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

FORM 10-Q

(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1999

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________________ TO _______________

COMMISSION FILE NUMBER 0-23827

PC CONNECTION, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 02-0497006 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 730 MILFORD ROAD MERRIMACK, NEW HAMPSHIRE | 03054 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code (603) 423-2000

Indicate by check mark (X) 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 X NO _____

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of the issuer's Common Stock, $.01 par value, as of May 11, 1999 was 15,624,956.

PC CONNECTION, INC.

FORM 10-Q

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PC CONNECTION, INC.
PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
BALANCE SHEETS
(UNAUDITED)
(AMOUNTS IN THOUSANDS)

| | MARCH 31, 1999 | December 31, 1998 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 8,579 | $11,910 |
| Accounts receivable, net | 63,891 | 58,890 |
| Inventories.merchandise | 55,525 | 63,425 |
| Deferred income taxes | 2,146 | 3,181 |
| Prepaid expenses and other current assets | 4,398 | 4,115 |
| TOTAL CURRENT ASSETS | 134,539 | 141,521 |
| Deferred income taxes | 361 | 314 |
| Property and equipment, net | 22,943 | 22,675 |
| TOTAL ASSETS | $157,843 | $164,510 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Current maturities of capital lease obligation to affiliate | $ 126 | $ 123 |
| Accounts payable | 68,741 | 77,561 |
| Accrued expenses and other liabilities | 7,519 | 10,069 |
| Total current liabilities | 76,386 | 87,753 |
| Capital lease obligation to affiliate | 7,049 | 7,081 |
| TOTAL LIABILITIES | 83,435 | 94,834 |
| Stockholders' Equity: | | |
| Common stock | 156 | 156 |
| Additional paid-in capital | 57,123 | 56,812 |
| Retained earnings | 17,129 | 12,708 |
| TOTAL STOCKHOLDERS' EQUITY | 74,408 | 69,676 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $157,843 | $164,510 |

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See notes to financial statements.

PC CONNECTION, INC.
PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
STATEMENTS OF INCOME
(UNAUDITED)
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

| THREE MONTHS ENDED MARCH 31, | 1999 | 1998 |
|---|---|---|
| Net sales | $224,979 | $168,643 |
| Cost of sales | 197,913 | 146,694 |
| GROSS PROFIT | 27,066 | 21,949 |
| Selling, general and administrative expenses | 19,763 | 16,858 |
| Additional stockholder/officer compensation | - | 2,354 |
| INCOME FROM OPERATIONS | 7,303 | 2,737 |
| Interest expense | (266) | (206) |
| Other, net | 94 | 86 |
| Income tax benefit (provision) | (2,710) | 3,788 |
| NET INCOME | $ 4,421 | $ 6,405 |
| Weighted average common shares outstanding: | | |
| Basic | 15,622 | |
| Diluted | 16,068 | |
| Earnings per share: | | |
| Basic | $ .28 | |
| Diluted | $ .28 | |
| Pro forma data: | | |
| Historical income before income taxes | | $ 2,617 |
| Pro forma adjustment - stockholder/officer compensation in excess of the aggregate base salaries | | 2,354 |
| Pro forma income before income taxes | | 4,971 |
| Pro forma income taxes | | 1,938 |
| Pro forma net income | | $ 3,033 |
| Pro forma weighted average shares outstanding: | | |
| Basic | | 14,236 |
| Diluted | | 14,835 |
| Pro forma earnings per share: | | |
| Basic | | $ .21 |
| Diluted | | $ .20 |

See notes to financial statements.

PC CONNECTION, INC.
PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)
(AMOUNTS IN THOUSANDS)

| | COMMON STOCK | | ADDITIONAL | RETAINED | |
|---|---|---|---|---|---|
| | SHARES | AMOUNT | PAID IN CAPITAL | EARNINGS | TOTAL |
| BALANCE, DECEMBER 31, 1998 | 15,605 | $ 156 | $56,812 | $12,708 | $69,676 |
| Exercise of stock options, including income tax benefits | 20 | - | 263 | - | 263 |
| Compensation under nonstatutory stock option agreements | - | - | 48 | - | 48 |
| Net income | - | - | - | 4,421 | 4,421 |
| BALANCE, MARCH 31, 1999 | 15,625 | $ 156 | $57,123 | $17,129 | $74,408 |

See notes to financial statements.

PC CONNECTION, INC.
PART I - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS
(UNAUDITED)
(AMOUNTS IN THOUSANDS)

| | THREE MONTHS ENDED MARCH 31, 1999 | 1998 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $4,421 | $6,405 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,137 | 684 |
| Deferred income taxes | 1,139 | (4,675) |
| Compensation under nonstatutory stock option agreements | 48 | 933 |
| Provision for doubtful accounts | 1,509 | 880 |
| Loss on disposal of fixed assets | 20 | 74 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (6,510) | (4,198) |
| Inventories | 7,900 | (263) |
| Prepaid expenses and other current assets | (283) | (124) |
| Accounts payable | (8,820) | 25,642 |
| Amounts payable to stockholders | - | (1,185) |
| Accrued expenses and other liabilities | (2,550) | 1,948 |
| Net cash provided by (used for) operating activities | (1,989) | 26,121 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (1,428) | (1,968) |
| Proceeds from sale of property and equipment | 3 | - |
| Net cash used for investing activities | (1,425) | (1,968) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from short-term borrowings | 142,420 | 20,796 |
| Repayment of short-term borrowings | (142,420) | (49,114) |
| Repayment of term loan | - | (4,500) |
| Repayment of capital lease obligation to affiliate | (29) | - |
| Issuance of stock upon exercise of nonstatutory stock options | 112 | - |
| Net proceeds from initial public offering | - | 57,253 |
| Payment of dividend | - | (33,037) |
| Net cash provided by (used for) financing activities | 83 | (8,602) |
| (Decrease) increase in cash and cash equivalents | (3,331) | 15,551 |
| Cash and cash equivalents, beginning of period | 11,910 | 758 |
| Cash and cash equivalents, end of period | $ 8,579 | $16,309 |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Interest paid | $ 258 | $ 358 |
| Income taxes paid | 268 | 4 |

