Through its financial adviser, Liberty Company, LLC (Liberty), Barron Partners LP, a Delaware limited partnership (Barron), became aware that CSI South Carolina was seeking to restructure. After the July 19, 2004 letter of intent with Yasup, LLC had terminated, Barron approached the owners of CSI South Carolina through Geneva about financing possibilities. On December 2, 2004, CSI South Carolina and Barron executed a letter of intent by which Barron proposed to buy common stock from the CSI South Carolina owners and acquire other rights in CSI South Carolina (or another company into which CSI South Carolina would merge) after the transaction.

Barron is a micro-cap fund, limited by its organizational documents to investments in companies that are public entities, so the transaction required the merger of CSI South Carolina into a public company that was already reporting to the SEC prior to the investment by Barron. In order to accomplish this, Barron and CSI South Carolina determined that the most effective alternative was for CSI South Carolina to merge into a publicly held inactive shell corporation. In addition, our shareholders believed that converting CSI South Carolina into a publicly held entity would provide the Company in the long term with access to public capital markets that could provide funds for future strategic growth. A public market for the Company's stock would also provide the five shareholders with liquidity for their equity investment in the recapitalized Company.

Barron searched for a publicly held inactive shell corporation, eventually identifying VerticalBuyer, Inc., a Delaware corporation, 77% of the common stock of which was held by Maximum Ventures, Inc. (Maximum Ventures), a New York corporation. VerticalBuyer, which is described in more detail under Q. VerticalBuyer, Inc. below, had formerly been engaged in the development of internet sites and had ceased all operations in September 2001. Maximum Ventures purchased its interest in VerticalBuyer on March 12, 2004.

CSI South Carolina and Barron originally envisioned that Barron would acquire the inactive shell corporation required to facilitate the contemplated investment by Barron. In December 2004, Barron entered into negotiations with Maximum Ventures for the shares held by it in VerticalBuyer, and advanced \$50,000 as an advisory fee, to be credited against the purchase price. However, subsequent to these initial negotiations by Barron with Maximum Ventures, Barron was advised that its organizational documents would not permit it to acquire a corporation with substantially no assets. Accordingly, CSI South Carolina and Barron agreed that CSI South Carolina would acquire a controlling interest in VerticalBuyer.

In December 2004 and January 2005, CSI South Carolina performed legal and financial due diligence on VerticalBuyer, completed negotiations with Maximum Ventures for the purchase of its stockholdings in the inactive corporation and finalized a stock purchase agreement. On January 28, 2005, CSI South Carolina and Barron entered into a second amendment to their letter of intent. In addition to extending Barron's exclusive due diligence period until February 28, 2005, CSI South Carolina also agreed that it would not sell or otherwise dispose of any of the shares of VerticalBuyer's common stock it was to purchase without the prior written consent of Barron, other than as a part of the transactions contemplated by the letter of intent. In addition, Barron agreed to purchase from CSI South Carolina all of such VerticalBuyer stock, at the same price at which it was to be purchased from Maximum Ventures, in the event that the closing of the transactions contemplated by the letter of intent were not consummated by February 28, 2005. The parties contemplated that any exercise of such right by Barron would have been accomplished through an assignee of Barron.

On January 31, 2005, CSI South Carolina and Maximum Ventures entered into a stock purchase agreement and CSI South Carolina concurrently purchased all of the 13,950,000 shares of the common stock of VerticalBuyer from Maximum Ventures. CSI South Carolina's acquisition of a majority interest in VerticalBuyer from Maximum Ventures is described in more detail under E. The Merger and Recapitalization Description of Merger and Related Investment Transactions Purchase of Majority Interest of VerticalBuyer by CSI South Carolina.

Upon the consummation of the stock purchase transaction with Maximum Ventures, VerticalBuyer became a 77% owned subsidiary of CSI South Carolina. Officers of CSI South Carolina were appointed as officers of

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VerticalBuyer as follows: Nancy K. Hedrick, President and CEO; Joe G. Black, Interim CFO; William J. Buchanan, Treasurer; and Beverly N. Hawkins, Secretary. Effective upon the closing of the Maximum Ventures transaction, the following persons, who had no previous association with VerticalBuyer or CSI South Carolina, were appointed to the board of directors: Anthony H. Sobel, Thomas V. Butta and Shaya Phillips. Prior to Barron, CSI South Carolina or VerticalBuyer entering into any definitive agreements, the management of CSI South Carolina was having difficulty in identifying and securing independent director candidates that it thought would add value to the Company. Accordingly, management solicited advice from Barron regarding potential independent director candidates. Barron introduced Messrs. Sobel, Butta and Phillips. Mr. Sobel, who had no prior business or investment ties to Barron, has experience in the management and financing of emerging enterprises. Mr. Sobel is the chief executive officer of Montana Metal Products, L.L.C., a precision sheet metal fabrication and machining company. Robert F. Steel, a consultant to us who is also an investor in Barron, is an investor with Mr. Sobel in Montana Metal Products. Messrs. Butta and Phillips were introduced to CSI South Carolina because of their experience in technology and software-based businesses. Mr. Butta, who subsequently resigned as a director on February 22, 2006, is President and Vice Chairman of the board of directors of a21, Inc., a concern in which Barron invested. Mr. Phillips previously served as chief operating officer and chief technology officer of Global Broadband, Inc., a concern in which Barron years earlier had invested. Mr. Phillips has consulted on a limited basis for Barron with respect to technology investments.

On February 10, 2005, CSI South Carolina and VerticalBuyer, its then 77% owned subsidiary, entered into the Agreement and Plan of Merger. The agreement provided that CSI South Carolina would merge into VerticalBuyer, with VerticalBuyer being the surviving corporation. As a result, CSI South Carolina would in effect become a publicly held company reporting to the SEC. Also on February 10, 2005, CSI South Carolina and Barron entered into definitive agreements for a preferred stock investment in VerticalBuyer following its merger with CSI South Carolina. The merger and other transactions contemplated by the Barron letter of intent and definitive agreements were consummated February 11, 2005 and are described in more detail in E. The Merger and Recapitalization below.

D. Subsidiaries

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

We have no other subsidiaries.

E. The Merger and Recapitalization

Incorporated in Delaware on September 24, 1999, we were previously known as VerticalBuyer, Inc. We ceased business operations of any kind in September 2001. Prior to assuming the business operations of CSI South Carolina in the February 2005 merger, VerticalBuyer was an inactive shell corporation without material assets or liabilities. The prior operations of VerticalBuyer are discussed in Q. VerticalBuyer, Inc.

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

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The merger was accomplished through an exchange of equity interests.

Under Statement of Financial Accounting Standards (SFAS) No. 141 Business Combinations, the merger of CSI South Carolina into VerticalBuyer was considered to be a reverse acquisition, whereby CSI South Carolina is considered to be the acquirer. Accordingly, the assets and liabilities of CSI South Carolina continued to be recorded at their actual cost. VerticalBuyer had no assets or liabilities at the time of acquisition. Under reverse acquisition accounting, the financial statements of the surviving corporation (VerticalBuyer) are the financial statements of the acquirer (CSI South Carolina). Costs associated with the reverse acquisition are required to be expensed as incurred. Shares issued in the transaction are shown in our financial statements as outstanding for all periods presented and the activities of the surviving company (VerticalBuyer) are included only from the date of the transaction forward. Shareholders' equity of CSI South Carolina, after giving effect for differences in par value, has been carried forward after the acquisition.

The accounting treatment for the merger is discussed in more detail in Item 6, Management's Discussion and Analysis or Plan of Operation B. Reverse Merger and Investment by Barron Partners LP and in Note 2, Acquisition and Merger to our audited consolidated financial statements as of December 31, 2005, included as part of this annual report.

Summary of Merger and Related Investment Transactions

The significant merger related activity, on a cash basis, in the order it occurred is as follows:

Purchase of majority interest in VerticalBuyer shell company by CSI South Carolina	\$ (415,024) ⁽¹⁾
CSI South Carolina's redemption of options	(899,144)
Initial cash payment of portion of CSI South Carolina \$3,460,000 dividends declared to shareholders	(960,000)
Proceeds from sale of preferred stock and warrants in merger	5,042,250
Proceeds from issuance of subordinated note to Barron	1,875,200
Payment of remaining outstanding dividends declared, from preferred stock and warrant proceeds	(2,500,000)
Payment on one of the two sets of subordinated notes issued to shareholders in connection with merger	(3,624,800)
Payment of debt issuance costs for \$3,000,000 revolving credit facility	(83,800)
Initial borrowings under revolving credit facility	1,500,000
Payment on second set of shareholder notes and Barron's note from loan proceeds	(1,500,000)
Net effect of merger transactions on cash, and cash used for financing activities	\$ (1,565,318)

(1) Consists of \$450,000 aggregate agreed-upon purchase price (including approximately \$5,000 used to satisfy outstanding liabilities of VerticalBuyer) and an additional \$20,000 paid to Maximum Ventures to offset its legal and accounting expenses, net of the \$50,000 contribution by Barron and a \$5,000 allowance to help defray our legal and professional expenses.

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

The above transactions are described in more detail below under Description of Merger and Related Investment Transactions. Our financial analysis of these transactions is discussed in Item 6, Management's Discussion and Analysis or Plan of Operation.

