

SECURITIES AND EXCHANGE COMMISSION

FORM 10QSB

Optional form for quarterly and transition reports of small business issuers under section 13 or 15(d)

Filing Date: **1999-09-10** | Period of Report: **1999-03-31**
SEC Accession No. **0000923141-99-000003**

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FILER

CSI COMPUTER SPECIALISTS INC

CIK: **923141** | IRS No.: **521599610** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **10QSB** | Act: **34** | File No.: **000-26464** | Film No.: **99709225**
SIC: **7370** Computer programming, data processing, etc.

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SUITE 430
ROCKVILLE MD 20850

Business Address
904 WIND RIVER LANE
SUITE 100
GAITHERSBURG MD 20878
3019218860

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended March 31, 1999

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: 0-26464

CSI Computer Specialists, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

52-1599610
(I.R.S. Employer
Identification No.)

904 Wind River Lane Suite 100
Gaithersburg, Maryland
(Address of principal executive offices)

20878
(Zip code)

301-921-8860

(Registrant's telephone number including area code)

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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No _____

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

Title Outstanding
Common Stock, par value \$0.001 per share 3,715,888 shares at August 31, 1999

Transitional Small Business Disclosure Format (check one);
Yes ___ No X

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CSI COMPUTER SPECIALISTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 1999	December 31, 1998
	-----	-----
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 170,036	\$ 49,035
Accounts receivable	3,867,539	3,647,632
Net investment in sales-type leases - current	118,502	118,502
Inventory for resale	413,880	513,179
Parts and supplies	933,204	926,044
Prepaid income taxes	343,662	343,662
Prepaid expenses	94,047	104,427
	-----	-----
Total current assets	5,940,870	5,702,481
	-----	-----
PROPERTY AND EQUIPMENT - AT COST	1,840,868	1,836,732
Less accumulated depreciation	1,194,318	1,131,490
	-----	-----
	646,550	705,242
	-----	-----
OTHER ASSETS		
Goodwill (Net of accumulated amortization)	491,410	500,890
Net investment in sales-type leases - non-current	25,928	72,360
Deferred tax asset	128,600	145,000
Cash - restricted	-	443,846
Other assets	96,683	96,403
	-----	-----
	742,621	1,258,499
	-----	-----
	\$ 7,330,041	\$ 7,666,222
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable	3,519,638	2,713,031
Accrued expenses	202,740	262,246
Revolving line of credit	1,643,656	2,308,656
Current maturities of long term debt	3,024	7,700
Deferred income taxes payable	-	-
	-----	-----
Total current liabilities	5,369,058	5,291,633
	-----	-----
LONG-TERM DEBT, less current maturities	4,474	4,474
	-----	-----
COMMITMENTS		
REDEEMABLE COMMON STOCK - 313,726 SHARES	-	400,000
STOCKHOLDERS' EQUITY		
Preferred stock - authorized, 10,000,000 shares of \$.001 par value	\$ -	\$ -
Common stock - authorized, 25,000,000 shares of \$.001 par value; issued and outstanding, 3,715,888 shares	3,716	3,716
Paid-in capital	5,073,593	5,117,439
Retained earnings	(3,120,800)	(3,151,040)
	-----	-----
Total stockholders' equity	1,956,509	1,970,115
	-----	-----
	\$ 7,330,041	\$ 7,666,222
	=====	=====

See accompanying notes to condensed financial statements.

CSI COMPUTER SPECIALISTS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended	
	March 31,	
	1999	1998
	-----	-----
Revenues		
Maintenance services	\$ 3,401,849	\$ 3,076,332
Parts and equipment sales	4,304,362	3,515,575

