EPLUS INC
Form 10-Q
September 21, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarter ended June 30, 2006

OR

o 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: **0-28926**

***e*Plus inc.**
(Exact name of registrant as specified in its charter)

Delaware	**54-1817218**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

13595 Dulles Technology Drive, Herndon, VA 20171-3413
(Address, including zip code, of principal executive offices)

Registrant's telephone number, including area code: **(703) 984-8400**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated filer o Accelerated filer o Non-accelerated filer x

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

The number of shares of common stock outstanding as of August 31, 2007, was 8,231,741.

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Explanatory Note

This Quarterly Report on Form 10-Q contains the restatement of our Condensed Consolidated Statements of Operations and Cash Flows for the three months ended June 30, 2005 for the effects of errors in accounting for stock options and other items. See Note 2, “Restatement of Consolidated Financial Statements” to our Unaudited Condensed Consolidated Financial Statements contained elsewhere in this document. For further discussion of the effects of the restatement see the following sections of our Annual Report on Form 10-K for the year ended March 31, 2006: Explanatory Note; Item 2. Management’s Discussion and Analysis of Results of Operations and Financial Condition; Item 9A. Controls and Procedures; and Note 2 to our Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

***e*Plus inc. AND SUBSIDIARIES**
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

ASSETS	As of March 31, 2006	As of June 30, 2006
	(in thousands)	
Cash and cash equivalents	$ 20,697	$ 22,616
Accounts receivable—net	103,060	129,779
Notes receivable	330	321
Inventories	2,292	12,025
Investment in leases and leased equipment—net	205,774	212,198
Property and equipment—net	5,629	5,253
Other assets	10,038	10,055
Goodwill	26,125	26,125
TOTAL ASSETS	$ 373,945	$ 418,372
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Accounts payable—equipment	$ 7,733	$ 8,530
Accounts payable—trade	19,235	22,364
Accounts payable—floor plan	46,689	66,455
Salaries and commissions payable	4,124	4,407
Accrued expenses and other liabilities	33,346	36,882
Income taxes payable	104	164
Recourse notes payable	6,000	15,000
Non-recourse notes payable	127,973	134,095
Deferred tax liability	165	1,078
Total Liabilities	245,369	288,975
COMMITMENTS AND CONTINGENCIES (Note 7)		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value; 2,000,000 shares authorized;none issued or outstanding	-	-
Common stock, $.01 par value; 25,000,000 shares authorized; 11,037,213 issued and 8,267,223 outstanding at March 31, 2006 and 11,191,231 issued and 8,212,241 outstanding at June 30, 2006	110	112
Additional paid-in capital	72,811	74,455
Treasury stock, at cost, 2,769,990 and 2,978,990 shares, respectively	(29,984)	(32,884)
Deferred compensation expense	(25)	-
Retained earnings	85,377	87,330
Accumulated other comprehensive income—foreign currency translation adjustment	287	384
Total Stockholders' Equity	128,576	129,397
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 373,945	$ 418,372

See Notes to Unaudited Condensed Consolidated Financial Statements.

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ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended June 30,	
	2005 As Restated (1)	2006
	(dollar amounts in thousands, except per share data)	
REVENUES		
Sales of product and services	$ 134,870	$ 175,493
Lease revenues	11,294	11,332
Fee and other income	3,640	2,845
TOTAL REVENUES	149,804	189,670
COSTS AND EXPENSES		
Cost of sales, product and services	122,107	156,362
Direct lease costs	3,777	5,024
Professional and other fees	947	1,286
Salaries and benefits	14,789	17,303
General and administrative expenses	4,461	4,356
Interest and financing costs	1,538	1,995
TOTAL COSTS AND EXPENSES (2)	147,619	186,326
EARNINGS BEFORE PROVISION FOR INCOME TAXES	2,185	3,344
PROVISION FOR INCOME TAXES	885	1,391
NET EARNINGS	$ 1,300	$ 1,953
NET EARNINGS PER COMMON SHARE—BASIC	$ 0.15	$ 0.24
NET EARNINGS PER COMMON SHARE—DILUTED	$ 0.14	$ 0.22
WEIGHTED AVERAGE SHARES OUTSTANDING—BASIC	8,545,744	8,207,369
WEIGHTED AVERAGE SHARES OUTSTANDING—DILUTED	9,078,604	8,723,439

(1) See Note 2, “Restatement of Consolidated Financial Statements.”
(2) Includes amounts to related parties of $219 thousand and $233 thousand for the three months ended June 30, 2005 and June 30, 2006, respectively.

