
**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 June 30, 2007

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)

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

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

03054
(Zip Code)

(603) 683-2000

Registrant's telephone number, including area code

Former name, former address and former fiscal year, if changed since last report: N/A

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 as of July 27, 2007 was 26,824,301.

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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 June 30, 2007, and the related condensed consolidated statements of income for the three-month and six-month periods ended June 30, 2007 and 2006, and the condensed consolidated statement of changes in stockholders’ equity for the six-month period ended June 30, 2007, and the condensed consolidated statements of cash flows for the six-month periods ended June 30, 2007 and 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 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, 2006, 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 28, 2007, 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, 2006 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

As discussed in Note 3 to the condensed consolidated interim financial statements, effective January 1, 2007, the Company adopted Financial Accounting Standards Board (“FASB”) Interpretation No. 48, “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement 109, Accounting for Income Taxes.”

DELOITTE & TOUCHE LLP
Boston, Massachusetts
August 10, 2007

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

	June 30, 2007 <i>(unaudited)</i>	December 31, 2006
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 17,466	\$ 17,582
Accounts receivable, net	169,303	170,222
Inventories—merchandise	75,242	69,407
Deferred income taxes	4,493	3,837
Income taxes receivable	797	627
Prepaid expenses and other current assets	3,642	3,882
Total Current Assets	270,943	265,557
Property and equipment, net	19,749	19,542
Goodwill	56,867	56,867
Other intangibles, net	3,827	4,363
Other assets	390	355
Total Assets	\$351,776	\$ 346,684
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current maturities of capital lease obligations:		
To affiliate	\$ 490	\$ 464
To third party	182	395
Accounts payable	100,809	110,977
Accrued expenses and other liabilities	19,028	17,389
Accrued payroll	7,838	9,367
Total Current Liabilities	128,347	138,592
Capital lease obligation, less current maturities:		
To affiliate	4,585	4,836
Other liabilities	2,488	—
Deferred income taxes	7,087	6,352
Total Liabilities	142,507	149,780
Stockholders' Equity:		
Common stock	272	269
Additional paid-in capital	93,107	89,537
Retained earnings	118,113	109,321
Treasury stock at cost	(2,223)	(2,223)
Total Stockholders' Equity	209,269	196,904
Total Liabilities and Stockholders' Equity	\$351,776	\$ 346,684

See notes to unaudited 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 June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales	\$441,122	\$408,094	\$839,302	\$788,572
Cost of sales	<u>387,082</u>	<u>357,351</u>	<u>735,347</u>	<u>691,411</u>
Gross profit	54,040	50,743	103,955	97,161
Selling, general and administrative expenses	45,005	44,534	89,198	86,489
Special charges	—	450	—	1,341
Income from operations	9,035	5,759	14,757	9,331
Interest expense	(242)	(437)	(450)	(1,081)
Other, net	<u>260</u>	<u>(15)</u>	<u>461</u>	<u>(4)</u>
Income before taxes	9,053	5,307	14,768	8,246
Income tax provision	<u>(3,300)</u>	<u>(2,196)</u>	<u>(5,630)</u>	<u>(3,429)</u>
Net income	\$ 5,753	\$ 3,111	\$ 9,138	\$ 4,817
Weighted average common shares outstanding:				
Basic	<u>26,798</u>	<u>25,283</u>	<u>26,740</u>	<u>25,271</u>
Diluted	<u>26,995</u>	<u>25,396</u>	<u>27,002</u>	<u>25,372</u>
Earnings per common share:				
Basic	<u>\$.21</u>	<u>\$.12</u>	<u>\$.34</u>	<u>\$.19</u>
Diluted	<u>\$.21</u>	<u>\$.12</u>	<u>\$.34</u>	<u>\$.19</u>

See notes to unaudited 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

Six Months Ended June 30, 2007

(Unaudited)

(amounts in thousands)

	<u>Common Shares</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Treasury Shares</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>			<u>Shares</u>	<u>Amount</u>	
Balance—January 1, 2007	26,862	\$ 269	\$ 89,537	\$ 109,321	(352)	\$ (2,223)	\$ 196,904
Cumulative effect of change in accounting principle	—	—	—	(346)	—	—	(346)
Stock compensation expense	—	—	(23)	—	—	—	(23)
Exercise of stock options, including income tax benefits	304	3	3,459	—	—	—	3,462
Issuance of stock under Employee Stock Purchase Plan	10	—	134	—	—	—	134
Net income	—	—	—	9,138	—	—	9,138
Balance—June 30, 2007	<u>27,176</u>	<u>\$ 272</u>	<u>\$ 93,107</u>	<u>\$ 118,113</u>	<u>(352)</u>	<u>\$ (2,223)</u>	<u>\$ 209,269</u>

See notes to unaudited 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)

	Six Months Ended June 30,	
	2007	2006
Cash Flows from Operating Activities:		
Net income	\$ 9,138	\$ 4,817
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,472	3,456
Provision for doubtful accounts	894	1,752
Deferred income taxes	79	1,267
Loss on disposal of fixed assets	8	63
Stock compensation expense	(23)	202
Excess tax benefit from exercise of stock options	(358)	—
Income tax benefit from exercise of stock options	918	17
Changes in assets and liabilities:		
Accounts receivable	25	(1,142)
Inventories	(5,835)	7,721
Prepaid expenses and other current assets	70	799
Other non-current assets	(35)	7
Accounts payable	(10,168)	(17,723)
Accrued expenses and other liabilities	2,252	4,185
Net cash provided by operating activities	<u>437</u>	<u>5,421</u>
Cash Flows from Investing Activities:		
Purchases of property and equipment	(3,151)	(4,647)
Proceeds from sale of property and equipment	—	20
Net cash used for investing activities	<u>(3,151)</u>	<u>(4,627)</u>
Cash Flows from Financing Activities:		
Proceeds from short-term borrowings	1,461	244,402
Repayment of short-term borrowings	(1,461)	(246,377)
Repayment of capital lease obligations	(438)	(406)
Exercise of stock options	2,544	227
Excess tax benefit from exercise of stock options	358	—
Issuance of stock under Employee Stock Purchase Plan	134	120
Net cash provided by (used for) financing activities	<u>2,598</u>	<u>(2,034)</u>
Decrease in cash and cash equivalents	(116)	(1,240)
Cash and cash equivalents, beginning of period	17,582	9,770
Cash and cash equivalents, end of period	<u>\$ 17,466</u>	<u>\$ 8,530</u>

See notes to unaudited 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 (the “Company,” “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, 2006 filed with the Securities and Exchange Commission (the “SEC”). 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 and six months ended June 30, 2007 may not be indicative of the results expected for any succeeding quarter or the entire year ending December 31, 2007.

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.

Similarly, we recognize revenue from agency sales transactions on a net sales basis. In agency sales transactions, we facilitate product sales by manufacturers directly to our customers and receive agency fees for

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

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, or SG&A, expenses. Total direct operating expenses relating to these functions included in SG&A expenses for the periods reported are shown below:

	<u>Three Months Ended</u>	<u>Six Months Ended</u>
June 30, 2007	\$ 2,728	\$ 5,516
June 30, 2006	2,708	5,406

Advertising Costs and Allowances

Costs of producing and distributing catalogs are charged to expense in the month the respective catalog is issued. 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 incremental and identifiable costs, are offset against SG&A expenses. Advertising allowances 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 02-16.

Gross advertising allowances received from vendors were \$8,316 and \$8,425 for the three months ended June 30, 2007 and 2006, respectively. We classified \$8,316 and \$6,503 of these allowances as offsets to cost of sales or inventory for the three months ended June 30, 2007 and 2006, respectively. Gross advertising allowances received from vendors were \$15,884 and \$15,645 for the six months ended June 30, 2007 and 2006, respectively. We classified \$15,884 and \$11,833 of these allowances as offsets to cost of sales or inventory for the six months ended June 30, 2007 and 2006, respectively. As advertising programs with our vendor partners have become more comprehensive, we have classified substantially all vendor consideration as a reduction of cost of inventory purchases rather than a reduction of advertising expense.

PC CONNECTION, INC. AND SUBSIDIARIES
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)
(amounts in thousands, except per share data)

Goodwill and Other Intangible Assets

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 in January 2007 and determined that our goodwill and trademarks were not impaired.

	<u>June 30,</u> <u>2007</u>
Goodwill	<u>\$56,867</u>
Trademarks	<u>1,190</u>

Intangible assets subject to amortization at June 30, 2007 consisted of customer lists of \$2,370 and a licensing agreement of \$267 (net of accumulated amortization of \$2,851 and \$208, respectively). Intangible assets subject to amortization at December 31, 2006 consisted of customer lists of \$2,846 and a licensing agreement of \$327 (net of accumulated amortization of \$2,374 and \$148, respectively). For the three-month periods ended June 30, 2007 and 2006, we recorded amortization expenses of \$268 and \$268, respectively. For the six-month periods ended June 30, 2007 and 2006, we recorded amortization expenses of \$536 and \$529, respectively.

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

<u>For the Year Ended December 31,</u>	
2007	\$ 536(A)
2008	1,071
2009	942
2010	88
2011 and thereafter	—

(A) Represents estimated amortization expense for the six months ending December 31, 2007.