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Description of Merger and Related Investment Transactions

Purchase of Majority Interest of VerticalBuyer by CSI South Carolina

On January 31, 2005, CSI South Carolina purchased 13,950,000 shares of the common stock, \$0.001 par value, of VerticalBuyer from Maximum Ventures pursuant to a Stock Purchase Agreement. The shares purchased by CSI South Carolina represented approximately 77% of VerticalBuyer's outstanding common stock. The purchase price was \$450,000, with approximately \$53,000 of that amount going to satisfy the outstanding liabilities of VerticalBuyer at that time. CSI South Carolina also reimbursed Maximum Ventures for legal expenses of \$20,000. The purchase price was reduced by a \$5,000 allowance from Maximum Ventures to defray a portion of the estimated costs of preparation of tax returns for 2001, 2002, 2003 and 2004 and accountant fees for the 2004 audit. CSI South Carolina also received credit for the \$50,000 pre-paid advisory fee previously paid by Barron to Maximum Ventures as earnest money. As a part of its preferred stock investment in the Company, Barron contributed the \$50,000 prepayment for the Company's benefit to help defray transaction legal expenses. There were no finder's fees or other monetary consideration paid in connection with the Stock Purchase Agreement and the purchase of the VerticalBuyer shares.

The purpose of the purchase of the VerticalBuyer shares was the procurement of a publicly held inactive shell corporation into which CSI South Carolina could merge and itself become a publicly held corporation reporting to the SEC. The reasons for utilizing a shell corporation are described in more detail under C. History and Development of CSI South Carolina Events Leading Up to 2005 Restructuring.

In connection with CSI South Carolina's purchase of the VerticalBuyer shares owned by Maximum Ventures, Mr. Abraham Mirman resigned as president, CEO and sole director of VerticalBuyer and Mr. Chris Kern resigned as its CFO. Messrs. Mirman and Kern also served as president and vice president, respectively, of Maximum Ventures. Anthony H. Sobel, Thomas V. Butta and Shaya Phillips were appointed as directors of VerticalBuyer. The board of directors appointed new officers of VerticalBuyer, who were also officers of CSI South Carolina. These were Nancy K. Hedrick, President and CEO; Joe G. Black, interim CFO; Beverly N. Hawkins, Secretary; and William J. Buchanan, Treasurer. The officer and director appointments were ratified by CSI South Carolina, as majority stockholder, acting by non-unanimous written consent on January 31, 2005.

Pursuant to a Stock Purchase Agreement between CSI South Carolina and Maximum Ventures dated January 31, 2005, CSI South Carolina and Maximum Ventures made certain representations and warranties, including representations and warranties by Maximum Ventures with respect to VerticalBuyer. In particular, Maximum Ventures made representations and warranties with respect to: (1) VerticalBuyer's due organization, valid existence and good standing under Delaware law; (2) the authorized and outstanding common and preferred stock of VerticalBuyer; (3) the absence of any outstanding options, warrants or convertible securities; (4) the absence of any obligation to file a registration statement with respect to common or preferred shares of VerticalBuyer; (5) the absence of any legal proceedings pending or threatened against VerticalBuyer or any of its properties or any of its officers or directors; (6) all tax returns being properly filed, except for income tax returns for years 2001 through 2004; (7) VerticalBuyer being current in its reporting obligations under the Securities Exchange Act of 1934; (8) the absence of any liens or encumbrances on the common stock to be transferred pursuant to the Stock Purchase Agreement, except for certain restrictions on transfer; (9) Maximum Ventures having the legal right to consummate the transactions contemplated by the Stock Purchase Agreement; (10) VerticalBuyer's compliance with, and absence of any violation by it of, laws and regulations; (11) the identity of the director, officers and employees of VerticalBuyer; (12) the identity of all existing creditors and claims (totaling approximately \$53,000); (13) the accuracy of the books and records; (14) the exemption from the registration requirements of the Securities Act of 1933 for the stock sale; and (15) the absence, to Maximum Venture's knowledge, of any material misstatement or of a material fact or omission to state a material fact contained in VerticalBuyer's filings with the SEC, and the absence of any material adverse change from the facts set forth in VerticalBuyer's Form 10-KSB for the fiscal year ended December 31, 2003. The filing deficiency with respect to income tax returns VerticalBuyer failed to file between 2001 and 2004 has been remedied. In view of VerticalBuyer having ceased operations during this period and reporting no income, the cost of remediating these filing deficiencies was not material.

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The parties also agreed to indemnify each other generally for any breaches of any of their respective representations, warranties and covenants. In the case of Maximum Ventures, indemnification liability is capped at \$450,000. CSI South Carolina and Maximum Ventures also gave further assurances that they would cooperate in the future to carry out the purposes of the Stock Purchase Agreement, including the preparation and filing of future reports of VerticalBuyer with the SEC.

Reverse Stock Split

On January 31, 2005, the board of directors of VerticalBuyer approved a reverse stock split in order to facilitate a potential merger with CSI South Carolina. In the reverse stock split, every 40 shares of VerticalBuyer's common stock issued and outstanding on the record date, February 10, 2005, were converted and combined into one share of post-split shares. The reverse split was effected pursuant to an amendment to our certificate of incorporation and was paid on February 11, 2005. No fractional shares were issued nor any cash paid in lieu thereof. Rather, all fractional shares were rounded up to the next highest number of post-split shares and the same issued to any beneficial holder of such pre-split shares which would have resulted in fractional shares. Accordingly, each beneficial holder of our common stock received at least one post-split share and no stockholders were eliminated. Pursuant to the amendment to our certificate of incorporation effecting the reverse stock split, the number of authorized and preferred shares remained unchanged at 50,000,000 and 5,000,000, respectively. Continental Stock Transfer & Trust Company, New York, New York, our transfer agent, served as exchange agent for the reverse split.

On January 31, 2005, following the board's approval of the reverse stock split, CSI South Carolina, acting as majority stockholder, approved by non-unanimous written consent the reverse split and the related amendment to our certificate of incorporation.

Par Value

In connection with the January 31, 2005 approval of the reverse stock split, the board of directors of VerticalBuyer also approved the elimination of par value of all shares of our authorized common and preferred stock. Such change was likewise approved on January 31, 2004 by CSI South Carolina, as majority stockholder acting by non-unanimous written consent. Subsequently, on February 9, 2005, the board decided it was in the best interest of VerticalBuyer and more economical to retain par value of \$0.001 for all of our authorized common and preferred stock. This decision was made prior to the filing of the amendment to our certificate of incorporation and accordingly, the par value of our common and preferred stock has not changed. CSI South Carolina as majority stockholder acting by non-unanimous written consent, also approved the subsequent retention of par value on February 9, 2005.

Name Change

On February 4, 2005, the board of directors of VerticalBuyer approved the change of our name from VerticalBuyer, Inc. to Computer Software Innovations, Inc. The board also approved an amendment to our certificate of incorporation effecting such change. Following the board's approval of the name change on February 4, 2005, CSI South Carolina, acting as majority stockholder by non-unanimous written consent, also approved the name change.

The change of our name to Computer Software Innovations, Inc. became effective on February 10, 2005, concurrently with the reverse stock split, upon the filing of an amendment to our certificate of incorporation.

CSI South Carolina Redemption of Options

Prior to the merger on February 9, 2005, CSI South Carolina redeemed stock options for 6,234 (738,195, as restated in our consolidated financial statements) shares of its common stock in exchange for \$899,144 cash. Under CSI South Carolina's stock option plan, certain non-executive employees had been granted stock options

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for an aggregate of 9,000 (1,065,746, as restated in our consolidated financial statements) shares of CSI South Carolina common stock. The redeemed options represented 73.34% of then outstanding options for 8,500 (1,006,538, as restated in our consolidated financial statements) shares. Pursuant to the plan, the option holders retained the remaining portion of their options. In connection with the merger, the surviving corporation assumed such options, which after the merger became exercisable for shares of common stock of the surviving corporation at the share ratio applicable to shares of CSI South Carolina common stock cancelled in the merger. Following the merger, the remaining options were exercisable for 268,343 shares of the Company's common stock.

The redemption by CSI South Carolina of the options was contemplated by the parties to the Merger Agreement between CSI South Carolina and VerticalBuyer, and the preferred stock purchase agreement between Barron and the Company relating to Barron's preferred stock investment in the merged Company. The option redemption was a condition to both agreements. The purpose of the redemption was to permit the option holders, consisting of non-executive employees of CSI South Carolina whom management believed to have contributed to the success of that company, to participate with the five shareholders in the cash consideration received by the shareholders in the merger.

For additional discussion of the redemption of the CSI South Carolina options and other option plans of the Company, see Item 6, Management's Discussion and Analysis or Plan of Operation B. Reverse Merger and Investment by Barron Partners LP Summary of Merger Transactions.

CSI South Carolina Dividends

Prior to the merger on February 11, 2005, CSI South Carolina declared dividends to its five shareholders totaling \$3,460,000. Those shareholders were: Nancy K. Hedrick, Joe G. Black, Beverly N. Hawkins, Thomas P. Clinton and William J. Buchanan. Of this amount, \$960,000 was paid in cash and \$2.5 million recorded as subordinated dividend notes payable to each shareholder. These notes were repaid immediately following the merger from the proceeds of the issuance of the preferred stock and the approximately \$1.9 million subordinated loan from Barron.

The dividends were contemplated by the parties to the Merger Agreement (CSI South Carolina and VerticalBuyer) and the Preferred Stock Purchase Agreement (Barron and VerticalBuyer), and were conditions in such agreements to the consummation of the merger and Barron's preferred stock investment. The dividends resulted from the desire of the five shareholders of CSI South Carolina to withdraw a substantial amount of cash which had accumulated in CSI South Carolina prior to the sale of their stock in the merger.