See notes to financial statements

NOTES TO FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The accompanying financial statements of PC Connection, Inc. ("PCC" or the "Company") have been prepared in accordance with generally accepted accounting principles. Such principles were applied on a basis consistent with those of the financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 1998 (the "10-K Report") filed with the Securities and Exchange Commission ("SEC"). The accompanying financial statements should be read in conjunction with the financial statements contained in the Company's 10-K Report. In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation. The operating results for the three months ended March 31, 1999 may not be indicative of the results expected for any succeeding quarter or the entire year ending December 31, 1999.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

Certain amounts in the prior year financial statements have been reclassified to conform to the current year presentation.

NOTE 2 - CASH AND CASH EQUIVALENTS

The Company considers all highly liquid short-term investments with original maturities of 90 days or less to be cash equivalents.

NOTE 3 -INITIAL PUBLIC OFFERING

On March 6, 1998, the Company completed its initial public offering of 3,593,750 shares of Common Stock ("the Offering") (including 468,750 shares issued upon the exercise of an underwriters' overallotment option) at a price of $17.50 per share, raising $57.3 million in net proceeds. The Company used the net proceeds from the Offering to repay bank indebtedness ($12.9 million) and to pay a dividend to stockholders of record as of February 27, 1998 ($33.0 million) equal to substantially all previously taxed, but undistributed, S Corporation earnings of the Company. The remaining net proceeds ($11.4 million) have been invested in short-term investment securities and used for general corporate purposes.

NOTE 4 - PRO FORMA INCOME STATEMENT DATA

The following pro forma adjustments have been made to the historical results of operations for the three months ended March 31, 1998 to make the pro forma presentation comparable to what would have been reported had the Company operated as a C Corporation for that period:

1. Elimination of stockholder/officer compensation in excess of aggregate established 1998 quarterly base salaries ($150,000) for the period prior to March 6, 1998. These amounts generally represented Company-related S Corporation tax obligations payable by the stockholder/officers for periods prior to March 6, 1998. Effective upon the closing of the Offering, these stockholder/officers are being paid annual base salaries aggregating $600,000.

2. Elimination of the historical income tax benefit/provision for the period prior to March 6, 1998 (including elimination of the $4.2 million income tax benefit related to the establishment of additional deferred tax assets for future tax deductions resulting from the termination of the Company's Subchapter S Corporation status) and establishment of a provision for federal and state income taxes that would have been payable by the Company if taxed under Subchapter C of the Code, assuming an effective tax rate of 39% for the quarter ended March 31, 1998 after an adjustment for stockholder/officer compensation described in No. 1 above.

NOTE 5 - 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 outstanding options to purchase common stock. The denominator used to determine pro forma basic earnings per share for the quarter ended March 31, 1998 includes the weighted average shares required to pay the S Corporation dividend, assuming a price per share of $17.50.

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

| THREE MONTHS ENDED MARCH 31, (AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA) | 1999 (ACTUAL) | 1998 (PRO FORMA) |
|---|---|---|
| Numerator: | | |
| Net income | $ 4,421 | $ 3,033 |
| Denominator: | | |
| Denominator for basic earnings per share: | | |
| Weighted average shares | 15,622 | 12,957 |
| Weighted average shares required to pay stockholder dividend | - | 1,279 |
| Denominator for pro forma basic earnings per share | 15,622 | 14,236 |
| Effect of dilutive securities | | |
| Employee stock options | 446 | 599 |
| Denominator for pro forma diluted earnings per share | 16,068 | 14,835 |
| Pro forma earnings per share: | | |
| Basic | $ .28 | $ .21 |
| Diluted | $ .28 | $ .20 |

The following stock options to purchase Common Stock were excluded from the computation of diluted earnings per share for the three months ended March 31, 1999 and 1998 because the effect of the options on the calculation would have been anti-dilutive:

| MARCH 31, (AMOUNTS IN THOUSANDS) | THREE MONTHS ENDED 1999 | 1998 |
|---|---|---|
| Anti-dilutive stock options | 834 | 0 |

NOTE 6 - REPORTING COMPREHENSIVE INCOME

The Company has adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." SFAS No. 130 requires the reporting of comprehensive income in addition to net income. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income. Based on the current financial structure and operations of the Company, the Company had no other components to be included in comprehensive income. Therefore, comprehensive income is the same as net income reported for the three months ended March 31, 1999 and 1998.

NOTE 7 - RECENT PRONOUNCEMENTS OF THE FINANCIAL ACCOUNTING STANDARDS BOARD

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", effective for fiscal years beginning after June 15, 1999. The new standard requires that all companies record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. Management is currently assessing the impact of SFAS No. 133 on the financial statements of the Company. The Company will adopt this accounting standard on January 1, 2000, as required.

NOTE 8 - 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 its "reportable operating segments" in its annual and interim financial statements.

Management has determined that the Company has only one "reportable operating segment", given the financial information provided to and used by the "chief decision maker" of the Company to allocate and assess the Company's performance. However, senior management does monitor revenue by platform (PC vs. Mac), sales channel (Corporate Outbound, Inbound Telesaless and On-line Internet), and product mix (Computer Systems and Memory, Peripherals, Software, and Networking and Communications).