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.

Share-Based Compensation

Effective January 1, 2006, we adopted Financial Accounting Standards Board (“FASB”) Statement No. 123 (revised), or SFAS 123(R), using the modified prospective application method. SFAS 123(R) requires a company to measure the grant date fair value of equity awards given to employees and recognize that cost, adjusted for forfeitures, over the period that such services are performed in its consolidated financial statements. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures experienced differ from these estimates. See Note 10, “Stockholders’ Equity and Share-Based

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

Compensation” of Notes to Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended December 31, 2006, to review the effect of adoption of SFAS 123(R) on our financial statements.

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 restricted stock and options outstanding to purchase common stock using the treasury stock method.

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

<u>June 30,</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Numerator:				
Net income	<u>\$ 5,753</u>	<u>\$ 3,111</u>	<u>\$ 9,138</u>	<u>\$ 4,817</u>
Denominator:				
Denominator for basic earnings per share	<u>26,798</u>	25,283	<u>26,740</u>	25,271
Dilutive effect of employee equity awards	<u>197</u>	113	<u>262</u>	101
Denominator for diluted earnings per share	<u>26,995</u>	<u>25,396</u>	<u>27,002</u>	<u>25,372</u>
Earnings per share:				
Basic	<u>\$.21</u>	<u>\$.12</u>	<u>\$.34</u>	<u>\$.19</u>
Diluted	<u>\$.21</u>	<u>\$.12</u>	<u>\$.34</u>	<u>\$.19</u>

The following unexercised stock options were excluded from the computation of diluted earnings per share for the three and six months ended June 30, 2007 and 2006 because the exercise prices of these options were generally greater than the average market price of common stock during the respective periods:

<u>June 30,</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Anti-dilutive stock options	<u>207</u>	<u>3,797</u>	<u>209</u>	<u>4,038</u>

Note 3—Recently Issued Accounting Standards

Effective January 1, 2007, we adopted FASB Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, Accounting for Income Taxes.” FIN 48 requires that the financial statement effects of a tax position taken or expected to be taken in a tax return to be recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. The cumulative effect of applying FIN 48 was \$346 and was recorded as an adjustment reducing the January 1, 2007 balance of retained earnings. See Note 7, “Income Taxes.”

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)

Effective January 1, 2007, we adopted the additional disclosure provisions of EITF Issue No. 06-03, “How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement.” EITF No. 06-03 permits the presentation of these taxes on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues). We classify sales taxes on a net basis in our income statements. Adoption of EITF No. 06-03 did not have an effect on our financial statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” which permits companies to voluntarily choose, at specified election dates, to measure specified financial instruments and other items at fair value on a contract-by-contract basis. Subsequent changes in fair value will be required to be reported in earnings each reporting period. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We do not expect SFAS 159 to have a material impact on our results of operation or financial position.

Note 4—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 entities and educational institutions.

Segment information applicable to our reportable operating segments for the three and six months ended June 30, 2007 and 2006 is shown below:

	Three Months Ended June 30, 2007				
	SMB Segment	Large Account Segment	Public Sector Segment	Eliminations	Consolidated
Sales to external customers	\$231,935	\$ 133,602	\$ 75,585	\$ —	\$ 441,122
Transfers between segments	73,041	—	—	(73,041)	—
Net Sales	<u>\$304,976</u>	<u>\$ 133,602</u>	<u>\$ 75,585</u>	<u>\$ (73,041)</u>	<u>\$ 441,122</u>
Operating income before allocations	\$ 14,438	\$ 7,810	\$ 3,598	\$ (16,811)	\$ 9,035
Allocations	(13,080)	20	(3,751)	16,811	—
Operating income (loss)	\$ 1,358	\$ 7,830	\$ (153)	\$ —	\$ 9,035
Interest and other—net	2	22	(6)	—	18
Income (loss) before taxes	<u>\$ 1,360</u>	<u>\$ 7,852</u>	<u>\$ (159)</u>	<u>\$ —</u>	<u>\$ 9,053</u>
<i>Selected Operating Expenses:</i>					
Depreciation and amortization	\$ 1,259	\$ 296	\$ 29	\$ —	\$ 1,584

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)

	Three Months Ended June 30, 2006				
	SMB Segment	Large Account Segment	Public Sector Segment	Eliminations	Consolidated
Sales to external customers	\$ 215,108	\$ 128,333	\$ 64,653	\$ —	\$ 408,094
Transfers between segments	67,325	—	—	(67,325)	—
Net Sales	<u>\$ 282,433</u>	<u>\$ 128,333</u>	<u>\$ 64,653</u>	<u>\$ (67,325)</u>	<u>\$ 408,094</u>
Operating income before allocations	\$ 14,491	\$ 7,007	\$ 1,459	\$ (17,198)	\$ 5,759
Allocations	(13,121)	(202)	(3,875)	17,198	—
Operating income (loss)	\$ 1,370	\$ 6,805	\$ (2,416)	\$ —	\$ 5,759
Interest and other—net	(334)	21	(139)	—	(452)
Income (loss) before taxes	<u>\$ 1,036</u>	<u>\$ 6,826</u>	<u>\$ (2,555)</u>	<u>\$ —</u>	<u>\$ 5,307</u>
<i>Selected Operating Expenses:</i>					
Depreciation and amortization	\$ 1,380	\$ 353	\$ 25	\$ —	\$ 1,758
Special Charges	—	—	450	—	450

	Six Months Ended June 30, 2007				
	SMB Segment	Large Account Segment	Public Sector Segment	Eliminations	Consolidated
Sales to external customers	\$ 465,868	\$ 243,917	\$ 129,517	\$ —	\$ 839,302
Transfers between segments	125,926	—	—	(125,926)	—
Net Sales	<u>\$ 591,794</u>	<u>\$ 243,917</u>	<u>\$ 129,517</u>	<u>\$ (125,926)</u>	<u>\$ 839,302</u>
Operating income before allocations	\$ 30,359	\$ 13,349	\$ 4,798	\$ (33,749)	\$ 14,757
Allocations	(26,331)	(230)	(7,188)	33,749	—
Operating income (loss)	\$ 4,028	\$ 13,119	\$ (2,390)	\$ —	\$ 14,757
Interest and other—net	(16)	41	(14)	—	11
Income (loss) before taxes	<u>\$ 4,012</u>	<u>\$ 13,160</u>	<u>\$ (2,404)</u>	<u>\$ —</u>	<u>\$ 14,768</u>
<i>Selected Operating Expenses:</i>					
Depreciation and amortization	<u>\$ 2,730</u>	<u>\$ 685</u>	<u>\$ 57</u>	<u>\$ —</u>	<u>\$ 3,472</u>
<i>Balance Sheet Data:</i>					
Total assets	\$ 237,433	\$ 143,752	\$ 66,503	\$ (95,912)	\$ 351,776
Goodwill	1,173	48,060	7,634	—	56,867

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)

	Six Months Ended June 30, 2006				
	SMB Segment	Large Account Segment	Public Sector Segment	Eliminations	Consolidated
Sales to external customers	\$ 434,229	\$ 236,695	\$ 117,648	\$ —	\$ 788,572
Transfers between segments	120,894	—	—	(120,894)	—
Net Sales	\$ 555,123	\$ 236,695	\$ 117,648	\$ (120,894)	\$ 788,572
Operating income before allocations	\$ 30,686	\$ 11,774	\$ 2,596	\$ (35,725)	\$ 9,331
Allocations	(27,532)	(434)	(7,759)	35,725	—
Operating income (loss)	\$ 3,154	\$ 11,340	\$ (5,163)	\$ —	\$ 9,331
Interest and other—net	(840)	39	(284)	—	(1,085)
Income (loss) before taxes	\$ 2,314	\$ 11,379	\$ (5,447)	\$ —	\$ 8,246
<i>Selected Operating Expenses:</i>					
Depreciation and amortization	\$ 2,682	\$ 711	\$ 63	\$ —	\$ 3,456
Special Charges	998	9	334	—	1,341
<i>Balance Sheet Data:</i>					
Total assets	\$ 235,141	\$ 146,020	\$ 66,555	\$ (119,483)	\$ 328,233
Goodwill	1,173	48,060	7,634	—	56,867

The operating costs of corporate headquarters functions are charged to the reportable operating segments based on their estimated usage of the underlying functions. These functions include finance, human resources, information systems, purchasing and distribution, and senior management expenses. We report these charges to the above segments as “Allocations.” Interest and other expense is charged to the segments, based on 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 and transfers reported above and from inter-segment service charges. Our capital expenditures are primarily comprised of IT hardware and software purchased to maintain or upgrade our management information systems. These systems serve all of our subsidiaries, to varying degrees, and as a result, our CODM does not evaluate capital expenditures by segment.