The Merger

At a meeting on February 4, 2005, the board of directors of VerticalBuyer considered and approved the potential merger of CSI South Carolina into VerticalBuyer and a related merger agreement. The board had previously discussed such merger at its January 31, 2005 meeting and in meetings with legal and other advisors.

On February 10, 2005, VerticalBuyer and CSI South Carolina executed the Agreement and Plan of Merger. On February 11, 2005, CSI South Carolina merged into VerticalBuyer, with VerticalBuyer continuing as the surviving corporation. In the merger, the former stockholders of CSI South Carolina received, in exchange for their shares of CSI South Carolina common stock, two sets of notes totaling \$3,624,800 and \$1,875,200, respectively, and 2,526,905 shares of our common stock. Such consideration was in addition to the pre-merger dividend by CSI South Carolina. The set of notes totaling \$3,624,800 was repaid to the former CSI South Carolina shareholders immediately following the merger from the proceeds of the preferred stock and the \$1,875,200 subordinated note issued to Barron, as described under Sale of Preferred Stock and Warrants below. Subordinated notes payable to the former shareholders of CSI South Carolina totaling \$1,875,200 remained outstanding following the merger. Amounts outstanding under these notes totaled \$1,125,200 as of December 31, 2005. The terms of the subordinated notes are described more fully under Subordinated Notes below.

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The shares of the common stock of VerticalBuyer previously held by CSI South Carolina, representing approximately 77% of VerticalBuyer's issued and outstanding capital stock, were cancelled in the merger. The remaining stockholders of VerticalBuyer retained their existing shares, subject to the 40 to 1 reverse stock split. Such minority stockholders had appraisal rights as provided in accordance with Delaware law, whereby they could elect to have their shares repurchased by the surviving corporation. No minority stockholders elected to exercise their appraisal rights.

As a result of the reverse stock split and merger, immediately following the merger the Company had approximately 2.6 million shares of common stock outstanding. As a result of the issuance of the preferred stock and warrants (discussed in Sale of Preferred Stock and Warrants below), on a diluted basis, assuming the conversion of the preferred stock and exercise of outstanding warrants and options, approximately 17.3 million shares of common stock were outstanding.

Pursuant to the Agreement and Plan of Merger, a new board of directors was constituted and new officers appointed. See Item 9 for information on our officers and directors.

In accordance with the Agreement and Plan of Merger, upon the consummation of the merger, the certificate of incorporation and the bylaws of the Company were each amended and restated.

Sale of Preferred Stock and Warrants

At its meeting on February 4, 2005, VerticalBuyer's board, in connection with the merger, approved the issuance and sale of shares of its preferred stock and common stock warrants to Barron in exchange for the payment of \$5,042,250 pursuant to the terms of a Preferred Stock Purchase Agreement. Pursuant to the agreement, Barron also agreed to lend an additional \$1.9 million, in the form of a subordinated note on the same terms as the subordinated notes payable to the former CSI South Carolina shareholders in the merger. Later, on February 4, 2005, CSI South Carolina, acting as majority stockholder by non-unanimous written consent, ratified the board's approval of the transactions with Barron.

On February 10, 2005, VerticalBuyer entered into the Preferred Stock Purchase Agreement with Barron. Pursuant to the agreement, on February 11, 2005, immediately following the consummation of the merger, we issued to Barron 7,217,736 shares of our newly created Series A Convertible Preferred Stock in exchange for the payment of \$5,042,250. Barron was also issued two warrants to purchase in the aggregate 7,217,736 shares of our common stock. The preferred stock is convertible into common stock on a one-for-one basis. The exercise prices of the warrants are \$1.3972 and \$2.0958 per share. Each warrant is exercisable for half of the total warrant shares. The terms and conditions of the warrants are identical except with respect to exercise price.

Both the conversion of the preferred stock and the exercise of the warrants are subject to restrictions on ownership that limit Barron's beneficial ownership of our common stock. Initially, Barron was generally prohibited from beneficially owning greater than 4.99% of our common stock, and such restriction could be waived by Barron upon 61 days prior notice. It was the intention of the Company and Barron that the preferred stockholder never acquire greater than 4.99% of the Company's common stock and never be deemed an affiliate or control person under federal securities laws. For avoidance of doubt, Barron and we agreed to remove the 61 day waiver provision and to impose a non-waivable beneficial ownership cap of 4.9%. These agreements were implemented on November 7, 2005. Pursuant to the terms of the Certificate of Designation governing the preferred stock and the warrants, the ownership cap may not be amended or waived without the approval of the common stockholders of the Company, excluding for such vote all shares held by the holders of preferred stock and warrants (including Barron) and any directors, officers or other affiliates of the Company.

As of March 17, 2006, Barron had not exercised any portion of the warrants. The warrants provide that they may be exercised on a cashless basis after February 11, 2006 if there were no registration statement effective permitting the resale of the common stock underlying the warrants. In such event, we would receive no proceeds

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from their exercise. However, our Form SB-2 registration statement covering the warrant shares was declared effective by the SEC on February 14, 2006. So long as we maintain the effectiveness of a registration statement for the resale of the shares underlying the warrants, the warrant holder is prohibited from utilizing a cashless exercise.

The terms of the Series A Convertible Preferred Stock are contained in the Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock, which is part of our charter and filed with the Secretary of State of Delaware. Disclosure on the provisions of the Certificate of Designation is contained in Certificate of Designation. The holder of the preferred stock also possesses rights pursuant to the Preferred Stock Purchase Agreement, which is discussed in Preferred Stock Purchase Agreement below. Other provisions of the warrants are discussed in Warrants below.

Registration Rights Agreement

In conjunction with the Preferred Stock Purchase Agreement, the Company also entered into a Registration Rights Agreement with Barron on February 10, 2005, whereby we agreed to register the shares of common stock underlying the preferred stock and warrants to be sold to Barron. Under the initial terms of the Registration Rights Agreement, the Company was obligated to file, within 45 days following the execution of the Registration Rights Agreement, a registration statement covering the resale of the shares. The agreement also obligated us to use our best efforts to cause the registration statement to be declared effective by the SEC within 120 days following the closing date of the registration rights agreement (February 11, 2005) or generally such earlier date as permitted by the SEC. Barron could have also demanded the registration of all or part of such shares on a one-time basis and, pursuant to piggy-back rights, require us (subject to carveback by a managing underwriter) to include such shares in certain registration statements we may file. We are obligated to pay all expenses in connection with the registration of the shares and may be liable for liquidated damages in the event the registration of shares is not maintained pursuant to the agreement.

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

Under the initial terms of the Registration Rights Agreement with Barron, the liquidated damages were payable in cash at a rate of 25% per annum on Barron's initial preferred stock and warrant investment of \$5,042,250. Because the liquidated damages were payable in cash, under EITF 00-19 Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock a potential obligation (referred to under EITF 00-19 as a derivative financial instrument) existed until the registration became effective. Accordingly, the entire proceeds of the preferred stock issuance except for the par value were allocated to the warrants and recorded as a liability. Additional information on this accounting treatment is presented in Note 8, Preferred Stock and Related Warrants to our audited consolidated financial statements as of December 31, 2005, included as part of this annual report.

It was not the intent of either CSI or Barron that the Registration Rights Agreement result in the majority of the proceeds from the preferred stock and warrant issuance being recorded as a liability rather than equity. In response, on November 7, 2005, CSI and Barron entered into an amendment to the Registration Rights Agreement that eliminated cash liquidated damages and replaced them with liquidated damages in the form of additional shares of Series A Convertible Preferred Stock. Accordingly, the fair value of the warrants at that date was reclassified to equity as additional paid-in capital. Pursuant to the amendment, 2,472 shares of preferred stock will be issued to Barron for each day when liquidated damages are triggered. The maximum number of

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shares that could be issued as of March 17, 2006 was 815,760. The amendment also resolved a conflict in the initial Registration Rights Agreement whereby some time periods for registration and liquidated damages were determined with respect to the date of the agreement (February 10, 2005) while others utilized the closing date of the agreement (February 11, 2005). Under the amended agreement, all such periods are determined in relation to February 11, 2005.

Prior to the execution of the amendment, Barron agreed to waive any liquidated damages through November 30, 2005 pursuant to a waiver dated September 30, 2005. Barron had also waived liquidated damages on three prior occasions. In exchange, during the fourth quarter of 2005 we paid Barron \$50,000 and agreed to cause the registration statement to become effective under the Registration Rights Agreement on or before November 30, 2005. We entered into a fifth waiver extending the required effectiveness date until January 31, 2006 and a sixth waiver extending the required effectiveness date until February 28, 2006. Our registration statement was declared effective by the SEC on February 14, 2006. We would again be subject to the payment of liquidated damages, in the form of 2,472 preferred shares per day through February 11, 2007, if we do not maintain the effectiveness of the registration statement, subject to allowances for Amendment Days or Black-Out Periods.

Subordinated Notes

On February 11, 2005, the Company also issued six subordinated promissory notes payable, respectively, to Barron and the five former shareholders of CSI South Carolina: Nancy K. Hedrick, Joe G. Black, Beverly N. Hawkins, Thomas P. Clinton and William J. Buchanan. The five notes payable to the former CSI South Carolina shareholders were issued pursuant to the Agreement and Plan of Merger and constituted a portion of the shareholders consideration in the merger. The note payable to Barron, issued pursuant to the Preferred Stock Purchase Agreement, evidences a subordinated loan to the Company in connection with Barron's investment in the preferred stock. All such notes rank equally in right of payment in the event of bankruptcy or liquidation of the Company, or similar events, and are subordinated in right of payment to all other non-subordinated debt of the Company. Payments of principal and interest may be paid as agreed under such subordinated notes, so long as, generally, we are not in default under any of our senior indebtedness.