See Notes to Unaudited Condensed Consolidated Financial Statements.

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ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended June 30,	
	2005 As Restated (1)	2006
	(in thousands)	
Cash Flows From Operating Activities:		
Net earnings	$ 1,300	$ 1,953
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	3,989	4,948
Reserves for credit losses	190	591
Provision for inventory losses	-	(2)
Impact of stock-based compensation	(3)	254
Excess tax benefit from exercise of stock options	-	(101)
Tax benefit of options exercised	5	-
Deferred taxes	(371)	913
Payments from lessees directly to lenders—operating leases	(1,173)	(2,520)
Loss on disposal of property and equipment	6	9
Gain on disposal of operating lease equipment	(116)	(316)
Changes in:		
Accounts receivable—net	(13,069)	(27,350)
Notes receivable	(231)	9
Inventories	(849)	(9,731)
Investment in leases and leased equipment—net	(3,127)	(12,275)
Other assets	321	38
Accounts payable—equipment	4,107	109
Accounts payable—trade	1,474	3,129
Salaries and commissions payable, accrued expenses and other liabilities	(12,501)	3,879
Net cash used in operating activities	(20,048)	(36,463)
Cash Flows From Investing Activities:		
Proceeds from sale of operating lease equipment	381	497
Purchases of operating lease equipment	(12,206)	(4,734)
Proceeds from sale of property and equipment	44	-
Purchases of property and equipment	(525)	(546)
Premiums paid on officers life insurance	-	(55)
Net cash used in investing activities	(12,306)	(4,838)

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ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS — continued
(UNAUDITED)

	Three Months Ended June 30, 2005 As Restated (1)	Three Months Ended June 30, 2006
	(in thousands)	
Cash Flows From Financing Activities:		
Borrowings:		
Non-recourse	$ 17,164	$ 23,497
Repayments:		
Non-recourse	(8,904)	(7,758)
Purchase of treasury stock	(622)	(2,900)
Proceeds from issuance of capital stock, net of expenses	31	1,109
Excess tax benefit from exercise of stock options	-	101
Tax benefit of stock options exercised	-	308
Net borrowings on floor plan financing	7,929	19,766
Net borrowings on lines of credit	148	9,000
Net cash provided by financing activities	15,746	43,123
Effect of Exchange Rate Changes on Cash	(11)	97
Net (Decrease) Increase in Cash and Cash Equivalents	(16,619)	1,919
Cash and Cash Equivalents, Beginning of Period	38,852	20,697
Cash and Cash Equivalents, End of Period	$ 22,233	$ 22,616
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	$ 691	$ 529
Cash paid for income taxes	$ 723	$ 16
Schedule of Noncash Investing and Financing Activities:		
Purchase of property and equipment included in accounts payable	$ 98	$ 112
Payments from lessees directly to lenders	$ 6,057	$ 9,617

(1) See Note 2, “Restatement of Consolidated Financial Statements.”
See Notes to Unaudited Condensed Consolidated Financial Statements.

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ePlus inc. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except percentages, share and per share amounts and where otherwise noted)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The Condensed Consolidated Financial Statements of *e*Plus inc. and subsidiaries and Notes thereto included herein are unaudited, have been prepared by us, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and reflect all adjustments that are, in the opinion of management, necessary for a fair statement of results for the interim periods. All adjustments made were of a normal recurring nature.

Certain information and note disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") have been condensed or omitted pursuant to SEC rules and regulations.

These interim financial statements should be read in conjunction with our Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended March 31, 2006. Operating results for the interim periods are not necessarily indicative of results for an entire year.

PRINCIPLES OF CONSOLIDATION — The Condensed Consolidated Financial Statements include the accounts of *e*Plus inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

REVENUE RECOGNITION — We adhere to guidelines and principles of sales recognition described in Staff Accounting Bulletin ("SAB") No. 104, "*Revenue Recognition*," issued by the staff of the SEC. Under SAB No. 104, sales are recognized when the title and risk of loss are passed to the customer, there is persuasive evidence of an arrangement for sale, delivery has occurred and/or services have been rendered, the sales price is fixed or determinable and collectibility is reasonably assured. Using these tests, the vast majority of our sales represent product sales recognized upon delivery.