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

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

June 30,	Three Months Ended		Six Months Ended	
	2007	2006	2007	2006
<i>Segment (excludes transfers between segments)</i>				
SMB	\$ 231,935	\$ 215,108	\$ 465,868	\$ 434,229
Large Account	133,602	128,333	243,917	236,695
Public Sector	75,585	64,653	129,517	117,648
Total	441,122	408,094	839,302	788,572
<i>Product Mix</i>				
Notebooks and PDAs	\$ 72,374	\$ 73,377	\$ 146,017	\$ 137,920
Desktop/Servers	62,479	55,893	120,007	112,388
Storage Devices	39,649	34,170	74,457	68,088
Software	56,205	51,656	104,491	99,579
Net/Com Products	35,630	32,946	65,449	62,799
Printers and Printer Supplies	41,743	40,684	83,396	80,718
Video, Imaging, and Sound	59,146	51,403	107,247	98,271
Memory and System Enhancements	24,032	19,892	43,981	38,748
Accessories/Other	49,864	48,073	94,257	90,061
Total	\$ 441,122	\$ 408,094	\$ 839,302	\$ 788,572

Substantially all of our net sales for the six months ended June 30, 2007 and 2006 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 June 30, 2007 and December 31, 2006 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 3% of total net sales in the three and six months ended June 30, 2007 and 2006. Net sales to the federal government accounted for \$18,356, or 4.2% of total net sales for the three months ended June 30, 2007, and \$13,053, or 3.2% of total net sales for the three months ended June 30, 2006. Net sales to the federal government accounted for \$31,649, or 3.8% of total net sales for the six months ended June 30, 2007, and \$25,903, or 3.3% of total net sales for the six months ended June 30, 2006.

Note 5—Share Based Compensation

The terms and conditions of outstanding awards previously granted are more fully described in Note 10 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2006. We did not grant any equity awards in the three and six months ended June 30, 2007.

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)***Note 6—Special Charges**

We did not record any special charges in the six months ended June 30, 2007. In the six months ended June 30, 2006, we recorded a charge of \$450 related to our review of a 2003 contract cancellation by the General Services Administration (“GSA”) and a charge of \$371 related to the temporary retention of facilities subsequent to our purchase of certain assets of Amherst Technologies, LLC (“Amherst transaction”). We also recorded a charge of \$520 in the six months ended June 30, 2006 related to management restructuring costs, classified as workforce reductions in the table below.

A roll forward of special charges for the six months ended June 30, 2007 is shown below.

	Workforce Reductions
Balance December 31, 2006	\$ 185
Charges	—
Cash payments	(185)
Liabilities at June 30, 2007	<u>\$ —</u>

The liability at December 31, 2006 is included in accrued expenses and other liabilities on the consolidated balance sheet.

Note 7—Income Taxes

We file one consolidated United States federal income tax return that includes all of our subsidiaries as well as several consolidated, combined, and separate company returns in many U.S. state tax jurisdictions. The tax years 2003-2006 remain open to examination by the major taxing jurisdictions in which we file.

Effective January 1, 2007, we adopted the provisions of FIN 48. As a result of the implementation of FIN 48, we recognized an increase of \$953 in the liability for unrecognized income tax benefits, a decrease of \$607 in the noncurrent liability for deferred income taxes, and a cumulative effect decrease of \$346 in the January 1, 2007 balance of retained earnings. As of the date of adoption and after recognition of the increase noted above, the aggregate liability for unrecognized income tax benefits is \$2,169, including interest and penalties. This balance includes \$607 relating to tax positions, the disallowance of which would not affect our annual effective income tax rate.

We have elected to continue our historic treatment for interest and penalties, recognizing potential interest and penalties related to unrecognized income tax benefits as a component of income tax expense, and the corresponding accrual is included as a component of our liability for unrecognized income tax benefits. Pursuant to our adoption of FIN 48, \$711 and \$236 of this liability as of January 1, 2007 related to interest and penalties, respectively. During the six months ended June 30, 2007, we recognized an additional \$319 liability for unrecognized income tax positions relating to tax positions taken in the current and prior periods. Of this amount, \$162 relates to additional interest and

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

(amounts in thousands, except per share data)

penalties associated with unrecognized tax benefits for total interest and penalties at June 30, 2007 of \$1,109. As of June 30, 2007, unrecognized tax benefits of \$1,794 would favorably affect our effective tax rate, if recognized.

We do not anticipate that total unrecognized tax benefits will change significantly due to the settlement of audits, expiration of statute of limitations, or other reasons prior to December 31, 2007.

Note 8—Commitments and Contingencies

We are subject to various legal proceedings and claims which have arisen during the ordinary course of business. 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 audits by states on sales and income taxes, unclaimed property, and other assessments. A multi-state unclaimed property audit is in progress, and certain sales tax audits may be imminent. While management believes that known liabilities have been adequately provided for, it is too early to determine the ultimate outcome of such audits. Such outcome could have a material impact on our results of operations and financial condition.

Note 9—Bank Borrowing and Trade Credit Arrangements

We have a \$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 (8.25% at June 30, 2007). 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. Funded debt ratio is the ratio of average outstanding advances under the facility to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation, and Amortization). The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at June 30, 2007 was 0.0 to 1.0 as our average borrowings during the three months ended June 30, 2007, were not material. The entire \$50,000 facility was available for borrowing at June 30, 2007. The credit facility matures on June 29, 2008, at which time amounts outstanding become due.

At June 30, 2007, 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 first position in certain branded products inventory financed by these 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 June 30, 2007 and December 31, 2006, accounts payable included \$13,465 and \$17,421, 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 Item 1A “Risk Factors” of this Quarterly Report on Form 10-Q.

OVERVIEW

We are a national direct marketer and procurement service provider 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 configuration, installation, repair, 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 government entities 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.

The primary challenges we face in effectively managing our business are (1) growing our revenues in the face of increasing competition 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 SG&A expenses over a higher sales base. We believe that our future success hinges on the ability of our sales representatives to foster loyal customer relationships. Only by better understanding and anticipating our customers’ IT needs will we strengthen customer loyalty, which we believe, will result in increased productivity of sales representatives and improved operating margins.

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.

June 30,	Three Months Ended		Six Months Ended	
	2007	2006	2007	2006
Net sales (<i>in millions</i>)	\$441.1	\$408.1	\$839.3	\$788.6
Net sales	100.0%	100.0%	100.0%	100.0%
Gross margin	12.3	12.4	12.4	12.3
Selling, general and administrative expenses	10.3	10.9	10.6	10.9
Special charges	—	0.1	—	0.2
Income from operations	2.0%	1.4%	1.8%	1.2%

Our year-over-year increase in sales in the three and six months ended June 30, 2007, resulted from sales growth in all three segments.

Gross margins benefited in the 2007 periods from our recording of substantially all vendor consideration as a reduction to cost of inventory purchases. As advertising programs with our vendor partners have become more

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comprehensive, we have classified substantially all vendor consideration as a reduction of cost of inventory purchases rather than a reduction of advertising expense. Accordingly, this additional consideration in the three and six months ended June 30, 2007, accounted for 22 and 39 basis-point increases, respectively, in gross margin and in SG&A expenses as a percentage of net sales, compared to the prior year periods. The increase in gross margin from these vendor allowances was offset by lower invoice product margins in the three and six months ended June 30, 2007, compared to the corresponding prior year periods.

Our operating margins increased year over year in the three and six months ended June 30, 2007, due to reductions in operating expenses and special charges.

Net Sales Distribution

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

<u>June 30,</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Business Segment				
SMB	53%	53%	56%	55%
Large Account	30	31	29	30
Public Sector	17	16	15	15
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
Product Mix				
Notebooks and PDAs	16%	18%	17%	18%
Desktop/Servers	14	14	14	14
Storage Devices	9	8	9	9
Software	13	13	13	13
Net/Com Products	8	8	8	8
Printers and Printer Supplies	10	10	10	10
Videos, Imaging, and Sound	13	12	13	12
Memory and System Enhancements	6	5	5	5
Accessories/Other	11	12	11	11
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

Gross Profit Margins

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

<u>June 30,</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Business Segment				
SMB	13.3%	13.8%	13.4%	13.6%
Large Account	11.3	10.7	11.1	10.6
Public Sector	10.8	11.3	11.2	11.0
Total	<u>12.3%</u>	<u>12.4%</u>	<u>12.4%</u>	<u>12.3%</u>

Consolidated gross profit dollars increased by \$3.3 million for the second quarter of 2007 from the second quarter of 2006 and increased by \$6.8 million for the six months ended June 30, 2007, over the prior year period.

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The year-over-year dollar increases in three- and six-month periods ended June 30, 2007, were due to increased net sales and, as discussed above, additional vendor consideration recorded as a reduction to cost of sales. Lower customer invoice product margins were partly offset by increased sales of higher margin services and by increased agency fees for Microsoft enterprise software agreement renewals.

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:

<u>June 30,</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Purchasing/Distribution Center	0.62%	0.66%	0.66%	0.69%

Operating Expenses

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

<u>June 30,</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Personnel costs	\$ 29.8	\$ 29.5	\$ 59.6	\$ 58.9
Advertising, net	5.1	3.6	9.7	5.8
Facilities operations	2.2	2.3	4.6	4.5
Credit card fees	2.0	1.8	4.0	3.8
Depreciation and amortization	1.6	1.8	3.5	3.5
Bad debts	0.4	0.6	0.6	1.4
Other, net	3.9	4.9	7.2	8.6
Total	\$ 45.0	\$ 44.5	\$ 89.2	\$ 86.5
Percentage of net sales	10.3%	10.9%	10.6%	10.9%

Personnel costs continue to represent the majority of our operating expenses, with sales personnel representing the largest portion of these costs. The increase in net advertising expense in the three- and six-month periods ended June 30, 2007, was attributable in large part to the additional vendor consideration discussed above, which previously would have offset net advertising expense. The year-over-year decrease in other costs is attributable primarily to decreases in compliance expense in the three and six months ended June 30, 2007.