The Barron note provides that the Company will repay to Barron \$1,875,200, with interest accruing at an annual rate of the prime rate plus 2%. We must pay the principal on the note in full on or before May 10, 2006. Any past due and unpaid amounts bear interest at the rate of 15% per annum until paid in full. At December 31, 2005, \$1,125,200 was outstanding under the Barron subordinated note.

The aggregate principal sum borrowed under the notes payable to the five former shareholders of CSI South Carolina is \$1,875,200, or \$375,040 per individual. Other than the principal amount borrowed, the terms of the notes are substantially identical to the note payable to Barron. On December 31, 2005, the aggregate outstanding balance on the five shareholder subordinated notes was \$1,125,200.

We anticipate repaying the subordinated notes from the proceeds from the exercise of the warrants and cash generated by operations. The repayment of the subordinated notes is discussed further in Item 6, Management's Discussion and Analysis or Plan of Operation F. Liquidity and Capital Resources.

Preferred Stock Purchase Agreement

Barron invested in our preferred stock and warrants pursuant to the Preferred Stock Purchase Agreement. It contains certain rights of the holders of the preferred stock and certain limitations on us in addition to those contained in the Certificate of Designation. In addition to the customary representations, warranties and other provisions, the Preferred Stock Purchase Agreement:

required Barron, as the investor in the preferred stock, to make a subordinated loan to the Company in the amount of approximately \$1.9 million. Barron's loan was funded with cash at closing and was substantially utilized to fund the merger consideration;

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required the five former shareholders of CSI South Carolina, collectively, to make subordinated loans totaling approximately \$1.9 million. The loans by the former CSI South Carolina shareholders were funded by merger consideration which otherwise would have been payable in cash;

provided that Barron waived reimbursement of certain prepaid expenses in the amount of \$81,726.50, so as to provide the Company with funds to apply toward its legal expenses relating to the sale of the preferred stock and related transactions. This amount included the \$50,000 prepayment by Barron to Maximum Ventures relating to the purchase of a majority of VerticalBuyer's common stock, as well as \$31,726.50 advanced by Barron to its financial adviser, Liberty Company LLC to reimburse expenses related to finding and initially investigating the VerticalBuyer shell corporation;

provided for the delivery of the two warrants;

required that the merger be consummated immediately prior to the sale of the preferred stock and the warrants;

required the execution and continued effectiveness of the Registration Rights Agreement;

requires us to reserve shares of common stock underlying the preferred stock and warrants;

obligates us to continue to report to the Commission under Section 15(d) of the Securities Exchange Act of 1934, as amended, or register under Section 12(b) or (g) thereunder;

prohibits us from issuing any shares of our preferred stock for a period of three years, which preferred stock is convertible into shares of our common stock other than on a conversion ratio that is fixed, with certain exceptions;

prohibits us for a period of three years from issuing any convertible debt;

prohibits us for a period of three years from entering into any transactions that have reset features that result in additional shares being issued;

required us within 90 days to employ a chief financial officer who has experience with public companies, and provides for liquidated damages for our failure to comply. On May 6, 2005, we employed David B. Dechant as our chief financial officer, in fulfillment of this provision. Biographical information on Mr. Dechant is presented in Item 9;

requires us to use the proceeds from the sale of the preferred stock and the warrants for working capital and the repayment of certain notes related to the merger;

provides that, until such time as all of the preferred stock shall have been converted into common stock, Barron and the five former shareholders of CSI South Carolina, Inc. will have the right to participate in any subsequent funding by the Company on a pro rata basis at 80% of the offering price;

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prohibits any insiders, including all of our officers and directors, from selling any shareholdings for a period of two years;

for two years, prohibits any employment and consulting contracts from containing any provisions for the following: bonuses not related directly to increases in earnings; any car allowances not approved by the unanimous vote of the board of directors; any anti-dilution or reverse split provisions for shares, options or warrants; any deferred compensation, any unreasonable compensation or benefit clauses; or any termination clauses paying over 18 months of salary; and

prohibits any variable rate or other transaction whereby a purchaser of securities is granted the right to receive additional shares based upon future transactions of the Company on terms more favorable than those granted to such investor in the investor's current offering. On November 7, 2005, Barron and the Company amended the Preferred Stock Purchase Agreement. The amendment reflected changes in the warrants and the Certificate of Designation in connection with the parties' agreements to make the beneficial ownership limitation on preferred stockholders and warrants holders (including Barron) non-waivable. For a discussion of the amendments relating to the beneficial ownership cap, see Sale of Preferred Stock and Warrants.

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Certificate of Designation

The terms of the Series A Convertible Preferred Stock are governed by an Amended and Restated Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock filed with the Delaware Secretary of State on November 7, 2005, which we refer to as the Certificate of Designation. The Certificate of Designation authorizes the issuance of up to 8,300,472 shares of Series A Convertible Preferred Stock. The preferred stock is convertible into shares of our common stock on a one-for-one basis at the election of the holder. There are no redemption provisions.

Significant features of the Certificate of Designation include:

A holder of preferred stock (including Barron) is prohibited from converting any shares of the preferred stock if such conversion would result in it beneficially owning greater than 4.9% of our common stock. The only exception to the beneficial ownership limitation is in the event of a change in control, whereby all of the preferred stock would be automatically converted;

Provides that the beneficial ownership limitation may only be amended or waived with the unanimous consent of the Series A Convertible Preferred stockholder(s) and a majority of the non-affiliated holders of outstanding common stock (excluding as affiliated holders all holders of the Series A Preferred Stock or the related warrants);

Provides that the preferred stockholder may elect liquidation treatment and recover its investment in the preferred stock under certain stock transfer or business combination transactions (for example, in the event of a tender offer or compulsory share exchange.)

No dividends are payable with respect to the Series A Convertible Preferred Stock or upon liquidation of the Company;

The Series A Convertible Preferred Stock generally has no voting rights; and

Upon liquidation of the Company, the preferred stockholders are entitled to be paid out of the assets of the Company an amount equal to \$0.6986 per share before any distributions are made to common stockholders.

Warrants

Pursuant to the terms of a Preferred Stock Purchase Agreement with Barron, we issued to Barron two warrants to purchase 7,217,736 shares of our common stock. The respective exercise prices of the warrants are \$1.3972 and \$2.0958 per share, with each warrant exercisable for half of such shares. The terms and conditions of the warrants are identical except with respect to the exercise price.

Initially, Barron was subject to the same waivable beneficial ownership limitation as it was with the preferred stock. For the same reason the preferred stock was amended, the warrants were amended on November 7, 2005 to impose a non-waivable beneficial ownership limitation of 4.9%. This limitation applies to any subsequent holder of the warrants of the Company currently held by Barron. Currently, Barron may not exercise its warrants to purchase shares of common stock if and to the extent Barron's beneficial ownership of our common stock would exceed 4.9%. The 4.9% beneficial ownership limitation is not applicable in the event of a change in control, which is defined as (i) our consolidation or merger with or into another company or entity in which we are not the surviving entity, or (ii) the sale of all or substantially all of our assets to another company or entity not controlled by our then existing stockholders in a transaction or series of transactions. We are obligated to give the holder of the warrant 30 days notice prior to a change in control. The beneficial ownership limitation may only be waived or amended with the consent of the holder of the warrant and the consent of the non-affiliate holders of a majority of the shares of our outstanding common stock.

The warrants provide that they may be exercised on a cashless basis after February 11, 2006 if there were no registration statement effective permitting the resale of the common stock underlying the warrants. However, our

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Form SB-2 registration statement covering the warrant shares was declared effective by the SEC on February 14, 2006. So long as we maintain the effectiveness of a registration statement for the shares underlying the warrants, the warrant holder is prohibited from utilizing a cashless exercise.

The number of shares of common stock underlying the warrants and the exercise price of the warrants will be adjusted to reflect any stock splits, stock dividends, recapitalizations, or similar events. The warrants will also be adjusted in the event of any reorganization, consolidation, merger, or similar event in which we are not the surviving corporation. Such adjustment will entitle the holder of the warrant to receive, after the effective date of any such merger, consolidation, etc., such stock or property as the holder would have been entitled to receive on the effective date had he exercised the warrant immediately prior to the effective date.

No fractional shares will be issued upon the conversion of the warrants. Instead, any fractional amounts are to be settled in cash or by rounding up each fractional share to the next whole number.

Summary of Consideration Received by Participants in Merger and Related Transactions

Five Former Shareholders of CSI South Carolina

In the merger and related transactions, the five former shareholders of CSI South Carolina received consideration in the form of cash, subordinated notes and common stock in the surviving Company. The net consideration received by the five former CSI South Carolina shareholders as of the closing on February 11, 2005 of the dividend, merger and related investment transactions, is summarized below.