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

| | THREE MONTHS ENDED MARCH 31, 1999 | 1998 |
|---|---|---|
| Platform | | |
| PC and Multi Platform | $182,458 | $135,856 |
| Mac | 42,521 | 32,787 |
| Total | $224,979 | $168,643 |
| Sales Channel | | |
| Corporate Outbound | $128,677 | $ 85,282 |
| Inbound Telesales | 84,267 | 77,809 |
| On-Line Internet | 12,035 | 5,552 |
| Total | $224,979 | $168,643 |
| Product Mix | | |
| Computer Systems and Memory | $106,351 | $ 69,570 |
| Peripherals | 75,646 | 59,887 |
| Software | 28,625 | 25,404 |
| Networking and Communications | 14,357 | 13,782 |
| Total | $224,979 | $168,643 |

NOTE 8 - SEGMENT AND RELATED DISCLOSURES-CONT'D.

Substantially, all of the Company's net sales for the quarters ended March 31, 1999 and 1998 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 2% in those respective quarters. All of the Company's assets at March 31, 1999 and December 31, 1998 were located in the United States. The Company's primary target customers are small- to medium-size businesses ("SMBs") comprised of 20 to 1,000 employees, although its customers also include individual consumers, larger companies, federal, state and local governmental agencies and educational institutions. No single customer (including the federal government) accounted for more than 2% of total net sales in the quarters ended March 31, 1999 and 1998.

PC CONNECTION, INC.
PART I - FINANCIAL INFORMATION
ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements based on management's current expectations, estimates and projections about the Company's industry, management's beliefs and certain assumptions made by management. All statements, trends, analyses and other information contained in this report relative to trends in net sales, gross margin and anticipated expense levels, as well as other statements, including words such as "anticipate", "believe," "plan," "estimate," "expect" and "intend" and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth in Item 7 under the caption "Factors That May Affect Future Results and Financial Condition" in the Company's Annual Report on Form 10-K for the year ended December 31, 1998 filed with the SEC, wich are incorporated by reference herein. Particular attention should be paid to the cautionary statements involving the industry's rapid technological change and exposure to inventory obsolescence, availability and allocation of goods, reliance on vendor support and relationships, continued sales of Mac products, competitive risks, pricing risks, and economic risks. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the SEC.

GENERAL

The Company was founded in 1982 as a mail-order business offering a broad range of software and accessories for IBM and IBM-compatible personal computers ("PCs"). The founders' goal was to provide consumers with superior service and high quality branded products at competitive prices. The Company initially sought customers through advertising in magazines and the use of inbound toll free telemarketing. Currently, the Company seeks to generate sales through (i) outbound telemarketing by account managers focused on the business, education and government markets, (ii) inbound calls from customers responding to the Company's catalogs and other advertising and (iii)commencing in 1997, selling products through its Internet web site.

The Company offers both PC compatible products and Mac personal computer compatible products. Reliance on Mac product sales has decreased over the last two years, from 23.0% of net sales for the year ended December 31, 1996 to 18.9% of net sales in the quarter ended March 31, 1999. Although net sales attributable to Mac products increased in the quarter ended March 31, 1999, as compared to the comparable period in 1998, the Company believes that such sales will continue to decrease as a percentage of net sales and may decline in dollar volume in future periods.

All of the Company's product categories experienced strong growth in the quarter ended March 31, 1999 over the comparable period in 1998, with sales of computer systems representing one of the fastest growing categories. Sales of computer systems result in a relatively high dollar sales order, as reflected in the increase in the Company's average order size from $522 in the quarter ended March 31, 1998 to $628 in the quarter ended March 31, 1999. Computer system sales generally provide the largest gross profit dollar contribution per order of all of the Company's products, although they usually yield the lowest gross margin percentage. Partially as a result of higher system sales, the Company's gross margin has declined over the last two years while the operating income margin has generally increased due to the leveraging of selling, general and administrative expenses over a larger sales base.

The Company's profit margins are also influenced by, among other things, industry pricing and the relative mix of inbound, outbound, and on-line Internet sales. Generally, pricing in the computer and related products market is very aggressive and the Company intends to maintain prices at competitive levels. Since outbound sales are typically to corporate accounts that purchase at volume discounts, the gross margin on such sales is generally lower than inbound sales. However, the gross profit dollar contribution per order is generally higher as average order sizes of orders to corporate accounts are usually larger. The Company believes that outbound and on-line Internet sales will continue to represent a larger portion of its business mix in future periods.

GENERAL - CONT'D.

The direct marketing of personal computers and related products is highly competitive. In addition to other direct marketers and manufacturers who sell direct, such as Dell Computer Corporation ("Dell") and Gateway, Inc. ("Gateway"), manufacturers of PCs sold by the Company, such as Compaq and IBM, have also announced varying plans to sell PCs directly to end users. Separately, however, both Compaq and IBM have announced plans to increase their reliance on reseller arrangements with direct marketers such as the Company as part of their own marketing programs designed to compete more effectively with Dell and Gateway. The Company currently believes that direct sales by Compaq and IBM will not have a significant adverse effect upon the Company's net sales.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 1999 COMPARED WITH THE THREE MONTHS ENDED MARCH 31, 1998