[Table of Contents](#)**Year-Over-Year Comparisons****Three Months Ended June 30, 2007 Compared to Three Months Ended June 30, 2006**

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

	Three Months Ended June 30,				
	2007		2006		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
Sales:					
SMB	\$ 231.9	52.6%	\$ 215.1	52.7%	7.8%
Large Account	133.6	30.3	128.3	31.4	4.1
Public Sector	75.6	17.1	64.7	15.9	16.8
Total	<u>\$ 441.1</u>	<u>100.0%</u>	<u>\$ 408.1</u>	<u>100.0%</u>	8.1%
Gross Profit:					
SMB	\$ 30.8	13.3%	\$ 29.6	13.8%	4.1%
Large Account	15.1	11.3	13.8	10.7	9.4
Public Sector	8.1	10.8	7.3	11.3	11.0
Total	<u>\$ 54.0</u>	<u>12.3%</u>	<u>\$ 50.7</u>	12.4%	6.5%

Net sales for the second quarter of 2007 increased compared to the second quarter of 2006, as explained by the following:

- Net sales for our SMB segment increased due to a 14% growth in corporate outbound sales compared to the prior year quarter. We believe such growth is attributable to the success of our sales representatives in acquiring a greater share of customers' IT purchasing. Decreased consumer sales during the second quarter of 2007 dampened overall SMB sales growth, reflecting our continued focus on more diverse marketing strategies and programs designed to reach our business customers. Sales representatives for our SMB segment totaled 439 at June 30, 2007, compared to 465 at June 30, 2006.
- Net sales for our Large Account segment increased modestly year over year reflecting the moderate growth experienced in the large enterprise market during the second quarter of 2007. Sales representatives for our Large Account segment totaled 74 at June 30, 2007, compared to 88 at June 30, 2006.
- Net sales for our Public Sector segment increased due to increased sales made under recently awarded federal and state government contracts, as well as the acquisition of new accounts. Sales representatives for our Public Sector segment totaled 112 at June 30, 2007, compared to 106 at June 30, 2006.

Gross profit for the second quarter of 2007 increased compared to the second quarter of 2006 in dollars but decreased as a percentage of sales as explained by the following:

- Gross profit for our SMB segment increased due to an increase in sales, partially offset by a decrease in gross profit margins. Lower invoice product margins and additional costs associated with certain customer rebate programs in the second quarter of 2007 offset the additional vendor consideration discussed earlier.
- Gross profit for our Large Account segment increased due to increases in both sales and gross profit margins. Gross profit margins increased year over year by 56 basis points as a percentage of net sales. Increased product margins and service revenues contributed to higher gross margins in this segment.

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- Gross profit for our Public Sector segment increased due to increased sales, partly offset by a decrease in gross profit margins. Decreased agency fees were partly offset by higher invoice product margins in this segment.

Selling, general and administrative expenses increased slightly for the second quarter of 2007 but decreased as a percentage of sales as compared to the second quarter of 2006.

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

	Three Months Ended June 30,				
	2007		2006		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
SMB	\$ 29.5	12.7%	\$ 28.3	13.2%	4.2%
Large Account	7.2	5.4	6.9	5.4	4.3
Public Sector	8.3	11.0	9.3	14.4	(10.8)
Total	\$ 45.0	10.3%	\$ 44.5	10.9%	1.1%

- SG&A expenses for our SMB segment increased in dollars primarily due to increased net advertising expense resulting from the recording of substantially all vendor allowances as a reduction to cost of sales, as discussed earlier.
- SG&A expenses for our Large Account segment increased in dollars in the second quarter of 2007 but were level as a percentage of net sales compared to the prior year quarter. The dollar increase resulted primarily from incremental sales compensation and other operating costs associated with higher sales levels.
- SG&A expenses for our Public Sector segment decreased in both dollars and as a percentage of net sales in the second quarter of 2007. The year-over-year decreases are attributable to a decrease in compliance expense and lower personnel cost in the second quarter of 2007 compared to the prior year quarter.

We did not record any special charges in the three months ended June 30, 2007. In the three months ended June 30, 2006, we recorded a charge of \$0.5 million related to our review of a 2003 contract cancellation by the GSA. Liabilities related to special charges are included in accrued expenses and other liabilities on the consolidated balance sheet as of December 31, 2006.

Income from operations increased by \$3.2 million to \$9.0 million for the second quarter of 2007 from \$5.8 million for the second quarter of 2006. Income from operations as a percentage of net sales increased to 2.0% for the second quarter of 2007 from 1.4% for the second quarter of 2006. Improved expense leverage and cost reductions in the second quarter of 2007 accounted for the improvement in SG&A as a percentage of net sales as compared to the second quarter of 2006.

Interest expense decreased due to lower average borrowings outstanding in the second quarter of 2007 as compared to the second quarter of 2006.

Our effective tax rate was 36.5% for the second quarter of 2007 and 41.4% for the second quarter of 2006. The year-over-year decrease in effective tax rate was due to a prior year state income tax settlement in the second quarter of 2007.

Net income increased to \$5.8 million for the second quarter of 2007 from \$3.1 million for the second quarter of 2006, principally as a result of the increase in income from operations and the decrease in the effective tax rate.

[Table of Contents](#)**Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006**

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

	Six Months Ended June 30,				
	2007		2006		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
Sales:					
SMB	\$465.9	55.5%	\$434.2	55.1%	7.3%
Large Account	243.9	29.1	236.7	30.0	3.0
Public Sector	129.5	15.4	117.7	14.9	10.0
Total	<u>\$839.3</u>	<u>100.0%</u>	<u>\$788.6</u>	<u>100.0%</u>	6.4%
Gross Profit:					
SMB	\$ 62.4	13.4%	\$ 59.1	13.6%	5.6%
Large Account	27.0	11.1	25.1	10.6	7.6
Public Sector	14.6	11.3	13.0	11.0	12.3
Total	<u>\$104.0</u>	<u>12.4%</u>	<u>\$ 97.2</u>	<u>12.3%</u>	7.0

Net sales for the six months ended June 30, 2007 increased compared to the six months ended June 30, 2006, in all three segments, as explained by the following:

- Net sales for our SMB segment increased due to our 13% growth in corporate outbound sales compared to the comparable prior year period. We believe such growth is attributable to sales representatives' success in acquiring a greater share of customers' IT purchasing. Decreased consumer sales during the first half of 2007 dampened overall SMB sales growth, reflecting our continued focus on more diverse marketing strategies and programs designed to reach our business customers. Sales representatives for our SMB segment totaled 439 at June 30, 2007, compared to 465 at June 30, 2006.
- Net sales for our Large Account segment increased modestly year over year. We experienced pent-up demand in the first quarter of 2006 due to the Amherst transaction which limited year-over-year growth in the first half of 2007. Sales representatives for our Large Account segment totaled 74 at June 30, 2007, compared to 88 at June 30, 2006.
- Net sales for our Public Sector segment increased due to increased sales made under recently awarded federal and state government contracts, as well as the acquisition of new accounts. Sales representatives for our Public Sector segment totaled 112 at June 30, 2007, compared to 106 at June 30, 2006.

Gross profit for the six months ended June 30, 2007 increased in dollars in all three segments compared to the six months ended June 30, 2006, as explained by the following:

- Gross profit for our SMB segment increased due to increased sales and to additional vendor consideration recorded as a reduction to cost of sales, as discussed earlier. Lower invoice product margins and additional costs associated with certain customer rebate programs in the first half of 2007 offset this additional vendor consideration.
- Gross profit for our Large Account segment increased due to increases in both sales and gross profit margins. Gross profit margins increased year over year by 46 basis points as a percentage of net sales, as increased product margins, service revenues, and net software agency fees contributed to higher gross margins in this segment.

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- Gross profit for our Public Sector segment increased due to increased sales and to additional vendor consideration recorded as an offset to cost of sales, as discussed earlier.

Selling, general and administrative expenses increased for the six months ended June 30, 2007, but decreased as a percentage of sales as compared to the six months ended June 30, 2006.

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

	Six Months Ended June 30,				
	2007		2006		% Change
	<u>Amount</u>	<u>% of Net Sales</u>	<u>Amount</u>	<u>% of Net Sales</u>	
SMB	\$ 58.4	12.5%	\$ 54.9	12.6%	
Large Account	13.9	5.7	13.8	5.8	0.7
Public Sector	16.9	13.1	17.8	15.1	(5.1)
Total	<u>\$ 89.2</u>	<u>10.6%</u>	<u>\$ 86.5</u>	10.9%	3.1%

- SG&A expenses for our SMB segment increased in dollars primarily due to increased net advertising expense resulting from the recording of substantially all vendor allowances as a reduction to cost of sales, as discussed earlier.
- SG&A expenses for our Large Account segment in dollars and as a percentage of net sales were largely level in the first half of 2007 compared to the prior year quarter.
- SG&A expenses for our Public Sector segment decreased in both dollars and as a percentage of net sales in the first half of 2007. The year-over-year decreases are attributable to a decrease in compliance expense and lower personnel costs in the first half of 2007 compared to the first half of 2006.

