# 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 September 30, 2009**

**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**<br>**(State or other jurisdiction of incorporation or organization)** | **02-0513618**<br>**(I.R.S. Employer Identification No.)** |
| **730 MILFORD ROAD, MERRIMACK, NEW HAMPSHIRE**<br>**(Address of principal executive offices)** | **03054**<br>**(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

**YES** ☐ **NO** ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☑ |
| Non-accelerated filer ☐ | Smaller reporting company ☐ |

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 November 1, 2009 was 27,167,879.

**PC CONNECTION, INC. AND SUBSIDIARIES**
**FORM 10-Q**

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**PC CONNECTION, INC. AND SUBSIDIARIES**

**PART I—FINANCIAL INFORMATION**
**Item 1—Financial Statements**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
***(amounts in thousands)***

| | September 30, 2009 *(unaudited)* | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 65,680 | $ 47,003 |
| Accounts receivable, net | 180,878 | 185,885 |
| Inventories | 59,979 | 60,813 |
| Deferred income taxes | 3,574 | 4,244 |
| Income taxes receivable | 3,227 | 1,448 |
| Prepaid expenses and other current assets | 2,958 | 3,626 |
| **Total current assets** | 316,296 | 303,019 |
| Property and equipment, net | 13,303 | 24,483 |
| Goodwill | 48,060 | 48,060 |
| Other intangibles, net | 1,417 | 2,220 |
| Other assets | 480 | 385 |
| **Total Assets** | $ 379,556 | $ 378,167 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current Liabilities: | | |
| Current maturities of capital lease obligation to affiliate | $ 759 | $ 699 |
| Accounts payable | 108,894 | 101,783 |
| Accrued expenses and other liabilities | 20,194 | 19,993 |
| Accrued payroll | 7,968 | 6,337 |
| **Total current liabilities** | 137,815 | 128,812 |
| Capital lease obligation to affiliate, less current maturities | 3,033 | 3,610 |
| Deferred income taxes | 3,821 | 6,183 |
| Other liabilities | 4,062 | 4,238 |
| **Total Liabilities** | 148,731 | 142,843 |
| Stockholders' Equity: | | |
| Common stock | 273 | 273 |
| Additional paid-in capital | 96,612 | 95,997 |
| Retained earnings | 137,147 | 142,336 |
| Treasury stock at cost | (3,207) | (3,282) |
| **Total Stockholders' Equity** | 230,825 | 235,324 |
| **Total Liabilities and Stockholders' Equity** | $ 379,556 | $ 378,167 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Net sales | $403,052 | $441,444 | $1,106,535 | $1,314,567 |
| Cost of sales | 356,708 | 388,121 | 974,238 | 1,151,660 |
| **Gross profit** | 46,344 | 53,323 | 132,297 | 162,907 |
| Selling, general and administrative expenses | 41,263 | 46,872 | 126,670 | 140,438 |
| Special charges | — | 1,431 | 12,955 | 1,431 |
| **Income (loss) from operations** | 5,081 | 5,020 | (7,328) | 21,038 |
| Interest expense | (99) | (187) | (385) | (548) |
| Other, net | 93 | 246 | 452 | 610 |
| **Income (loss) before taxes** | 5,075 | 5,079 | (7,261) | 21,100 |
| Income tax (provision) benefit | (2,186) | (1,865) | 2,072 | (8,025) |
| **Net income (loss)** | $ 2,889 | $ 3,214 | $ (5,189) | $ 13,075 |
| Earnings (loss) per common share: | | | | |
| Basic | $ 0.11 | $ 0.12 | $ (0.19) | $ 0.49 |
| Diluted | $ 0.11 | $ 0.12 | $ (0.19) | $ 0.49 |
| Weighted average common shares outstanding: | | | | |
| Basic | 27,078 | 26,835 | 27,017 | 26,834 |
| Diluted | 27,095 | 26,892 | 27,017 | 26,941 |