From time to time, in the sales of product and services, we may enter into contracts that contain multiple elements. Sales of services currently represent a small percentage of our sales. For services that are performed in conjunction with product sales and are completed in our facilities prior to shipment of the product, sales for both the product and services are recognized upon shipment. Sales of services that are performed at customer locations are recorded as Sales of Product and Services on the accompanying Statement of Operations when the services are performed. If the service is performed at a customer location in conjunction with a product sale or other service sale, we recognize the sale in accordance with SAB No. 104 and Emerging Issues Task Force ("EITF") 00-21, "*Accounting for Revenue Arrangements with Multiple Deliverables*." Accordingly, in an arrangement with multiple deliverables, we recognize sales for delivered items only when all of the following criteria are satisfied:

- the delivered item(s) has value to the client on a stand-alone basis;
- there is objective and reliable evidence of the fair value of the undelivered item(s); and
- if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in our control.

We sell certain third-party service contracts and software assurance or subscription products for which we evaluate whether the subsequent sales of such services should be recorded as gross sales or net sales in accordance with the sales recognition criteria outlined in SAB No. 104, EITF 99-19, "*Reporting Revenue Gross as a Principal versus Net as an Agent*" and Financial Accounting Standards Board ("FASB") Technical Bulletin 90-1, "*Accounting for Separately Priced Extended Warranty and Product Contracts*." We must determine whether we act as a principal in the transaction and assume the risks and rewards of ownership or if we are simply acting as an agent or broker. Under gross sales recognition, the entire selling price is recorded in sales of product and services and our costs to the third-party service provider or vendor is recorded in cost of sales, product and services. Under net sales recognition, the cost to the third-party service provider or vendor is recorded as a reduction to sales resulting in net sales equal to the gross profit on the transaction and there is no cost of sales.

In accordance with EITF 00-10, "*Accounting for Shipping and Handling Fees and Costs*," we record freight billed to our customers as sales of product and services and the related freight costs as a cost of sales, product and services.

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We receive payments and credits from vendors, including consideration pursuant to volume sales incentive programs, volume purchase incentive programs and shared marketing expense programs. Vendor consideration received pursuant to volume sales incentive programs is recognized as a reduction to costs of sales, product and services in accordance with EITF Issue No. 02-16, "*Accounting for Consideration Received from a Vendor by a Customer (Including a Reseller of the Vendor's Products)*." Vendor consideration received pursuant to volume purchase incentive programs is allocated to inventories based on the applicable incentives from each vendor and is recorded in cost of sales, product and services, as the inventory is sold. Vendor consideration received pursuant to shared marketing expense programs is recorded as a reduction of the related selling and administrative expenses in the period the program takes place only if the consideration represents a reimbursement of specific, incremental, identifiable costs. Consideration that exceeds the specific, incremental, identifiable costs is classified as a reduction of cost of sales, product and services.

We are the lessor in a number of transactions and these transactions are accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 13, "*Accounting for Leases*." Each lease is classified as either a direct financing lease, sales-type lease, or operating lease, as appropriate. Under the direct financing and sales-type lease methods, we record the net investment in leases, which consists of the sum of the minimum lease payments, initial direct costs (direct financing leases only), and unguaranteed residual value (gross investment) less the unearned income. The difference between the gross investment and the cost of the leased equipment for direct finance leases is recorded as unearned income at the inception of the lease. The unearned income is amortized over the life of the lease using the interest method. Under sales-type leases, the difference between the fair value and cost of the leased property plus initial direct costs (net margins) is recorded as revenue at the inception of the lease. For operating leases, rental amounts are accrued on a straight-line basis over the lease term and are recognized as lease revenue. SFAS No. 140, "*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*," establishes criteria for determining whether a transfer of financial assets in exchange for cash or other consideration should be accounted for as a sale or as a pledge of collateral in a secured borrowing. Certain assignments of direct finance leases we make on a non-recourse basis meet the criteria for surrender of control set forth by SFAS No. 140 and have therefore been treated as sales for financial statement purposes.

Sales of leased equipment represent revenue from the sales of equipment subject to a lease in which we are the lessor. If the rental stream on such lease has non-recourse debt associated with it, sales revenue is recorded at the amount of consideration received, net of the amount of debt assumed by the purchaser. If there is no non-recourse debt associated with the rental stream, sales revenue is recorded at the amount of gross consideration received, and costs of sales is recorded at the book value of the lease. Sales of equipment represents revenue generated through the sale of equipment sold primarily through our technology business unit.

Lease revenues consist of rentals due under operating leases and amortization of unearned income on direct financing and sales-type leases. Equipment under operating leases is recorded at cost and depreciated on a straight-line basis over the lease term to our estimate of residual value.