We did not record any special charges in the six months ended June 30, 2007. In the six months ended June 30, 2006, we recorded a charge of \$0.5 million related to our review of a 2003 contract cancellation by the GSA. We also recorded a charge of \$0.4 million related to the temporary retention of certain Amherst Technologies facilities and a charge of \$0.5 million related to management restructuring costs, classified as workforce reductions in the table below. A roll forward of special charges for the period presented is shown below (in thousands of dollars).

	Workforce Reductions
Balance December 31, 2006	\$ 185
Charges	—
Cash payments	(185)
Liabilities at June 30, 2007	<u>\$ —</u>

Liabilities related to special charges are included in accrued expenses and other liabilities on the consolidated balance sheet as of December 31, 2006.

Income from operations increased by \$5.5 million to \$14.8 million for the six months ended June 30, 2007, from \$9.3 million for the six months ended June 30, 2006. Income from operations as a percentage of net sales increased year over year to 1.8% for the first half of 2007 from 1.2% for the first half of 2006. This increase was attributable to reductions in operating expenses and special charges as discussed above.

Interest expense decreased due to lower average borrowings outstanding in the six months ended June 30, 2007, as compared to the six months ended June 30, 2006.

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Our effective tax rate was 38.2% for the six months ended June 30, 2007, and 41.6% for the six months ended June 30, 2006. The year-over-year decrease in effective tax rate was due primarily to a prior year state income tax settlement in the six months ended June 30, 2007. Additionally, in 2006 state tax losses of certain subsidiaries were not offsettable against state tax profits of other subsidiaries.

Net income increased to \$9.1 million for the six months ended June 30, 2007, from \$4.8 million for the six months ended June 30, 2006, principally as a result of the increase in income from operations and the decrease in the effective tax rate.

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.

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 months. 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, borrowings on our bank line of credit, as follows:

- *Cash on Hand.* At June 30, 2007, we had approximately \$17.5 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 June 30, 2007, our entire \$50.0 million bank line of credit was available for borrowing. 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 under Item 1A, "Risk Factors."

Summary of Sources and Uses of Cash

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

June 30,	Six Months Ended	
	2007	2006
Net cash provided by operating activities	\$ 0.4	\$ 5.4
Net cash used for investing activities	(3.1)	(4.6)
Net cash provided by (used for) financing activities	2.6	(2.0)
Decrease in cash and cash equivalents	\$ (0.1)	\$ (1.2)

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Cash provided by operating activities decreased in the first half of 2007 compared to the first half of 2006. Cash flow from operations for the six months ended June 30, 2007, resulted primarily from net income before depreciation and amortization, offset largely by an increase in inventory and a decrease in accounts payable. Inventory increased by \$5.8 million from December 31, 2006, due to higher levels of inventory staged for planned customer roll-outs at June 30, 2007, as compared to the December 31, 2006 balance. Inventory turns were 22 turns for the second quarter of 2007, compared to 23 turns for the second quarter of 2006. Accounts receivable decreased by \$0.9 million from December 31, 2006 levels, due to improved collection efforts. Days sales outstanding improved to 42 days for the second quarter of 2007, compared to 44 days for the prior year period. Cash flow from operations for the six months ended June 30, 2006 resulted primarily from net income before depreciation and amortization and a decrease in inventory, offset partly by a decrease in accounts payable.

At June 30, 2007, we had \$100.8 million in outstanding accounts payable. Such accounts are generally paid within 30 days of incurrence, or earlier when favorable cash discounts are offered. This balance will be financed by cash flows from operations or short-term borrowings under the line of credit. This balance includes \$13.5 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 in the six months ended June 30, 2007 and 2006 include our capital expenditures in the periods presented, primarily for computer equipment and capitalization of internally-developed software. We expect total capital expenditures in 2007 to be between \$6.0 million and \$8.0 million.

Cash provided by financing activities in the six months ended June 30, 2007 benefited from proceeds of \$2.5 million from the exercise of common stock options under employee stock plans. Cash used for financing activities in the six months ended June 30, 2006, related primarily to our \$2.0 million paydown of borrowings on 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 condensed consolidated financial statements and the accompanying notes included in this quarterly report.

Bank Line of Credit. Our bank line of credit provides us with a borrowing capacity of up to \$50.0 million at the prime rate (8.25% at June 30, 2007). In addition, we have the option to increase the facility by 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 expense, taxes, depreciation, and amortization) and equity requirements, described below under "Factors Affecting Sources of Liquidity." The facility also gives us the option of obtaining Eurodollar Rate Loans in multiples of \$1.0 million for durations of one, two, three, four, or six months. Substantially all of our assets are collateralized as security for this facility, and all of our subsidiaries are guarantors under the line of credit. The entire \$50 million facility was available for borrowing at June 30, 2007.

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.

Inventory Trade Credit Agreements. We have additional security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. These

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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 \$13.5 million as of June 30, 2007, are recorded in accounts payable, and the inventory financed is classified as inventory on the consolidated balance sheet.

Sports Marketing Commitments. We have entered into multi-year sponsorship agreements with the Boston Red Sox and the New England Patriots that extend to 2012 and 2013, respectively. These agreements, which grant us various marketing rights and seating arrangements, require payments aggregating \$1.9 million in 2007 and annual payments aggregating from \$0.3 million to \$1.1 million per year beginning in 2008.

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, under these agreements, 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.

Contractual Obligations. 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. The disclosures relating to our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2006 have not materially changed since we filed that report.

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 trailing four quarters) must not be more than 2.0 to 1.0. Our actual funded debt ratio at June 30, 2007 was 0.0 to 1.0, as average borrowings outstanding against our credit facility during the first half of 2007 were not material.
- Minimum Consolidated Net Worth must be at least \$150.0 million, plus 50% of consolidated net income for each quarter, beginning with the quarter ended March 31, 2006 (loss quarters not counted). Such amount was calculated at June 30, 2007 as \$161.5 million. Our actual consolidated stockholders' equity at June 30, 2007 was \$209.3 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 June 30, 2007, the entire \$50.0 million facility was available for borrowings.

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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, 2007, we adopted FIN 48, “Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, Accounting for Income Taxes.” FIN 48 requires that the financial statement effects of a tax position taken or expected to be taken in a tax return to be recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. The cumulative effect of applying FIN 48 was \$346 and was recorded as an adjustment reducing the January 1, 2007 balance of retained earnings. See Note 7 “Income Taxes.”

Effective January 1, 2007, we adopted the additional disclosure provisions of EITF Issue No. 06-03, “How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement.” EITF No. 06-03 permits the presentation of these taxes on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues). We classify sales taxes on a net basis in our income statements. Adoption of EITF No. 06-03 did not have an effect on our financial statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” which permits companies to voluntarily choose, at specified election dates, to measure specified financial instruments and other items at fair value on a contract-by-contract basis. Subsequent changes in fair value will be required to be reported in earnings each reporting period. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We do not expect SFAS 159 to have a material impact on our results of operation or financial position.

Our critical accounting policies have not materially changed from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2006, except as to FIN 48 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 no borrowings outstanding pursuant to our credit agreement as of June 30, 2007. 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, no borrowings were outstanding at June 30, 2007, and the average borrowings during the three and six months ended June 30, 2007 were not material. Accordingly, 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 June 30, 2007. 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 June 30, 2007 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.

The following discussion includes one revised risk factor (“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”) that reflects developments subsequent to the discussion of risk factors included in our most recent Annual Report on Form 10-K.

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;
- fluctuations in response rates;
- changes in vendor distribution of products;
- fluctuations in postage, paper, shipping, and printing costs and in merchandise returns;
- adverse weather conditions that affect response, distribution, or shipping; and
- changes in our product offerings.

Our results also may vary based on our ability to hire and retain sales representatives and other essential personnel, as well as our success in integrating acquisitions into our business, and their relative costs.

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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, or GSA, schedule, our sales to federal government entities 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 was referred to the Department of Justice, or DOJ, for review. We cooperated in that review, and in 2006, we concluded a settlement with the DOJ of this matter. 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 "configure-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 70% of our total product purchases in each of the six months ended June 30, 2007 and 2006, respectively. Among these five vendors, purchases from Ingram represented 25% and 27% of our total product purchases in the six months ended June 30, 2007 and 2006, respectively. Purchases from Tech Data comprised 17% and 18% of our total product purchases in the six months ended June 30, 2007 and 2006, respectively. Purchases from HP represented 14% and 15% of our total product purchases in the six months ended June 30, 2007 and 2006, respectively. No other vendor supplied more than 10% of our total product purchases in the six months ended June 30, 2007 and 2006, respectively. If we are unable to acquire products from Ingram, HP, or Tech Data, 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 June 30, 2007 was \$100.8 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 PC Connection, Inc. 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 advertising allowances, and in exchange, we feature their products in our catalogs and other marketing vehicles. These vendor allowances, to the extent that they represent specific reimbursements of incremental and identifiable costs, are offset against SG&A expenses. Advertising allowances 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 the past, we have experienced a decrease in the level of vendor consideration available to us from certain manufacturers. The level of such consideration we receive from some manufacturers may decline in the future. Such a decline could decrease our gross margin 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 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. 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. 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.