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**
**Nine Months Ended September 30, 2009**
**(Unaudited)**
**(*amounts in thousands*)**

| | Common Stock | | Additional | Retained | Treasury Stock | | |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-In Capital | Earnings | Shares | Amount | Total |
| **Balance—January 1, 2009** | 27,326 | $ 273 | $ 95,997 | $142,336 | (492) | $(3,282) | $ 235,324 |
| Stock-based compensation expense | — | — | 952 | — | — | — | 952 |
| Issuance of common stock under Employee Stock Purchase Plan | 28 | — | 138 | — | — | — | 138 |
| Nonvested stock awards | — | — | (372) | — | 58 | 372 | — |
| Tax shortfall from stock-based compensation | — | — | (103) | — | — | — | (103) |
| Repurchase of common stock for treasury | — | — | — | — | (72) | (297) | (297) |
| Net loss | — | — | — | (5,189) | — | — | (5,189) |
| **Balance—September 30, 2009** | **27,354** | **$ 273** | **$ 96,612** | **$137,147** | **(506)** | **$(3,207)** | **$ 230,825** |

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)***

| | Nine Months Ended September 30, 2009 | 2008 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net (loss) income | $ (5,189) | $ 13,075 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | |
| Non-cash portion of special charges | 11,625 | — |
| Depreciation and amortization | 5,221 | 5,234 |
| Provision for doubtful accounts | 1,771 | 1,396 |
| Deferred income taxes | (1,692) | 1,318 |
| Stock-based compensation expense | 952 | 1,096 |
| Tax (shortfall) benefit from stock-based compensation | (103) | 16 |
| Loss (gain) on disposal of fixed assets | 15 | (13) |
| Excess tax benefit from exercise of stock options | — | (3) |
| Changes in assets and liabilities: | | |
| Accounts receivable | 3,236 | 17,937 |
| Inventories | 834 | 394 |
| Prepaid expenses and other current assets | (1,111) | (599) |
| Other non-current assets | (95) | 15 |
| Accounts payable | 7,243 | 4,225 |
| Accrued expenses and other liabilities | 1,656 | (1,149) |
| Net cash provided by operating activities | 24, 363 | 42,942 |
| **Cash Flows from Investing Activities:** | | |
| Purchases of property and equipment | (5,012) | (8,708) |
| Proceeds from sale of property and equipment | 2 | 44 |
| Net cash used for investing activities | (5,010) | (8,664) |
| **Cash Flows from Financing Activities:** | | |
| Proceeds from short-term borrowings | 22, 055 | 37, 343 |
| Repayment of short-term borrowings | (22,055) | (37,343) |
| Repayment of capital lease obligation | (517) | (383) |
| Purchase of treasury shares | (297) | (1,200) |
| Issuance of stock under Employee Stock Purchase Plan | 138 | 129 |
| Exercise of stock options | — | 204 |
| Net share settlement obligation | — | 55 |
| Excess tax benefit from exercise of stock options | — | 3 |
| Net cash used for financing activities | (676) | (1,192) |
| Increase in cash and cash equivalents | 18,677 | 33,086 |
| Cash and cash equivalents, beginning of period | 47,003 | 13,741 |
| Cash and cash equivalents, end of period | $ 65,680 | $ 46,827 |

See notes to unaudited condensed consolidated financial statements.

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
*(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 the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission. The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements contained in our Annual Report on Form 10-K.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the results of operations for the interim periods reported and of the Company's financial condition as of the date of the interim balance sheet. The Company considers events or transactions that occur after the balance sheet date but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date of issuance of these financial statements. The operating results for the three and nine months ended September 30, 2009 may not be indicative of the results expected for any succeeding quarter or the entire year ending December 31, 2009.

***Use of Estimates in the Preparation of Financial Statements***

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.

**Note 2—Earnings Per Share**

Basic earnings (loss) per common share is computed using the weighted average number of shares outstanding. Diluted earnings (loss) per share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to options outstanding to purchase common stock and nonvested stock, if dilutive. In the nine months ended September 30, 2009, dilutive securities were antidilutive in calculating loss per share due to operating losses realized in this period and therefore were not included in the calculations.

