
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

(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, 2006

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 0-23827

PC CONNECTION, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

**730 MILFORD ROAD,
MERRIMACK, NEW HAMPSHIRE**
(Address of principal executive offices)

02-0513618
(I.R.S. Employer
Identification No.)

03054
(Zip Code)

(603) 683-2000
Registrant's telephone number, including area code

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 ☒ NO ☐

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 ☐

Accelerated filer ☐

Non-accelerated filer ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

The number of shares outstanding of the issuer's Common Stock, \$.01 par value, as of April 30, 2006 was 25,259,261.

PC CONNECTION, INC. AND SUBSIDIARIES
FORM 10-Q

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
PC Connection, Inc.
Merrimack, New Hampshire

We have reviewed the accompanying condensed consolidated balance sheet of PC Connection, Inc. and subsidiaries (the “Company”) as of March 31, 2006, and the related condensed consolidated statements of income and of cash flows for the three-month periods ended March 31, 2006 and 2005, and the condensed consolidated statement of changes in stockholders’ equity for the three-month period ended March 31, 2006. These interim financial statements are the responsibility of the Company’s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and of making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of PC Connection, Inc. and subsidiaries as of December 31, 2005, and the related consolidated statements of income, stockholders’ equity, and cash flows for the year then ended (not presented herein); and in our report dated March 30, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

As discussed in Note 1 to the condensed consolidated financial statements, effective January 1, 2006 the Company changed its method of accounting for stock-based compensation to conform to Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*.

DELOITTE & TOUCHE LLP
Boston, Massachusetts
May 12, 2006

PC CONNECTION, INC. AND SUBSIDIARIES
PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands)

	March 31, 2006 <i>(unaudited)</i>	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 8,202	\$ 9,770
Accounts receivable, net	150,957	162,525
Inventories—merchandise	61,085	75,374
Deferred income taxes	3,318	3,769
Income taxes receivable	1,545	1,742
Prepaid expenses and other current assets	4,911	4,219
Total current assets	230,018	257,399
Property and equipment, net	17,761	17,700
Goodwill, net	56,867	56,820
Other intangibles, net	5,166	5,427
Other assets	360	359
Total assets	\$310,172	\$ 337,705
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current maturities of capital lease obligations:		
To affiliate	\$ 427	\$ 416
To third party	417	412
Note payable—bank	15,149	19,975
Accounts payable	89,635	114,413
Accrued expenses and other liabilities	21,363	21,290
Total current liabilities	126,991	156,506
Capital lease obligation, less current maturities:		
To affiliate	5,189	5,299
To third party	289	396
Deferred income taxes	4,458	4,105
Total liabilities	136,927	166,306
Stockholders' Equity:		
Common stock	256	256
Additional paid-in capital	78,024	77,884
Retained earnings	97,251	95,545
Treasury stock at cost	(2,286)	(2,286)
Total stockholders' equity	173,245	171,399
Total liabilities and stockholders' equity	\$310,172	\$ 337,705

See notes to condensed consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES
PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(amounts in thousands, except per share data)

	Three Months Ended March 31,	
	2006	2005
Net sales	<u>\$380,478</u>	<u>\$323,851</u>
Cost of sales	<u>334,060</u>	<u>286,517</u>
Gross profit	46,418	37,334
Selling, general, and administrative expenses	<u>41,955</u>	<u>35,416</u>
Special charges	<u>891</u>	<u>—</u>
Income from operations	3,572	1,918
Interest expense	<u>(644)</u>	<u>(272)</u>
Other, net	<u>11</u>	<u>(25)</u>
Income before taxes	2,939	1,621
Income tax provision	<u>(1,233)</u>	<u>(673)</u>
Net income	\$ 1,706	\$ 948
Weighted average common shares outstanding:		
Basic	<u>25,259</u>	<u>25,127</u>
Diluted	<u>25,299</u>	<u>25,362</u>
Earnings per common share:		
Basic	<u>\$.07</u>	<u>\$.04</u>
Diluted	<u>\$.07</u>	<u>\$.04</u>

See notes to condensed consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES
PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
Three Months Ended March 31, 2006
(Unaudited)
(amounts in thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Shares		Total
	Shares	Amount			Shares	Amount	
Balance—December 31, 2005	25,622	\$ 256	\$ 77,884	\$ 95,545	(362)	\$ (2,286)	\$ 171,399
Stock compensation expense	—	—	140	—	—	—	140
Net income	—	—	—	1,706	—	—	1,706
Balance—March 31, 2006	<u>25,622</u>	<u>\$ 256</u>	<u>\$ 78,024</u>	<u>\$ 97,251</u>	<u>(362)</u>	<u>\$ (2,286)</u>	<u>\$ 173,245</u>

See notes to condensed consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES
PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(amounts in thousands)

	Three Months Ended March 31,	
	2006	2005
Cash Flows from Operating Activities:		
Net income	\$ 1,706	\$ 948
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,698	1,714
Provision for doubtful accounts	894	878
Deferred income taxes	804	353
Loss on disposal of fixed assets	14	41
Stock compensation expense	140	—
Changes in assets and liabilities:		
Accounts receivable	10,674	774
Inventories	14,289	5,879
Prepaid expenses and other current assets	(495)	(839)
Other non-current assets	(1)	(34)
Accounts payable	(24,778)	(4,685)
Income tax benefits from exercise of stock options	—	49
Accrued expenses and other liabilities	73	(1,407)
Net cash provided by operating activities	<u>5,018</u>	<u>3,671</u>
Cash Flows from Investing Activities:		
Purchases of property and equipment	(1,579)	(773)
Proceeds from sale of property and equipment	20	13
Net cash used for investing activities	<u>(1,559)</u>	<u>(760)</u>
Cash Flows from Financing Activities:		
Proceeds from short-term borrowings	125,911	50,560
Repayment of short-term borrowings	(130,737)	(53,947)
Repayment of capital lease obligations	(201)	(218)
Exercise of stock options	—	201
Net cash used for financing activities	<u>(5,027)</u>	<u>(3,404)</u>
Decrease in cash and cash equivalents	(1,568)	(493)
Cash and cash equivalents, beginning of period	9,770	6,829
Cash and cash equivalents, end of period	<u>\$ 8,202</u>	<u>\$ 6,336</u>

See notes to condensed consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES
PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(amounts in thousands, except per share data)

Note 1—Basis of Presentation

The accompanying condensed consolidated financial statements of PC Connection, Inc. and its subsidiaries (“PC Connection,” “we,” “us,” or “our”) have been prepared in accordance with accounting principles generally accepted in the United States of America. Such principles were applied on a basis consistent with those of the financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission. The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements contained in our Annual Report on Form 10-K. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the results of operations for the interim periods reported and of the Company’s financial condition as of the date of the interim balance sheet. The operating results for the three months ended March 31, 2006 may not be indicative of the results expected for any succeeding quarter or the entire year ending December 31, 2006.

Revenue Recognition

Revenue on product sales is recognized at the point in time when persuasive evidence of an arrangement exists, the price is fixed and final, delivery has occurred, and there is a reasonable assurance of collection of the sales proceeds. We generally obtain oral or written purchase authorizations from our customers for a specified amount of product at a specified price. Because we either (i) have a general practice of covering customer losses while products are in-transit despite title transferring at the point of shipment or (ii) have FOB–destination specifically set out in our arrangements with federal agencies and certain commercial customers, delivery is deemed to have occurred at the point in time when the product is received by the customer.

We provide our customers with a limited thirty-day right of return generally limited to defective merchandise. Revenue is recognized at delivery and a reserve for sales returns is recorded. We have demonstrated the ability to make reasonable and reliable estimates of product returns in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 48, “Revenue Recognition When Right of Return Exists,” based on significant historical experience.

All amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenues earned for the goods provided, and these amounts have been classified as “net sales.” Costs related to such shipping and handling billings are classified as “cost of sales.”

Revenue for third party service contracts is recorded on a net sales recognition basis because we do not assume the risks and rewards of ownership in these transactions. For such contracts, we evaluate whether the sales of such services should be recorded as gross sales or net sales as required under the guidelines described in Staff Accounting Bulletin No. 104, “Revenue Recognition” and Emerging Issues Task Force (“EITF”) Issue No. 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent.” Under gross sales recognition, we are the primary obligor, and the entire selling price is recorded in sales with our cost to the third party service provider recorded as a cost of sales. Under net sales recognition, we are not the primary obligor, and the cost to the third party service provider is recorded as a reduction to sales, with no cost of goods sold, thus leaving the entire gross profit as the reported net sale for the transaction.

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(Unaudited)
(amounts in thousands, except per share data)

Similarly, we recognize revenue from agency sales transactions on a net sales basis. In agency sales transactions, we facilitate product sales by equipment manufacturers directly to our customers and receive agency fees for such transactions. We do not take title to the products in these transactions; title is passed directly from the supplier to our customer.

Cost of Sales and Certain Other Costs

Cost of sales includes the invoice cost of the product, packaging, inbound and outbound freight, and provisions for inventory obsolescence, adjusted for discounts, rebates, and other vendor consideration adjustments, including those pursuant to EITF Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor” (“EITF 02-16”). Direct operating expenses relating to our purchasing function and receiving, inspection, internal transfer, warehousing, packing and shipping, and other expenses of our distribution center are included in selling, general, and administrative expenses. Total direct operating expenses relating to these functions included in selling, general, and administrative expenses for the three-month periods ended March 31, 2006 and 2005 are shown below:

Three Months Ended March 31,	
2006	2005
\$2,286	\$ 2,045

Advertising Costs and Reimbursements

Costs of producing and distributing catalogs are deferred and charged to expense over the period that each catalog remains the most current selling vehicle (generally one to two months) which approximates the period of probable benefits. Other advertising costs are expensed as incurred. Vendors have the ability to place advertisements in the catalogs for which we receive advertising allowances. These vendor allowances, to the extent that they represent specific reimbursements of such specific, incremental, and identifiable costs, are offset against selling, general, and administrative expense. Advertising reimbursements that cannot be associated with a specific program funded by an individual vendor or that exceed the fair value of advertising expense associated with that program are classified as offsets to cost of sales or inventory in accordance with EITF Issue No. 02-16.

Advertising costs charged to expense were \$4,059 and \$5,697 for the three months ended March 31, 2006 and 2005, respectively. Gross advertising reimbursements received from vendors were \$7,220 and \$6,618 for the three months ended March 31, 2006 and 2005, respectively. We classified \$5,330 and \$3,148 of these reimbursements as offsets to cost of sales or inventory for the three months ended March 31, 2006 and 2005, respectively.

Goodwill and Other Intangible Assets

Intangible assets subject to amortization at March 31, 2006 consisted of customer lists of \$3,560 and a licensing agreement of \$416 (net of accumulated amortization of \$1,660 and \$59, respectively). Intangible assets subject to amortization at December 31, 2005 consisted of customer lists of \$3,815 and a licensing agreement of \$422 (net of accumulated amortization of \$1,405 and \$53, respectively). For the three-month periods ended March 31, 2006 and 2005, we recorded amortization expense of \$261 and \$88, respectively.

	March 31, 2006	December 31, 2005
Goodwill	\$ 56,867	\$ 56,820
Trademarks	1,190	1,190

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)
(amounts in thousands, except per share data)

A rollforward of goodwill is as follows:

Balance, December 31, 2005	\$56,820
Adjustment to property and equipment, net	47
Balance, March 31, 2006	<u>\$56,867</u>

We have designated January 1 of each year as the date we perform our annual impairment tests relative to goodwill. We completed the impairment review on January 1, 2006 and determined that our goodwill and trademarks were not impaired.

The estimated amortization expense for each of the five succeeding years and thereafter is as follows:

<u>For the Year Ended December 31,</u>	
2006	\$ 804(A)
2007	1,071
2008	1,071
2009	942
2010	88
2011 and thereafter	—

(A) Represents estimated amortization expense for the nine months ending December 31, 2006.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the amounts reported in the accompanying condensed consolidated financial statements. Actual results could differ from those estimates.

Stock-Based Compensation

Effective January 1, 2006, we adopted SFAS 123(R), "Share-Based Payment," ("SFAS 123(R)") using the modified prospective transition method. This Statement replaced SFAS No. 123 "Accounting for Stock-Based Compensation," ("SFAS 123") and superseded Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25"). SFAS 123(R) requires a company to measure the grant date fair value of equity awards given to employees in exchange for services and recognize that cost over the period that such services are performed. In addition, SFAS 123(R) requires that the excess tax benefits related to stock compensation be reported as a cash inflow from financing activities rather than as a reduction of taxes paid in cash from operations.

We did not grant any options in the three months ended March 31, 2006. We recorded however compensation cost in the first quarter of 2006 for the unvested portion of outstanding stock options granted prior to January 1, 2006 as required by SFAS 123(R). The total expense recognized in the financial statements in the

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION

Item 1—Financial Statements

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

(amounts in thousands, except per share data)

first quarter of 2006 was \$140 pre-tax, \$125 after-tax, or less than \$0.01 per basic and diluted share. See Note 4 for additional information on our stock-based compensation plans and related compensation expense.