Pre-merger Dividend

CSI South Carolina dividends. These dividends were declared by CSI South Carolina on February 9, 2005. Of the total, \$960,000 was paid in cash prior to the merger on February 9, and \$2.5 million in a subordinated note, which note was repaid in cash at the closing on February 11, 2005. The dividends that were paid to the five former shareholders of CSI South Carolina were paid to remove accumulated cash in CSI South Carolina. The dividends did not constitute consideration for the sale of their shares in CSI South Carolina. Although a condition to the merger and investment by Barron, the dividends were effected independently of such subsequent transactions. Absent the merger and recapitalization, it was anticipated that the five shareholders of CSI South Carolina would have distributed excess cash out of CSI South Carolina upon the imminent retirement of Joe G. Black. \$ 3,460,000

Merger

In the merger, the five shareholders of CSI South Carolina tendered their shares of common stock (being all of the issued and outstanding capital stock of CSI South Carolina), which was cancelled, in exchange for the following consideration:

(a) *Merger cash (gross)*. The five shareholders received subordinated notes totaling \$3,624,800, which were repaid in cash later on the day of closing upon the receipt of investment proceeds from Barron. Net merger cash received by the shareholders totaled \$3,212,015, after the payment from their merger proceeds of the fee to The Geneva Companies, Inc. totaling \$412,785. \$ 3,624,800

(b) *Merger subordinated notes*. These subordinated notes were received in the merger on February 11, 2005. They mature on May 10, 2006. As of December 31, 2005, the aggregate outstanding balance of these notes was \$1,125,200. 1,875,200

5,500,000

Less: advisory fee paid to The Geneva Companies, Inc. by the five shareholders (412,785)

Net non-equity consideration received by former CSI South Carolina shareholders in the merger \$ 5,087,215

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(c) 2,526,905 shares of the surviving Company's common stock (estimated value). This estimate, as of the closing, is based on the price per share of \$0.6986 paid by Barron for the preferred stock and issuance of warrants. These shares represented approximately 26% of the Company's common stock at the time, assuming conversion into common of all of the preferred stock held by Barron. The shares received were not registered under federal and state securities laws, and therefore were restricted as to resale. Also, pursuant to the Preferred Stock Purchase Agreement, the five former CSI South Carolina shareholders are restricted for two years from selling any of such shares. The estimate is based on the arms length transaction with Barron and represents the parties' per share value of stock received in the transaction. 1,765,295

Estimate of total consideration received by five former CSI South Carolina shareholders in the merger \$ 6,852,510

Total consideration received by five former CSI South Carolina shareholders from pre-merger dividends and in the merger \$ 10,312,510

On February 11, 2005, four of the five former CSI South Carolina shareholders entered into employment agreements with the Company. These were Nancy K. Hedrick, President and Chief Executive Officer; Thomas P. Clinton, Vice President of Sales; William J. Buchanan, Vice President of Delivery and Support; and Beverly N. Hawkins, Vice President of Product Development. The employment agreements provide for compensation at a rate of \$185,000 a year, plus such bonuses and raises as the board of directors may determine. Each agreement is for a term of three years, and is described in more detail under Item 10 Executive Compensation.

The remaining former CSI South Carolina shareholder, Joe G. Black, served as our interim Chief Financial Officer from the closing on February 11, 2005 until May 5, 2005. We entered into a consulting agreement with Mr. Black to provide financial and accounting consulting services to us with compensation at \$75 an hour. The consulting agreement has an initial term of one year and is described in more detail under Item 12, Certain Relationships and Related Transactions.

Fees Paid to Financial Advisors

CSI South Carolina and the five former shareholders, as discussed in C. History and Development of CSI South Carolina Events Leading Up to 2005 Restructuring, retained The Geneva Companies, Inc. as their financial advisor. On February 11, 2005, upon the consummation of the merger and related transactions, Geneva received a commission of \$412,785. The commission was paid by the five former shareholders.

Barron's financial advisor and finder for its preferred stock investment in the Company was Liberty Company, LLC. Liberty was paid a fee of \$275,000 upon the consummation of the merger and related transactions on February 11, 2005, which fee was based on a percentage of Barron's investment. Pursuant to the terms of the Preferred Stock Purchase Agreement, Liberty's fees were paid by the Company. In addition, in March 2005, pursuant to the Preferred Stock Purchase Agreement, Liberty was paid an additional \$83,800 in fees by the Company upon the closing of its \$3.0 million credit facility with RBC Centura Bank, again pursuant to its finder arrangement with Barron. The Company has been informed by a representative of Liberty that Liberty is a registered broker-dealer.

Maximum Ventures, Inc. was paid a financial advisory fee of \$50,000 by Barron on or about December 2004. The payment essentially constituted earnest money, which was to be offset against the \$450,000 purchase price. The prepaid advisory fee so reduced the \$450,000 purchase price for the shares of VerticalBuyer purchased from Maximum Ventures by CSI South Carolina, pursuant to the Stock Purchase Agreement between CSI South Carolina and Maximum Ventures. Pursuant to the Preferred Stock Purchase Agreement, Barron waived reimbursement of the \$50,000 paid to Maximum Ventures.

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No other brokerage, advisory or other fees were paid or payable by the Company, the five former CSI South Carolina shareholders, Barron, or other parties to the merger, the preferred stock investment, loan or related transactions.

Barron Partners LP

On February 11, 2005, Barron invested and loaned the following monies to the Company:

Preferred stock and warrants	\$ 5,042,250.00
Subordinated note	\$ 1,875,200.00
Contribution, per Preferred Stock Purchase Agreement, for Company's costs and legal fees	\$ 81,726.50 ⁽¹⁾
Total investment/loan by Barron	\$ 6,999,176.50

- (1) Includes the waiver of the Company's obligation to repay \$50,000 earnest money paid by Barron to Maximum Ventures, as well as \$31,726.50 paid by Barron to its financial advisor to reimburse it for out-of-pocket costs incurred in finding and investigating the VerticalBuyer shell corporation.

Barron received no fees or other compensation with respect to the acquisition of the VerticalBuyer shares by CSI South Carolina, the merger of CSI South Carolina into VerticalBuyer, its preferred stock, warrant and subordinated debt investments in the Company or any related transactions. Barron did not act as a broker-dealer with respect to these transactions. Barron's activities related solely to its purpose of investment for its own account. Barron's involvement in the procurement of VerticalBuyer related only its use as a vehicle to facilitate an investment in CSI South Carolina, or another such private company should the CSI South Carolina transaction not have been successfully completed.

F. Our Niche in the Governmental and Educational Technology Market

There are approximately 3,100 counties (according to the U.S. Dept. of Census), 36,000 cities and towns (according to the National League of Cities) and more than 14,000 school districts (according to the National Center for Education Statistics) in the United States. Each of these organizations is a potential candidate for an integrated financial management system as well as for various technology services and products. Since many local governments are moving toward outsourcing of information technology services, even more opportunities are available for our services. In 2005, the sale of software, hardware and services to non-educational governmental organizations accounted for approximately 35% of our total sales.

IDC, a subsidiary of International Data Group, Inc. (the parent company of IDG News Service), projected in May 2002 that U.S. public schools would substantially increase their information technology-related expenditures as technology and traditional education resources become interwoven. IDC projected that information technology spending for K-12 schools would reach \$9.5 billion by 2006. IDC estimated that computer hardware would account for just over a quarter of district technology budgets.

Our customer base is discussed in more detail under **K. Customers** below.

G. Products and Services**CSI Fund Accounting Software**

We provide the CSI Fund Accounting Software (CSI Accounting+Plus) to a variety of clients in an integrated financial management system. We generate revenue from the CSI Accounting+Plus as outlined below. Each of these sources of revenue is described in the remainder of this section.

Sales of software licenses to new clients;

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Sales of new/additional modules to existing clients;

Installation of software;

Data conversion from legacy systems;

End user training;

Guaranteed service agreements; and

Sales of third party products to enhance functionality of CSI Accounting+Plus.

Prior to 1999, our proprietary fund accounting system was a DOS-based product. DOS, or Disk Operating System, was the personal computer operating software used widely before the release of Microsoft's Windows software. In July 1999, we released a Windows® based version of the system as CSI Accounting+Plus. This product was written with Microsoft's Visual FoxPro® database, a relational database, and utilizes Crystal Reports®, an industry standard report generator. Over the next four years, approximately 120 software clients upgraded from the DOS based system to the new product. For our clients, this upgrade process included data conversion, installation and training on the new system and, in many cases, a hardware upgrade. The CSI Accounting+Plus system has also been installed in approximately 100 new clients during the period from 1999 to 2005. In addition to software sales, we offer ongoing customer support for the accounting software. This support is provided under a guaranteed service agreement, providing the client with phone support, online user assistance and routine updates to the software.

While we continue to market the Visual FoxPro version, the CSI Accounting+Plus system is currently being rewritten with Microsoft's .Net (pronounced dot-net) and SQL (pronounced sequel and standing for Structured Query Language) database technologies. This new version will provide improved performance, scalability, more flexible data access and native data-tagging (XML or Extensible Mark-up Language) web support. SQL and .Net have become the industry standards for software development, and XML has become an industry standard for data tagging and retrieval. We anticipate that the first components of this new version will be available for release by the third quarter of 2006. At that time, we plan to begin upgrading existing clients to the new version and begin marketing this version to new clients. The current CSI product contains the functionality required by our clients but moving to the SQL and .Net platform will allow us to be more competitive on both a regional and national level.

A new software service option called Service+Plus has also been developed. This plan will provide the normal coverage of a guaranteed service agreement but will also include version protection: clients will get new major releases of the software without additional fees. Service+Plus will also provide clients free attendance to webinars (seminars which may be attended remotely by use of the internet), free user conference attendance, one free Crystal Reports training class each year, disaster recovery (off-site data storage) and discounts on additional software modules, training and engineering services.