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **September 30,** | **2009** | **2008** | **2009** | **2008** |
| Numerator: | | | | |
| Net income (loss) | $ 2,889 | $ 3,214 | $ (5,189) | $13,075 |
| Denominator: | | | | |
| Denominator for basic earnings (loss) per share | 27,078 | 26,835 | 27,017 | 26,834 |
| Dilutive effect of employee equity awards | 17 | 57 | — | 107 |
| Denominator for diluted earnings (loss) per share | 27,095 | 26,892 | 27,017 | 26,941 |
| Earnings (loss) per share: | | | | |
| Basic | $ 0.11 | $ 0.12 | $ (0.19) | $ 0.49 |
| Diluted | $ 0.11 | $ 0.12 | $ (0.19) | $ 0.49 |

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
*(amounts in thousands, except per share data)*

For the three and nine months ended September 30, 2009 and 2008, the following weighted average outstanding stock options and other common stock equivalents were excluded from the computation of diluted earnings (loss) per share because the effect would have been anti-dilutive:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| September 30, | 2009 | 2008 | 2009 | 2008 |
| Anti-dilutive common stock equivalents | 813 | 1,007 | 934 | 612 |

**Note 3—Goodwill and Other Intangible Assets**

Goodwill and certain intangible assets with indefinite lives are not amortized but are subject to an annual impairment test, and more frequently, if events or circumstances occur that would indicate a potential decline in our fair value. We perform the assessment annually as of January 1, and on an interim basis if potential impairment indicators arise, and determine the fair value of the reporting units using established income and market valuation approaches.

We performed an interim impairment review effective December 31, 2008 and determined that the goodwill carried by our SMB and Public Sector segments was fully impaired, and as a result, we recognized an impairment loss of $8,807, or $5,383 net of taxes, in our operating results for the year ended December 31, 2008. The fair value of the Large Account reporting unit exceeded its carrying value, and accordingly there was no need to perform the second step of the impairment test for this reporting unit at December 31, 2008. Given the results of the December 31, 2008 review, we concluded there was no impairment on January 1, 2009. We considered the operating results and future projections of the Large Account reporting unit, as well as changes in our overall market capitalization, and did not identify any events or circumstances that would indicate that it is more likely than not that the carrying value of the reporting unit was in excess of its fair value during the period ended September 30, 2009.

| | September 30, 2009 |
|---|---|
| Goodwill | $ 48,060 |
| Trademarks | 1,190 |

Intangible assets subject to amortization at September 30, 2009 consisted of customer lists of $227 (net of accumulated amortization of $4,993). Intangible assets subject to amortization at December 31, 2008 consisted of customer lists of $941 and a licensing agreement of $89 (net of accumulated amortization of $4,278 and $386, respectively). For each of the three-month periods ended September 30, 2009 and 2008, we recorded amortization expenses of $268. For the nine-month periods ended September 30, 2009 and 2008, we recorded amortization expense of $803 and $804, respectively.

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

| For the Year Ending December 31, | |
|---|---|
| 2009 | $139(*) |
| 2010 | 88 |
| 2011 and thereafter | — |

(*) Represents estimated amortization expense for the three months ending December 31, 2009.

We also periodically consider whether there are any indications of impairment of our indefinite and long-lived assets and determined, except as noted below, that the undiscounted cash flows expected from the use of our assets exceeded the carrying amounts of such assets, and thus were not impaired during the nine months ended September 30, 2009.

During the nine months ended September 30, 2009, we determined to stop further development on a customer relationship management ("CRM") module of our internally developed software. We further determined that we would not realize any future cash flows from this CRM module. As a result, we recognized a non-cash charge of $11,609 in the nine months ended September 30, 2009 to write-off the carrying amount of the module. Please see "Note 5—Special Charges" for further discussion.

**Note 4—Segment and Related Disclosures**

We are required to report profits and losses and certain other information on our "reportable operating segments" in our annual and interim financial statements. Our chief operating decision maker ("CODM") evaluates operations and allocates resources based on a measure of operating income. The internal reporting structure used by our 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 and educational institutions—together with our Headquarters/Other group that provide services in areas such as finance, human resources, information technology, legal, product management, communications, and marketing. Most of the operating costs associated with the Headquarters/Other group functions are charged to the reportable operating segments based on their estimated usage of the underlying functions. We report these charges to the operating segments as "Allocations." Certain of the headquarters costs relating to executive oversight functions that are not allocated to the operating segments are included under the heading of "Headquarters/Other" in the tables below.