Prior to our adoption of SFAS 123(R), we used the intrinsic value method prescribed in APB 25 and also followed the disclosure requirements of SFAS 123, as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," which required certain pro forma disclosures as if the fair value method had been followed for accounting for such compensation. The following table presents the pro forma effect on net income as if we had applied the fair value method to measure compensation cost prior to our adoption of SFAS 123(R):

	Three Months Ended March 31, 2005
Net income, as reported	\$ 948
Compensation expense, net of taxes, pro forma	120
Net income, pro forma	828
Basic net income per share, as reported	.04
Basic net income per share, pro forma	.03
Diluted net income per share, as reported	.04
Diluted net income per share, pro forma	.03

We measured the fair value of options on their grant date using the Black-Scholes-Merton option-pricing model. We did not grant any options in the three months ended March 31, 2006. The key weighted-average assumptions we used to apply this pricing model during the three months ended March 31, 2005 were as follows:

	Three Months Ended March 31, 2005
Risk-free interest rates	3.48%
Volatility	75.80%
Expected life of option grants	4 years
Dividend yield	0%

Note 2—Earnings Per Share

Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to options outstanding to purchase common stock, if dilutive.

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(Unaudited)
(amounts in thousands, except per share data)

The following table sets forth the computation of basic and diluted earnings per share:

March 31,	Three Months Ended	
	2006	2005
Numerator:		
Net income	<u>\$ 1,706</u>	<u>\$ 948</u>
Denominator:		
Denominator for basic earnings per share	25,259	25,127
Dilutive effect of employee stock options	<u>40</u>	<u>235</u>
Denominator for diluted earnings per share	<u>25,299</u>	<u>25,362</u>
Earnings per share:		
Basic	<u>\$.07</u>	<u>\$.04</u>
Diluted	<u>\$.07</u>	<u>\$.04</u>

The following unexercised stock options were excluded from the computation of diluted earnings per share for the three months ended March 31, 2006 and 2005 because the exercise prices of these options were generally greater than the average market price of common shares during the respective periods:

March 31,	Three Months Ended	
	2006	2005
Anti-dilutive stock options	<u>1,760</u>	<u>1,242</u>

Note 3—Segment and Related Disclosures

SFAS No. 131, “Disclosures About Segments of an Enterprise and Related Information,” requires that public companies report profits and losses and certain other information on their “reportable operating segments” in their annual and interim financial statements. The internal organization used by our Chief Operating Decision Maker (CODM) to assess performance and allocate resources determines the basis for our reportable operating segments. Our CODM is our Chief Executive Officer.

Our operations are organized under three reportable operating segments—the “SMB” segment, which serves small- and medium-sized businesses, as well as consumers, the “Large Account” segment, which serves medium-to-large corporations, and the “Public Sector” segment, which serves federal, state, and local government organizations and educational institutions.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)
(amounts in thousands, except per share data)

Segment information applicable to our reportable operating segments for the three months ended March 31, 2006 and 2005 is shown below:

	Three Months Ended March 31, 2006				
	SMB Segment	Large Account Segment	Public Sector Segment	Eliminations	Consolidated
Sales to external customers	\$219,121	\$ 108,362	\$ 52,995	\$ —	\$ 380,478
Transfers between segments	53,569	—	—	(53,569)	—
Net Sales	<u>\$272,690</u>	<u>\$ 108,362</u>	<u>\$ 52,995</u>	<u>\$ (53,569)</u>	<u>\$ 380,478</u>
Operating income (loss) before allocations	\$ 16,195	\$ 4,767	\$ 1,137	\$ (18,527)	\$ 3,572
Allocations	14,411	232	3,884	(18,527)	—
Operating income (loss)	1,784	4,535	(2,747)	—	3,572
Interest and other—net	(506)	18	(145)	—	(633)
Income (loss) before taxes	<u>\$ 1,278</u>	<u>\$ 4,553</u>	<u>\$ (2,892)</u>	<u>\$ —</u>	<u>\$ 2,939</u>
<i>Selected Operating Expenses:</i>					
Depreciation and amortization	\$ 1,302	\$ 358	\$ 38	\$ —	\$ 1,698
Special charges	998	9	(116)	—	891
<i>Balance Sheet Data:</i>					
Total assets	\$238,558	\$ 113,455	\$ 55,406	\$ (97,247)	\$ 310,172
Goodwill, net	1,173	48,060	7,634	—	56,867

	Three Months Ended March 31, 2005				
	SMB Segment	Large Account Segment	Public Sector Segment	Eliminations	Consolidated
Sales to external customers	\$200,325	\$ 76,366	\$ 47,160	\$ —	\$ 323,851
Transfers between segments	46,244	—	—	(46,244)	—
Net Sales	<u>\$246,569</u>	<u>\$ 76,366</u>	<u>\$ 47,160</u>	<u>\$ (46,244)</u>	<u>\$ 323,851</u>
Operating income (loss) before allocations	\$ 12,595	\$ 4,360	\$ 123	\$ (15,160)	\$ 1,918
Allocations	11,451	347	3,362	(15,160)	—
Operating income (loss)	1,144	4,013	(3,239)	—	1,918
Interest and other—net	(247)	10	(60)	—	(297)
Income (loss) before taxes	<u>\$ 897</u>	<u>\$ 4,023</u>	<u>\$ (3,299)</u>	<u>\$ —</u>	<u>\$ 1,621</u>
<i>Selected Operating Expenses:</i>					
Depreciation and amortization	\$ 1,492	\$ 178	\$ 44	\$ —	\$ 1,714
Special charges	—	—	—	—	—
<i>Balance Sheet Data:</i>					
Total assets	\$194,254	\$ 95,938	\$ 49,208	\$ (61,169)	\$ 278,231
Goodwill, net	1,173	42,880	7,634	—	51,687

General and administrative expenses were charged to the reportable operating segments, based on their estimated usage of the underlying functions. Interest and other expense was charged to the segments, based on

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PART I—FINANCIAL INFORMATION
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)
(amounts in thousands, except per share data)

the actual costs incurred by each segment, net of interest and other income generated. The amount shown above representing total assets eliminated consists of inter-segment receivables, resulting primarily from inter-segment sales transfers reported above and from inter-segment service charges.

Net sales by business segment, sales channel, and product mix are presented below:

March 31,	Three Months Ended	
	2006	2005
<i>Segment (excludes transfers between segments)</i>		
SMB	\$ 219,121	\$ 200,325
Large Account	108,362	76,366
Public Sector	52,995	47,160
Total	<u>\$ 380,478</u>	<u>\$ 323,851</u>
<i>Sales Channel</i>		
Outbound Telemarketing and Field Sales	\$ 246,617	\$ 227,233
Online Internet	119,595	78,217
Inbound Telesales	14,266	18,401
Total	<u>\$ 380,478</u>	<u>\$ 323,851</u>
<i>Product Mix</i>		
Notebooks and PDAs	\$ 64,543	\$ 60,850
Desktop/Servers	56,495	47,957
Storage Devices	33,918	28,861
Software	47,923	38,254
Net/Com Products	29,853	24,871
Printers and Printer Supplies	40,034	34,418
Video, Imaging, and Sound	46,868	37,565
Memory and System Enhancements	18,856	17,747
Accessories/Other	41,988	33,328
Total	<u>\$ 380,478</u>	<u>\$ 323,851</u>

Substantially all of our net sales for the three months ended March 31, 2006 and 2005 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 2% in each of those respective periods. All of our assets at March 31, 2006 and December 31, 2005 were located in the United States. Our primary target customers are SMBs comprised of 20 to 1,000 employees, federal, state, and local governmental agencies, educational institutions, and medium-to-large corporate accounts. Except for the federal government, no single customer accounted for more than 2% of total net sales in the three months ended March 31, 2006 and 2005. Net sales to the federal government accounted for \$12,850, or 3.4% of total net sales for the three months ended March 31, 2006, and \$10,030, or 3.1 % of total net sales for the three months ended March 31, 2005.

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Note 4—Share Based Compensation

Effective January 1, 2006, we adopted SFAS 123(R), “Share-Based Payment,” using the modified prospective transition method, and therefore prior periods have not been restated. SFAS 123(R) requires a company to measure compensation cost arising from the grant of share-based payments to employees at fair value and to recognize such cost over the period during which the employee provides service in exchange for the award, usually the vesting period. Accordingly, we record compensation cost for all stock options granted or modified after December 31, 2005 and for the unvested stock options awarded prior to adoption.

Incentive and Non-Statutory Stock Option Plans

In December 1993, the Board adopted and the stockholders approved the 1993 Incentive and Non-Statutory Stock Option Plan (the “1993 Plan”). Under the terms of the 1993 Plan, we were authorized, for a ten-year period, to make awards of restricted stock and to grant incentive and non-statutory options to our employees, consultants, and advisors to purchase shares of our stock. Options vested over varying periods up to four years and had contractual lives up to ten years. We did not issue any stock options under the 1993 Plan after 1998 and have outstanding grants totaling 32 shares as of March 31, 2006.

In November 1997, the Board adopted and the stockholders approved the 1997 Stock Incentive Plan (the “1997 Plan”), which became effective on the closing of our initial public offering in 1998. The 1997 Plan provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, performance shares, and awards of restricted stock and unrestricted stock. A total of 3,600 shares have been reserved for issuance under the 1997 Plan. We have issued stock options under the 1997 Plan, generally with a graded vesting period of four years and a contractual life of ten years. We did not issue any equity awards in the first quarter of 2006. In connection with the adoption of SFAS 123(R), our Compensation Committee is evaluating our equity award plan and its ability to motivate senior executives to better advance stockholders’ interests.

Information regarding the 1993 and 1997 Plans is as follows:

	Option Shares	Weighted Average Exercise Price
Outstanding, January 1, 2006	2,542	\$ 9.74
Granted	—	—
Exercised	—	—
Forfeited and cancelled	(45)	5.82
Outstanding, March 31, 2006	<u>2,497</u>	\$ 9.81

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The following table summarizes the status of outstanding stock options as of March 31, 2006:

Exercise Price Range	No. of Shares	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	No. of Shares	Weighted Average Exercise Price
\$ 3.81—\$5.20	336	7.41	\$ 4.93	246	\$ 4.83
\$ 5.38— 5.44	118	9.55	5.38	95	5.38
\$ 5.54— 5.54	294	7.05	5.54	239	5.54
\$ 6.03— 7.10	288	5.68	6.85	243	6.98
\$ 7.11— 7.51	95	8.02	7.30	75	7.30
\$ 7.91— 7.91	252	8.71	7.91	80	7.91
\$ 8.54— 8.92	303	4.92	8.76	303	8.76
\$ 9.71—10.99	234	6.09	10.32	209	10.34
\$11.67—11.67	363	2.37	11.67	363	11.67
\$13.17—52.75	214	4.06	30.88	214	30.88
<u>\$ 3.81—52.75</u>	<u>2,497</u>	<u>5.98</u>	<u>\$ 9.81</u>	<u>2,067</u>	<u>\$ 10.43</u>

The weighted-average intrinsic value of all outstanding options as of March 31, 2006 was \$2,193. The weighted-average intrinsic value of all exercisable options as of March 31, 2006 was \$276, and the weighted-average remaining life of such exercisable options as of March 31, 2006 was 5.4 years. Unearned compensation cost related to the unvested portion of outstanding stock options as of March 31, 2006 was \$1,318 and is expected to be recognized over a weighted-average period of approximately 2.0 years.

On December 30, 2005, our board of directors approved the acceleration of the vesting of the following outstanding options: (1) all unvested options from grants of 20,000 shares or more held by officers of the Company and any of its subsidiaries that would otherwise vest in 2006, (2) all “market condition” options (those options whose vesting depends upon reaching certain stock prices), held by officers, and (3) all unvested options from grants of less than 20,000 shares, held by directors, officers and other employees. Accordingly, all outstanding options were fully vested except options to purchase 470 shares of common stock. No options will therefore vest in 2006, and the options to purchase 470 shares of our common stock will continue to vest, commencing in 2007, in accordance with their terms.

Accounting for Share Based Compensation Prior to Adoption of SFAS 123(R)

Prior to our adoption of SFAS 123(R), we used the intrinsic value method prescribed by APB 25 and also followed the disclosure requirements of SFAS 123, as amended by SFAS 148, which required certain pro forma disclosures as if the fair value had been recorded for share-based compensation expense. We used the Black-Scholes-Merton option valuation model to assess the fair value of each grant. In general, our option grants vested with a four-year graded vesting and a ten year contractual term. We elected to value each grant as a single award and to recognize cost on a straight-line method. See Note 1 for the pro forma disclosure of share-based compensation for the first quarter of 2005.