We have a close business relationship with AIG Technology, Inc. (AIG) to enhance the functionality of our accounting software. AIG is a developer of document workflow systems. Through this relationship, we offer our clients enhanced printing, faxing and emailing capabilities (Doc e Serve), document imaging (Doc e Scan) and the routing of documents across the web for distribution and approval (Doc e Fill). CSI markets the AIG product line and receives a commission for the sales of these products and services. The commissions have not constituted a significant part of our revenues. However, the ability to offer enhancements improves our competitive position.

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The CSI Accounting+Plus software suite is designed as a modular solution. The modules are sold separately to enable customers to pick and choose only those modules that are needed to provide desired functionality. The modules in the software suite are shown in the following table:

Accounting Modules

Accounts Payable
 Accounts Receivable
 Budget Preparation
 Check Reconciliation
 Cost Allocation
 Fixed Assets
 Fund Ledger
 Payroll
 Purchasing
 System Manager

Specialty Modules

Audit Reporting
 Claims Reimbursement
 Food Service Reporting
 Inventory
 Pupil Activity Accounting
 Warehouse Requisitions

Payroll / Personnel Support Modules

Absent Employee Tracking
 Applicant Tracking
 Available Substitutes
 Insurance and Benefits
 Personnel

Municipal Modules

Business License
 Cash Collections
 Construction Permits
 Utility Billing

Our development team writes and maintains the CSI Accounting+Plus modules. The support of these modules includes routine enhancements, governmentally required changes (e.g., Form W-2 format changes) and problem fixes. We provide updates to the CSI system through our website.

Standards Based Lesson Planner

In September 2005, we acquired a standards based lesson planning software product from Eric Levitt of Carolina Education Services. We have renamed this software curriculator. The software is designed to allow teachers to create lesson plans that are tied to a state's curriculum standards. These lesson plans may then be reviewed by school administrators and a report generated to determine the standards that have been met or need to be met. This is particularly important as school systems develop higher accountability standards. In addition, the federal legislation of No Child Left Behind Act has focused greater attention on schools' adequate yearly progress (AYP), and meeting curriculum standards is an important component of these measurements. Standards based lesson planning software allows a school to document its compliance with the curriculum standards as a component of its compliance with the No Child Left Behind Act legislation.

We have converted this product to a Microsoft SQL database and internet-based product and are marketing it as curriculatorTM standards based lesson planner.

We believe the addition of this product, while not yet material, may provide significant additional revenue in the future as we are able to offer an additional product to our existing school-based customers. We believe it may also provide a source of additional contacts and referrals. The gross profit received from each sale of this product may be significantly less than that of our traditional fund accounting software. As a result, we intend to use telesales as a cost effective method of generating additional contacts and may use the Internet as the primary medium for demonstrations and software delivery, in order to minimize selling and delivery costs.

Hardware Sales and Related Support Services

Our technology solutions segment provides network system solutions to more than 200 governmental organizations in South Carolina, North Carolina and Georgia. This segment provides professional network

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integration services as well as network computing solutions to our customers. We strive to deliver high-quality hardware, software and related professional services to help our customers plan, acquire, implement, manage and upgrade their organizations' information systems.

We have established associations with some of the largest vendors in the industry, and with others whom we believe offer innovative products. We believe that strong industry relationships will further enhance our competitive position. We have developed and maintain the following vendor relationships:

Our primary focuses in the technology solutions segment include IP (internet packet-based) telephony, wireless, system security and routing/switching. We have a strategic relationship with **Cisco Systems, Inc.**, (Cisco) a worldwide leader in networking for the Internet and technology innovation, whereby Cisco provides the hardware necessary to implement these systems. We purchase the majority of our Cisco equipment through Ingram Micro. Ingram Micro is a multi-national distributor of technology hardware. Although we are an indirect reseller of Cisco products, we periodically work closely with Cisco representatives, particularly on large sales. This relationship occasionally produces customer leads and referrals. We also encourage our employees to pursue Cisco technical certifications, as such certifications as well as the achievement of certain sales volumes of Cisco products can make us eligible for certain incentives periodically offered by Cisco. We also participate in certain state contract pricing frameworks that Cisco has established with public entities. Purchases from Ingram Micro are made on an individual purchase order basis. We have no formal agreements with Ingram Micro.

We deploy desktops, notebook computers, personal devices and file servers in a variety of client network environments. We have a strategic relationship with **Hewlett Packard** (HP), who produces technology solutions that span information technology infrastructure, personal computing and access devices, global services and imaging and printing for consumers, enterprises and small and medium business. We provide professional services to deploy these devices. Our relationship with HP consists primarily of the purchase of computers and printer equipment for resale. We purchase these products on an individual purchase order basis under a standard, nonexclusive reseller agreement. In addition to purchases directly from HP, we have arms-length business relationships with certain customers whereby the customers have elected to name us as their authorized HP representative. As the named representative, and as an incentive for the customer to approve us as the named representative, we provide various forms of assistance which can include assisting the customer in identifying the specific HP products that will meet its needs, summarizing and processing orders on behalf of the customer with HP, and providing certain support and HP authorized repair and maintenance for which we are separately compensated by HP. To provide these services, some of our personnel have received training and certifications from HP. As the named representative of HP, we assist the customers in placing their orders directly with, and we receive commissions from HP, rather than acting as the purchaser and reseller of HP's products. Due to the volume of business we do with HP, we also work very closely with HP representatives and receive support which may include special quantity or other pricing in competitive situations with products from other manufacturers, and may receive customer leads or referrals from time to time.

Our focus on the K-12 sector has led to our developing relationships with vendors who specialize in technologies for the classroom. **Promethean** Collaborative Classroom Solutions offer what we consider to be the industry-leading solution for transforming the classroom into an interactive learning environment. Using Promethean's ActivBoards, students are able to use a stylus on a special electronic white board to interact with computer projected images. The computer reacts to the stylus activity and projects the results. By having an exclusive sales arrangement to market Promethean ActivBoards in North Carolina and South Carolina, we believe we are able to maintain gross margins higher than most hardware products. In addition to selling the ActivBoards, we offer installation services, end user training and market complementary products (e.g., projectors, PC Tablets) to be used with the boards for the collaborative classroom.

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In keeping with our focus on IP-based systems, we also have a business relationship with DIVR (**Digital Image Viewing and Retrieval**) Systems, Inc., providing IP-based surveillance solutions to the industry. With growing demand and governmental initiatives to provide security solutions, we believe the DIVR Systems technologies represent significant opportunity. In November 2003, J.P. Freeman & Co. a market research firm that follows the security industry, forecast that the overall video surveillance market would reach \$3 billion per year by 2007.

In order to offer visual communication equipment to our clients and prospective clients in order to allow video conferencing, administrative communications, home bound learning and professional development, we have developed a business relationship with **Tandberg**. In the education environment, Tandberg provides worldwide access to people, places and experiences without time or travel constraints. Through the public sector and business environment, Tandberg offers solutions in providing more efficient and effective training to employees, saving travel, time and money. Tandberg solutions include cameras, monitors, videophones and software.

Our relationships with Promethean, DIVR and Tandberg are established through standard reseller agreements. These agreements make us eligible to resell products on a generally non-exclusive basis, many in specifically authorized geographic regions, and make us eligible, from time to time, for periodic promotions, special offers and manufacturing standard volume discounts and rebates, when offered. Occasionally we may request special pricing for large volume deals, particularly in competitive situations, which may be approved on a case by case basis. Due to our sales and marketing success on behalf of vendors, we have been asked from time to time to represent products in new geographic regions. As we expand we will exploit these opportunities as they come available and as we have the financial justification for the physical presence to do so.

In addition to the above relationships, we also have developed relationships with Microsoft, Novell, Packeteer, Symantec, and Citrix, which are on similar terms with those of Promethean, DIVR and Tandberg. We also have one additional vendor, Synnex. Our purchases from Synnex, like those from Ingram Micro have equaled more than 10% of our annual purchase volume. Synnex is a distributor of technology hardware. We have no formal agreement with Synnex and purchase technology accessories on a purchase order by purchase order basis. The products purchased from Synnex are readily available through other vendors.

Our technical services include the following:

Consulting Services

Project Management

Deployment Management

Procurement Management

Product Evaluation Management

Outsourcing Management

Bid Management

Network Services

Network Needs Analysis

Network System Design

Network System Integration

Network System Implementation

Network System Maintenance

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Convergence Services

Integration Needs Analysis

Integration Design

Integration Implementation

Integration Maintenance

Support Services

Hardware Support

Network Support

Convergence Support

Network Operating Systems Support

Collaboration Systems Support

H. Strategy

In addition to our sales of software applications, technology solutions and related support and maintenance services, we provide technology consulting, including network and systems integration services as a part of our solutions sales efforts. These services also generate a significant amount of revenue from the sale of computer hardware equipment. 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.

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 higher long-term client satisfaction and a competitive advantage in the marketplace. Repeat business from our existing customer base has been key to our success and we expect it will continue to play a vital role in our growth. Over the past ten years we have retained more than 90% of our software customers.

Software

Fund Accounting Software

New Product Development

We continue to market the primary CSI software applications, which contain the functionality required by our clients. However, we are in the process of rewriting these applications using the latest Microsoft application programming tools and current Microsoft data storage and retrieval technologies. The new release will allow us to expand more easily into additional states. We will continue to expand our product offerings to meet the needs of our clients both in the current version and in the new version.

Service+Plus

Our new service offering provides version protection for major releases of the software without additional fees, free attendance to seminars accessed remotely by use of the internet, free user conference attendance and disaster recovery (off-site data storage).