PC CONNECTION, INC. AND SUBSIDIARIES

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

Net sales represent net sales to external customers and exclude inter-segment product revenues, as they are not reviewed by our CODM. In addition, our CODM reviews income tax expense on a consolidated basis, and accordingly, we do not report income tax expense by operating segment. Segment information applicable to our reportable operating segments for the three and nine months ended September 30, 2009 and 2008 is shown below:

| | Three Months Ended September 30, 2009 | | | | |
|---|---|---|---|---|---|
| | SMB Segment | Large Account Segment | Public Sector Segment | Headquarters/ Other | Consolidated |
| Net sales | $182,564 | $ 103,921 | $ 116,567 | | $ 403,052 |
| Operating income (loss) before allocations | $ 12,242 | $ 5,006 | $ 5,045 | $ (17,212) | $ 5,081 |
| Allocations | (9,480) | (803) | (4,356) | 14,639 | — |
| Operating income (loss) | $ 2,762 | $ 4,203 | $ 689 | $ (2,573) | $ 5,081 |
| Net interest expense and other, net | | | | | (6) |
| Income before taxes | | | | | $ 5,075 |
| *Selected Operating Expenses:* | | | | | |
| Depreciation and amortization | $ 28 | $ 329 | $ 29 | $ 1,299 | $ 1,685 |

| | Three Months Ended September 30, 2008 | | | | |
|---|---|---|---|---|---|
| | SMB Segment | Large Account Segment | Public Sector Segment | Headquarters/ Other | Consolidated |
| Net sales | $217,463 | $ 117,300 | $ 106,681 | | $ 441,444 |
| Operating income (loss) before allocations | $ 14,874 | $ 6,168 | $ 3,967 | $ (19,989) | $ 5,020 |
| Allocations | (10,821) | (782) | (3,936) | 15,539 | — |
| Operating income (loss) | $ 4,053 | $ 5,386 | $ 31 | $ (4,450)[1] | 5,020 |
| Net interest expense and other, net | | | | | 59 |
| Income before taxes | | | | | $ 5,079 |
| *Selected Operating Expense:* | | | | | |
| Depreciation and amortization | 72 | 337 | 33 | 1,288 | 1,730 |
| Special charges | 13 | — | 42 | 1,376[1] | 1,431 |

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
*(amounts in thousands, except per share data)*

| | Nine Months Ended September 30, 2009 | | | | |
|---|---|---|---|---|---|
| | SMB Segment | Large Account Segment | Public Sector Segment | Headquarters/ Other | Consolidated |
| **Net sales** | $531,669 | $ 304,318 | $ 270,548 | | $1,106,535 |
| Operating income (loss) before allocations | $ 34,419 | $ 13,126 | $ 10,648 | $ (65,521) | $ (7,328) |
| Allocations | (31,204) | (2,519) | (12,102) | 45,825 | — |
| Operating income (loss) | $ 3,215 | $ 10,607 | $ (1,454) | $ (19,696)(1) | $ (7,328) |
| Net interest expense and other, net | | | | | 67 |
| Loss before taxes | | | | | $ (7,261) |
| *Selected Operating Expenses:* | | | | | |
| Depreciation and amortization | $ 164 | $ 988 | $ 91 | $ 3,978 | $ 5,221 |
| Special charges | 112 | 107 | 143 | 12,593(1) | 12,955 |
| *Balance Sheet Data as of September 30, 2009:* | | | | | |
| Total assets | $150,762 | $ 136,479 | $ 58,895 | $ 33,420 | $ 379,556 |
| Goodwill | — | 48,060 | — | — | 48,060 |

| | Nine Months Ended September 30, 2008 | | | | |
|---|---|---|---|---|---|
| | SMB Segment | Large Account Segment | Public Sector Segment | Headquarters/ Other | Consolidated |
| Net sales | $693,987 | $ 361,876 | $ 258,704 | | $1,314,567 |
| Operating income (loss) before allocations | $ 49,505 | $ 19,825 | $ 9,432 | $ (57,724) | $ 21,038 |
| Allocations | (32,694) | (2,370) | (10,780) | 45,844 | — |
| Operating income (loss) | $ 16,811 | $ 17,455 | $ (1,348) | $ (11,880)(1) | 21,038 |
| Net interest expense and other, net | | | | | 62 |
| Income before taxes | | | | | $ 21,100 |
| *Selected Operating Expense:* | | | | | |
| Depreciation and amortization | 215 | 985 | 128 | 3,906 | 5,234 |
| Special charges | 13 | — | 42 | 1,376(1) | 1,431 |