Accounting for Share Based Compensation Under SFAS 123(R)

We recognized compensation cost for the unvested portion of awards granted prior to adoption. Such cost was recognized using the original grant date fair value as assessed for the pro forma disclosures required by

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SFAS 123. Also, as required by the modified prospective transition method, which we have elected, compensation related to the unvested portion of such pre-adopted grants will be recognized using the same attribution method used under SFAS 123. As discussed above, we treated our four-year graded vesting awards as a single award. As permitted, we will recognize compensation cost ratably over the service period.

The following table summarizes the components of share-based compensation recorded as expense:

	Three Months Ended March 31, 2006
Pre-tax compensation expense	\$ 140
Tax benefit	(15)
After-tax compensation expense	<u>\$ 125</u>

The stock compensation expense effect on both basic and diluted earnings per share was less than \$0.01 per share. We recorded a deferred tax asset of \$15 in the first quarter of 2006 related to the benefit of non-qualified options.

Note 5—Special Charges

In the three months ended March 31, 2006, we recorded a charge of \$371 related to the temporary retention of Amherst Technologies facilities subsequent to the purchase of certain assets of Amherst (as defined below). We also recorded in the first quarter of 2006 a charge of \$520 related to management restructuring costs, classified as workforce reductions in the table below. Although we incurred \$104 in expenses related to staff reductions in the first quarter of 2005, these were included in selling, general, and administrative expenses.

A roll forward of special charges for the three months ended March 31, 2006 is shown below.

	Workforce Reductions	Amherst Technologies	Total
Balance December 31, 2005	\$ 866	\$ 132	\$ 998
Charges	520	371	891
Cash payments	(377)	(382)	(759)
Liabilities at March 31, 2006	<u>\$ 1,009</u>	<u>\$ 121</u>	<u>\$1,130</u>

Liabilities at March 31, 2006 and December 31, 2005 are included in accrued expenses and other liabilities on the balance sheet.

Note 6—Purchase of Certain Assets of Amherst Technologies, LLC

On October 21, 2005, we completed the acquisition of certain assets of Amherst Technologies, LLC and certain other parties (collectively, “Amherst”) from IBM Credit, LLC (“IBM”) for \$7,751 in cash. Prior to this transaction, IBM was granted a security interest by Amherst covering the acquired assets. The assets we acquired

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include customer relationships and related intangibles; intellectual property; and miscellaneous furniture, fixtures, and equipment. The acquired assets were combined with our MoreDirect, Inc. subsidiary to expand its reach into the medium-to-large corporate customer segment and enhance its sales efforts. In the prior year, we incurred an additional \$28 of costs directly related to the transaction.

The transaction was accounted for by the purchase method, and accordingly, any sales generated by former Amherst sales representatives are included in our consolidated financial statements only for periods after October 21, 2005.

The following table summarizes the estimated fair values of the assets acquired at the date of acquisition. We did not assume any liabilities in this transaction. The fair values of certain intangible assets were determined by management, utilizing in part a third party valuation.

<u>At October 21, 2005</u>	
Intangible assets	\$2,400
Property, plant and equipment and other assets	199
Goodwill	5,180
Purchase price of selected assets	<u>\$7,779</u>

The \$2,400 of acquired intangible assets represents customer relationships (four-year weighted-average useful life). Goodwill of \$5,180 was assigned to our Large Account segment. All of this goodwill is expected to be deductible for income tax purposes as a result of this transaction. During the first quarter of 2006, we revised our purchase accounting to reduce property, plant and equipment and other assets by \$47, and increased goodwill by \$47.

Note 7—Commitments and Contingencies

We are subject to various legal proceedings and claims which have arisen during the ordinary course of business. These claims include certain patent infringement litigation naming us and several other resellers as well as certain manufacturers of products we sell or use in our business. No specific amounts have been claimed as damages. In the opinion of management, the outcome of such matters is not expected to have a material effect on our financial position, results of operations, and cash flows.

We are also subject to audit by various government agencies relating to sales under certain government contracts. An audit was conducted on our contract with the General Services Administration (“GSA”) for the period May 1, 1997 to March 31, 2002, and in November 2003, the GSA’s contract with our subsidiary, GovConnection, was cancelled. Management has concluded that such cancellation was precipitated by an audit of contractual compliance, although we have not received an audit report or received a claim from the GSA concerning amounts that might be owed pursuant to this audit. A new GSA contract was awarded in August 2004.

Based on our own internal review of contractual compliance, we have noted that several internal control deficiencies existed at GovConnection surrounding its compliance with the GSA contract. Actions were taken to address these deficiencies. We believe that we have provided adequate reserves to cover any claims as they relate to payment of fees required under the contract or any penalties assessed. We have reserved \$1,050 for such fees or any penalties assessed. However, we will continue to evaluate such reserves in light of additional information that comes to our attention.

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We have been informally advised that audit matters related to GovConnection have been referred to the Department of Justice for its review. Such a referral exposes us to possible civil damages for non-compliance with the GSA contract. Such damages can be substantial. No reserves have been provided for such a claim because of the preliminary nature of this matter. We will continue to evaluate our reserves—as they relate both to the GSA audit and the Department of Justice investigation—in light of additional information that comes to our attention. The ultimate outcome of these matters cannot be determined. Future events may result in conclusions that could have a material impact, either positively or negatively, on our results of operations or financial condition. We have no indication of intentional wrongdoing by GovConnection regarding the GSA contract. In order to assist in this evaluation, we engaged outside counsel and an independent accounting firm to review our systems, policies, and procedures relative to our federal, state, and local government contracts and to assist us in resolving this matter.

We are also subject to audit by states on sales and income taxes, unclaimed property, and other assessments. Certain sales tax audits have begun and we have received notification of an impending unclaimed property audit. While management believes that known liabilities have been adequately provided for, it is too early to determine the ultimate outcome of such audits.

Note 8—Bank Borrowing and Trade Credit Arrangements

On June 29, 2005, we secured from our current bank an increased \$50,000 credit facility collateralized by substantially all of our business assets. This facility also gives us the option of increasing the borrowing amount by an additional \$20,000 at substantially the same terms. Amounts outstanding under this facility bear interest at the prime rate (7.75% at March 31, 2006). The facility also gives us the option of obtaining Eurodollar Rate Loans in multiples of \$1,000 for durations of one, two, three, four, or six months. The credit facility includes various customary financial and operating covenants, including minimum net worth and maximum funded debt ratio requirements, and restrictions on the payment of dividends, repurchase of our common stock, and default acceleration provisions, none of which we believe significantly restricts our operations. The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at March 31, 2006 was 1.0 to 1.0. Funded debt ratio is the ratio of average outstanding advances under the facility to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation, and Amortization). Borrowing availability under the agreement was \$34,851 at March 31, 2006.

Borrowings of \$15,149 and \$19,975 were outstanding under this credit facility at March 31, 2006 and December 31, 2005, respectively. A total of \$8,000 of the March 31, 2006 outstanding borrowings consisted of a one-month Eurodollar Rate Loan at 5.63% interest. The credit facility matures on June 29, 2008, at which time amounts outstanding become due.

At March 31, 2006 and December 31, 2005, we had security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. The agreements allow a collateralized position in inventory financed by the financial institutions up to an aggregate amount of \$45,000. The cost of such financing under these agreements is borne by the suppliers by discounting their invoices to the financial institutions as an incentive for us to purchase their products. We do not pay any interest or discount fees on such inventory financing. At March 31, 2006 and December 31, 2005, accounts payable included \$6,185 and \$12,316, respectively, owed to these financial institutions.

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION

**Item 2—MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

Our management’s discussion and analysis of our financial condition and results of operations include the identification of certain trends and other statements that may predict or anticipate future business or financial results that are subject to important factors that could cause our actual results to differ materially from those indicated. See “Factors That May Affect Future Results and Financial Condition.”

OVERVIEW

PC Connection is a national direct marketer of a wide range of IT products and services—including computer systems, software and peripheral equipment, networking communications, and other products and accessories, that we purchase from manufacturers, distributors, and other suppliers. We also offer a growing range of repair, configuration, installation, and other services performed by our personnel and third-party providers. We operate through three primary business segments: (a) consumers and small- to medium-sized businesses, or SMBs, through our PC Connection Sales subsidiaries, (b) large corporate accounts, or Large Account, through our MoreDirect subsidiary, and (c) federal, state, and local governments and educational institutions, or Public Sector, through our GovConnection subsidiary.

We generate sales through (i) outbound telemarketing and field sales contacts by account managers focused on the business, education, and government markets, (ii) our Web sites, and (iii) inbound calls from customers responding to our catalogs and other advertising media.

Opportunities and Challenges

The primary challenges we face in effectively managing our business are (1) increasing our revenues while improving our gross profit margins in all three business segments, (2) recruiting, retaining, and improving the productivity of our sales personnel, and (3) effectively managing and leveraging our selling, general, and administrative (“SG&A”) expenses over a higher sales base. With only moderate growth projected in the overall IT industry, any significant sales growth for us must come through increased market share. Competition is expected to be even more intense in the future, which could put more pressure on margins.

We enjoyed a modest improvement in sales productivity (average annualized sales per sales representative) in much of our business in the first quarter of 2006 compared to the prior year period and have made significant investments in our sales training programs and information systems in anticipation of further productivity gains later this year. We also launched in the fourth quarter of 2005 our “Core 1” sales training program with the goal of improving sales representatives’ retention and productivity. Increasing our sales representatives’ productivity will remain a key corporate challenge for the upcoming periods.

As previously reported, the General Services Administration, or GSA, cancelled its contract with GovConnection in November 2003, following its review of that subsidiary’s contract management system and procedures and the possibility of the sale of unqualified items and underpayment of required fees. Although we were awarded a new GSA contract in August 2004, we have experienced significant declines in our federal government sales from 2003 levels. Our federal government revenues may continue to be negatively impacted as GovConnection seeks to regain sales under the new GSA contract. This matter is further discussed in “Risk Factors” in Item 1A of Part II of this Quarterly Report on Form 10-Q.

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RESULTS OF OPERATIONS

The following table sets forth information derived from our statements of income expressed as a percentage of net sales for the periods indicated.

March 31,	Three Months Ended	
	2006	2005
Net sales (in millions)	\$380.5	\$323.9
Net sales	100.0%	100.0%
Gross margin	12.2	11.5
Selling, general, and administrative expenses	11.0	10.9
Special charges	0.3	—
Income from operations	0.9	0.6

Our overall increase in sales resulted from sales growth in all three segments, as well as the inclusion of \$27.3 million in sales generated by former Amherst Technologies representatives during the first quarter of 2006. As previously reported, we purchased certain assets of Amherst Technologies in October 2005. Through our customer acquisition initiatives in each business segment, we continued to acquire new accounts and, therefore, increased our market share in the first quarter of 2006. Consolidated gross profit dollars increased due to increases in both sales and gross profit margins. Gross margin improvement resulted from higher customer invoice product margins; increased sales of higher margin services, software, and accessories; lower freight charges as a percentage of sales; and increased vendor consideration. SG&A expenses increased in both dollars and as a percentage of sales. The dollar increase was largely attributable to the Amherst transaction, increased variable compensation associated with higher sales, the opening of a new sales center in Texas, and continued investments in sales, systems, services, and sales training.

Net Sales Distribution

The following table sets forth our percentage of net sales by business segment, sales channel, and product mix:

March 31,	Three Months Ended	
	2006	2005
<i>Business Segment</i>		
SMB	58%	62%
Large Account	28	24
Public Sector	14	14
Total	100%	100%
<i>Sales Channel</i>		
Outbound Telemarketing and Field Sales	65%	70%
Online Internet	31	24
Inbound Telesales	4	6
Total	100%	100%
<i>Product Mix</i>		
Notebooks and PDAs	17%	19%
Desktop/Servers	15	15
Storage Devices	9	9
Software	13	12
Net/Com Products	8	8
Printers and Printer Supplies	10	11
Videos, Imaging, and Sound	12	11
Memory and System Enhancements	5	5
Accessories/Other	11	10
Total	100%	100%

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Gross Profit Margins

The following table summarizes our overall gross profit margins, as a percentage of net sales, over the periods indicated:

March 31, <i>Segment</i>	Three Months Ended	
	2006	2005
SMB	13.4%	12.3%
Large Account	10.5	10.5
Public Sector	10.7	10.1
Total	<u>12.2%</u>	<u>11.5%</u>

Consolidated gross profit dollars increased over the first quarter of 2005 by \$9.1 million, due to increases in both net sales and gross profit margins. Gross margin improvement resulted from higher customer invoice product margins; increased sales of higher margin services, software, and accessories; lower freight charges as a percentage of sales; and increased vendor consideration.