Hosted Services (ASP)

We are beginning to offer an ASP (Application Service Provider or CSI hosted) solution to new clients whereby they can access the software on CSI servers and run it remotely over the internet at a fixed monthly cost. Under this business model, the client can forego the significant up-front investment required to purchase computer hardware and install the software at their location.

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Reseller Model

In order to move into new regions and states, we are pursuing a reseller model in those areas where it will be the most expedient way to introduce our primary software application. There are often information technology organizations established in an area that have the sales staff in place to market our products.

Lesson Planning Software

New Product Acquisition

In September 2005, we acquired a standards based lesson planning software product, which we have renamed *Curriculator*. The software product, potential customer list, install base and all related rights purchased did not constitute a material addition to the business. This software is designed to allow teachers to create lesson plans that are tied to a state's curriculum standards. These lesson plans may then be reviewed by school administrators and reports may be generated to determine the standards that have been met or need to be met. This is particularly important as school systems develop higher accountability standards. In addition, the federal No Child Left Behind Act legislation has focused greater attention on schools' adequate yearly progress (AYP) and meeting curriculum standards is an important component of these measurements. Standards based lesson planning software allows a school to document its compliance with the curriculum standards as a component of its compliance with the No Child Left Behind Act legislation.

Product Enhancement

We will be rewriting the lesson planning software to be web-enabled. In addition, we will be building in curriculum standards for all states.

Market Penetration

Addressing No Child Left Behind Act requirements and meeting state curriculum standards are issues for educators in every state. We plan to use telemarketing, our web presence, attendance at educational trade shows and direct mail campaigns to introduce and sell our lesson planning software nationally. Our initial efforts will be focused on the southeastern states.

Technology

Expansion of Offerings

We are continually seeking new hardware offerings to present to our clients. Our spending on research and development is generally insignificant. As old technologies expire and new technologies emerge we work to stay a short distance behind the new product curve, adopting primarily those solutions that are proven in the marketplace. As a reseller with more than 300 public sector clients and internal technical personnel, we are periodically approached by vendors and manufacturers to expand into new territories or represent new or additional products. We also pursue these opportunities. For example, new product opportunities we evaluate could include additional products in the following market spaces in which we are already engaging: storage solutions, database technologies such as standardized data-tagging (XML or Extensible Mark-up Language) applications for improved data retrieval, internet based audio and video distribution (equipment used to broadcast audio and video communications), metropolitan wireless (city-wide wireless public internet access and city-wide wireless network access by city employees) and additional service capabilities. As with our other hardware-based solutions, we plan to enter into reseller arrangements with equipment and solutions providers or manufacturers who already have experience and can provide installation, support, equipment warranties and technical training to our personnel to offer additional solutions to our existing client base and new customers. Except for internally developed software or acquired products, we enter new areas as a reseller as opportunities arise and customer needs present themselves. This approach allows us to mitigate the risk a product will not have sufficient demand or profitability. By doing this, we forego the investment in inventory a manufacturer or large distributor would

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have to commit to a new product. We are already proposing solutions involving some of these areas, including metropolitan wireless networking for small towns and housing communities, although they do not yet represent a significant portion of our business. We typically do not commit significant resources to them unless we achieve reasonable profitability on the initial opportunities. Periodically, certain products introduced at a new client site, in response to a client's specific needs or requests and to maintain or improve the client relationship, never become a significant portion of our business. Other products become significant contributors to profitability and we add them as a standard offering to our client base.

Managed Services and Guaranteed Service Agreements

In addition to guaranteed service agreements on our software products, we will be offering guaranteed service agreements on many of our hardware offerings. Guaranteed service agreements allow us to increase our recurring revenue.

Geographic Expansion

We are pursuing a national presence with a primary, initial focus on the southeastern region of the United States.

Generally, our technology offerings require hands-on implementation and support. In order to expand into new geographic territories, we must find qualified personnel in an area to service our business. The need for hands-on implementation and support may also require investment in additional physical offices and other overhead. We believe our approach is conservative. Our strategy is to limit the number of new target areas until they become cash flow positive before expanding into additional ones. Accordingly, we intend to expand the geographic reach of our technology offerings from our primary client locations of South Carolina, North Carolina and Georgia to surrounding states methodically over time. We may, however, accelerate expansion if we find complementary businesses in other regions that we are able to acquire. Until such time as we are able to find appropriate acquisitions, our geographic reach for the technology solutions segment is likely to be limited to the southeast for the next several years. Our marketing efforts to expand into new territories may include telemarketing, attendance at trade shows, and direct mail in addition to personal contact.

We are able to deliver software applications, demonstrations and training over the internet and deliver support by internet or phone. Accordingly, for our software applications segment, we plan to expand our geographic reach to a national level more quickly than for our technology solutions segment. Software marketing efforts may include attendance at national trade shows and national telemarketing, direct mail and web advertising. Because our lesson planning software product is less complex than our accounting software, it is likely we will focus our efforts on that product first while looking for any opportunities to sell the accounting software that may arise in the process.

Growth Through Acquisitions

One significant reason for our entering into the merger and recapitalization transaction in February 2005 was to allow us to access public capital markets as a source of funding to permit us to grow through acquisitions. In addition, the merger transaction facilitated the sale of warrants, the exercise of which (absent a cashless exercise) represents a significant potential source of capital. Our competitive markets are occupied by a number of competitors, many substantially larger than we, and with significantly greater geographic reach. 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 whenever appropriate expand our technological capabilities and product offerings. While we may use a portion of any cash proceeds to pay down debt on an interim basis, we intend to use any additional liquidity and/or availability of assets generated by the paydown and remaining proceeds to fund acquisitions. Additionally, we are in the process of engaging a consultant to assist us with acquisitions, including identifying potential acquisition opportunities.

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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 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.

Organizations focused on providing products and solutions to commercial large company (Fortune 100) and small business (SMB) accounts. Many of our current technology solutions translate to the corporate market, especially IP telephony, IP surveillance, video conferencing and network security.

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. 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.

Following the merger in February 2005, we have pursued and entered into preliminary discussions with various acquisition candidates. However, the Company has not entered into agreements or understandings for any acquisitions which management deems material.

I. Sales, Marketing and Distribution

We market our products and services through direct sales throughout North Carolina, South Carolina and Georgia. We are currently expanding our direct sales to cover the southeastern United States. Our in-house sales staff provides lead generation and support to the direct sales team.

We have twelve outside sales persons, including a Vice-President of Sales and a Sales Manager, and six additional employees on our inside sales staff. In line with our expansion plans described under H. Strategy, we plan to expand both of these teams in 2006. Other employees are involved in selling on a daily basis. Engineers and trainers have excellent opportunities to sell additional products and services to clients while delivering services.

We have a Chief Technology Officer who helps to determine which technology products will be marketed. A staff member also provides marketing services and coordinates vendor relations. Our marketing efforts include participation in various trade shows (for municipalities, counties and education), road shows to showcase various products and services, and mailings to target specific products and services.

Our inside sales staff provides leads to the outside staff and also produces proposals to be delivered to prospects and clients. In 2004, the software inside sales staff began making outbound calls to pre-qualify leads for the outside sales staff. This has proven successful and we intend to expand these calls by both the software and the technology inside sales teams.

Our outside sales personnel call on existing and prospective clients. Due to our wide range of product and service offerings and rapidly changing technology, we believe there are sales opportunities within the existing client base. Recurring sales account for a significant part of our overall revenue. Our sales teams are segmented by geography and also product lines (technology and software). Depending on the product or service being offered, we may call upon an information technology director, city manager, director of finance, director of operations, utility manager or curriculum coordinator.

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On February 19, 2006, CSI renewed its Cisco Premier certified partner status pursuant to its Indirect Channel Partner Agreement with Cisco Systems, Inc. The renewal is effective through March 11, 2007. The agreement grants us a limited, nonexclusive, revocable license to receive from authorized distributors and distribute to end users both those Cisco products made available to the authorized distributors and Cisco's proprietary rights in those products. The prices we pay for the Cisco products are set by the authorized distributors. In 2005, sales of Cisco products accounted for 38% of our sales revenue. In 2004, that number was 33%.

Pursuant to a Hewlett Packard U.S. Business Development Partner Agreement, we were appointed a Business Development Partner for the purchase and resale or sublicense of Hewlett Packard's products, services and support. In this capacity, we will purchase Hewlett Packard's products, services and support from authorized distributors and resell them to end users. The agreement was originally effective until May 31, 2005, and we received notification that it has been extended in its current form until May 31, 2006. The prices we pay for Hewlett Packard products, services and support are set by the authorized distributors. Sales of Hewlett Packard products accounted for 8% of gross sales revenues in 2005 and 17% in 2004. In addition, we received commissions on customer orders of Hewlett Packard products of \$930,814 (4% of 2005 gross sales) in 2005 and \$1,061,705 (5% of 2004 gross sales) in 2004. See Note 1 to our audited consolidated financial statements, which are included in this annual report, captioned "Computer Hardware Sales Revenues" for further information regarding the accounting related to Hewlett Packard hardware sales.

K. Customers

Our customers are predominantly educational institutions (K-12 and higher education), municipalities, non-profit organizations and other local governments. We sold services and products to more than 300 customers during 2005. Eleven customers constituted approximately 50% of the 2005 gross revenues, but no customer constituted more than 20% of gross revenues. One of our customers accounted for at least 10% of our revenues in 2005, the Greenville County, South Carolina school district. Due to the nature of the large technology projects we install, it is not unusual for a relatively small number of customers to account for the majority of sales. Many of these customers have ongoing projects extending across several years.