The following table sets forth the Company's percentage of net sales (in dollars) of computer systems/memory, peripherals, software, and networking and communications products during the periods ended March 31, 1999 and 1998:

| THREE MONTHS ENDED MARCH 31, | 1999 | 1998 |
|---|---|---|
| Computer Systems/Memory | 47.3% | 41.3% |
| Peripherals | 33.6 | 35.5 |
| Software | 12.7 | 15.1 |
| Networking and Communications | 6.4 | 8.1 |
| Total | 100.0% | 100.0% |

NET SALES increased $56.3 million, or 33.4%, to $225.0 million for the quarter ended March 31, 1999 from $168.6 million for the comparable period in 1998. Growth in net sales was primarily attributable to the continued expansion and increased productivity of the Company's outbound telemarketing group, continued growth in average order size, an increase in the number of catalog mailings and growth in the Company's Internet sales. Outbound sales increased $43.4 million, or 50.9%, to $128.7 million in the three months ended March 31, 1999 from $85.3 million in the three months ended March 31, 1998. Inbound and on-line Internet sales increased $12.9 million, or 15.5%, to $96.3 million in the three months ended March 31, 1999 from $83.4 million in the three months ended March 31, 1998. Computer system/memory sales increased to 47.3% of net sales for the three months ended March 31, 1999 from 41.3% for the comparable period in 1998.

GROSS PROFIT increased $5.1 million, or 23.3%, to $27.1 million for the quarter ended March 31, 1999 from $21.9 million for the comparable quarter in 1998. The increase in gross profit dollars was primarily attributable to the increase in net sales described above. Gross profit margin decreased from 13.0% for the three months ended March 31, 1998 to 12.0% for the three months ended March 31, 1999, due primarily to the continued decline in margins for system sales and growth in outbound telemarketing sales, which generally carry lower margins. During 1999, certain product manufacturers changed the focus of their vendor support programs from providing general cooperative advertising dollars to issuing rebates based on specified product sell through. The effect of this change in vendor focus impacted both cost of sales and selling, general and administrative expenses, because rebates are accounted for as credits to cost of sales and cooperative advertising revenue is credited to advertising expense. The Company anticipates that this trend may continue in the future.

The Company expects that its gross margin in the future is likely to fluctuate and may decline from the level achieved in the first quarter of 1999 since it is dependent upon several variables including vendor support programs, product mix, pricing strategies, market conditions and other factors.

RESULTS OF OPERATIONS - GENERAL - CONT'D.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES increased $2.9 million, or 17.2%, to $19.8 million for the quarter ended March 31, 1999 from $16.9 million for the comparable quarter in 1998, but decreased as a percentage of sales from 10.0% in the three months ended March 31, 1998 to 8.8% for the three months ended March 31, 1999. The increase in expenses was primarily attributable to increases in volume-sensitive costs such as sales personnel and credit card fees. However, the 1998 quarter included a $870,000 one-time charge for stock option compensation expense relating to the acceleration in the vesting period of certain of the Company's stock options from seven to four years in connection with the Offering. Selling, general and administrative expenses, excluding the one-time charge in 1998 for stock option compensation expense, increased $3.8 million, or 23.6%, in the quarter ended March 31, 1999 over the comparable period in 1998, but decreased as a percentage of sales from 9.5% for the three months ended March 31, 1998 to 8.8% for the comparable period in 1999. The decrease as a percentage of net sales was primarily attributable to the leveraging of selling, general and administrative expenses over a larger sales base.

ADDITIONAL STOCKHOLDER/OFFICER COMPENSATION was $0 for the three months ended March 31, 1999, compared to $2.4 million for the comparable period in 1998. This amount generally represented Company-related S Corporation income tax obligations payable by the stockholder/officers for periods prior to March 6, 1998. Effective upon closing of the Offering, the stockholder/officers are being paid annual base salaries aggregating $600,000.

INCOME FROM OPERATIONS increased $4.6 million, or 166.8%, to $7.3 million for the quarter ended March 31, 1999, from $2.7 million for the quarter ended March 31, 1998. Income from operations as a percentage of sales increased from 1.6% in the three months ended March 31, 1998 to 3.3% in the comparable period in 1999 for the reasons discussed above.Income from operations, excluding both the 1998 one-time charge for stock option compensation expense ($870,000) and the additional 1998 stockholder/officer compensation in excess of their aggregate quarterly base salaries of $150,000 ($2.4 million), increased by $1.3 million, or 22.5%, for the quarter ended March 31, 1999. Such income from operations as a percentage of net sales changed from 3.5% for the three month period ended March 31, 1998 to 3.3% for the comparable period in 1999.

INTEREST EXPENSE increased $60,000, or 29.1%, to $266,000 in the three months ended March 31, 1999 from $206,000 for the comparable period in 1998. This increase in interest expense was due primarily to the interest recognized on the capital lease of the Company's new headquarters facility which began in December 1998, offset in part by generally lower average outstanding bank borrowings in the three months ended March 31, 1999, compared to the comparable period in 1998.

INCOME TAXES for the three months ended March 31, 1999 was a tax provision of $2.7 million compared to a pro forma tax provision of $1.9 million for the comparable quarter in 1998. The effective tax rate was 38% for the three months ended March 31, 1999, compared to the pro forma effective tax rate of 39% for the three months ended March 31, 1998.

RESULTS OF OPERATIONS - GENERAL - CONT'D.

NET INCOME for the quarter ended March 31, 1999 decreased $2.0 million, or 31.0%, to $4.4 million from $6.4 million for the comparable quarter in 1998, principally as a result of a net $3.8 million income tax benefit in 1998, offset in part by the increases in operating income.