Cost of Sales and Certain Other Costs

Cost of sales includes the invoice cost of the product, packaging, inbound and outbound freight, and provisions for inventory obsolescence, adjusted for discounts, rebates, and other vendor consideration adjustments. Direct operating expenses relating to our purchasing function and receiving, inspection, internal transfer, warehousing, packing and shipping, and other expenses of our distribution center are included in SG&A expenses. Accordingly, our gross margins may not be comparable to those of other entities who include all of the costs related to their distribution network in cost of goods sold. Such costs, as a percentage of net sales for the periods reported, are as follows:

Three Months Ended March 31,	
2006	2005
0.60%	0.63%

Operating Expenses

The following table breaks out our more significant operating expenses for the periods indicated (in millions of dollars):

March 31,	Three Months Ended	
	2006	2005
Personnel costs	\$ 29.3	\$ 23.6
Advertising, net	2.2	2.2
Facilities operations	2.3	2.1
Credit card fees	1.9	1.8
Depreciation and amortization	1.7	1.7
Bad debts	0.7	0.6
Other, net	3.9	3.4
Total	<u>\$ 42.0</u>	<u>\$ 35.4</u>
Percentage of net sales	<u>11.0%</u>	<u>10.9%</u>

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Personnel costs continue to represent the majority of our operating expenses, with sales personnel representing the largest portion of these costs. The year-over-year increase in personnel costs resulted primarily from additional sales and service personnel from our Amherst transaction and increased variable compensation related to higher sales. Our other operating costs, except for credit card fees and bad debts, tend to be relatively fixed over changing sales levels.

Year-Over-Year Comparisons

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005

Changes in net sales and gross profit by business segment are shown in the following table (dollars in millions):

	Three Months Ended March 31,				
	2006		2005		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
Sales:					
SMB	\$219.1	57.6%	\$200.3	61.8%	9.4%
Large Account	108.4	28.5	76.4	23.6	41.9
Public Sector	53.0	13.9	47.2	14.6	12.3
Total	<u>\$380.5</u>	<u>100.0%</u>	<u>\$323.9</u>	<u>100.0%</u>	<u>17.5%</u>
Gross Profit:					
SMB	\$ 29.3	13.4%	\$ 24.5	12.3%	19.6%
Large Account	11.4	10.5	8.0	10.5	42.5
Public Sector	5.7	10.7	4.8	10.1	18.8
Total	<u>\$ 46.4</u>	<u>12.2%</u>	<u>\$ 37.3</u>	<u>11.5%</u>	<u>24.4%</u>

Net sales for the first quarter of 2006 increased compared to the first quarter of 2005 in all three of our segments, as explained by the following:

- Net sales for our SMB segment increased due to increases in both headcount and productivity of its sales representatives, as well as the inclusion of \$3.3 million in sales generated by former Amherst Technologies representatives. Sales representatives for our SMB segment totaled 452 at March 31, 2006, an increase from 413 at March 31, 2005. Sales productivity improved as a result of increased focus on selling services and accessories, in addition to our recent initiatives to acquire new customers and re-establishing inactive ones.
- Net sales for our Public Sector segment increased due to a 28.1% increase in federal government sales and an 8.1% increase in sales to state and local governments and educational organizations. Federal revenues benefited from the addition of vendors to our current GSA and other contract vehicles. Our sales to state and local government and education customers increased year over year due to an increase in sales representatives. Sales representatives for our Public Sector segment totaled 108 at March 31, 2006, an increase from 102 at March 31, 2005.
- Net sales for our Large Account segment increased due to organic growth and the inclusion of \$24.0 million of sales generated by former Amherst sales representatives. Average annualized sales productivity increased 4.6% compared to the prior year quarter as its sales representatives increased revenues from existing customers. Sales representatives for our Large Account segment totaled 90 at March 31, 2006, an increase from 71 at March 31, 2005.

Gross profit for the first quarter of 2006 increased compared to the first quarter of 2005 in both dollars and as a percentage of sales, on a consolidated basis, as explained by the following:

- Gross profit for our SMB segment increased year over year in both dollars and as a percentage of net sales. These increases were primarily the result of increased vendor consideration, higher customer invoice margins, and increased sales of higher-margin software and accessories.

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- Gross profit for our Public Sector segment increased year over year in dollars and as a percentage of net sales. The dollar increase was largely the result of increased vendor consideration associated with higher sales levels. The increase in gross margin rates were partly offset by decreased customer invoice margins, as competition in this segment's markets continues to accelerate.
- Gross profit for our Large Account segment increased year over year in dollars but was flat as a percentage of sales. Increased revenues, as discussed earlier, led to the gross profit dollar increase.

Selling, general, and administrative expenses increased for the first quarter of 2006 and also increased as a percentage of sales as compared to the first quarter of 2005.

SG&A expenses attributable to our operating segments are summarized below (dollars in millions):

	Three Months Ended March 31,				
	2006		2005		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
SMB	\$ 26.6	12.1%	\$ 23.4	11.7%	13.7%
Large Account	6.8	6.3	4.0	5.2	70.0
Public Sector	8.6	16.1	8.0	16.9	7.5
Total	<u>\$ 42.0</u>	<u>11.0%</u>	<u>\$ 35.4</u>	<u>10.9%</u>	<u>18.6%</u>

- SG&A expenses for our SMB segment increased year over year, and were higher as a percentage of net sales in the first quarter of 2006 compared to the same period in 2005, primarily due to increased investments made in our sales systems and services, as well as incremental variable compensation associated with increased revenues. Our investments in making our sales support systems more responsive and flexible are expected to provide a better buying experience for our customers and increase the productivity and retention of our sales force. SG&A expenses also increased due to our opening of a new sales office in Dallas County, Texas.
- SG&A expenses for our Large Account segment increased year over year in both dollars and as a percentage of net sales in the first quarter of 2006 compared to the prior year period. These increases resulted largely from the additional sales and service representatives added from our Amherst Transaction. SG&A expenses for this segment represent the lowest of the three segments as a percentage of net sales, reflecting the nature and efficiency of this segment's variable cost field sales and drop-shipping operating model.
- SG&A expenses for our Public Sector segment increased year over year, but decreased as a percentage of net sales in the first quarter of 2006. Similar to the SMB segment, SG&A expenses increased as a result of our investments in making our sales support systems more responsive and flexible, as well as incremental variable compensation associated with higher revenues.

In the three months ended March 31, 2006, we recorded a charge of \$0.4 million related to the temporary retention of certain Amherst Technologies facilities subsequent to the purchase of certain assets of Amherst Technologies. We also recorded in the first quarter of 2006 a charge of \$0.5 million related to management restructuring costs, classified as workforce reductions in the table below. At the year ended December 31, 2005, we recorded a liability of \$0.1 million for a workforce reduction charge, which we reversed in the first quarter of 2006, when a change in circumstances reduced the amount outstanding. A roll forward of special charges for the period presented is shown below (in thousands of dollars).

	Workforce Reductions	Amherst Technologies	Total
Balance December 31, 2005	\$ 866	\$ 132	\$ 998
Charges	520	371	891
Cash payments	(377)	(382)	(759)
Liabilities at March 31, 2006	<u>\$ 1,009</u>	<u>\$ 121</u>	<u>\$1,130</u>

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We did not record any special charges in the three months ended March 31, 2005. Although we incurred \$0.1 million in expenses related to staff reductions in the first quarter of 2005, these were included in SG&A expense.

Income from operations increased by \$1.7 million to \$3.6 million for the first quarter of 2006 from \$1.9 million for the first quarter of 2005. Income from operations as a percentage of net sales increased to 0.9% for the first quarter of 2006 from 0.6% for the first quarter of 2005. This increase was attributable to the changes in net sales, gross margin, and SG&A expenses as discussed above.

Interest expense increased due to higher average borrowings outstanding and increased interest rates in the first quarter of 2006 as compared to the first quarter of 2005.

Our effective tax rate was 42.0% for the first quarter of 2006 and 41.5% for the first quarter of 2005. Our increased effective tax rates are the result of state tax loss carry forwards in certain jurisdictions not recognizable as offsets to tax charges in other jurisdictions.

Net income increased to \$1.7 million for the first quarter of 2006 from \$0.9 million for the first quarter of 2005, principally as a result of the increase in income from operations.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity have historically been internally generated funds from operations and borrowings under our bank line of credit. We have used those funds to meet our capital requirements, which consist primarily of working capital for operational needs, capital expenditures for computer equipment and software used in our business, and recently our purchase of certain assets of Amherst Technologies.

We believe that funds generated from operations, together with available credit under our bank line of credit and inventory trade credit agreements, will be sufficient to finance our working capital, capital expenditure, and other requirements for at least the next twelve calendar months. We expect our capital needs for the next twelve months to consist primarily of capital expenditures of \$4.0 to \$5.0 million and payments on capital and operating lease obligations of approximately \$5.0 million. We expect to meet our cash requirements for the next twelve months through a combination of cash on hand, cash generated from operations and, if necessary, additional borrowings on our bank line of credit, as follows:

- *Cash on Hand.* At March 31, 2006, we had approximately \$8.2 million in unrestricted accounts.
- *Cash Generated from Operations.* We expect to generate cash flows from operations in excess of operating cash needs by generating earnings and balancing net changes in inventories and receivables with compensating changes in payables to generate a positive cash flow. Historically, we have consistently generated positive cash flows from operations.
- *Credit Facilities.* As of March 31, 2006, we had drawn \$15.1 million of our \$50.0 million bank line of credit. This line of credit can be increased, at our option, to \$70.0 million for approved acquisitions or other uses authorized by the bank. Borrowings are, however, limited by certain minimum collateral and earnings requirements, as described more fully below.

Our ability to continue funding our planned growth, both internally and externally, is dependent upon our ability to generate sufficient cash flow from operations or to obtain additional funds through equity or debt financing, or from other sources of financing, as may be required. While at this time we do not anticipate needing any additional sources of financing to fund our operations, if demand for information technology products declines, our cash flows from operations may be substantially affected. See also related risks listed below at Item 1A, "Risk Factors."

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Summary Sources and Uses of Cash

The following table summarizes our sources and uses of cash over the periods indicated (in millions):

March 31,	Three Months Ended	
	2006	2005
Net cash provided by operating activities	\$ 5.0	\$ 3.7
Net cash used for investing activities	(1.6)	(0.8)
Net cash used for financing activities	(5.0)	(3.4)
Decrease in cash and cash equivalents	\$ (1.6)	\$ (0.5)

Cash provided by operating activities increased in the first quarter of 2006 over the first quarter of 2005. The primary reason for the increase in the first quarter of 2006 was an increase in net earnings before depreciation, as decreases in receivables and inventories were largely offset by a decrease in payables. Our overall Days Sales Outstanding for the three months ended March 31, 2006 increased to 45 days from 43 days for the comparable prior year period. Inventory turns, however, improved in the first quarter of 2006 to 20 times from 16 times for the first quarter of 2005.

At March 31, 2006, we had \$89.6 million in outstanding accounts payable. Such accounts are generally paid within 30 days of incurrence and will be financed by cash flows from operations or short-term borrowings under the line of credit. This amount includes \$6.2 million payable to two financial institutions under inventory trade credit agreements we use to finance our purchase of certain inventory, secured by the inventory so financed. We believe we will be able to meet our obligations under our accounts payable with cash flows from operations and our existing line of credit.

Cash used for investing activities include our capital expenditures in the periods presented, primarily for computer equipment and capitalization of internally-developed software.

Cash used for financing activities in the first quarters of 2006 and 2005 related primarily to a decrease in net borrowings of \$4.8 million and \$3.4 million, respectively, under our bank line of credit.

Debt Instruments, Contractual Agreements, and Related Covenants

Below is a summary of certain provisions of our credit facilities and other contractual obligations. It is qualified in its entirety by the terms of the actual agreements, which are on file with the Securities and Exchange Commission. For more information about the restrictive covenants in our debt instruments and inventory financing agreements, see “Factors Affecting Sources of Liquidity.” For more information about our obligations, commitments, and contingencies, see our consolidated financial statements and the accompanying notes included in this quarterly report.

Bank Line of Credit. We secured from our current bank an increased line of credit in June 2005 to provide us with a borrowing capacity of up to \$50.0 million. In addition, we have the option to increase the facility an additional \$20.0 million, based on sufficient levels of trade receivables to meet borrowing base requirements, and depending on meeting minimum EBITDA (earnings before interest, taxes, depreciation, and amortization) and equity requirements, described below under “Factors Affecting Sources of Liquidity.” Amounts outstanding under this facility were \$15.1 million at March 31, 2006. Approximately \$8.0 million of this amount bears interest at Eurodollar rates (5.63%). The balance bears interest at the prime rate (7.75% at March 31, 2006). Substantially all of our assets are collateralized as security for this facility, and all of our subsidiaries are guarantors under the line of credit. Borrowing availability under the line was \$34.9 million at March 31, 2006.

This facility, which matures in June 2008, operates under an automatic cash management program whereby disbursements in excess of available cash are added as borrowings at the time disbursement checks clear the bank, and available cash receipts are first applied against any outstanding borrowings and then invested in short-term qualified cash investments. Accordingly, borrowings under the line are classified as current.

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Inventory Trade Credit Agreements. We have security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. These agreements allow a collateralized first position in certain branded products inventory financed by these financial institutions. Although the agreements provide for up to 100% financing on the purchase price, up to an aggregate of \$45.0 million, any outstanding financing must be fully secured by available inventory. We do not pay any interest or discount fees on such inventory financing; such costs are borne by the suppliers as an incentive for us to purchase their products. Amounts outstanding under such facilities, equal to \$6.2 million as of March 31, 2006, are recorded in accounts payable, and the inventory financed is classified as inventory on the consolidated balance sheet.