(1) Special charges incurred by the Headquarters/Other group are not allocated to our operating segments.

Our operating segments' assets presented above are primarily accounts receivables, intercompany receivables, and goodwill. Assets for the Headquarters/Other group are managed by corporate headquarters, including cash, inventory, and property and equipment. Total assets for the Headquarters/Other group at September 30, 2009 are presented net of intercompany balance elimination of $44,873. Our capital expenditures largely consist of information technology ("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 on a segment basis.

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
*(amounts in thousands, except per share data)*

Senior management also monitors revenue by product mix (Software; Notebooks and PDAs; Desktops and Servers; Video, Imaging, and Sound; Net/Com Products; Printers and Printer Supplies; Storage Devices; Memory and System Enhancements; and Accessories/Other).

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

| September 30, | Three Months Ended 2009 | Three Months Ended 2008 | Nine Months Ended 2009 | Nine Months Ended 2008 |
|---|---|---|---|---|
| *Segment (excludes transfers between segments)* | | | | |
| SMB | $ 182,564 | $ 217,463 | $ 531,669 | $ 693,987 |
| Large Account | 103,921 | 117,300 | 304,318 | 361,876 |
| Public Sector | 116,567 | 106,681 | 270,548 | 258,704 |
| Total | $ 403,052 | $ 441,444 | $ 1,106,535 | $ 1,314,567 |
| *Product Mix* | | | | |
| Notebooks and PDAs | $ 61,679 | $ 70,215 | $ 163,640 | $ 204,255 |
| Desktop/Servers | 56,714 | 59,169 | 150,053 | 179,613 |
| Software | 55,582 | 56,039 | 157,031 | 169,195 |
| Video, Imaging and Sound | 53,672 | 65,776 | 144,315 | 192,588 |
| Net/Com Products | 42,930 | 46,140 | 114,380 | 132,980 |
| Printers and Printer Supplies | 35,188 | 41,557 | 97,454 | 122,701 |
| Storage Devices | 31,762 | 35,565 | 91,879 | 114,710 |
| Memory and System Enhancements | 13,760 | 13,716 | 37,975 | 46,697 |
| Accessories/Other | 51,765 | 53,267 | 149,808 | 151,828 |
| Total | $ 403,052 | $ 441,444 | $ 1,106,535 | $ 1,314,567 |

Substantially all of our net sales for the three and nine months ended September 30, 2009 and 2008 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 1% in each of those respective periods. All of our assets at September 30, 2009 and December 31, 2008 were located in the United States. Our primary target customers are small- and medium-sized businesses with 20 to 1,000 employees, federal, state, and local government 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 nine months ended September 30, 2009 and 2008. Net sales to the federal government accounted for $42,773, or 10.6% of total net sales for the three months ended September 30, 2009, and $37,759, or 8.6% of total net sales for the three months ended September 30, 2008. Net sales to the federal government accounted for $92,759, or 8.4% of total net sales for the nine months ended September 30, 2009, and $84,281, or 6.4% of total net sales for the nine months ended September 30, 2008.

**Note 5—Special Charges**

In June 2009, we determined to stop the further development of an internally developed CRM module as a result of identified significant increases in the estimated costs to complete and significant extensions of delivery schedules. We further determined that we would not realize any future cash flows from this CRM module, and as a result, we recognized a non-cash asset write-off of $11,609 representing the CRM module’s capitalized cost. We also recorded charges of $1,346 in the nine months ended September 30, 2009 related to workforce reduction

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
*(amounts in thousands, except per share data)*

and management restructuring costs, classified as workforce reductions and other in the table below. In the nine months ended September 30, 2008, we recorded a charge of $1,431 related to workforce reduction and management restructuring costs.