PRO FORMA NET INCOME calculated for the three months ended March 31, 1998, is determined by (i) eliminating stockholder/officer compensation in excess of quarterly base salaries ($150,000) and (ii) by eliminating the actual income tax provision/benefit and adding a provision for federal and state income taxes that would have been payable by the Company under Subchapter C of the Internal Revenue Code ("Code"). Net income for the quarter ended March 31, 1999 was $4.4 million, or $.28 per share, compared to pro forma net income for the quarter ended March 31, 1998 of $3.0 million, or $.20 per share.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically financed its operations and capital expenditures through cash flow from operations and bank borrowings. In March 1998, the Company completed an initial public offering and used the net proceeds of the Offering, aggregating $57.3 million, to repay all outstanding bank indebtedness of $12.9 million and to pay a dividend of $33.0 million to its then current stockholders, equal to substantially all previously taxed, but undistributed, S Corporation earnings of the Company. The remaining net proceeds of $11.4 million were invested in short-term investment securities and are being used for general corporate purposes. The Company believes that funds generated from operations, together with the net proceeds from the Offering and available credit under its bank line of credit, will be sufficient to finance its working capital and capital expenditure requirements at least through 1999. The Company's ability to continue funding its planned growth is dependent upon its 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.

Net cash used by operating activities was $2.0 million for the three months ended March 31, 1999, as compared to $26.1 million provided in the comparable period in 1998. The primary factors historically affecting cash flows from operations are the Company's net income and changes in the levels of accounts receivable, inventories and accounts payable. Accounts receivable have increased primarily due to an increase in open account purchases by commercial customers resulting from the Company's continued efforts to increase its sales to such customers. Historically, inventories and accounts payable have increased as a result of the sales growth of the Company; however, inventory and accounts payable decreased in the three months ended March 31, 1999 by $7.9 million and $8.8 million, respectively, compared to relatively little change in inventory and an increase in accounts payable of $25.6 million in the comparable period in 1998, principally related to the timing of payments and steps taken to improve inventory turns.

At March 31, 1999, the Company had cash and cash equivalents of $8.6 million and working capital of $58.2 million. At December 31, 1998, the Company had cash and cash equivalents of $11.9 million and working capital of $53.8 million.

Capital expenditures were $1.4 million in the three months ended March 31, 1999, as compared to $2.0 million in the comparable period in 1998. The majority of the capital expenditures for the respective 1999 and 1998 periods relate to computer hardware and software for the Company's management information systems. The Company has been in the process over the last year of upgrading its order management and fulfillment systems to new hardware and software. The conversion was completed during the third quarter of 1998. Total capital expenditures for the year ending December 31, 1999 are estimated at $10.0 million.

LIQUIDITY AND CAPITAL RESOURCES - CONT'D.

The Company has a credit agreement with a bank providing for short-term borrowings equal to the lesser of $45 million or an amount determined by a formula based on accounts receivable and inventory balances. Borrowing availability at March 31, 1999 was $45 million. Such borrowings are collateralized by the Company's accounts receivable and inventories (other than inventories pledged to secure trade credit arrangements) and bear interest at the prime rate (7.75% at March 31, 1999). The credit agreement includes various customary financial and operating covenants, including restrictions on the payment of dividends, except for dividends to stockholders in respect of income taxes, none of which the Company believes significantly restricts its operations. No borrowings were outstanding at March 31, 1999.

The Company had $68.7 million in outstanding accounts payable at March 31, 1999, including $4.0 million for in-transit inventory from vendors not yet received by the Company but for which title passed to the Company upon shipment. Such accounts are generally paid within 30 days of incurrence and will be financed by cash flows from operations or short-term borrowings under the line of credit.

YEAR 2000 COMPLIANT INFORMATION SYSTEMS

The change in date from 1999 to 2000 poses potential problems for many computer and electro-mechanical systems around the world. Some of the Company's systems could be affected by this problem which could have a material adverse effect on the Company's business, financial condition and results of operations.

In order to minimize any potential disruption to the Company's business, the Company has an active, on-going program to evaluate its systems and take corrective action prior to the millennium change. A full-time senior manager is responsible for managing the Year 2000 Project, which is comprised of five phases: awareness, assessment, renovation, validation and implementation. For each system that is determined to be non-compliant, the Company is taking one of the following three courses of action to achieve date compliance: (i) renovate (convert) the current system; (ii) replace the current system with a new date compliant system; or (iii) retire the current system because it no longer serves a valid business need.

The Company recently replaced its order management and fulfillment software with new software and converted its principal computer equipment to new IBM AS400 platform systems, both of which are better suited to the Company's expected scale of operations and are designed to be Year 2000 compliant. The Company is investigating the extent to which its other systems may be affected and communicating to all of its system vendors concerning timely and completed remedies for those systems requiring modification. The Company currently believes it will be able to modify or replace any affected systems in time to minimize any detrimental effect on operations.

The Company is also communicating with all third parties on which it relies to assess their progress in evaluating their systems and implementing appropriate corrective measures, and such assessments are expected to be completed by June 30, 1999. Furthermore, the Company is actively encouraging its customers to undertake their own Year 2000 compliance projects in order to ensure the continued viability of the Company's commercial business pursuits. The Company has been taking, and will continue to pursue, all reasonably necessary steps to protect its operations, assets and the interests of its customers, shareholders, employees and community partners.

Utilizing both internal and external resources to identify and assess needed Year 2000 remediation, the Company currently anticipates that its Year 2000 awareness, assessment, renovation and validation efforts, which began in 1996, will be completed by June 30, 1999, and that such efforts will be completed prior to any currently anticipated impact on its computer equipment and software. The Company estimates that as of March 31, 1999, it had completed approximately 90% of the initiatives that it believes will be necessary to fully address potential Year 2000 issues relating to its computer equipment and software. The majority of the projects comprising the remaining 10% of the initiatives are in process and expected to be substantially completed by June 30, 1999.