Contractual Obligations. The following table sets forth information with respect to our long-term obligations payable in cash as of March 31, 2006 (in thousands):

	Payments Due By Period				
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
Contractual Obligations:					
Capital lease obligations(1)	\$ 9,166	\$ 1,467	\$2,382	\$2,279	\$ 3,038
Operating lease obligations	7,261	3,096	3,412	753	—
Total	<u>\$16,427</u>	<u>\$ 4,563</u>	<u>\$5,794</u>	<u>\$3,032</u>	<u>\$ 3,038</u>

(1) Including interest, excluding taxes, insurance, and common area maintenance charges.

We do not have any other off-balance sheet arrangements that have or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Capital Leases. We have a 15-year lease for our corporate headquarters with an affiliated company related through common ownership. We also have a three-year lease for certain computer equipment with an unrelated party. We are required to make lease payments aggregating from \$1.0 million to \$1.5 million per year. In addition to the rent payable under the facility lease, we are required to pay real estate taxes, insurance, and common area maintenance charges.

Operating Leases. We also lease facilities from our principal stockholders and facilities and equipment from third parties under non-cancelable operating leases. See “Contractual Obligations” above for lease commitments under these leases.

Factors Affecting Sources of Liquidity

Internally Generated Funds. The key factors affecting our internally generated funds are our ability to minimize costs and fully achieve our operating efficiencies, timely collection of our customer receivables, and management of our inventory levels.

Bank Line of Credit. Our credit facility contains certain financial ratios and operational covenants and other restrictions (including restrictions on additional debt, guarantees, stock repurchases, dividends and other distributions, investments, and liens) with which we and all of our subsidiaries must comply. Any failure to comply with these covenants would not only prevent us from borrowing additional funds under this line of credit, but would also constitute a default. This credit facility contains two financial tests:

- The funded debt ratio (defined as the average outstanding advances under the line for the quarter, divided by the consolidated EBITDA for the four quarters) must not be more than 2.0 to 1.0. Our actual funded debt ratio at March 31, 2006 was 1.0 to 1.0.

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- Minimum Consolidated Net Worth must be at least \$150.0 million, plus 50% of consolidated net income for each quarter, beginning with the quarter ending March 31, 2006 (loss quarters not counted). Such amount was calculated at March 31, 2006 as \$150.9 million. Our actual consolidated stockholders' equity at March 31, 2006 was \$173.2 million.

The borrowing base under this facility is set at 80% of qualified commercial receivables, plus 50% of qualified government receivables, less \$5 million of the formula availability which must be held in reserves. As of March 31, 2006, \$34.9 million of the facility was available for additional borrowings.

Inventory Trade Credit Agreements. These agreements contain similar financial ratios and operational covenants and restrictions as those contained in our bank line of credit described above. Such agreements also contain cross-default provisions whereby a default under the bank agreement would also constitute a default under these agreements. Financing under these agreements is limited to the purchase of specific branded products from authorized suppliers, and amounts outstanding must be fully collateralized by inventories of those products on hand.

Capital Markets. Our ability to raise additional funds in the capital market depends upon, among other things, general economic conditions, the condition of the information technology industry, our financial performance and stock price, and the state of the capital markets.

RECENTLY ISSUED FINANCIAL ACCOUNTING STANDARDS

Effective January 1, 2006, we adopted SFAS 123(R), "Share-Based Payment," ("SFAS 123(R)") using the modified prospective transition method. This Statement replaced SFAS No. 123, "Accounting for Stock-Based Compensation," and superseded Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". SFAS 123(R) requires a company to measure the grant date fair value of equity awards given to employees in exchange for services and recognize that cost over the period that such services are performed. In addition, SFAS 123(R) requires that the excess tax benefits related to stock compensation be reported as a cash inflow from financing activities rather than as a reduction of taxes paid in cash from operations. Refer to Note 4 for additional information on our stock-based compensation plans and related compensation expense.

Our critical accounting policies have not materially changed from those discussed in our Annual Report of Form 10-K for the year ended December 31, 2005, except as to SFAS 123(R) as described above.

INFLATION

We have historically offset any inflation in operating costs by a combination of increased productivity and price increases, where appropriate. We do not expect inflation to have a significant impact on our business in the future.

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION

Item 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We invest cash balances in excess of operating requirements in short-term securities, generally with maturities of 90 days or less. In addition, our unsecured credit agreement provides for borrowings which bear interest at variable rates based on the prime rate and Euro dollar rates. We had borrowings outstanding of \$15.1 million pursuant to our credit agreement as of March 31, 2006. We believe that the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows should not be material. Our credit agreement exposes earnings to changes in short-term interest rates since interest rates on the underlying obligations are variable. However, as noted above, borrowings outstanding totaled \$15.1 million on the credit agreement at March 31, 2006, and the average outstandings borrowing during the first quarter of 2006 were not material. A change in earnings resulting from a hypothetical 10% increase or decrease in interest rates is not material.

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION

Item 4—CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2006. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as described above. Based on the evaluation of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended March 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1A. Risk Factors

Statements contained or incorporated by reference in this Quarterly Report on Form 10-Q that are not based on historical fact are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts, and projections and the beliefs and assumptions of our management including, without limitation, our expectations with regard to the industry’s rapid technological change and exposure to inventory obsolescence, availability and allocations of goods, reliance on vendor support and relationships, competitive risks, pricing risks, and the overall level of economic activity and the level of business investment in information technology products. Forward-looking statements may be identified by the use of forward-looking terminology such as “may,” “could,” “will,” “expect,” “estimate,” “anticipate,” “continue,” or similar terms, variations of such terms or the negative of those terms.

We cannot assure investors that our assumptions and expectations will prove to have been correct. Important factors could cause our actual results to differ materially from those indicated or implied by forward-looking statements. Such factors that could cause or contribute to such differences include those factors discussed below. We undertake no intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer.

We have experienced variability in sales, and there is no assurance that we will be able to maintain profitable operations.

Several factors have caused our sales and results of operations to fluctuate and we expect these fluctuations to continue on a quarterly basis. Causes of these fluctuations include:

- changes in the overall level of economic activity;
- the condition of the personal computer industry in general;
- changes in the level of business investment in information technology products;
- shifts in customer demand for hardware and software products;
- variations in levels of competition;
- industry shipments of new products or upgrades;
- the timing of new merchandise and catalog offerings;
- fluctuations in response rates;
- fluctuations in postage, paper, shipping, and printing costs and in merchandise returns;
- adverse weather conditions that affect response, distribution, or shipping;
- changes in our product offerings;
- changes in consumer demand for information technology products; and
- changes in vendor distribution of products.

Our results also may vary based on our success of integrating acquisitions into our business, the impact of the costs of acquisitions and integration, and our ability to hire and retain sales representatives and other essential personnel. In addition, customer response rates for our catalogs and other marketing vehicles are subject to variations. The first and last quarters of the year generally have higher response rates while the two middle quarters typically have lower response rates.

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We base our operating expenditures on sales forecasts. If our revenues do not meet anticipated levels in the future, we may not be able to reduce our staffing levels and operating expenses in a timely manner to avoid significant losses from operations.

Despite our August 2004 award of an authorization to sell to the federal government under a new General Services Administration (“GSA”) schedule, our sales to that organization may not regain prior years’ sales levels, which would negatively impact our business.

In November 2003, we were advised that the GSA canceled its contract with our subsidiary, GovConnection, following a review of its contract management system and procedures and the possibility of the sale of unqualified items or underpayment of required fees. The matter has been referred to the Department of Justice for review, and we are cooperating in that review. While we were awarded authorization in August 2004 to resume selling to the federal government under a new GSA schedule, we experienced significant declines in our federal government sales from 2003 levels. Accordingly, our revenues may continue to be adversely impacted as we attempt to regain this business.

We are exposed to inventory obsolescence due to the rapid technological changes occurring in the personal computer industry.

The market for personal computer products is characterized by rapid technological change and the frequent introduction of new products and product enhancements. Our success depends in large part on our ability to identify and market products that meet the needs of customers in that marketplace. In order to satisfy customer demand and to obtain favorable purchasing discounts, we have and may continue to carry increased inventory levels of certain products. By so doing, we are subject to the increased risk of inventory obsolescence. Also, in order to implement our business strategy, we intend to continue, among other things, placing larger than typical inventory stocking orders and increasing our participation in first-to-market purchase opportunities. We may also participate in end-of-life-cycle purchase opportunities and market products on a private-label basis, which would increase the risk of inventory obsolescence. In addition, we sometimes acquire special purchase products without return privileges. There can be no assurance that we will be able to avoid losses related to obsolete inventory. In addition, manufacturers are limiting return rights and are taking steps to reduce their inventory exposure by supporting “build-to-order” programs authorizing distributors and resellers to assemble computer hardware under the manufacturers’ brands. These trends reduce the costs to manufacturers and shift the burden of inventory risk to resellers like us, which could negatively impact our business.

We acquire products for resale from a limited number of vendors. The loss of any one of these vendors could have a material adverse effect on our business.

We acquire products for resale both directly from manufacturers and indirectly through distributors and other sources. The five vendors supplying the greatest amount of goods to us constituted 71% and 69% of our total product purchases in the three months ended March 31, 2006 and 2005, respectively. Among these five vendors, purchases from Ingram represented 27% and 24% of our total product purchases in the three months ended March 31, 2006 and 2005, respectively. Purchases from Tech Data comprised 19% and 24% of our total product purchases in the three months ended March 31, 2006 and 2005, respectively. Purchases from HP represented 15% and 9% of our total product purchases in the three months ended March 31, 2006 and 2005, respectively. No other vendor supplied more than 10% of our total product purchases in the three months ended March 31, 2006 and 2005, respectively. If we were unable to acquire products from Ingram, Tech Data, or HP, we could experience a short-term disruption in the availability of products, and such disruption could have a material adverse effect on our results of operations and cash flows.

Substantially all of our contracts and arrangements with our vendors that supply significant quantities of products are terminable by such vendors or us without notice or upon short notice. Most of our product vendors provide us with trade credit, of which the net amount outstanding at March 31, 2006 was \$89.6 million.

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Termination, interruption, or contraction of relationships with our vendors, including a reduction in the level of trade credit provided to us, could have a material adverse effect on our financial position.

Some product manufacturers either do not permit us to sell the full line of their products or limit the number of product units available to direct marketers such as us. An element of our business strategy is to continue increasing our participation in first-to-market purchase opportunities. The availability of certain desired products, especially in the direct marketing channel, has been constrained in the past. We could experience a material adverse effect to our business if we are unable to source first-to-market purchase or similar opportunities, or if we face the reemergence of significant availability constraints.

We may experience a reduction in the incentive programs offered to us by our vendors.

Some product manufacturers and distributors provide us with incentives such as supplier reimbursements, payment discounts, price protection, rebates, and other similar arrangements. The increasingly competitive computer hardware market has already resulted in the following:

- reduction or elimination of some of these incentive programs;
- more restrictive price protection and other terms; and
- reduced advertising allowances and incentives, in some cases.

Many product suppliers provide us with co-op advertising support, and in exchange, we feature their products in our catalogs. This support significantly defrays our catalog production expense. In the past, we have experienced a decrease in the level of co-op advertising support available to us from certain manufacturers. The level of co-op advertising support we receive from some manufacturers may further decline in the future. Such a decline could decrease our gross margin and increase our selling, general and administrative expenses as a percentage of sales and have a material adverse effect on our cash flows.

We face many competitive risks.

The direct marketing industry and the computer products retail business, in particular, are highly competitive. We compete with consumer electronics and computer retail stores, including superstores. We also compete with other direct marketers of hardware and software and computer related products, including CDW Corporation, Insight Enterprises, Inc., and Dell Inc., who are much larger than we are. Certain hardware and software vendors, such as HP, Lenovo, and Apple, who provide products to us, are also selling their products directly to end users through their own catalogs and over the Internet. We compete not only for customers, but also for co-op advertising support from personal computer product manufacturers. Some of our competitors have larger catalog circulations and customer bases and greater financial, marketing, and other resources than we do. In addition, some of our competitors offer a wider range of products and services than we do and may be able to respond more quickly to new or changing opportunities, technologies, and customer requirements. Many current and potential competitors also have greater name recognition, engage in more extensive promotional activities, and adopt pricing policies that are more aggressive than ours. We expect competition to increase as retailers and direct marketers who have not traditionally sold computers and related products enter the industry.

In addition, product resellers and direct marketers are combining operations or acquiring or merging with other resellers and direct marketers to increase efficiency. Moreover, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to enhance their products and services. Accordingly, it is possible that new competitors or alliances among competitors may emerge and acquire significant market share.

We cannot assure you that we can continue to compete effectively against our current or future competitors. If we encounter new competition or fail to compete effectively against our competitors, our business may be harmed.