Our success in growing our Internet business will depend in large part upon the development of an increasingly sophisticated infrastructure for providing Internet access and services. If the number of Internet

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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 sophistication, 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.

Many of our customers elect to have their purchases shipped by an interstate common carrier, such as DHL Worldwide Express, United Parcel Service, or FedEx Corporation. 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, our primary freight carrier. 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 collect and remit sales and use taxes in states in which we have either voluntarily registered or have a physical presence. 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, 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

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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 constitutionally 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 64% 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 our Company. 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.

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 June 30, 2007 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

ISSUER PURCHASES OF EQUITY SECURITIES

<u>Period</u>	(a) <u>Total Number of Shares (or Units) Purchased</u>	(b) <u>Average Price Paid per Share (or Unit)</u>	(c) <u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	(d) <u>Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (1)</u>
04/01/07–04/30/07	—	—	—	\$ 12,714,000
05/01/07–05/31/07	—	—	—	\$ 12,714,000
06/01/07–06/30/07	—	—	—	\$ 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.

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

At the 2007 Annual Meeting of Stockholders of the Company (the “Annual Meeting”) on June 7, 2007, the following matters were acted upon by the stockholders of the Company:

1. The election of six Directors.
2. The approval of the 2007 Stock Incentive Plan.
3. The ratification of the selection by the Audit Committee of Deloitte & Touche LLP as the Company’s independent registered public accounting firm for the current fiscal year.

The number of shares of common stock issued, outstanding, and eligible to vote as of the record date of April 10, 2007 was 26,801,771. The results of the voting on each of the matters presented to stockholders at the Annual Meeting are set forth below:

1. Election of Directors:

<u>Nominees</u>	<u>Votes For</u>	<u>Votes Withheld</u>
Patricia Gallup	19,586,057	4,612,547
David Hall	19,585,917	4,612,687
Bruce Barone	23,101,996	1,096,608
David Beffa-Negrini	23,096,396	1,102,208
Joseph Baute	19,586,451	4,612,153
Donald Weatherson	22,107,453	2,091,151

2. 2007 Stock Incentive Plan

<u>Votes For</u>	<u>Votes Against</u>	<u>Votes Abstain</u>
21,952,676	531,911	15,272

3. Ratification of the selection by the Audit Committee of Deloitte & Touche LLP as the Company’s independent registered public accounting firm for the current fiscal year:

<u>Votes For</u>	<u>Votes Against</u>	<u>Votes Abstain</u>
24,122,531	67,318	2,434

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Item 6—Exhibits

<u>Exhibit Number</u>	<u>Description</u>
10.1	2007 Stock Incentive Plan, incorporated by reference to our definitive proxy statement filed on April 30, 2007.
10.2*	Form of Incentive Stock Option Agreement for 2007 Stock Incentive Plan.
10.3*	Form of Nonstatutory Stock Option Agreement for 2007 Stock Incentive Plan.
10.4*	Form of Restricted Stock Agreement for 2007 Stock Incentive Plan.
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 Executive 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 Executive 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.

* Filed herewith.

PC Connection, Inc.

Incentive Stock Option Agreement
Granted Under 2007 Stock Incentive Plan

1. Grant of Option.

This agreement evidences the grant by PC Connection, Inc., a Delaware corporation (the "Company"), on _____, 200[] (the "Grant Date") to [_____] , an employee of the Company (the "Participant"), of an option to purchase, in whole or in part, on the terms provided herein and in the Company's 2007 Stock Incentive Plan (the "Plan"), a total of [_____] shares (the "Shares") of common stock, \$0.01 par value per share, of the Company ("Common Stock") at \$[_____] per Share. Unless earlier terminated, this option shall expire at 5:00 p.m., Eastern time, on [_____] (the "Final Exercise Date").

It is intended that the option evidenced by this agreement shall be an incentive stock option as defined in Section 422 of the Internal Revenue Code of 1986, as amended, and any regulations promulgated thereunder (the "Code"). Except as otherwise indicated by the context, the term "Participant", as used in this option, shall be deemed to include any person who acquires the right to exercise this option validly under its terms.

2. Vesting Schedule.

This option will become exercisable ("vest") as to []% of the original number of Shares on the [] anniversary of the Grant Date and as to an additional []% of the original number of Shares at the end of each successive [] period following the first anniversary of the Grant Date until the [] anniversary of the Grant Date.

The right of exercise shall be cumulative so that to the extent the option is not exercised in any period to the maximum extent permissible it shall continue to be exercisable, in whole or in part, with respect to all Shares for which it is vested until the earlier of the Final Exercise Date or the termination of this option under Section 3 hereof or the Plan.

3. Exercise of Option.

(a) Form of Exercise. Each election to exercise this option shall be by written notice in the form attached hereto as Exhibit A, in writing, signed by the Participant, and received by the Company at its principal office, accompanied by this agreement, and payment in full in the manner provided in the Plan. The Participant may purchase less than the number of shares covered hereby, provided that no partial exercise of this option may be for any fractional share.

(b) Continuous Relationship with the Company Required. Except as otherwise provided in this Section 3, this option may not be exercised unless the Participant, at the time he or she exercises this option, is, and has been at all times since the Grant Date, an employee or officer of, or consultant or advisor to, the Company or any parent or subsidiary of the Company as defined in Section 424(e) or (f) of the Code (an "Eligible Participant").

(c) Termination of Relationship with the Company. If the Participant ceases to be an Eligible Participant for any reason, then, except as provided in paragraphs (d) and (e) below, the right to exercise this option shall terminate three months after such cessation (but in no event after the Final Exercise Date), provided that this option shall be exercisable only to the extent that the Participant was entitled to exercise this option on the date of such cessation. Notwithstanding the foregoing, if the Participant, prior to the Final Exercise Date, violates the non-competition or confidentiality provisions of any employment contract, confidentiality and nondisclosure agreement or other agreement between the Participant and the Company, the right to exercise this option shall terminate immediately upon written notice to the Participant from the Company describing such violation.

(d) Exercise Period Upon Death or Disability. If the Participant dies or becomes disabled (within the meaning of Section 22(e)(3) of the Code) prior to the Final Exercise Date while he or she is an Eligible Participant and the Company has not terminated such relationship for "cause" as specified in paragraph (e) below, this option shall be exercisable, within the period of one year following the date of death or disability of the Participant, by the Participant (or in the case of death by an authorized transferee), provided that this option shall be exercisable only to the extent that this option was exercisable by the Participant on the date of his or her death or disability, and further provided that this option shall not be exercisable after the Final Exercise Date.

(e) Termination for Cause. If, prior to the Final Exercise Date, the Participant's employment is terminated by the Company for Cause (as defined below), the right to exercise this option shall terminate immediately upon the effective date of such termination of employment. If the Participant is party to an employment or severance agreement with the Company that contains a definition of "cause" for termination of employment, "Cause" shall have the meaning ascribed to such term in such agreement. Otherwise, "Cause" shall mean willful misconduct by the Participant or willful failure by the Participant to perform his or her responsibilities to the Company (including, without limitation, breach by the Participant of any provision of any employment, consulting, advisory, nondisclosure, non-competition or other similar agreement between the Participant and the Company), as determined by the Company, which determination shall be conclusive. The Participant shall be considered to have been discharged for Cause if the Company determines, within 30 days after the Participant's resignation, that discharge for cause was warranted.

4. Tax Matters.

(a) Withholding. No Shares will be issued pursuant to the exercise of this option unless and until the Participant pays to the Company, or makes provision satisfactory to the Company for payment of, any federal, state or local withholding taxes required by law to be withheld in respect of this option.

(b) Disqualifying Disposition. If the Participant disposes of Shares acquired upon exercise of this option within two years from the Grant Date or one year after such Shares were acquired pursuant to exercise of this option, the Participant shall notify the Company in writing of such disposition.

5. Nontransferability of Option.

This option may not be sold, assigned, transferred, pledged or otherwise encumbered by the Participant, either voluntarily or by operation of law, except by will or the laws of descent and distribution, and, during the lifetime of the Participant, this option shall be exercisable only by the Participant.

6. Provisions of the Plan.

This option is subject to the provisions of the Plan, a copy of which is furnished to the Participant with this option.

IN WITNESS WHEREOF, the Company has caused this option to be executed under its corporate seal by its duly authorized officer. This option shall take effect as a sealed instrument.

PC Connection, Inc.

Dated: _____

By: _____
Name: _____
Title: _____

PARTICIPANT'S ACCEPTANCE

The undersigned hereby accepts the foregoing option and agrees to the terms and conditions thereof. The undersigned hereby acknowledges receipt of a copy of the Company's 2007 Stock Incentive Plan.