We assign all rights, title, and interests in a number of our leases to third-party financial institutions without recourse. These assignments are accounted for as sales since we have completed our obligations as of the assignment date, and we retain no ownership interest in the equipment under lease.

Revenue from hosting arrangements is recognized in accordance with EITF 00-3, "*Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware*." Our hosting arrangements do not contain a contractual right to take possession of the software. Therefore, our hosting arrangements are not in the scope of SOP 97-2, "*Software Revenue Recognition*," and require that the portion of the fee allocated to the hosting elements be recognized as the service is provided. Currently, the majority of our software revenue is generated through hosting agreements and is included in fee and other income on our Condensed

Consolidated Statements of Operations.

Revenue from sales of our software is recognized in accordance with SOP 97-2, as amended by SOP 98-4, "*Deferral of the Effective Date of a Provision of SOP 97-2*," and SOP 98-9, "*Modification of SOP 97-2 With Respect to Certain Transactions*." We recognize revenue when all the following criteria exist: (1) there is persuasive evidence that an arrangement exists; (2) delivery has occurred; (3) no significant obligations by us related to services essential to the functionality of the software remain with regard to implementation; (4) the sales price is determinable; and (5) and it is probable that collection will occur. Revenue from sales of our software is included in fee and other income on our Condensed Consolidated Statements of Operations.

At the time of each sale transaction, we make an assessment of the collectibility of the amount due from the customer. Revenue is only recognized at that time if management deems that collection is probable. In making this assessment, we consider customer creditworthiness and assess whether fees are fixed or determinable and free of contingencies or significant uncertainties. If the fee is not fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. In assessing whether the fee is fixed or determinable, we consider the payment terms of the transaction and our collection experience in similar transactions without making concessions, among other factors. Our software license agreements generally do not include customer acceptance provisions. However, if an arrangement includes an acceptance provision, we record revenue only upon the earlier of (1) receipt of written acceptance from the customer or (2) expiration of the acceptance period.

Our software agreements often include implementation and consulting services that are sold separately under consulting engagement contracts or as part of the software license arrangement. When we determine that such services are not essential to the functionality of the licensed software and qualify as "service transactions" under SOP 97-2, we record revenue separately for the license and service elements of these agreements. Generally, we consider that a service is not essential to the functionality of the software based on various factors, including if the services may be provided by independent third parties experienced in providing such consulting and implementation in coordination with dedicated customer personnel. If an arrangement does not qualify for separate accounting of the license and service elements, then license revenue is recognized together with the consulting services using either the percentage-of-completion or completed-contract method of contract accounting. Contract accounting is also applied to any software agreements that include customer-specific acceptance criteria or where the license payment is tied to the performance of consulting services. Under the percentage-of-completion method, we may estimate the stage of completion of contracts with fixed or "not to exceed" fees based on hours or costs incurred to date as compared with estimated total project hours or costs at completion. If we do not have a sufficient basis to measure progress towards completion, revenue is recognized upon completion of the contract. When total cost estimates exceed revenues, we accrue for the estimated losses immediately. The use of the percentage-of-completion method of accounting requires significant judgment relative to estimating total contract costs, including assumptions relative to the length of time to complete the project, the nature and complexity of the work to be performed, and anticipated changes in salaries and other costs. When adjustments in estimated contract costs are determined, such revisions may have the effect of adjusting, in the current period, the earnings applicable to performance in prior periods.

We generally use the residual method to recognize revenues from agreements that include one or more elements to be delivered at a future date when evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements (e.g., maintenance, consulting and training services) based on vendor-specific objective evidence ("VSOE") is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements (i.e., software license). If evidence of the fair value of one or more of the undelivered services does not exist, all revenues are deferred and recognized when delivery of all of those services has occurred or when fair values can be established. We determine VSOE of the fair value of services revenue based upon our recent pricing for those services when sold separately. VSOE of the fair value of maintenance services may also be determined based on a substantive maintenance renewal clause, if any, within a customer contract. Our current pricing practices are influenced primarily by product type, purchase volume, maintenance term and customer location. We review services revenue sold separately and maintenance renewal rates on a periodic basis and update our VSOE of

fair value for such services to ensure that it reflects our recent pricing experience, when appropriate.

Maintenance services generally include rights to unspecified upgrades (when and if available), telephone and Internet-based support, updates and bug fixes. Maintenance revenue is recognized ratably over the term of the maintenance contract (usually one year) on a straight-line basis and is included in fee and other income on our Condensed Consolidated Statements of Operations.