We face and will continue to face significant price competition.

Generally, pricing is very aggressive in the personal computer industry, and we expect pricing pressures to continue. An increase in price competition could result in a reduction of our profit margins. There can be no assurance that we will be able to offset the effects of price reductions with an increase in the number of customers, higher sales, cost reductions, or otherwise. Also, our sales of personal computer hardware products are generally producing lower profit margins than those associated with software products. Such pricing pressures could result in an erosion of our market share, reduced sales, and reduced operating margins, any of which could have a material adverse effect on our business.

The methods of distributing personal computers and related products are changing, and such changes may negatively impact us and our business.

The manner in which personal computers and related products are distributed and sold is changing, and new methods of distribution and sale, such as online shopping services, have emerged. Hardware and software manufacturers have sold, and may intensify their efforts to sell, their products directly to end users. From time to time, certain manufacturers have instituted programs for the direct sales of large order quantities of hardware and software to certain major corporate accounts. These types of programs may continue to be developed and used by various manufacturers. Some of our vendors, including Apple, HP, and Lenovo, currently sell some of their products directly to end users and have stated their intentions to increase the level of such direct sales. In addition, manufacturers may attempt to increase the volume of software products distributed electronically to end users. An increase in the volume of products sold through or used by consumers of any of these competitive programs or distributed electronically to end users could have a material adverse effect on our results of operations.

We could experience system failures which would interfere with our ability to process orders.

We depend on the accuracy and proper use of our management information systems, including our telephone system. Many of our key functions depend on the quality and effective utilization of the information generated by our management information systems, including:

- our ability to manage inventory and accounts receivable collection;
- our ability to purchase, sell, and ship products efficiently and on a timely basis; and
- our ability to maintain operations.

Our management information systems require continual upgrades to most effectively manage our operations and customer database. We are currently in the midst of a major upgrade to our sales processing system. Although we maintain some redundant systems, with full data backup, a substantial interruption in management information systems or in telephone communication systems, including those resulting from natural disasters as well as power loss, telecommunications failure, and similar events, would substantially hinder our ability to process customer orders and thus could have a material adverse effect on our business.

We rely on the continued development of electronic commerce and Internet infrastructure development.

We have had an increasing level of sales made over the Internet in part because of the growing use and acceptance of the Internet by end users. No one can be certain that acceptance and use of the Internet will continue to develop or that a sufficiently broad base of consumers will adopt and continue to use the Internet and other online services as a medium of commerce. Sales of computer products over the Internet represent a significant and increasing portion of overall computer product sales. Growth of our Internet sales is dependent on potential customers using the Internet in addition to traditional means of commerce to purchase products. We cannot accurately predict the rate at which they will do so.

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Our success in growing our Internet business will depend in large part upon the development of an infrastructure for providing Internet access and services. If the number of Internet users or their use of Internet resources continues to grow rapidly, such growth may overwhelm the existing Internet infrastructure. Our ability to increase the speed with which we provide services to customers and to increase the scope of such services ultimately is limited by, and reliant upon, the speed, reliability, and cost-effectiveness of the networks operated by third parties, and these networks may not continue to be developed or be available at prices consistent with our required business model.

We depend heavily on third-party shippers to deliver our products to customers.

We ship approximately 50% of our products to customers by DHL Worldwide Express ("DHL"), with the remainder being shipped by United Parcel Service, Inc. and other overnight delivery and surface services. A strike or other interruption in service by these shippers could adversely affect our ability to market or deliver products to customers on a timely basis.

We may experience potential increases in shipping, paper, and postage costs, which may adversely affect our business if we are not able to pass such increases on to our customers.

Shipping costs are a significant expense in the operation of our business. Increases in postal or shipping rates and paper costs could significantly impact the cost of producing and mailing our catalogs and shipping customer orders. Postage prices and shipping rates increase periodically, and we have no control over future increases. We have a long-term contract with DHL whereby DHL ships products to our customers. We believe that we have negotiated favorable shipping rates with DHL. We generally invoice customers for shipping and handling charges. There can be no assurance that we will be able to pass on to our customers the full cost, including any future increases in the cost, of commercial delivery services such as DHL.

We also incur substantial paper and postage costs related to our marketing activities, including producing and mailing our catalogs. Paper prices historically have been cyclical, and we have experienced substantial increases in the past. Significant increases in postal or shipping rates and paper costs could adversely impact our business, financial condition, and results of operations, particularly if we cannot pass on such increases to our customers or offset such increases by reducing other costs.

Privacy concerns with respect to list development and maintenance may materially adversely affect our business.

We mail catalogs and send electronic messages to names in our proprietary customer database and to potential customers whose names we obtain from rented or exchanged mailing lists. World-wide public concern regarding personal privacy has subjected the rental and use of customer mailing lists and other customer information to increased scrutiny. Any domestic or foreign legislation enacted limiting or prohibiting these practices could negatively affect our business.

We face many uncertainties relating to the collection of state sales and use tax.

We presently collect sales and use tax on sales of products to residents in many states. During the three months ended March 31, 2006, we collected sales and use tax on approximately 19% of our net sales. Various states have sought to impose on direct marketers the burden of collecting state sales and use taxes on the sales of products shipped to their residents. In 1992, the United States Supreme Court affirmed its position that it is unconstitutional for a state to impose sales or use tax collection obligations on an out-of-state mail-order company whose only contacts with the state are limited to the distribution of catalogs and other advertising materials through the mail and the subsequent delivery of purchased goods by United States mail or by interstate common carrier. However, legislation that would expand the ability of states to impose sales and use tax collection obligations on direct marketers has been introduced in Congress on many occasions. Additionally,

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certain states have adopted rules that require companies and their affiliates to register in those states as a condition of doing business within those states. Moreover, due to our presence on various forms of electronic media and other operational factors, our contacts with many states may exceed the limited contacts involved in the Supreme Court case. We cannot predict the level of contacts that is sufficient to permit a state to impose on us a sales or use tax collection obligation. Two of our competitors have elected to collect sales and use taxes in all states. If the Supreme Court changes its position, or if legislation is passed to overturn the Supreme Court's decision, or if a court were to determine that our contacts with a state exceed the constitutionality permitted contacts, the imposition of a sales or use tax collection obligation on us in states to which we ship products would result in additional administrative expenses to us, could result in tax liability for past sales as well as price increases to our customers, and could reduce demand for our product.

We are dependent on key personnel.

Our future performance will depend to a significant extent upon the efforts and abilities of our senior executives. The competition for qualified management personnel in the computer products industry is very intense, and the loss of service of one or more of these persons could have an adverse effect on our business. Our success and plans for future growth will also depend on our ability to hire, train, and retain skilled personnel in all areas of our business, including sales account managers and technical support personnel. There can be no assurance that we will be able to attract, train, and retain sufficient qualified personnel to achieve our business objectives.

We are controlled by two principal stockholders.

Patricia Gallup and David Hall, our two principal stockholders, beneficially own or control, in the aggregate, approximately 68% of the outstanding shares of our common stock. Because of their beneficial stock ownership, these stockholders can continue to elect the members of the Board of Directors and decide all matters requiring stockholder approval at a meeting or by a written consent in lieu of a meeting. Similarly, such stockholders can control decisions to adopt, amend, or repeal our charter and our bylaws, or take other actions requiring the vote or consent of our stockholders and prevent a takeover of us by one or more third parties, or sell or otherwise transfer their stock to a third party, which could deprive our stockholders of a control premium that might otherwise be realized by them in connection with an acquisition of us. Such control may result in decisions that are not in the best interest of our public stockholders. In connection with our initial public offering, the principal stockholders placed substantially all shares of common stock beneficially owned by them into a voting trust, pursuant to which they are required to agree as to the manner of voting such shares in order for the shares to be voted. Such provisions could discourage bids for our common stock at a premium as well as have a negative impact on the market price of our common stock.

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Item 2—Unregistered Sales of Equity Securities and Use of Proceeds

(e) The following table provides information about purchases by the Company during the quarter ended March 31, 2006 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (1)
01/01/06–01/31/06	—	—	—	\$ 12,714,000
02/01/06–02/28/06	—	—	—	\$ 12,714,000
03/01/06–03/31/06	—	—	—	\$ 12,714,000
Total:	—	—	—	\$ 12,714,000

- (1) Our Board of Directors approved the repurchase by us of shares of our common stock having a value of up to \$15.0 million in the aggregate pursuant to a repurchase program announced on March 28, 2001.

Item 5—Other Information

On May 9, 2006, the Compensation Committee of the Board of Directors of PC Connection, Inc. reviewed executive officer compensation and approved base salary increases for the following executive officers (as defined in Item 402(a)(3) of Regulation S-K) effective May 20, 2006.

Executive	Previous Base Salary	New Base Salary
Patricia Gallup President, Chief Executive Officer, and Chairman	\$ 445,000	\$ 500,000
Peter Cannone Senior Vice President, Sales Operations	\$ 300,000	\$ 340,000
Jack Ferguson Senior Vice President, Treasurer and Chief Financial Officer	\$ 260,750	\$ 280,000
Bradley Mousseau Senior Vice President, Human Resources	\$ 208,000	\$ 240,000

On May 12, 2006, the Board of Directors of PC Connection, Inc. approved an Executive Bonus Plan for 2006. This plan replaces in its entirety the Discretionary Bonus Plan previously adopted on December 30, 2005. The Executive Bonus Plan rewards executive management for achieving specified net income targets and meeting individual performance goals. The Chief Executive Officer is eligible to earn 50% of base salary upon achieving 90% of specified targets, up to 170% of base salary for exceeding such targets. The other executive officers are each eligible to earn 25% of his individual base salary upon achieving 90% of specified targets, up to 85% of base salary for exceeding such targets. The Board may distribute any earned bonus under the plan with cash, stock options, or restricted stock, or a combination of the foregoing, to meet its goals for short and long term incentives.

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Item 6—Exhibits

Exhibit Number	Description
10.1 ⁽¹⁾	Lease between MoreDirect, Inc. and RMC Midway Walnut, LP, dated January 06, 2006, for property located at 14295 Midway Road, Addison, Texas.
10.2 ⁽¹⁾	Lease between PC Connection Sales of Massachusetts, Inc. and RMC Midway Walnut, LP, dated January 6, 2006, for property located at 14295 Midway Road, Addison, Texas.
10.3*	Separation Agreement, dated March 30, 2006, by and between the Company and Robert Wilkins.
10.4*	Consulting Agreement, dated March 30, 2006, by and between the Company and Robert Wilkins.
15*	Letter on unaudited interim financial information.
31.1*	Certification of the Company's President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Company's Senior Vice President, Treasurer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Company's President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Company's Senior Vice President, Treasurer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

⁽¹⁾ Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 000-23827, filed on March 30, 2006.

* Filed herewith.

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.

PC CONNECTION, INC. AND SUBSIDIARIES

Date: May 12, 2006

By: /S/ PATRICIA GALLUP
Patricia Gallup
Chairman and Chief Executive Officer

Date: May 12, 2006

By: /s/ JACK FERGUSON
Jack Ferguson
Senior Vice President, Treasurer and
Chief Financial Officer

PC CONNECTION, INC.

By hand delivery

Mr. Robert F. Wilkins
215 General Miller Road
Peterborough, NH 03458

Dear Bob:

As we have discussed, your employment with PC Connection, Inc. ("PCC" or "the Company") has terminated, effective as of March 30, 2006 (the "Separation Date"). The purpose of this letter is to confirm the agreement between you and the Company concerning your severance arrangements, as follows:

1. **Final Salary and Vacation Pay.** You acknowledge that you have received pay for all work you have performed for the Company during the current payroll period, to the extent not previously paid, as well as pay, at your final base rate of pay, for all vacation days you had earned, but not used, as of the Separation Date determined in accordance with Company policy and as reflected on the books of the Company.

2. **Severance Benefits.** In consideration of your acceptance of this Agreement and subject to your meeting in full your obligations under it and under the Employment Agreement between you and the Company dated December 23, 1995 (the "Employment Agreement"), the Company will provide you the following severance pay and benefits:

(a) The Company will pay you your salary, at your final base rate of pay, for the period of 52 weeks following the Separation Date (the "Severance Pay Period"). Payments will be made in the form of salary continuation and will begin on the next regular Company payday which is at least five business days following the later of the effective date of this Agreement or the date it is received by the Company. The first payment will be retroactive to the day following the Separation Date.

(b) If you were enrolled in the Company's medical and dental plans on the Separation Date, you may elect to continue your participation and that of your eligible dependents in those plans for a period of time under the federal law known as "COBRA." If you do so by signing and returning the COBRA election form no later than the effective date of this Agreement, then, until the conclusion of the Severance Pay Period or, if earlier, until the date you begin new employment, the Company will contribute to the premium cost of your coverage and that of your eligible dependents under those plans at the same rate that it contributes to the premium cost of coverage of active employees and their eligible dependents. To be eligible for these Company premium contributions, however, you must pay the remainder of the premium cost by payroll deduction. You agree to notify the Company immediately if you begin new employment during the Severance Pay Period and to repay promptly any excess contributions made by the Company. After the Company's contributions end, you may continue coverage for the remainder of the COBRA period, if any, by paying the full premium cost plus a small administrative fee.