	-----	-----
	\$ 7,706,211	\$ 6,591,907
Costs and expenses		
Cost of maintenance services	2,458,735	2,214,180
Cost of parts and equipment sales	3,851,251	3,050,760
Selling, general and administrative	1,326,073	1,543,699
	-----	-----
	7,636,059	6,808,639
	-----	-----
Operating profit	70,152	(216,732)
Other deductions		
Net interest income (expense)	(23,512)	(12,753)
	-----	-----
Earnings before income taxes	46,640	(229,485)
Income taxes		
Currently payable	16,400	(105,796)
Deferred	-	24,788
	-----	-----
	16,400	(81,008)
NET EARNINGS	\$ 30,240	\$ (148,477)
	=====	=====
Per share amounts		
Net earnings per share	\$ 0.01	\$ (0.04)
	=====	=====
Weighted average number of shares outstanding	3,820,497	4,029,212
	=====	=====

See accompanying notes to condensed financial statements

CSI COMPUTER SPECIALISTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended	
	March 31,	
	1999	1998
	-----	-----
Net cash flows from operating activities	\$ 794,813	\$ (464,556)
	-----	-----
Cash flows used in investing activities		
(Increase) decrease in restricted cash	443,846	-
Acquisition of property and equipment	(4,136)	(82,610)
	-----	-----
Net cash used in investing activities	439,710	(82,610)
	-----	-----
Cash flows used in financing activities		
Payments on long-term debts	(4,676)	(2,502)
Acquisition of treasury stock	(443,846)	(110,000)
Increase (Decrease) in revolving line of credit	(665,000)	507,000
	-----	-----
Net cash used in financing activities	(1,113,522)	394,498
	-----	-----
NET INCREASE (DECREASE) IN CASH	121,001	(152,668)
Cash at beginning of period	49,035	193,056
	-----	-----
Cash at end of period	\$ 170,036	\$ 40,388
	=====	=====

Supplemental disclosure of cash flow information

Cash paid through March 31, 1999 and 1998 for:		
Interest	21,419	28,465
Income taxes	-	-

See accompanying notes to condensed financial statements

CSI COMPUTER SPECIALISTS, INC. AND SUBSIDIARY

NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

The condensed financial statements at March 31, 1999 and for the three month periods ended March 31, 1999 and 1998 are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The condensed financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, and therefore omit certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles. The Company believes that the disclosures contained in the condensed financial statements are adequate to make the information presented therein not misleading. The financial statements should be read in conjunction with the financial statements and notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-KSB for the fiscal year ending December 31, 1998.

The results of operations for the three months ended March 31, 1999 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 31, 1999.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Certain statements made in this Quarterly Report on Form 10-QSB are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, the Company's actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference include, but are not limited to, the timing of revenues, rapid technological change, the demand for services for computer hardware systems and computer equipment, the timing and amount of capital expenditures and other risks

detailed herein.

GENERAL

The Company provides a full range of computer hardware services, including sales and maintenance of mainframe and mid-range computer equipment and parts, network design and installation, computer upgrades, and installation and de-installation of equipment. These services are provided to commercial customers, agencies of federal, state and local governments, universities, associations and hospitals primarily in the Mid-Atlantic region of the United States, including West Virginia, Virginia, Maryland, the District of Columbia, New Jersey, New York, Connecticut and Pennsylvania, and also in Illinois and California.

The Company's principal business is providing computer maintenance and repair services, which are provided under both fixed fee and time and materials arrangements. Under the fixed fee arrangement, which is the primary method of service, a customer pays a fixed monthly fee for the term of the agreement, generally one to two years, for which the Company provides the parts and labor for both scheduled preventative maintenance and emergency repairs. The Company records the revenue from fixed fee contracts ratably over the term of the contract, while the costs the Company incurs to provide the maintenance and emergency repairs are charged to expense as incurred. Accordingly, the profitability of the Company's maintenance and repair services can and will be affected by period to period fluctuations in the number and severity of the emergency repairs required by its customers, which the Company cannot predict or control. Additionally, in certain circumstances the Company will choose to provide the contracted-for services by subcontracting with others, particularly when the equipment covered by the agreement cannot be serviced in a cost effective manner, is difficult to repair or replace, or requires unique engineering expertise that is not applicable to equipment utilized by a significant number of Company's other customers. The Company obtains such subcontracting services through short-term agreements, and its profit margin will generally be lower than if the work were not subcontracted. Accordingly, operating results may fluctuate from period to period as a result of changes in the level and nature of subcontracted services.