YEAR 2000 COMPLIANT INFORMATION SYSTEMS- CONT'D.

| | TIME FRAME | PERCENT COMPLETED |
|---|---|---|
| Status of overall Year 2000 Project: | | |
| Awareness | 10/97 - 06/98 | 100% |
| Assessment | 10/97 - 12/98 | 100% |
| Renovation | 04/98 - 09/99 | 90% |
| Validation | 05/98 - 11/99 | 75% |
| Implementation | 05/98 - 12/99 | 80% |
| Summary of significant Year 2000 projects completed: | | |
| Conversion to new IBM AS400 | 10/96 - 09/98 | 100% |
| Conversion to new order management and fulfillment software | 10/96 - 09/98 | 100% |

The primary objectives of the Year 2000 Project relating to the Company's internal systems were met when the Company implemented its new order management and fulfillment software and upgraded its IBM AS400 data processing platform. The majority of the costs (approximately $5.5 million) of the new software and hardware were capitalized during the period October 1, 1997 to September 30, 1998. The Company believes that the costs of its Year 2000 awareness, assessment, renovation, validation and implementation for all other computer equipment and software, as well as currently anticipated costs to be incurred by the Company with respect to Year 2000 issues of third parties, will not exceed $500,000, which will be funded from operating cash flow. These costs will be expensed as incurred and funded from working capital.

The Company presently believes that the Year 2000 issue will not pose significant operational problems for the Company. However, for all Year 2000 issues that are not properly identified, or assessments, renovation, validation and implementation are not effected timely with respect to Year 2000 problems, there can be no assurance that the Year 2000 issues of other entities will not have a material adverse impact on the Company's systems or results of operations.

The Company is presently undertaking, a comprehensive analysis of the operational problems and costs (including loss of revenues) that would be reasonably likely to result from the failure by the Company and certain third parties to complete efforts necessary to achieve Year 2000 compliance on a timely basis. A contingency plan has not been developed for dealing with worst case scenarios, and such scenarios have not yet been clearly identified. The Company currently plans to complete such analysis and contingency planning before December 31, 1999.

The costs of the Company's Year 2000 awareness, assessment, renovation, validation and implementation efforts and the dates on which the Company believes it will complete such efforts are based upon management's best estimates, which were derived using numerous assumptions regarding future events, including the continued availability of certain resources, third-party remediation plans, and other factors. There can be no assurance that these estimates will prove to be accurate and actual results could differ materially from those currently anticipated. Specific factors that could cause such material differences include, but are not limited to, the availability and cost of personnel trained in Year 2000 issues, the ability to assess, renovate and implement all relevant computer codes and embedded technology and similar uncertainties. In addition, variability of definitions of "Year 2000 Compliance" and the myriad of different products and services and combinations thereof, sold by the Company may lead to claims whose impact on the Company is not currently estimable. No assurance can be given that the aggregate cost of defending and resolving such claims, if any, will not materially adversely affect the Company's results of operations. Although some of the Company's agreements with manufacturers and others from whom it purchases products for resale contain provisions requiring such parties to indemnify the Company under some circumstances, there can be no assurance that such indemnification arrangements will cover all of the Company's liabilities and costs related to claims by third parties related to the Year 2000 issue.

RECENTLY ISSUED FINANCIAL ACCOUNTING STANDARDS

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", effective for fiscal years beginning after June 15, 1999. The new standard requires that all companies record derivatives on the balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. Management is currently assessing the impact of SFAS No. 133 on the financial statements of the Company. The Company will adopt this accounting standard on January 1, 2000, as required.

INFLATION

The Company has historically offset any inflation in operating costs by a combination of increased productivity and price increases, where appropriate. The Company does not expect inflation to have a significant impact on its business in the future.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company invests cash balances in excess of operating requirements in short-term securities, generally with maturities of 90 days or less. The Company

believes that the effect, if any, of reasonably possible near-term changes in interest rates on the Company's financial position, results of operations and cash flows should not be material.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

Not applicable

ITEM 2 - CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

ITEM 5 - OTHER INFORMATION

Not applicable

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

| Exhibit Number | Description |
| --- | --- |
| 27 | Financial Data Schedule |
| 99.1 | Pages 23 through 27 of the Company's Annual Report on Form 10-K for the year ended December 31, 1998 as filed with the SEC (which is not deemed filed except to the extent that portions thereof are expressly incorporated by reference herein). |

(b) REPORTS ON FORM 8-K

(i) None

## SIGNATURES

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

PC CONNECTION, INC.

May 14, 1999

By: /s/
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Wayne L. Wilson
President and Chief Operating Officer

May 14, 1999

By: /s/
---------------------------------
Mark A. Gavin
Vice President of Finance
and Chief Financial Officer

This schedule contains summary financial information extracted from the Company's financial statements on Form 10-Q and is qualfiied in its entirety by reference to such financial statements

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3-MOS
DEC-31-1999
JAN-01-1999
MAR-31-1999
8,579
0
71,170
7,279
55,525
134,539
44,257
21,314
157,843
76,386
7,049
0
0
156
74,252
157,843
224,979
224,979
197,913
197,913
(94)
858
266
7,131
2,710
4,421
0
0
0
4,421
.28
.28

EXHIBIT 99.1

FACTORS THAT MAY AFFECT FUTURE RESULTS AND FINANCIAL CONDITION

The Company's future results and financial condition are dependent on the Company's ability to continue to successfully market, sell, and distribute computers, hardware and software.Inherent in this process are a number of factors that the Company must successfully manage in order to achieve favorable operating results and financial condition. Potential risks and uncertainties that could affect the Company's future operating results and financial condition include, without limitation, the factors discussed below:

No Assurance of Future Growth

Net sales have grown from $196.7 million for the year ended December 31, 1994 to $732.4 million for the year ended December 31, 1998. This growth has placed increasing demands on the Company's management resources and facilities. The Company's business strategy is to pursue additional growth and expand its customer base, which is likely to result in additional demands on the Company's resources. The Company's future success will depend in part on the ability of the Company to manage any future growth effectively. There can be no assurance that the Company will realize future growth in net sales or will not experience decreases in net sales.