PARTICIPANT:

Address: _____

EXHIBIT A

NOTICE OF STOCK OPTION EXERCISE

Date: _____

Participant name and address:

Attention: Treasurer

Dear Sir or Madam:

I am the holder of an Incentive Stock Option granted to me under the PC Connection, Inc. (the "Company") 2007 Stock Incentive Plan on _____ for the purchase of _____ shares of Common Stock of the Company at a purchase price of \$_____ per share.

I hereby exercise my option to purchase _____ shares of Common Stock (the "Shares"), for which I have enclosed _____ in the amount of \$_____. Please register my stock certificate as follows:

(check applicable box)

Name(s): _____	<input type="checkbox"/>	TEN COM
_____	<input type="checkbox"/>	TEN ENT
Address: _____	<input type="checkbox"/>	JT TEN
Tax I.D. #: _____	<input type="checkbox"/>	UNIF GIFT MIN ACT

I represent, warrant and covenant as follows:

1. I am purchasing the Shares for my own account for investment only, and not with a view to, or for sale in connection with, any distribution of the Shares in violation of the Securities Act of 1933 (the "Securities Act"), or any rule or regulation under the Securities Act.
2. I have had such opportunity as I have deemed adequate to obtain from representatives of the Company such information as is necessary to permit me to evaluate the merits and risks of my investment in the Company.

3. I have sufficient experience in business, financial and investment matters to be able to evaluate the risks involved in the purchase of the Shares and to make an informed investment decision with respect to such purchase.

4. I can afford a complete loss of the value of the Shares and am able to bear the economic risk of holding such Shares for an indefinite period.

5. I understand that (i) the Shares have not been registered under the Securities Act and are “restricted securities” within the meaning of Rule 144 under the Securities Act, (ii) the Shares cannot be sold, transferred or otherwise disposed of unless they are subsequently registered under the Securities Act or an exemption from registration is then available; (iii) in any event, the exemption from registration under Rule 144 will not be available for at least one year and even then will not be available unless a public market then exists for the Common Stock, adequate information concerning the Company is then available to the public, and other terms and conditions of Rule 144 are complied with; and (iv) there is now no registration statement on file with the Securities and Exchange Commission with respect to any stock of the Company and the Company has no obligation or current intention to register the Shares under the Securities Act.

Very truly yours,

(Signature)

PC Connection, Inc.

Nonstatutory Stock Option Agreement
Granted Under 2007 Stock Incentive Plan

1. Grant of Option.

This agreement evidences the grant by PC Connection, Inc., a Delaware corporation (the "Company"), on _____, 200[] (the "Grant Date") to [_____] , an [employee], [consultant], [director] of the Company (the "Participant"), of an option to purchase, in whole or in part, on the terms provided herein and in the Company's 2007 Stock Incentive Plan (the "Plan"), a total of [_____] shares (the "Shares") of common stock, \$0.01 par value per share, of the Company ("Common Stock") at \$[_____] per Share. Unless earlier terminated, this option shall expire at 5:00 p.m., Eastern time, on [_____] (the "Final Exercise Date").

It is intended that the option evidenced by this agreement shall not be an incentive stock option as defined in Section 422 of the Internal Revenue Code of 1986, as amended, and any regulations promulgated thereunder (the "Code"). Except as otherwise indicated by the context, the term "Participant", as used in this option, shall be deemed to include any person who acquires the right to exercise this option validly under its terms.

2. Vesting Schedule.

This option will become exercisable ("vest") as to []% of the original number of Shares on the [] anniversary of the Grant Date and as to an additional [] % of the original number of Shares at the end of each successive [] period following the first anniversary of the Grant Date until the [] anniversary of the Grant Date.

The right of exercise shall be cumulative so that to the extent the option is not exercised in any period to the maximum extent permissible it shall continue to be exercisable, in whole or in part, with respect to all Shares for which it is vested until the earlier of the Final Exercise Date or the termination of this option under Section 3 hereof or the Plan.

3. Exercise of Option.

(a) Form of Exercise. Each election to exercise this option shall be by written notice in the form attached hereto as Exhibit A, signed by the Participant, and received by the Company at its principal office, accompanied by this agreement, and payment in full in the manner provided in the Plan. The Participant may purchase less than the number of shares covered hereby, provided that no partial exercise of this option may be for any fractional share

(b) Continuous Relationship with the Company Required. Except as otherwise provided in this Section 3, this option may not be exercised unless the Participant, at the time he or she exercises this option, is, and has been at all times since the Grant Date, an employee, officer or director of, or consultant or advisor to, the Company or any other entity the employees, officers, directors, consultants, or advisors of which are eligible to receive option grants under the Plan (an "Eligible Participant").

(c) Termination of Relationship with the Company. If the Participant ceases to be an Eligible Participant for any reason, then, except as provided in paragraphs (d) and (e) below, the right to exercise this option shall terminate three months after such cessation (but in no event after the Final Exercise Date), provided that this option shall be exercisable only to the extent that the Participant was entitled to exercise this option on the date of such cessation. Notwithstanding the foregoing, if the Participant, prior to the Final Exercise Date, violates the non-competition or confidentiality provisions of any employment contract, confidentiality and nondisclosure agreement or other agreement between the Participant and the Company, the right to exercise this option shall terminate immediately upon written notice to the Participant from the Company describing such violation.

(d) Exercise Period Upon Death or Disability. If the Participant dies or becomes disabled (within the meaning of Section 22(e)(3) of the Code) prior to the Final Exercise Date while he or she is an Eligible Participant and the Company has not terminated such relationship for "cause" as specified in paragraph (e) below, this option shall be exercisable, within the period of one year following the date of death or disability of the Participant, by the Participant (or in the case of death by an authorized transferee), provided that this option shall be exercisable only to the extent that this option was exercisable by the Participant on the date of his or her death or disability, and further provided that this option shall not be exercisable after the Final Exercise Date.

(e) Termination for Cause. If, prior to the Final Exercise Date, the Participant's employment or other relationship with the Company is terminated by the Company for Cause (as defined below), the right to exercise this option shall terminate immediately upon the effective date of such termination of employment or other relationship. If the Participant is party to an employment, consulting or severance agreement with the Company that contains a definition of "cause" for termination of employment or other relationship, "Cause" shall have the meaning ascribed to such term in such agreement. Otherwise, "Cause" shall mean willful misconduct by the Participant or willful failure by the Participant to perform his or her responsibilities to the Company (including, without limitation, breach by the Participant of any provision of any employment, consulting, advisory, nondisclosure, non-competition or other similar agreement between the Participant and the Company), as determined by the Company, which determination shall be conclusive. The Participant shall be considered to have been discharged for "Cause" if the Company determines, within 30 days after the Participant's resignation, that discharge for cause was warranted.

4. Withholding.

No Shares will be issued pursuant to the exercise of this option unless and until the Participant pays to the Company, or makes provision satisfactory to the Company for payment of, any federal, state or local withholding taxes required by law to be withheld in respect of this option.

5. Nontransferability of Option.

This option may not be sold, assigned, transferred, pledged or otherwise encumbered by the Participant, either voluntarily or by operation of law, except by will or the laws of descent and distribution, and, during the lifetime of the Participant, this option shall be exercisable only by the Participant.

6. Provisions of the Plan.

This option is subject to the provisions of the Plan, a copy of which is furnished to the Participant with this option.

IN WITNESS WHEREOF, the Company has caused this option to be executed under its corporate seal by its duly authorized officer. This option shall take effect as a sealed instrument.

PC Connection, Inc.

Dated: _____

By: _____
Name: _____
Title: _____

PARTICIPANT'S ACCEPTANCE

The undersigned hereby accepts the foregoing option and agrees to the terms and conditions thereof. The undersigned hereby acknowledges receipt of a copy of the Company's 2007 Stock Incentive Plan.

PARTICIPANT:

Address: _____

EXHIBIT A

NOTICE OF STOCK OPTION EXERCISE

Date: _____

Participant name and address:

Attention: Treasurer

Dear Sir or Madam:

I am the holder of a Nonstatutory Stock Option granted to me under the PC Connection, Inc. (the "Company") 2007 Stock Incentive Plan on _____ for the purchase of _____ shares of Common Stock of the Company at a purchase price of \$_____ per share.

I hereby exercise my option to purchase _____ shares of Common Stock (the "Shares"), for which I have enclosed _____ in the amount of \$_____. Please register my stock certificate as follows:

(check applicable box)

Name(s): _____	<input type="checkbox"/>	TEN COM
_____	<input type="checkbox"/>	TEN ENT
Address: _____	<input type="checkbox"/>	JT TEN
Tax I.D. #: _____	<input type="checkbox"/>	UNIF GIFT MIN ACT

I represent, warrant and covenant as follows:

1. I am purchasing the Shares for my own account for investment only, and not with a view to, or for sale in connection with, any distribution of the Shares in violation of the Securities Act of 1933 (the "Securities Act"), or any rule or regulation under the Securities Act.
2. I have had such opportunity as I have deemed adequate to obtain from representatives of the Company such information as is necessary to permit me to evaluate the merits and risks of my investment in the Company.

3. I have sufficient experience in business, financial and investment matters to be able to evaluate the risks involved in the purchase of the Shares and to make an informed investment decision with respect to such purchase.