When consulting qualifies for separate accounting, consulting revenues under time and materials billing arrangements are recognized as the services are performed. Consulting revenues under fixed-price contracts are generally recognized using the percentage-of-completion method. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved. Consulting revenues are classified as fee and other income on our Condensed Consolidated Statements of Operations.

Training services include on-site training, classroom training and computer-based training and assessment. Training revenue is recognized as the related training services are provided and is included in fee and other income on our Condensed Consolidated Statements of Operations.

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Amounts charged for our Procur*e*+ service are recognized as services are rendered. Amounts charged for the Manag*e*+ service are recognized on a straight-line basis over the contractual period for which the services are provided. Fee and other income results from: (1) income from events that occur after the initial sale of a financial asset; (2) remarketing fees; (3) brokerage fees earned for the placement of financing transactions; and (4) interest and other miscellaneous income. These revenues are included in fee and other income in our Condensed Consolidated Statements of Operations.

RESIDUALS — Residual values, representing the estimated value of equipment at the termination of a lease, are recorded in our Condensed Consolidated Financial Statements at the inception of each sales-type or direct financing lease as amounts estimated by management based upon its experience and judgment. Unguaranteed residual values for sales-type and direct financing leases are recorded at their net present value and the unearned income is amortized over the life of the lease using the interest method. The residual values for operating leases are included in the leased equipment's net book value.

We evaluate residual values on an ongoing basis and record any downward adjustment, if required. No upward revision of residual values is made subsequent to lease inception.

RESERVES FOR CREDIT LOSSES — The reserves for credit losses (the "reserve") is maintained at a level believed by management to be adequate to absorb losses inherent in our lease and accounts receivable portfolio. Management's determination of the adequacy of the reserve is based on an evaluation of historical credit loss experience, current economic conditions, volume, growth, the composition of the lease portfolio, and other relevant factors. The reserve is increased by provisions for potential credit losses charged against income. Accounts are either written off or written down when the loss is both probable and determinable, after giving consideration to the customer's financial condition, the value of the underlying collateral and funding status (i.e., discounted on a non-recourse or recourse basis).

CASH AND CASH EQUIVALENTS — Cash and cash equivalents include funds in operating accounts as well as money market funds.

INVENTORIES — Inventories are stated at the lower of cost (weighted average basis) or market.

PROPERTY AND EQUIPMENT — Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from three to ten years.

CAPITALIZATION OF COSTS OF SOFTWARE FOR INTERNAL USE — We have capitalized certain costs for the development of internal use software under the guidelines of SOP 98-1, "*Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*." Approximately $50 thousand and $69 thousand of internal use software were capitalized during the quarters ended June 30, 2006 and 2005, respectively, which is included in the accompanying Condensed Consolidated Balance Sheets as a component of property and equipment.

CAPITALIZATION OF COSTS OF SOFTWARE TO BE MADE AVAILABLE TO CUSTOMERS — In accordance with SFAS No. 86, "*Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*," software development costs are expensed as incurred until technological feasibility has been established. At such time such costs are capitalized until the product is made available for release to customers. For the quarter ended June 30, 2006, costs of $20 thousand were capitalized for software to be made available to customers. There were no such costs capitalized for the quarter ended June 30, 2005.

INTANGIBLE ASSETS — In June 2001, the FASB issued SFAS No. 141, "*Business Combinations*." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations transacted after June 30, 2001.

SFAS No. 141 also specifies criteria that intangible assets acquired in a business combination must be recognized and reported separately from goodwill. In May 2004, we acquired certain assets and liabilities of Manchester Technologies, Inc. The excess of the cost over the fair value of net tangible assets acquired was assigned to identifiable intangible assets and goodwill utilizing the purchase method of accounting. The final determination of the purchase price allocation was based on the fair values of the assets and liabilities assumed, including acquired intangible assets. This determination was made by management through various means, including obtaining a third-party valuation of identifiable intangible assets acquired and an evaluation of the fair value of other assets and liabilities acquired.

Effective January 1, 2002, we adopted SFAS No. 142, "*Goodwill and Other Intangible Assets*," which eliminates amortization of goodwill and intangible assets that have indefinite useful lives and requires annual tests of impairment of those assets. SFAS No. 142 also provides specific guidance about how to determine and measure goodwill and intangible asset impairments, and requires additional disclosures of information about goodwill and other intangible assets.