A roll forward of special charges for the nine months ended September 30, 2009 is shown below.

| | Workforce Reductions & Other | Asset Write-off | Total |
|---|---|---|---|
| Balance December 31, 2008 | $ 1,264 | $ — | $ 1,264 |
| Charges | 1,346 | 11,609 | 12,955 |
| Adjustments | (16) | (11,609) | (11,625) |
| Cash payments | (1,613) | — | (1,613) |
| Liabilities at September 30, 2009 | $ 981 | $ — | $ 981 |

Non-cash special charges in the nine months ended September 30, 2009 totaled $11,625 and are reflected as an “adjustment” in the above roll forward. Liabilities at September 30, 2009 consist of $885 of current liabilities and $96 of non-current other liabilities on the condensed consolidated balance sheet and are expected to be paid through January 2011. Liabilities at December 31, 2008 consist of $955 of current liabilities and $309 of non-current other liabilities on the condensed consolidated balance sheet.

**Note 6—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 subject to audits by states on sales and income taxes, unclaimed property, and other assessments. A comprehensive multi-state unclaimed property audit is currently in progress. While management believes that known and estimated liabilities have been adequately provided for, it is too early to determine the ultimate outcome of this audit. Such outcome could have a material negative impact on our financial position, results of operations, and cash flows.

**Note 7—Bank Borrowing and Trade Credit Arrangements**

We have a $50,000 credit facility collateralized by substantially all of our business assets. This facility can be increased to $80,000 for approved acquisitions or other uses authorized by the bank at substantially the same terms. Amounts outstanding under this facility bear interest at the prime rate (3.25% at September 30, 2009). The facility also gives us the option of obtaining Eurodollar Rate Loans in multiples of $1,000 for various short-term durations. The credit facility includes various customary financial ratios and operating covenants, including minimum net worth and maximum funded debt ratio requirements, and restrictions on the payment of dividends to shareholders, 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 credit facility for the quarter to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation, and Amortization), excluding non-cash special charges, for the trailing twelve months. The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at September 30, 2009 was less than 0.01 to 1.0. Future decreases in our consolidated EBITDA, however, could limit our potential borrowings under the credit facility.

No borrowings were outstanding under this credit facility at September 30, 2009 and December 31, 2008, and accordingly the entire $50,000 facility was available for borrowing at both dates. The credit facility matures on October 15, 2012, at which time amounts outstanding become due.

At September 30, 2009, 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 the financial institutions up to an aggregated 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 September 30, 2009 and December 31, 2008, accounts payable included $9,350 and $13,499, respectively, owed to these financial institutions.

**Note 8—Treasury Stock Purchases**

On March 28, 2001, our Board of Directors authorized the spending of up to $15,000 to repurchase our common stock. Share purchases will be made in the open market from time to time depending on market conditions. Our current bank line of credit however limits repurchases made after September 2005 to $10,000 without bank approval of higher amounts.

We have permitted employees to surrender shares of restricted stock awards to the Company to satisfy statutory withholding requirements due upon the vesting of such stock awards. Such net share settlements are reported as a purchase of treasury shares in our financial statements similar to the Company's open market treasury purchases. Our employees surrendered 15 shares for $72 in net share settlements during the nine months ended September 30, 2009. In addition, we repurchased 57 shares for $225 in the nine months ended September 30, 2009. As of September 30, 2009, we have repurchased an aggregate of 615 shares for $3,960. The maximum approximate dollar value of shares, however, that may yet be purchased under the program without further bank approval is $8,326. In the nine months ended September 30, 2009, we issued shares from treasury stock for restricted stock awards and have reflected upon vesting of such stock awards the net remaining balance of treasury stock on the condensed consolidated balance sheet.

**Note 9—Fair Value**

Our financial instruments consist primarily of cash and cash equivalents, accounts receivable, and accounts payable. The carrying values of cash, accounts receivable, and accounts payable approximates their fair market values due to their short-term nature. We are required to measure fair value under a fair value hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs may be used to measure fair value:

Level 1—Quoted prices in active markets for identical assets or liabilities.