3. **Withholding.** All payments made by the Company under this Agreement shall be reduced by any tax or other amounts required to be withheld by the Company under applicable law and all other deductions authorized by you.

4. **Acknowledgement of Full Payment.** You acknowledge and agree that the payments provided

under paragraph 1 of this Agreement are in complete satisfaction of any and all compensation due to you from the Company, whether for services provided to the Company or otherwise, through the Separation Date and that, except as expressly provided under this Agreement, no further compensation is owed to you.

5. Status of Employee Benefits, Paid Time Off and Stock Options. Except as otherwise expressly provided in paragraph 2(b) of this Agreement, your participation in all employee benefit plans of the Company has ended as of the Separation Date, in accordance with the terms of those plans. You will not continue to earn vacation or other paid time off after the Separation Date. Your rights and obligations with respect to any stock options granted to you by the Company which had vested as of the Separation Date shall be governed by the applicable stock option plan.

6. Confidentiality and Non-Disparagement.

(a) You agree that you will continue to protect Confidential Information, as defined here, and that you will never, directly or indirectly, use or disclose it. As used in this agreement, "Confidential Information" means any and all information of the Company that is not generally known to others with whom it competes or does business or with whom it plans to compete or do business. Confidential Information also includes all information received by the Company from customers or other third parties with any understanding, express or implied, that the information would not be disclosed.

(b) You agree that you will not disclose this Agreement or any of its terms or provisions, directly or by implication, except to members of your immediate family and to your legal and tax advisors, and then only on condition that they agree not to further disclose this Agreement or any of its terms or provisions to others. You also agree that, during the Severance Pay Period and thereafter, you will not disparage or criticize the Company, its business, its management or its products, and that you will not otherwise do or say anything that could disrupt the good morale of Company employees or harm its interests or reputation.

7. Return of Company Documents and Other Property. In signing this Agreement, you represent and warrant that you have returned to the Company any and all documents, materials and information (whether in hardcopy, on electronic media or otherwise) related to Company business (whether present or otherwise) and all keys, access cards, credit cards, computer hardware and software, telephones and telephone-related equipment and all other property of the Company in your possession or control, with the exception of the computer equipment previously furnished to you by the Company which the Company has agreed that, purged of any software licensed to the Company, you may retain. Further, you represent and warrant that you have not retained any copy or derivative of any Company documents, materials or information (whether in hardcopy, on electronic media or otherwise). Recognizing that your employment with the Company has ended, you agree that you will not, for any purpose, attempt to access or use any Company computer or computer network or system, including without limitation its electronic mail system. Further, you acknowledge that you have disclosed to the Company all passwords necessary or desirable to enable the Company to access all information which you have password-protected on any of its computer equipment or on its computer network or system.

8. Employee Cooperation. You agree to cooperate with the Company hereafter with respect to all matters arising during or related to your employment, including but not limited to all matters in connection with any governmental investigation, litigation or regulatory or other proceeding which may have arisen or which may arise following the signing of this Agreement. The Company will reimburse your out-of-pocket expenses incurred in complying with Company requests hereunder, provided such expenses are authorized by the Company in advance.

9. Release of Claims.

(a) In exchange for the special severance pay and benefits provided you under this Agreement, to which you would not otherwise be entitled, on your own behalf and that of your heirs, executors, administrators, beneficiaries, personal representatives and assigns, you agree that this Agreement shall be in complete and final settlement of any and all causes of action, rights or claims, whether known or unknown, that you have had in the past, now have, or might now have, in any way related to, connected with or arising out of your employment or its termination or pursuant to Title VII of the Civil Rights Act, the Americans with Disabilities Act, the Age Discrimination in Employment Act, the fair employment practices statutes of New Hampshire and any other

states in which you have provided services to the Company or any other federal, state or local law, regulation or other requirement and you hereby release and forever discharge the Company and its subsidiaries and other affiliates and all of their respective past, present and future directors, shareholders, officers, members, managers, general and limited partners, employees, agents, representatives, successors and assigns, and all others connected with any of them, both individually and in their official capacities, from any and all such causes of action, rights or claims.

(b) This Agreement, including the release of claims set forth the paragraph immediately above, creates legally binding obligations and the Company therefore advises you to consult an attorney before signing this Agreement. In signing this Agreement, you give the Company assurance that you have signed it voluntarily and with a full understanding of its terms; that you have had sufficient opportunity, before signing this Agreement, to consider its terms and to consult with an attorney, if you wished to do so, or to consult with any other of those persons to whom reference is made in the first sentence of paragraph 6[b] above; and that, in signing this Agreement, you have not relied on any promises or representations, express or implied, that are not set forth expressly in this Agreement.

10. Miscellaneous.

(a) This Agreement constitutes the entire agreement between you and the Company and supersedes all prior and contemporaneous communications, agreements and understandings, whether written or oral, with respect to your employment, its termination and all related matters, excluding only the Employment Agreement, and your obligations with respect to the securities of the Company, all of which shall remain in full force and effect in accordance with their terms.

(b) This Agreement may not be modified or amended, and no breach shall be deemed to be waived, unless agreed to in writing by you and the Chief Executive Officer of the Company or his/her expressly authorized designee. The captions and headings in this Agreement are for convenience only and in no way define or describe the scope or content of any provision of this Agreement.

(c) The obligation of the Company to make payments to you or on your behalf under this Agreement is expressly conditioned upon your continued full performance of your obligations under this Agreement, and the Employment Agreement.

If the terms of this Agreement are acceptable to you, please sign, date and return it to me within twenty-one days of the date you receive it. You may revoke this Agreement at any time during the seven-day period immediately following the date of your signing. If you do not revoke it, then, at the expiration of that seven-day period, this letter will take effect as a legally-binding agreement between you and the Company on the basis set forth above. The enclosed copy of this letter, which you should also sign and date, is for your records.

Sincerely,
PC CONNECTION, INC.

By: /s/ Bradley Mousseau 3/30/2006
Bradley Mousseau
Sr. Vice President of Human Resources

Accepted and agreed:

Signature: /s/ Robert Wilkins
Robert F. Wilkins

Date: March 30, 2006

CONSULTING AGREEMENT

Consulting Agreement made as of this 30th day of March, 2006, by and between PC Connection, Inc., a New Hampshire Corporation, having a principal place of business at 730 Milford Road, Merrimack, NH 03054 ("PCC" or the "Company"), and Robert F. Wilkins, having a principal place of business at 215 General Miller Road, Peterborough, NH 03458 (the "Consultant").

Whereas PCC wishes to engage the Consultant to perform services as an independent contractor and Consultant wishes to accept such engagement;

Now, therefore, in consideration of the mutual promises of PCC and the Consultant contained in this Agreement, PCC and the Consultant hereby agree as follows:

1. Statement of Services. PCC agrees to retain the Consultant as an independent contractor under the terms and conditions provided in this Agreement. The parties agree that the consulting services will be provided by the Consultant in accordance with both the terms of this Agreement and PCC policy as in effect from time to time.
 - 1.1 The Consultant agrees to provide PCC with agreed-upon consulting services in a timely manner and in accordance with generally accepted professional standards for such services. The Consultant further agrees to furnish PCC with written reports with respect to his consulting services if and when requested by the Company.
 - 1.2 The term of this Agreement shall be for a period of one (1) year, subject to earlier termination in accordance with the provisions of Section 8 hereof.
2. Compensation
 - 2.1 Subject to the Consultant's performance of services to the reasonable satisfaction of PCC, the Consultant's compensation for services rendered under this Agreement (including but not limited to services in connection with the Company's K2 project) shall be paid at the rate of \$22,000.00 per month. If and to the extent that the Consultant remains actively engaged by PCC hereunder through the conclusion of the Company's K2 project, the K2 project successfully hits its agreed milestones and falls within its prescribed budget, and the K2 project yields the Company its anticipated time savings, all as determined by the Company in its reasonable discretion (but in any event, and subject to such determination, upon the expiration of six months from the termination hereof), PCC shall pay the Consultant a one-time, lump sum success bonus of \$40,000.00. Payment of this bonus, if earned, shall be made to the Consultant within ten (10) business days of the Company's determination that the K2 project has been successfully completed, unless the parenthetical in the preceding sentence shall apply. The Company's determination shall be made by reference to the mutually-agreed project specifications, including the funding and personnel assumptions therein.
 - 2.2 The Consultant's fees for services hereunder shall be considered all-inclusive, and the Company shall not be responsible for the reimbursement of meals, overhead costs, or other out of pocket expenses of any kind unless expressly agreed to in writing by the Company's Chief Executive Officer in advance.
 - 2.3 Prior to May 1, 2006, the Consultant shall submit to PCC a master invoice for the services to be furnished during the twelve-month term of this Agreement. PCC shall pay the Consultant monthly in arrears under such invoice, in accordance with the timing of the Company's regular accounts payable cycle.

- 2.4 The Consultant understands and agrees that, as an independent contractor, the Consultant's compensation under this Agreement is not subject to withholding for federal, social security, state or local taxes. The Consultant agrees that all taxes and other legally required payments, and any insurance required by law, shall be the Consultant's sole responsibility, and further agrees to assume all employer obligations imposed by applicable law for the Consultant and his Associates as herein defined. The Consultant agrees to indemnify and hold PCC and all its shareholders, directors, officers, employees, agents, successors and assigns harmless from any and all losses, claims or damages, of whatever name or nature, and all costs and expenses, including without limitation attorneys' fees and any and all other liabilities incurred by any of the foregoing arising out of or in connection with the Consultant's responsibilities under this Section 2.4.
3. Independent Contractor Relationship
- The relationship of the Consultant to PCC is that of an independent contractor, and nothing in this Agreement shall be construed as creating employment or any other type of business relationship. The Consultant will work independently and may adopt such arrangements as the Consultant desires with regard to the details of the consulting services performed under this Agreement, the hours during which such services are to be provided, and the place or places where such services are to be furnished, provided that (i) such details, hours and services shall be consistent with the proper accomplishment of the agreed services, and (ii) such services shall be performed in a manner calculated to attain the most satisfactory results for PCC. The Consultant is free to accept engagements from others during the term of this Agreement, so long as these engagements do not violate the confidentiality, non-competition and assignment of rights provisions of this Agreement, and so long as such engagements do not impair the Consultant's ability to perform his work hereunder.
4. No Eligibility for Employee Benefits
- 4.1 The Consultant understands and agrees that, as an independent contractor, neither the Consultant nor any of his Associates, as herein defined, shall be eligible to participate in, and/or receive benefits under, any PCC employee benefit plan or program.
5. Insurance and Indemnification
- 5.1 The Contractor acknowledges that PCC does not maintain any comprehensive general liability, workers' compensation or other insurance for the benefit of him or his Associates, and that it is the Consultant's sole responsibility to obtain and keep in force such insurance as the Consultant determines to be appropriate. The Consultant assumes all risk in connection with the adequacy of any and all such insurance which the Consultant elects to obtain.
- 5.2 The Consultant hereby agrees to indemnify and hold harmless PCC and its Affiliates and all of their respective shareholders, directors, officers, employees, agents, successors and assigns, from any and all injuries, losses, claims and damages to any person or property, and all reasonable costs and expenses, including without limitation attorneys' fees, and any other liabilities incurred by any of the foregoing, to the extent caused by any negligent action or omission by the Consultant or any of his Associates, except to the extent that any such loss, damage or cost results from the Consultant's following the specific directions or instructions of PCC or its Affiliates.
6. Confidentiality and Non-Competition
- 6.1 The Consultant acknowledges that, during the term hereof, the Consultant and his Associates may develop or learn of Confidential Information, as defined below. The Consultant and his Associates will, at all times, hold in confidence all Confidential Information obtained incident to the provision of services or any other association with PCC or any of its Affiliates, and will never use or disclose any Confidential Information to any third party other than as expressly authorized by the Chief Executive Officer of PCC. The Consultant shall disclose Confidential Information to the Consultant's Associates, and the Consultant's Associates shall disclose Confidential Information to each other, only as required for the proper provision of services hereunder. It is understood and agreed that this restriction will continue to apply after the termination of this Agreement, regardless of the manner of or reason for such termination.