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Further, SFAS No. 142 requires us to perform an impairment test at least on an annual basis at any time during the fiscal year, provided the test is performed at the same time every year. We perform the impairment test as of September 30th of each year and follow the two-step process prescribed in SFAS No. 142 to test our goodwill for impairment under the goodwill impairment test. The first step is to screen for potential impairment, while the second step measures the amount of the impairment, if any.

IMPAIRMENT OF LONG-LIVED ASSETS — We review long-lived assets, including property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and the carrying value of the asset.

FAIR VALUE OF FINANCIAL INSTRUMENTS — The carrying value of our financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable, and other accrued expenses and debt, approximates fair value due to their short maturities.

TREASURY STOCK — We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity.

INCOME TAXES — Deferred income taxes are accounted for in accordance with SFAS No. 109, "*Accounting for Income Taxes*." Under this method, deferred income tax assets and liabilities are determined based on the temporary differences between the financial statement reporting and tax bases of assets and liabilities, using tax rates currently in effect. Future tax benefits, such as net operating loss carryforwards, are recognized to the extent that realization of these benefits is considered to be more likely than not.

ESTIMATES — The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

COMPREHENSIVE INCOME — Comprehensive income consists of net income and foreign currency translation adjustments. Accumulated other comprehensive income increased $97.0 thousand for the three months ended June 30, 2006 and decreased $10.5 thousand for the three months ended June 30, 2005, resulting in total comprehensive income of $2.1 million and $1.3 million, respectively.

EARNINGS PER SHARE — Earnings per share ("EPS") have been calculated in accordance with SFAS No. 128, "*Earnings per Share*." In accordance with SFAS No. 128, basic EPS amounts were calculated based on weighted average shares outstanding of 8,545,744 for the three months ended June 30, 2005 and 8,207,369 for the three months ended June 30, 2006. Diluted EPS amounts were calculated based on weighted average shares outstanding and potentially dilutive common stock equivalents of 9,078,604 for the three months ended June 30, 2005, and 8,723,439 for the three months ended June 30, 2006. Additional shares included in the diluted EPS calculations are attributable to incremental shares issuable upon the assumed exercise of stock options and other common stock equivalents. Both basic and diluted EPS and weighted average shares outstanding for the three months ended June 30, 2005 have been restated for changes in measurement dates resulting from the Audit Committee Investigation (as defined in Note 2, "Restatement of Consolidated Financial Statements").

STOCK-BASED COMPENSATION — In December 2004, the FASB issued SFAS No. 123 (revised 2004), "*Share-Based Payment*," or SFAS No. 123R. SFAS No. 123R replaces SFAS No. 123, "*Accounting for Stock-Based Compensation*," and supersedes APB 25, "*Accounting for Stock Issued to Employees*," and subsequently issued stock option related guidance. This statement focuses primarily on accounting for transactions in which an entity obtains

employee services in share-based payment transactions. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Entities are required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (usually the vesting period). The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models. If an equity award is modified after the grant date, incremental compensation expense will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification.

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On April 1, 2006, we adopted SFAS No. 123R and elected the modified-prospective transition method. Under the modified prospective method, we must recognize compensation expense for all awards subsequent to adopting the standard and for the unvested portion of previously granted awards outstanding upon adoption. We have recognized compensation expense equal to the fair values for the unvested portion of share-based awards at April 1, 2006 over the remaining period of service, as well as compensation expense for those share-based awards granted or modified on or after April 1, 2006 over the vesting period based on the grant-date fair values using the straight-line method. For those awards granted prior to the date of adoption, compensation expense is recognized on an accelerated basis based on the grant-date fair value amount as calculated for pro forma purposes under SFAS No. 123.

RECENT ACCOUNTING PRONOUNCEMENTS —In May 2005, the FASB issued SFAS No. 154, "*Accounting Changes and Error Corrections — A Replacement of APB Opinion No. 20 and FASB Statement No. 3*." SFAS No. 154 requires retrospective application, or the latest practical date, as the preferred method to report a change in accounting principle or correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. While the adoption of SFAS No. 154 did not have a material impact on our Condensed Consolidated Financial Statements, the restatement disclosures included herein comply with the provisions of the standard.

In June 2006, the FASB issued FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109*" ("FIN 48"). The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, "*Accounting for Income Taxes*." Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation is effective for us on April 1, 2007. We are currently evaluating the impact that FIN 48 will have on our financial condition and results of operations.