Risks Related to Transition or Expansion of Facilities

Additional and/or alternative facilities for distribution and sales may be required to support significant future growth in the Company's net sales, if realized. There can be no assurance that suitable facilities will be available, and in the absence of such facilities, future growth could be impaired.

Dependence on Management Information Systems

The Company's success is dependent on the accuracy, reliability and proper use of its management information systems, including its telephone system, and the information generated by its management information systems. The Company does not currently have redundant systems for all functions performed by its management information systems or a redundant or back-up telephone system. Any interruption in these systems or in telephone service could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Rapid Technological Change and Exposure to Inventory Obsolescence

The market for personal computer products is characterized by rapid technological change and the frequent introduction of new products and product enhancements. The Company's success depends in part on its ability to identify and market products that meet the needs of the marketplace. In order to satisfy customer demand and to obtain favorable purchasing discounts, the Company may carry increased inventory levels of certain products in the future, which will subject it to increased risk of inventory obsolescence. In the implementation of its business strategy, the Company intends, among other things, to place larger than typical inventory stocking orders, increase its participation in first-to-market purchase opportunities, and may in the future participate in end-of-life-cycle purchase opportunities and market products on a private-label basis, all of which will further increase the risk of inventory obsolescence. Special purchase products are sometimes acquired without return privileges and there can be no assurance that the Company will be able to avoid losses related to obsolete inventory. In addition, some manufacturers provide the Company with co-op advertising support in the form of products, for which there may be no return privileges. Finally, certain build-to-order programs currently being implemented by some computer systems manufacturers will likely include reductions in the levels of price protection and product returns made available by such manufacturers. See ''Business_ Products and Merchandising.''

Availability and Allocation of Goods

The Company acquires products for resale from manufacturers as well as from distributors. Purchases of products from the five vendors supplying the greatest amount of goods to the Company constituted 44.5% and 46.5% of the Company's total product purchases in the years ended December 31, 1998 and 1997, respectively. Among these five vendors, purchases from Ingram Micro, Inc. (''Ingram Micro'') represented 20.3% and 28.0% of the Company's total product purchases in the years ended December 31, 1998 and 1997, respectively. No other vendor supplied more than 10% of the Company's total product purchases in the year ended December 31, 1998. The loss of Ingram Micro could cause a short-term disruption in the availability of products and could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Substantially all of the Company's contracts and arrangements with its vendors that supply significant quantities of products are terminable by such vendors or the Company without notice or upon short notice. Most of the Company's product vendors provide the Company with trade credit, of which the net amount outstanding at December 31, 1998 was $72.2 million. Termination, interruption or contraction of the Company's relationships with its vendors, including a reduction in the level of trade credit provided to the Company, could have a material adverse effect on the Company's financial position, results of operations and cash flows. See ''Business_ Purchasing and Vendor Relations.''

Certain product manufacturers either do not permit the Company to sell the full line of their products or limit the number of product units available to direct marketers such as the Company. An element of the Company's business strategy is to increase its participation in first-to-market purchase opportunities. In the past, availability of certain desired products, especially in the direct marketing channel, has been constrained. The inability to source first-to-market purchase or similar opportunities, or the reemergence of significant availability constraints, could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Reliance on Vendor Support and Relationships
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Some product manufacturers and distributors provide the Company with substantial incentives in the form of payment discounts, supplier reimbursements, price protection and rebates. No assurance can be given that the Company will continue to receive such incentives in the future or that it will be able to collect outstanding amounts relating to any future incentives in a timely manner or at all.

Most product manufacturers provide the Company with co-op advertising support in exchange for product coverage in the Company's catalogs. This support significantly defrays the expense of catalog production. The level of co-op advertising support available to the Company from certain manufacturers has declined. The level of support from some manufacturers may further decline in the future. Such a decline could increase the Company's selling, general and administrative expenses as a percentage of sales and have a material adverse effect on the Company's financial position, results of operations and cash flows. See ''Business_ Purchasing and Vendor Relations.''

Competitive Risks
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The Company competes with national and international direct marketers; product manufacturers that sell directly to end users; specialty personal computer retailers; personal computer and general merchandise superstores; consumer electronic and office supply stores; and shopping services on television, the Internet and commercial on-line networks. The Company competes not only for customers, but also for co-op advertising support from personal computer product manufacturers. Some of the Company's competitors are larger and have substantially greater financial resources, superior operating results, and larger catalog circulations and customer bases than the Company. In addition, several direct marketers have recently been acquired by larger competitors. This industry consolidation could result in short-term price-cutting in certain markets. There can be no assurance that the Company will be able to compete effectively with existing competitors or any new competitors that may enter the market, or that the Company's financial position, results of operations and cash flows will not be adversely affected by intensified competition. See ''Business - Competition.''