The sale of computer equipment expanded rapidly in 1997 and leveled out in 1998, but, due to increased competition, decreases in profit margins and changes in purchasers' buying patterns, revenues therefrom are likely to show some fluctuation from period to period. Cross marketing among the Company's subsidiaries and divisions should decrease these fluctuations over time. Mainframe equipment sales are entered into more commonly to secure contracts for the maintenance thereof than for the profit on the equipment sale itself, and the margins on these sales of equipment are subject to market conditions. Consequently, operating profits as a percentage of gross sales are subject to fluctuation due to the volume and the makeup of equipment sales. Other areas of expansion are in the areas of servicing laser printers, providing help desk support services, and expanding the Company's technical capabilities to maintain the more current mainframe technology.

RESULTS OF OPERATIONS

The Company's first quarter revenues of \$7,706,211 was an increase of 17 % over the first quarter revenues of the prior year of \$6,591,907. The increase in net revenues resulted from sales growth in both maintenance services and equipment sales. Maintenance revenues for the first quarter of 1999 increased approximately 11% over the first quarter of 1998, primarily from expansion of the Company's book of business. Equipment sales for the first quarter of 1999 increased 22% over the same period of 1998. Management intends to increase marketing efforts to promote continued growth in both of these areas, and anticipates that the marketing staffs of the Company and each of its subsidiaries will be able to cross promote products and services. Maintenance revenues accounted for approximately 44% and 47%, respectively, of the Company's consolidated revenues for the first quarters of 1999 and 1998.

The Company's cost of sales as a percentage of revenues was 82% in the first quarter of 1999 compared to 80% for the same period in 1998. A small decrease in the costs of maintenance services as a percentage of maintenance service income was offset by a decrease in the profit margins on equipment sales. The decreased costs of maintenance services resulted primarily from a current decrease in the need for emergency replacement parts and decreased reliance on subcontracted services. Subcontractor costs could continue to decrease as the necessary expertise is further developed in-house to service newer technology; however, as the Company enters into contracts on even more recent technology, the services of subcontractors may still be required. Gross margins on equipment sales dropped primarily due to the mix of equipment sold. As personal computer and mid-range network computer sales increase, the normally lower margin on these sales will offset the higher margins on mainframe computer sales, and decrease the overall profit percentages.

Selling, general and administrative expenses as a percentage of net revenues were 17% and 24% respectively, for the first quarter of 1999 and 1998. The decrease in the percentage is primarily due efforts by management to eliminate duplication of administrative functions by the Company and each of its subsidiaries. The Company expects short-term fluctuations in this percentage in the future as it adds to its technical support, marketing staff and other administrative personnel in order to expand its customer base and increase equipment sales. The selling, general and administrative expenses decreased 14% to \$1,326,073 for the first three months of 1999 compared to \$1,543,699 for the same period of 1998.

The Company showed operating profit of \$70,152 for the first quarter of 1999 compared to an operating loss of \$216,732 for the first quarter of 1998. The increase in profitability was primarily attributable to the overall decrease in selling, general and administrative costs, achieved as a result of consolidating administrative functions to eliminate duplication of services.

Net interest expense increased to \$23,512 for the first three months of 1999 compared to \$12,753 for the same period of 1998, primarily as a result of the increased use of the bank revolving line of credit to provide working

capital, especially after last year's losses. The Company expects that net interest expense will continue to increase until the Company starts generating additional cash from operations on a consistent basis.

Net income increased from a loss of \$148,477 for the first quarter of 1998 to a profit of \$30,240 for the same period of 1999, again primarily as a result of the decrease in the selling, general and administrative expenses, partially offset by an increase in costs of sales. The Company expects that its cross marketing efforts, as well as cost-cutting efforts to further reduce duplication of administrative expenses, will improve its performance in the future.