During September 2006, the SEC released SAB No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*." SAB No. 108 requires a registrant to quantify all misstatements that could be material to financial statement users under both the "rollover" and "iron curtain" approaches. If either approach results in quantifying a misstatement that is material, the registrant must adjust its financial statements. SAB No. 108 is applicable for our fiscal year 2007. We are currently evaluating the impact that SAB No. 108 will have on our financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 is effective for our fiscal year 2009. We are currently evaluating the impact that SFAS No. 157 will have on our financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115*." SFAS No. 159 gives companies an opportunity to use fair value measurements in financial reporting and permits entities to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that SFAS No. 159 will have on our financial condition and results of operations.

2. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

As a result of the errors discussed below, we have restated our Condensed Consolidated Statements of Operations and Cash Flows, including related disclosures, for the three months ended June 30, 2005.

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Restatement for Historical Stock Option Grants

Restated Accounting for Historical Stock Option Grants

In response to a letter received by our Chief Executive Officer ("CEO"), the Audit Committee, with the assistance of outside legal counsel and forensic accountants, commenced an investigation ("Audit Committee Investigation" or "Investigation") into our historical practices related to stock options, including a review of option grant measurement dates. Prior to April 1, 2006, we accounted for all of our employee and director-based compensation awards under APB 25 and provided the required disclosures in accordance with SFAS No. 123.

In connection with the Audit Committee Investigation, we performed a review of stock option grants recorded for financial reporting purposes. Based on the individual facts and circumstances, we concluded that the exercise price for a number of option grants from our initial public offering ("IPO") in 1996 through August 10, 2006 were below the fair market value of our common stock on the revised measurement date of the grant. This resulted from certain option grant dates having been established prior to the completion of all the final granting actions necessary for those grants. In some cases, the exercise price and date of the grant was determined with hindsight to provide a more favorable exercise price for such grants at quarterly or monthly low stock prices. The grants in question included grants made to newly hired employees, annual director grants, grants made to employees in connection with an acquisition, and discretionary grants made to officers, non-employee and employee directors, and rank and file employees. Applying the revised measurement dates to the impacted stock option grants resulted in a stock-based compensation charge if the fair market value of our common stock as of the revised measurement date exceeded the exercise price of the option grant, in accordance with APB 25.

Based on the facts and circumstances, we concluded that we (1) used incorrect measurement dates for the accounting of certain stock options, (2) had not properly accounted for certain modifications of stock options, and (3) had incorrectly accounted for certain stock options that required the application of the variable accounting method.

We determined revised measurement dates for those option grants with incorrect measurement dates and recorded stock-based compensation expense to the extent that the fair market value of our stock on the revised measurement date exceeded the exercise price of the stock option, in accordance with APB 25 and related FASB interpretations. Additionally, we restated both basic and diluted weighted average shares outstanding for changes in measurement dates resulting from the Investigation. The combination of recording stock-based compensation expense and restating our weighted average shares outstanding has resulted in restated basic and diluted EPS.

We also determined that we should have recorded stock-based compensation expense associated with the modification of certain stock option grants which resulted in the application of variable accounting under FASB Interpretation No. 44, "*Accounting for Certain Transactions Involving Stock Compensation*" ("FIN 44"). The modified grants included certain grants made to newly hired employees, annual director grants, grants made to employees in connection with an acquisition, and discretionary grants made to officers, employee directors, and rank and file employees. For these grants, documentation exists that supports the completion of all the final granting actions necessary for an original grant and measurement date. However, certain of the terms of the awards were subsequently modified.

Income and Payroll Tax Related Matters

In certain instances where a revised measurement date was applied to those stock options classified as incentive stock options ("ISO"), in accordance with United States tax rules, it had the effect of disqualifying the ISO tax treatment of those stock options, causing those stock options to be recharacterized as non-qualified options. For purposes of assessing the tax impact of the accounting change, we concluded that the grant date for tax purposes is the same as the measurement date for financial reporting purposes. The recharacterization of the ISOs to non-qualified status resulted

in a failure to withhold certain employee payroll taxes and consequently we have recorded an adjustment to salaries and benefits, along with an adjustment to interest and financing costs for penalties and interest, based on the period of exercise. In subsequent periods in which the liabilities were legally extinguished due to statutes of limitations, the payroll taxes, interest and penalties were reversed, and recognized as a reduction in the related functional expense category in our Condensed Consolidated Statements of Operations.