Pricing Risks
- - - - - - - - - - - - - -------------

The personal computer industry has experienced intense price competition. The Company believes that price competition may increase in the future and that such competition could result in a reduction of the Company's profit margins. Also, the Company has recently increased its sales of personal computer hardware products that generally produce lower profit margins than those associated with software products. Significant margin decreases could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Economic Risks
- - - - - - - - - - - - - --------------

The market for personal computers and related products has grown rapidly in recent years. Recent statements by industry observers have indicated that there may be a slowdown in the growth rate of the personal computing industry. If the growth of this market or the direct marketing channel were to cease or decrease, the Company's financial position, results of operations and cash flows would be materially adversely affected. Demand for many of the products carried by the Company may be subject to economic cycles. The Company's business and growth could be affected by the spending patterns of existing or prospective customers, a recession or prolonged economic slowdown, the cyclical nature of capital expenditures of businesses, continued competition and pricing pressures and other trends in the general economy, any one of which could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Dependence on Third Party Shippers
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The Company ships approximately 75% of its products to customers by Airborne Freight Corporation D/B/A ''Airborne Express'' (''Airborne Express''), with the remainder being shipped by United Parcel Service of America, Inc. and other overnight delivery and surface services. Strikes or other service interruptions by such shippers could adversely affect the Company's ability to market or deliver product on a timely basis and have a material adverse effect on the Company's financial position, results of operations and cash flows. See ''Business - Distribution.''

Potential Increases in Shipping, Paper and Postage Costs
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Shipping costs are a significant expense in the operation of the Company's business. The Company has a long-term contract with Airborne Express for shipment of its products under which the Company believes it has negotiated favorable shipping rates. The Company generally invoices customers for shipping and handling charges. There can be no assurance that the full cost, including any future increases in the cost, of commercial delivery services can be passed on to the Company's customers, which could have a material adverse effect on the Company's financial position, results of operations and cash flows. In addition, the current shipping rates under the Airborne Express contract are subject to renegotiation in 1999, and there can be no assurance that such renegotiated rates will continue to be as favorable to the Company, which could have a material adverse effect on the Company's financial position, results of operations and cash flows. See ''Business -  Distribution'' and ''Business - Marketing and Sales.''

The Company also incurs substantial paper and postage costs related to its marketing activities, including its catalog production and mailings. Any increases in postal or paper costs could have a material adverse effect on the Company's financial position, results of operations and cash flows.

No Assurance of Future Profitability; Variability of Quarterly Results
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The Company has experienced significant fluctuations in its operating results, and these fluctuations may continue in the future. The Company incurred net losses in the year ended December 31, 1994. The Company's results of operations are significantly affected by many factors, including seasonal and other fluctuations in demand for personal computer products and in profit margins on products sold, catalog timing and circulation, product availability, and timing of releases of new and upgraded products. Many of these factors are outside the control of the Company. The Company's operating results are heavily dependent upon its ability to predict sales levels, monitor and control associated expenses, and carefully manage all aspects of its operations, including product selection and pricing, purchasing and payables practices, inventory management, and catalog funding, production and circulation. If revenues do not meet expectations in any given quarter, or if the Company experiences difficulty in monitoring or controlling associated expenses, the Company's financial position, results of operations and cash flows may be materially adversely affected. There can be no assurance that the Company will be profitable on a quarterly or annual basis. It is possible that in some future quarter the expectations of public market analysts and investors will exceed the Company's operating results. In such event, the price of the Common Stock would likely be materially adversely affected. See "Selected Quarterly Financial Results"  within this section.

Changing Methods of Distribution
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The manner in which personal computers and related products are distributed and sold is changing, and new methods of distribution and sale, such as on-line 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. Certain of the Company's vendors, including Apple, Compaq and IBM, currently sell some of their products directly to end users. 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 the Company's financial position, results of operations and cash flows.

State Sales or Use Tax Collection Uncertainties
- - - - - - - - - - - - - - ---------------------------------------------

The Company presently collects sales tax only on sales of products to residents of the State of Ohio. Sales to customers located within the State of Ohio were less than 2% of the Company's net sales during the year ended December 31, 1998. Various states have sought to impose on direct marketers the burden of collecting state sales 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 tax collection obligations on direct marketers has been introduced in Congress on many occasions. Due to its presence on various forms of electronic media and other factors, the Company's contact with many states may exceed the contact involved in the Supreme Court case. The Company cannot predict the level of contact that is sufficient to permit a state to impose on the Company a sales tax collection obligation. If the Supreme Court changes its position or if legislation is passed to overturn the Supreme Court's decision, the imposition of a sales or use tax collection obligation on the Company in states to which it ships products would result in additional administrative expenses to the Company, could result in price increases to the customer, and could reduce demand for the Company's products or could otherwise have a material adverse effect on the Company's financial position, results of operations and cash flows.

## Dependence on Key Personnel

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

## Control by Principal Stockholders

Patricia Gallup and David Hall, the principal stockholders of the Company, beneficially own or control, in the aggregate, approximately 75% of the outstanding shares of 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 (i) control decisions to adopt, amend or repeal the Restated Certificate and the Company's Bylaws, or take other actions requiring the vote or consent of the Company's stockholders and (ii) prevent a takeover of the Company by one or more third parties, or sell or otherwise transfer their stock to a third party, which could deprive the Company's stockholders of a control premium that might otherwise be realized by them in connection with an acquisition of the Company. Such control may result in decisions that are not in the best interest of the public stockholders of the Company. In connection with the Offering, the principal stockholders placed all except 40,000 of the shares of Common Stock of the Company that they beneficially own 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 the shares of Common Stock at a premium as well as have a negative impact on the market price of the shares of Common Stock.