- 6.2 All documents, records and files, in any media of whatever kind and description, relating to the business, present or otherwise, of PCC or any of its Customers and Affiliates, including without limitation those created in connection with any work assignment hereunder, and any copies, in whole or in part, thereof (the "Documents"), whether or not prepared by the Consultant or any of his Associates, shall be the sole and exclusive property of PCC. The Consultant shall safeguard all Documents and shall surrender to PCC at the earlier of (i) the completion of a work assignment or (ii) such other time or times as PCC may request, all Documents related to said work assignment. At the time of termination of this Agreement, or at such earlier time or times as PCC may specify, the Consultant shall return all Documents and other property of PCC then in the possession or control of the Consultant or any of the Consultant's Associates; provided, however, that, if the Document is on electronic media, the Consultant, in lieu of surrender of the Document, may provide a copy on electronic media to PCC and delete and overwrite all other electronic media copies thereof.
- 6.3 During the term of this Agreement, and for two (2) years thereafter, neither the Consultant nor the Consultant's Associates shall, directly or indirectly, compete with PCC or its Affiliates, whether as a contractor, consultant, agent, partner, principal, investor (other than ownership of less than 1% of the voting equity), employee, or accept employment with any Competitor of PCC or its Affiliates.
- 6.4 The Consultant agrees that, during the term of this Agreement and for a period of two (2) years thereafter, neither the Consultant nor any of the Consultant's Associates shall directly or indirectly solicit or encourage any Customer to terminate or diminish its relationship with PCC or any of its Affiliates or to conduct with the Consultant or any of the Consultant's Associates or with any other person, organization or entity any business or activity which such Customer conducts or could conduct with PCC or any of its Affiliates. For purposes of this Agreement, a "Customer" means a person or entity which does business with PCC or any of its Affiliates to which the Consultant provides services hereunder or with which the Consultant is otherwise brought into contact as a result of the Consultant's association with PCC or any of its Affiliates.
- 6.5 The Consultant further agrees that, during the term of this Agreement and for a period of two (2) years thereafter, neither the Consultant nor any of the Consultant's Associates shall, directly or indirectly, (i) hire, solicit, or attempt to hire or otherwise engage, any employee of PCC or any of its Affiliates or any independent contractor who has provided services to the Company or any of its Affiliates within the preceding year without prior written approval from the CEO, (ii) assist in such hiring or engagement by any other person or entity, or (iii) encourage any such employee or independent contractor to terminate or diminish his or her relationship with PCC or any of its Affiliates. General advertising of open positions shall not by itself be deemed to violate this Section 6.5.

7. Assignment of Rights

- 7.1 The Consultant agrees that all Works, as defined below, shall be the sole property of PCC or its designee. The Consultant hereby assigns and agrees to assign to PCC, or its designee, the Consultant's full right, title and interest, if any, to any and all Works and agrees that all copyrightable Works that are created by the Consultant shall be considered "work made for hire." The Consultant agrees to execute, without additional compensation, any further documentation that PCC may request in order to make this assignment fully effective, and agrees to otherwise cooperate fully with PCC in its efforts to obtain and define in the name of PCC any intellectual property or proprietary rights in the Works.
- 7.2 The Consultant agrees to include and maintain all copyright notices on PCC products and services in the following format:

© [PC Connection, Inc.] [year created]

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- 7.3 The Consultant agrees that neither the Consultant nor any of the Consultant's Associates will ever, directly or through another, register any copyright claim on any of the Works, other than on behalf of PCC at the express written direction of its Chief Executive Officer. The Consultant agrees that neither the Consultant nor any of the Consultant's Associates will ever, directly or through another, publish or present any of the Works, other than at the express written direction of the Chief Executive Officer of PCC or her designee.
- 7.4 The Consultant represents and warrants that none of the Works will contain any material that infringes any intellectual property or proprietary rights of third parties. To the extent that material in any of the Works is owned by others (including without limitation one of the Consultant's Associates), the Consultant promises and agrees that written permission will be obtained for publication and re-publication by PCC in a form satisfactory to Company.
- 7.5 The Consultant may elect to incorporate into the Works material as to which the Consultant has a legally protectable interest, such as a copyright. Such incorporated material is hereafter referred to as the "Consultant Material." It is agreed that the Consultant will retain his interest in the Consultant Material and shall be entitled to continue to use the Consultant Material, but PCC shall hold the copyright on any Works into which the Consultant Material is incorporated and hereby grants an irrevocable royalty-free license to PCC for the use of the Consultant Material, including without limitation its publication and republication, its incorporation into other PCC products and services, and its sale to customers of PCC, and as otherwise necessary or desirable in order that PCC and its Customers may fully and freely utilize the Consultant Material.
8. Termination
- 8.1 Either PCC or the Consultant may terminate this Agreement and the Consultant's services hereunder at any time upon 30 days' written notice to the other. PCC may terminate without such notice either for Cause or by providing equivalent compensation in lieu thereof (including an additional 30 days extension of the time period during which any PCC stock options may be exercised).
- 8.2 Upon termination of the Consultant's services other than for Cause, PCC shall be obligated to continue paying the Consultant his \$22,000 per month compensation through the balance of this Agreement's one-year term, but shall have no other economic obligations to the Consultant hereunder. In the event PCC terminates the Consultant's services for Cause, PCC shall have no further obligation to the Consultant other than for any amounts then due and unpaid under the express provisions of this Agreement. The Consultant's obligations under paragraphs 6 and 7 of this Agreement shall survive any termination of the Consultant's services or this Agreement, and shall be binding upon the Consultant and his Associates.
9. Enforcement of Covenants. The Consultant acknowledges that the Consultant has carefully read and considered all the terms and conditions of this Agreement, including the restraints imposed on the Consultant and the Consultant's Associates pursuant to paragraphs 6 and 7 hereof. The Consultant agrees that said restraints are necessary for the reasonable and proper protection of PCC and its Affiliates, and that each and every one of the restraints is reasonable in respect to subject matter, length of time and geographic area. The Consultant further acknowledges that, were the Consultant or any of the Consultant's Associates to breach any of the covenants contained in paragraphs 6 or 7 hereof, the damage to PCC and its Affiliates would be irreparable. The Consultant therefore agrees that PCC, in addition to any other remedies available to it, shall be entitled to preliminary and permanent injunctive relief against any breach or threatened breach by the Consultant or any of the Consultant's Associates of any of said covenants, without having to post bond, as well as an award of its costs and attorney's fees incurred in enforcing its rights hereunder. The parties further agree that, in the event that any provision of paragraphs 6 or 7 hereof shall be determined by any court of competent jurisdiction to be unenforceable by reason of its being extended over too great a time, too large a geographic area or too great a range of activities, such provision shall be deemed to be modified to permit its enforcement to the maximum extent permitted by law.

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10. Conflicting Agreements. The Consultant hereby represents and warrants that the execution of this Agreement and the performance of the obligations of the Consultant and the Consultant's Associates under this Agreement will not breach or be in conflict with any other agreement to which the Consultant or any of the Consultant's Associates is a party or is bound, and will not otherwise violate any obligations that the Consultant or any of the Consultant's Associates may have to any third party, including without limitation obligations arising under any court order.
11. Obligations of Associates of the Consultant. The Consultant shall inform all of the Consultant's Associates of their obligations hereunder, and shall be responsible for the compliance of all of the Consultant's Associates with the terms and provisions of this Agreement.
12. Policies and Procedures Applicable to Consultants.
- 12.1 The Consultant agrees that the Consultant and the Consultant's Associates will comply with all policies, practices and procedures of PCC applicable to independent contractors, including the Company's Code of Business Conduct and Ethics, as these may be changed by the Company from time to time.
- 12.2 The Consultant acknowledges that neither the Consultant nor any of the Consultant's Associates has the authority to obligate PCC or any of its Affiliates to any contracts, in any form, or pledge their credit, and the Consultant agrees that neither the Consultant nor any of the Consultant's Associates will attempt to obligate the Company in any way or form unless expressly authorized in writing by the Chief Executive Officer of PCC.
13. Arbitration. In case any disagreement shall arise between the parties hereto or any person claiming under them in relation to this Agreement, whether as to the construction or operation thereof or the respective rights and liabilities thereunder, such disagreement shall be referred to binding single-arbitrator arbitration. Unless otherwise agreed to by the parties, the arbitration shall be conducted in New Hampshire in accordance with the rules and regulations then in effect of the American Arbitration Association.
14. Definitions.
- 14.1 "Affiliates" means all persons and entities directly or indirectly controlling, controlled by or under common control with PCC, where control may be by management authority or equity interest.
- 14.2 "Associates" means all officers, directors, employees, agents, successors, heirs, executors, administrators, representatives and assigns of the Consultant and all other persons and entities utilized by or associated with the Consultant, in any manner, in connection with the provision of services hereunder.
- 14.3 "Cause" means the Consultant's failure to comply with applicable rules, standards or procedures promulgated by PCC, neglect or substandard performance of assigned responsibilities, falsification of PCC records or documents, or any act of dishonesty or moral turpitude having an adverse effect on PCC or its business.
- 14.4 "Confidential Information" means any and all information of PCC that is not generally known by others with whom PCC competes or does business or with whom PCC plans to compete or do business, and any information received by PCC, or by the Consultant or any of the Consultant's Associates in connection with a work assignment, from customers of PCC or others with any understanding, express or implied, that it will not be disclosed.
- 14.5 "Works" means all inventions, discoveries, compositions, concepts, ideas and the like (whether or not patentable or copyrightable or constituting trade secrets) conceived, made, created, developed or reduced to practice by the Consultant or any of his Associates (whether alone or with others, whether or not during normal business hours and whether on or off PCC premises) during the term of this Agreement that relate in any way to PCC's K2 project, Service Connection project, or any other projects assigned to the Consultant in writing and accepted by the Consultant.

15. Notices.

- 15.1 Any and all notices required or permitted to be given under this Agreement shall be in writing and shall be effective when delivered in person or deposited in the United States mail, postage prepaid, registered or certified, and addressed to the Consultant's last known address on the books of PCC, or, in the case of PCC, to it at its principal place of business, attention of the Chief Executive Officer, or to such other address as either the Consultant or PCC may specify by notice to the other actually received.

16. Miscellaneous.

- 16.1 This Agreement sets forth the entire agreement between PCC and the Consultant and supersedes all prior and contemporaneous agreements and understandings, written or oral, with respect to any services the Consultant or any of the Consultant's Associates may provide to PCC and all related matters, with the exception of the Separation Agreement executed concurrently herewith (the provisions of which shall remain in full force and effect). In accepting this Agreement, the Consultant represents and warrants that the Consultant has not relied on any promises or representations not expressly contained in this Agreement.
- 16.2 This Agreement may not be modified or amended, and no breach shall be deemed to be waived, unless agreed to in a writing signed by the Consultant and the Chief Executive Officer of PCC. The Consultant agrees that the Consultant will not attempt to assign this Agreement or any of the Consultant's rights or obligations under it without the express written consent of the Chief Executive Officer of PCC. If any provision of this Agreement should, for any reason, be held invalid or unenforceable in any respect, it shall not affect any other provisions hereof, and shall be construed by limiting it so as to be enforceable to the maximum extent permissible by law. The captions contained in this Agreement are for convenience of reference only, and in no way define or describe the scope or content of any provision of this Agreement. This Agreement may be executed in two or more counterparts, each of which shall be an original and all of which together shall constitute one and the same instrument.
- 16.3 This is a New Hampshire contract and shall be construed, enforced and governed in all respects by the laws of the State of New Hampshire, without regard to the conflict of laws principles thereof.
- 16.4 Intending to be legally bound by the foregoing, the parties have executed this Agreement as a sealed document as of March 30, 2006, which shall be the effective date of this Agreement.

CONSULTANT:

Signature /s/ Robert F. Wilkins

Name (Please print): Robert Wilkins

Date: March 30, 2006

PC CONNECTION, INC.

By: /s/ Bradley G. Mousseau
Senior V.P. H.R. Brad Mousseau

Date: March 30, 2006

May 12, 2006

PC Connection, Inc.
730 Milford Road
Merrimack, NH 03054

We have made a review, in accordance with the standards of the Public Company Accounting Oversight Board (United States), of the unaudited interim financial information of PC Connection, Inc. and subsidiaries for the periods ended March 31, 2006 and 2005, as indicated in our report dated May 12, 2006 (which included an explanatory paragraph regarding the adoption of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*); because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended March 31, 2006, is incorporated by reference in Registration Statement Nos. 333-40172, 333-50845, 333-50847, 333-66450, 333-69981, 333-83943, 333-91584, 333-106652, and 333-130389 on Form S-8.

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

DELOITTE & TOUCHE LLP
Boston, Massachusetts

CERTIFICATIONS

I, Patricia Gallup, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of PC Connection, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Not applicable;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2006

/s/ Patricia Gallup

Patricia Gallup
President and Chief Executive Officer

CERTIFICATIONS

I, Jack Ferguson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of PC Connection, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Not applicable;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 12, 2006

/s/ Jack Ferguson

Jack Ferguson

Senior Vice President, Treasurer and Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report on Form 10-Q of PC Connection, Inc. (the "Company") for the period ended March 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Patricia Gallup, President and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 350, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 12, 2006

/s/ Patricia Gallup

Patricia Gallup

President and Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report on Form 10-Q of PC Connection, Inc. (the "Company") for the period ended March 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Jack Ferguson, Senior Vice President, Treasurer and Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 12, 2006

/s/ Jack Ferguson

Jack Ferguson

Senior Vice President, Treasurer and Chief Financial Officer