Summary of the Restatement — Other Items

In addition to the stock option errors described above, we have also restated our Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2005 for the following reasons:

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We use floor planning agreements for dealer financing of products purchased from distributors and resold to end-users. Historically, we classified the cash flows from our floor plan financing agreements in operating activities in our Condensed Consolidated Statements of Cash Flows. We previously treated the floor plan facility as an outsourced accounts payable function, and, therefore, considered the payments made by our floor plan facility as cash paid to suppliers under Financial Accounting Standards No. 95, "*Statement of Cash Flows*."

We have now determined that when an unaffiliated finance company remits payments to our suppliers on our behalf, we should show this transaction as a financing cash inflow and an operating cash outflow. In addition, when we repay the financing company, we should present this transaction as a financing cash outflow. As a result, we have restated the accompanying Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2005 to correct this error.

Also, payments made by our lessees directly to third-party, non-recourse lenders were previously reported on our Condensed Consolidated Statements of Cash Flows as repayments of non-recourse debt in the financing section and a decrease in our investment in leases and leased equipment—net in the operating section. As these payments were not received or disbursed by us, management determined that these amounts should not be shown as cash used in financing activities and cash provided by operating activities on our Condensed Consolidated Statements of Cash Flows. Rather, these payments are now disclosed as a non-cash financing activity on our Condensed Consolidated Statements of Cash Flows.

In addition, certain corrections were made for errors noted on our Condensed Consolidated Statements of Cash Flows between the line items reserve for credit losses and changes in accounts receivable, both of which are in the operating section.

Reclassifications

We have also reclassified certain items for our June 30, 2005 Condensed Consolidated Statement of Cash Flows to conform to our presentation on our June 30, 2006 Condensed Consolidated Financial Statements. These reclassifications include: (1) certain liabilities that had been included in accounts payable—trade have been reclassified to accrued expenses and other liabilities; and (2) certain personal property taxes have been reclassified to eliminate from investment in leases and leased equipment—net and accounts payable—equipment.

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Impact of the Restatement

The following tables present the effects of the restatement and reclassifications on our previously issued Condensed Consolidated Statements of Operations and the Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2005 (in thousands, except per share data):

Unaudited Condensed Consolidated Statements of Operations Three Months Ended June 30, 2005	As Previously Reported	Adjustments Stock-based Compensation and Tax Impact	As Restated
Revenues:			
Sales of product and services	$ 134,870	$ -	$ 134,870
Lease revenues	11,294	-	11,294
Fee and other income	3,640	-	3,640
Total Revenues	149,804	-	149,804
Costs and Expenses:			
Cost of sales, product and services	122,107	-	122,107
Direct lease costs	3,777	-	3,777
Professional and other fees	947	-	947
Salaries and benefits	14,794	(5)	14,789
General and administrative expenses	4,461	-	4,461
Interest and financing costs	1,538	-	1,538
Total Costs and Expenses	147,624	(5)	147,619
Earnings Before Provision for Income Taxes	2,180	5	2,185
Provision for income taxes	883	2	885
Net Earnings	$ 1,297	$ 3	$ 1,300
Net Earnings Per Share:			
Basic	$ 0.15	$ -	$ 0.15
Diluted	$ 0.14	$ -	$ 0.14
Shares Used in Computing Net Earnings Per Share:			
Basic	8,545,744	-	8,545,744
Diluted	9,042,438	36,166	9,078,604

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Unaudited Condensed Consolidated Statements of Cash Flows

	As Previously Reported	Adjustments: Stock-Based Compensation	Floor Plan	Lessee Payments to Lenders	Other	As Restated
Three Months Ended June 30, 2005						
Cash Flows From Operating Activities:						
Net earnings	$ 1,297	3	-	-	-	$ 1,300
Depreciation and amortization	3,989	-	-	-	-	3,989
Reserves for credit losses	(40)	-	-	-	230	190
Tax benefit of stock options exercised	5	-	-	-	-	5
Impact of stock-based compensation	-	(3)	-	-	-	(3)
Deferred taxes	(371)	-	-	-	-	(371)
Payments from lessees directly to lenders— operating leases	(1,425)	-	-	252	-	(1,173)
Loss on disposal of property and equipment	6	-	-	-	-	6
Gain on disposal of operating lease equipment	(116)	-	-	-	-	(116)
Changes in accounts receivable—net	(12,839)	-	-	-	(230)	(13,069)
Changes in notes receivable	(231)	-	-	-	-	(231)
Changes in inventories	(849)	-	-	-	-	(849)
Changes in investment in leases and leased equipment—net	1,751	-	-	(4,884)	6	(3,127)
Changes in other assets	321	-	-	-	-	321
Changes in accounts payable—equipment	4,113					