2005 Revenues by Market Type		2005 Revenues by State		
Sector		%	State	%
Private		6	Georgia	8
Public	Education	82	North Carolina	18
Public	Government	12	South Carolina	70
			Other	4

L. Competition

The market for the services that we provide is highly competitive, includes a large number of competitors, and is subject to rapid change. Our primary competitors include participants from a variety of market segments, including publicly and privately held firms, systems and consulting and implementation firms, application software firms and service groups of computer equipment companies. Competition is generally based on quality of products and customer support, timeliness, cost of services, relevant targeted expertise and return on investment.

In the fund accounting software market, there are a handful of national companies and many regional companies that have carved a niche in their region much as CSI has done in the southeast. On a national level these include divisions of Tyler Technologies, particularly MUNIS and INCODE, and divisions of Sungard Data Systems, Sungard Bi-Tech and Sungard Pentamation.

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The hardware and technology services market tends to have more regional rather than national competitors. In some cases hardware vendors, such as Hewlett Packard, offer engineering services that are in direct competition with our engineering services. On a national level, Pomeroy IT Solutions is the primary competitor in the IT products and services market.

We were recognized by *VAR Business Magazine* as one of the top 500 network integration companies in the United States (the VAR Business 500) in 2004 and 2005. Additionally, in 2005 we were recognized by *VAR Business Magazine* as one of the top 100 network integration companies serving the government sector (the Government VAR 100). The bases for this recognition were growth measures in revenues and client base. We were also one of three finalists for the Educational Solution Provider of the Year award also presented by *VAR Business Magazine*.

There is a disadvantage to this recognition in that we are now highly visible as potential competition for those with whom we compete for business. Virtually all of the companies listed on the VAR Business 500 and Government VAR 100 are competitors or potential competitors of ours. The VAR Business 500 and Government VAR 100 lists include IBM Global Services, EDS, Lockheed Martin IT, Accenture and Computer Sciences, to name a few. Most of the companies are significantly larger than we are, and some may enter our market space should they choose to do so. While we believe we will be able to continue to compete effectively in the future, there is no guarantee we will be able to do so or achieve any future recognition.

As CSI begins to market its products and services nationally, we will continue to compete with the same national companies and will be faced with additional regional competitors in the new markets we enter.

We believe a primary strategic advantage of CSI is combining the sale of our fund accounting software with network integration and hardware sales and services. We believe that providing one-stop shopping with a single point of contact is a material benefit to our clients and that this has been a key factor in our successful penetration of the educational and governmental software and technology markets in South Carolina, North Carolina and Georgia. Although competitors exist in these markets, we believe very few organizations offer the blend of services and products that is available through CSI. We are expanding into surrounding states with the goal of leveraging this strategic advantage in new areas.

Customer Service

Our historical growth has been, in large part, due to the high level of repeat business from our existing client base. This is evidenced by a greater than 95% client retention rate by our software applications segment and significant recurring sales opportunities to this client base through our technology solutions segment. We believe clients continue to utilize our products and services due to our focus on customer service, attention to detail and regular follow-up. We strive to have technical and customer service staff members available to address swiftly the needs, questions or concerns of clients. Specifically, our software customer service includes user conferences, a support desk access and a website, which offers documentation and downloadable upgrades.

Ability to Carry Out a Broad Range of Projects of Varying Scope

We strive to be agile and adaptable in fulfilling the technology needs of our clients, traits which are instilled in our corporate culture. We have managed multi-million dollar, multi-year projects for our clients, as well as requests for projects of a much smaller scale. We believe that our clients appreciate our range and flexibility in meeting their technology requirements.

Long-term Relationships With Clients

A large percentage of revenue continues to flow from our existing client base. The preservation of these client relationships is a high priority of our management team. We believe the longevity of these relationships evidences a high degree of customer satisfaction.

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Seamless Implementation of Software and Hardware

Because of our dual capabilities with respect to providing both software and integration services, we believe that we are able to coordinate the implementation of software and hardware, minimizing disruption to our client's day-to-day operations.

Diversification of Products and Service

Our products and services can address the needs of many departments within a city, county or educational facility. We offer a wide variety of services and products, including financial software, workflow management solutions, network integration products and services, specialized classroom technologies, IP telephony and IP surveillance, distance learning technology and wireless solutions.

M. Intellectual Property

We develop new software as part of our business activities. The software products we develop are generally works made for hire, prepared by our employees within the scope of their employment and with copyright ownership vesting in the Company pursuant to the Copyright Act. We routinely license software to our customers through unwritten, implied nonexclusive licenses, the terms of which are commensurate with our copyright protection in the software. Licenses for our products are ordinarily on a site license or user-based license basis. Generally, implied licenses are created by law when an express, written agreement does not exist between the parties. An implied license provides certain rights to the licensee, and typically such rights would be those the copyright owner would have given to the licensee as customarily given in the industry for similar types of software products. Other than password protection of the software for preventing unauthorized access to the software and/or the company receiving actual knowledge of a violation of its licenses, we have no formal methods in place for monitoring compliance with our licenses. Our software is generally entitled to receive copyright protection automatically, by operation of law, upon its creation. Copyright protection provides protection against unauthorized copies and derivative versions of the software being made. Copyright protection may also provide protection against the unauthorized distribution, public performance and display of the software. We typically do not assign our copyrights in our software to our customers. We have not, however, pursued registration of copyrights for our software under the Copyright Act nor have we pursued obtaining patents on the software we develop. In 2005, we applied for trademark protection of TECHNOLOGY OUTFITTERS and CURRICULATOR with the United States Patent and Trademark Office.

The length of such implied licenses of our software are generally coextensive with the length of the applicable copyright term provided for by federal law. Currently, the term for copyright protection is the life of the author of the software, plus 70 years. For software works that are made for hire (as defined by the Copyright Act), the length of the copyright term is 95 years from the first publication.

Enforcement of the implied licenses on our software would be primarily on copyright infringement grounds and/or on common law principles pertaining to implied licenses. Violations of copyrights on our software could include, among other things, unauthorized distribution of our software, and unauthorized derivative works being made of our software (such as by reverse engineering), each of the foregoing being rights uniquely held by the copyright owner.

N. Software Development

In 2004, we spent and capitalized \$559,847 on software development; in 2005 we spent and capitalized \$709,972. Our software development efforts focus on the implementation of known technological capabilities applied to common business processes to enhance our existing products. Historically, we have spent no material efforts on technological innovation for which the feasibility has been unknown. These software development amounts were accounted for as deferred software development costs and are amortized over the economic life of the related product (generally three years).

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O. Government Regulations

Procurement Regulations

We are subject to certain laws, regulations, policies and procedures governing the procurement by local governmental units of goods and services generally. These vary by jurisdiction, and there is a wide variance in the policies and procedures with which we must comply among our clients. For example, some governmental units require that we strictly comply with a request for proposal, some of our projects are subject to bid, and in others, the official handling procurement has considerable discretion. We have integrated compliance with these governmental procurement requirements into our sales process. As a result, the sales cycle associated with our products tends to be complex and lengthy. Factors contributing to the length and complexity of the sales cycle are the potential need to provide written responses to product demonstrations, customizing software to meet a particular customer's needs and the integration of our products with third party products.

Also, the governmental entities that comprise our customer base generally have the ability to terminate a contract from convenience, typically on a year-to-year basis. This right could adversely impact us, particularly in the case of technology solution projects we may be performing or ongoing service agreements that we may have in place. Although the potential for termination of a governmental customer for convenience exists, we have never had a customer terminate a contract in this manner.

Impact of Regulations on Maintenance of our Software

With respect to our software products, compliance with existing and future government regulations is a potential cost to CSI. Upon certain changes in law, we may be required to review the construction and content of our software to determine what impact, if any, the changes will have on the underlying rules tables in, and the operation of, our software. For example, our CSI Accounting+*Plus* system has to be modified as the federal and state governments change reporting requirements. Modifications for Form W-2, Form 1099, various health and retirement reporting and payroll tax table updates are a few examples of the changes that may need to be made.

If a regulatory change does impact our software, modification will need to be made at a cost and burden to CSI. In an extreme case, the software may be required to be rewritten entirely. This cost may potentially be passed on to customers in the form of product updates and product service agreements, but in certain circumstances we will absorb the costs entirely. For example, if we have a support agreement with a customer for a software product serviced, but no longer sold, by CSI, then our cost for updating the software may not be fully recoverable from the customer, but instead may be limited by the terms of the support agreement.

Federal E-Rate Program

Because we participate in the federal E-Rate Program, we are subject to the rules and regulations of that program. These rules and regulations are continually reviewed and modified and we must stay current with these changes. The risk factor entitled *A significant portion of our revenue stems from sales to schools receiving funding through the E-Rate Program. A loss of such funding could have a material adverse impact on our revenues and financial condition* contains additional information about the E-Rate program. Approximately 10% of our 2004 and 20% of our 2005 revenues, respectively, were generated from the E-Rate program. The Company and its customers compete for federal funds with many other entities and projects. As a result the revenue we receive from the federal E-Rate Program can be volatile.

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P. Employees

As of December 31, 2005, we had 99 full-time employees and six part-time employees. Our relationship with our employees is good. Many employees have worked at CSI for more than five years, some more than ten years. Full-time staff are assigned to the following areas:

Administration/Finance	13
Technical/Support Services/Training	24
Software Product Development	17
Engineering Services/Project Management	