LIQUIDITY AND CAPITAL RESOURCES

Working capital was \$571,812 at March 31, 1999 compared to \$410,848 at December 31, 1998. Cash flows provided by operations for the first quarter of 1999 totaled \$794,813, resulting primarily from operations and increased due to an increase in accounts payable. The ratio of current assets to current liabilities held steady at 1.1:1 at March 31, 1999 and at December 31, 1998.

The Company has a \$2.5 million revolving line of credit with Crestar Bank which expired in October, 1998 and continued under a forbearance agreement until May, 1999, at which time the financial operations of the Company could be reevaluated by the bank. The bank has since rejected extending this line for another year, but has extended the line until August 31, 1999, or until the Company has acquired alternative financing. At March, 31, 1999, the balance owed on this line of credit was \$1,643,656.

The Company's principal commitments at March 31, 1999 consisted of obligations under operating leases for facilities.

The Company believes that its existing cash, as supplemented by expected cash flow from operations and existing credit facility, is sufficient to satisfy its currently anticipated working capital needs. Management acknowledges that failure to renew the line of credit with Crestar Bank or find alternative financing could significantly affect the ability of the Company to meet short-term working capital requirements, and is vigorously exploring other options to obtain the required financing.

Year 2000 Issues

Year 2000 Compliance means the ability of software and other processing capabilities to interpret and manipulate correctly all data that includes the Year 2000 and dates thereafter. The Company principally sells and services computer hardware and, to date, has not been confronted with Year 2000 issues in providing such services. Further, the Company has surveyed all of its internal business systems and software applications and determined that they are Year

2000 compliant. Consequently, the Company does not expect its business to be adversely affected in any material respect because of Year 2000 issues.

Part II. Other Information

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit

Number

Title of Exhibit

3.4 ** Agreement and Plan of Merger between CSI Computer Specialists, Inc. (Delaware) and Computer Specialists, Inc. (Maryland) filed with the Securities and Exchange Commission as an exhibit to the Registration Statement filed on July 19, 1995 (the "Registration Statement") and incorporated herein by reference.

3.5 ** Bylaws of CSI Computer Specialists, Inc. (Registrant) filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.

3.7 ** Certificate of Amendment of Certificate of Incorporation of CSI Computer

Specialists, Inc. (Delaware) as filed with the Secretary of State of the State of Delaware on August 5, 1994, filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.

- 4.1 ** Specimen Common Stock Certificate, filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 4.2 ** Specimen Warrant Certificate, filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 4.3 ** Form of Underwriter's Unit Purchase Option, filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 4.4 ** Form of Warrant Agreement by and among the Company, Biltmore Securities, Inc. and Continental Stock Transfer & Trust Company, amended from that which was filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.1 ** Form of Maintenance Agreement filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.2 ** Form of Subcontracting (Microcomputer Service) Agreement filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.3 ** Form of Equipment Sales Agreement filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.6 ** Employment Agreement, dated April 7, 1994, by and between the Company and Donald C. Weymer filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.7 ** Employment Agreement, dated April 7, 1994, by and between the Company and William Pershin filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.8 ** CSI Computer Specialists, Inc. 1994 Stock Option Plan filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.
- 10.9 ** Plan for Incentive Compensation of Donald C. Weymer filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.

10.10** Revolving Commercial Loan Note, dated May 27, 1994, in favor of Citizens Bank of Maryland in the principal amount of \$750,000 filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.

10.11** Security Agreement, dated May 27, 1994, in favor of Citizens Bank of Maryland and corresponding Financing Statement filed with the Securities and Exchange Commission as an exhibit to the Registration Statement and incorporated herein by reference.

11. Computation of Net Income per Common Share (included in the Financial Statements in Item 7).

21. Subsidiaries of the Company

27. Financial Data Schedule.

** Previously filed as noted.

(b) Reports on Form 8-K

None.

SIGNATURES

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

CSI Computer Specialists, Inc.

August 31, 1999

By: /s/ William F. Pershin

Date

William F. Pershin
Chief Accounting Officer

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