4. I can afford a complete loss of the value of the Shares and am able to bear the economic risk of holding such Shares for an indefinite period.

5. I understand that (i) the Shares have not been registered under the Securities Act and are “restricted securities” within the meaning of Rule 144 under the Securities Act, (ii) the Shares cannot be sold, transferred or otherwise disposed of unless they are subsequently registered under the Securities Act or an exemption from registration is then available; (iii) in any event, the exemption from registration under Rule 144 will not be available for at least one year and even then will not be available unless a public market then exists for the Common Stock, adequate information concerning the Company is then available to the public, and other terms and conditions of Rule 144 are complied with; and (iv) there is now no registration statement on file with the Securities and Exchange Commission with respect to any stock of the Company and the Company has no obligation or current intention to register the Shares under the Securities Act.

Very truly yours,

(Signature)

PC Connection, Inc.

Restricted Stock Agreement

The terms and conditions of the award of shares of restricted common stock of the Company (the "Restricted Shares") made to the Recipient, as set forth on the cover page of this Agreement, are as follows:

1. Issuance of Restricted Shares.

(a) The Restricted Shares are issued to the Recipient, effective as of the Grant Date (as set forth on the cover page of this Agreement), in consideration of employment services rendered and to be rendered by the Recipient to the Company.

(b) As promptly as practicable following the Grant Date, the Company shall issue one or more certificates in the name of the Recipient for the Restricted Shares. Such certificate(s) shall initially be held on behalf of the Recipient by the Secretary of the Company. Following the vesting of any Restricted Shares pursuant to Section 2 below, the Secretary shall, if requested by the Recipient, deliver to the Recipient a certificate representing the vested Restricted Shares. The Recipient agrees that the Restricted Shares shall be subject to the forfeiture provisions set forth in Section 3 of this Agreement and the restrictions on transfer set forth in Section 4 of this Agreement.

2. Vesting Schedule. Unless otherwise provided in this Agreement or the Plan, the Restricted Shares shall vest in accordance with the vesting schedule set forth on Schedule A attached hereto. Any fractional number of Restricted Shares resulting from the application of the foregoing percentages shall be rounded down to the nearest whole number of Restricted Shares.

3. Forfeiture of Unvested Restricted Shares Upon Employment Termination.

In the event that the Recipient ceases to be employed by the Company for any reason or no reason, with or without cause all of the Restricted Shares that are unvested as of the time of such employment termination shall be forfeited immediately and automatically to the Company, without the payment of any consideration to the Recipient, effective as of such termination of employment: The Recipient hereby authorizes the Company to take any actions necessary or appropriate to cancel any certificate(s) representing forfeited Restricted Shares and transfer ownership of such forfeited Restricted Shares to the Company; and if the Company or its transfer agent requires an executed stock power or similar confirmatory instrument in connection with such cancellation and transfer, the Recipient shall promptly execute and deliver the same to the Company. The Recipient shall have no further rights with respect to any Restricted Shares that are so forfeited. If the Recipient is employed by a subsidiary of the Company, any references in this Agreement to employment with the Company shall instead be deemed to refer to employment with such subsidiary.

4. Restrictions on Transfer.

The Recipient shall not sell, assign, transfer, pledge, hypothecate or otherwise dispose of, by operation of law or otherwise (collectively “transfer”) any Restricted Shares, or any interest therein, until such Restricted Shares have vested, except that the Recipient may transfer such Restricted Shares: (a) to or for the benefit of any spouse, children, parents, uncles, aunts, siblings, grandchildren and any other relatives approved by the Compensation Committee (collectively, “Approved Relatives”) or to a trust established solely for the benefit of the Recipient and/or Approved Relatives, provided that such Restricted Shares shall remain subject to this Agreement (including without limitation the forfeiture provisions set forth in Section 3 and the restrictions on transfer set forth in this Section 4) and such permitted transferee shall, as a condition to such transfer, deliver to the Company a written instrument confirming that such transferee shall be bound by all of the terms and conditions of this Agreement; or (b) as part of the sale of all or substantially all of the shares of capital stock of the Company (including pursuant to a merger or consolidation); provided that the securities or other property received by the Participant in connection with such transaction shall remain subject to this Agreement. The Company shall not be required (i) to transfer on its books any of the Restricted Shares which have been transferred in violation of any of the provisions of this Agreement or (ii) to treat as owner of such Restricted Shares or to pay dividends to any transferee to whom such Restricted Shares have been transferred in violation of any of the provisions of this Agreement.

5. Restrictive Legends.

All certificates representing Restricted Shares shall have affixed thereto a legend in substantially the following form, in addition to any other legends that may be required under applicable law:

“These shares of stock are subject to forfeiture provisions and restrictions on transfer set forth in a certain Restricted Stock Agreement between the corporation and the registered owner of these shares (or his or her predecessor in interest), and such Agreement is available for inspection without charge at the office of the Secretary of the corporation.”

6. Rights as a Shareholder.

Except as otherwise provided in this Agreement, for so long as the Recipient is the registered owner of the Restricted Shares, the Recipient shall have all rights as a shareholder with respect to the Restricted Shares, whether vested or unvested, including, without limitation, any rights to receive dividends and distributions with respect to the Restricted Shares and to vote the Restricted Shares and act in respect of the Restricted Shares at any meeting of shareholders. If any such dividends or distributions are paid in shares, or consist of a dividend or distribution to holders of common stock other than a ordinary cash dividend, the shares, cash or other property will be subject to the same restrictions on transferability and forfeitability as the Restricted Shares with respect to which they were paid.

7. Provisions of the Plan.

This Agreement is subject to the provisions of the Plan, a copy of which is furnished to the Recipient with this Agreement.

8. Tax Matters.

(a) Acknowledgments; Section 83(b) Election. The Recipient acknowledges that he or she is responsible obtaining the advice of the Recipient's own tax advisors with respect to the acquisition of the Restricted Shares and the Recipient is relying solely on such advisors and not on any statements or representations of the Company or any of its agents with respect to the tax consequences relating to the Restricted Shares. The Recipient understands that the Recipient (and not the Company) shall be responsible for the Recipient's tax liability that may arise in connection with the acquisition, vesting and/or disposition of the Restricted Shares. The Recipient acknowledges that he or she has been informed of the availability of making an election under Section 83(b) of the Internal Revenue Code, as amended, with respect to the issuance of the Restricted Shares and that the Recipient has decided not to file a Section 83(b) election.

(b) Withholding. The Recipient acknowledges and agrees that the Company has the right to deduct from payments of any kind otherwise due to the Recipient any federal, state, local or other taxes of any kind required by law to be withheld with respect to the vesting of the Restricted Shares. On each date on which Restricted Shares vest, the Company shall deliver written notice to the Recipient of the amount of withholding taxes due, if any, with respect to the vesting of the Restricted Shares that vest on such date; provided, however, that the total tax withholding cannot exceed the Company's minimum statutory withholding obligations (based on minimum statutory withholding rates for federal and state tax purposes, including payroll taxes, that are applicable to such supplemental taxable income).

9. Miscellaneous.

(a) No Right to Continued Employment. The Recipient acknowledges and agrees that, notwithstanding the fact of the vesting of the Restricted Shares is contingent upon his or her continued employment by the Company this Agreement does not constitute an express or implied promise of continued employment or confer upon the Recipient any rights with respect to continued employment by the Company.

(b) Governing Law. This Agreement shall be construed, interpreted and enforced in accordance with the internal laws of the State Delaware without regard to any applicable conflicts of laws provisions.

(c) Recipient's Acknowledgments. The Recipient acknowledges that he or she has read this Agreement, has received and read the Plan, and understands the terms and conditions of this Agreement and the Plan.

PC Connection, Inc.

Restricted Stock Agreement

Name of Recipient: _____

Number of shares of restricted common stock awarded: _____

Grant Date: _____

PC Connection, Inc. (the "Company") has selected you to receive the restricted stock award described above, which is subject to the provisions of the Company's 2007 Amended and Restated Stock Incentive Plan (the "Plan") and the terms and conditions contained in this Restricted Stock Agreement. Please confirm your acceptance of this restricted stock award and of the terms and conditions of this Agreement by signing a copy of this Agreement where indicated below.

PC Connection, Inc.

By: _____
[insert name and title]

Accepted and Agreed:

[insert name of recipient]

August 10, 2007

PC Connection, Inc.
730 Milford Road
Merrimack, NH

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of PC Connection, Inc. and subsidiaries for the periods ended June 30, 2007 and 2006, as indicated in our report dated August 10, 2007; 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 June 30, 2007, is incorporated by reference in Registration Statement Nos. 333-40172, 333-50845, 333-50847, 333-66450, 333-69981, 333-83943, 333-91584, 333-106652, 333-130389, and 333-144065 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: August 10, 2007

/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: August 10, 2007

/s/ Jack Ferguson

Jack Ferguson

Executive 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 June 30, 2007 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 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: August 10, 2007

/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 June 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Jack Ferguson, Executive 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: August 10, 2007

/s/ Jack Ferguson

Jack Ferguson

Executive Vice President, Treasurer, and Chief Financial Officer