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION
Item 1—Financial Statements
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
*(amounts in thousands, except per share data)*

Level 2—Include other inputs that are directly or indirectly observable in the marketplace.
Level 3—Unobservable inputs which are supported by little or no market activity.

We measure our cash equivalents at fair value and are classified within Level 1 or Level 2 of the fair value hierarchy. The classification has been determined based on the manner in which we value our cash equivalents, primarily using quoted market prices or alternative pricing sources. Assets measured at fair value on a recurring basis consisted of the following types of instruments and were reported as cash equivalents as of September 30, 2009:

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Instruments (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Balance |
| **Assets** | | | | |
| Cash Equivalents: | | | | |
| Bank time deposits | $ — | $ 47,967 | $ — | $ 47,967 |
| Money market fund deposits | 17,713 | — | — | 17,713 |
| **Total assets measured at fair value** | $ 17,713 | $ 47,967 | — | $ 65,680 |

As discussed in Notes 3 and 5, we abandoned the development of CRM software during the nine months ended September 30, 2009. We wrote off the total amount capitalized of $11,609 as the fair value of the CRM software was deemed to be zero as there was no alternative use or salvage value. The measurement of the fair value of zero and resulting charge is considered a Level 3 input.

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 leading direct marketer of a wide range of information technology, or IT, products—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 wide range of installation, configuration, 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 enterprise customers, or Large Account, through our MoreDirect subsidiary, and (c) federal, state, and local government 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 websites, and (iii) inbound calls from customers responding to our catalogs and other advertising media.

As a value added reseller in the IT supply chain, we do not manufacture IT hardware or software. We are dependent on our suppliers that consist of manufacturers and distributors that historically have sold only to resellers rather than directly to end users. Certain manufacturers have on many occasions attempted to sell directly to our customers, thereby eliminating our role. Consolidation in this industry is more evident than ever, as further streamlining of our supply chain occurs. If more of our suppliers were to succeed in selling to our customers directly, including the electronic distribution of software products, our financial condition, results of operations, and cash flows could be negatively affected.

Market conditions and technology advances significantly affect the demand for our products and services. Virtual delivery of software products and advanced Internet technology providing customers enhanced functionality have substantially increased customer expectations, requiring us to invest more heavily in our own IT development to meet these new demands. As buying trends change and electronic commerce continues to grow, customers become more sophisticated and have more choices than ever before. Customers are also better able to make price comparisons through the Internet, thereby increasing price competition. These conditions have had, and could continue to have, a negative effect on our financial condition, results of operations, and cash flows.

The primary challenges we face in effectively managing our business are (1) maintaining, if not increasing, our revenues in the face of a global recession, while at the same time improving our gross profit margins in all three business segments, (2) recruiting, retaining, and improving the productivity of our sales personnel, and (3) effectively controlling our selling, general and administrative, or SG&A, expenses over a possible lower sales base. If recent declines in IT spending continue, any significant sales growth for us must come through increased market share. Competition may become even more intense in the future, which would put more pressure on margins. Given the deterioration in the demand environment, management implemented cost reductions late in the first quarter of 2009 to lower expenses, which contributed to reduced SG&A expenses in both dollars and as a percentage of net sales in the third quarter of 2009 compared to the third quarter of 2008.

We believe that more of our customers are seeking total IT solutions, rather than simply specific IT products. Through the formation of our services organization, ProConnection, we are able to provide customers complete IT solutions, from identifying their needs, to designing, developing, and managing the integration of products and services to implement their IT projects. Such service offerings carry higher margins than traditional product sales. Additionally, the technical certifications of our service engineers permit us to offer higher-end, more complex products that also carry higher gross margins. We expect these service offerings and technical certifications to continue to play a role in sales generation and gross margins in this competitive environment.

We seek to recruit, retain, and increase the productivity of our sales personnel through training, mentoring, financial incentives based on performance, and updating and streamlining our information systems to make our operations more efficient. In addition, as stated above, we continue to actively monitor and manage our expense structure in order to obtain better leverage of our operating costs and to adjust our expense structure to changing revenue levels.

**RESULTS OF OPERATIONS**

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| **September 30,** | **2009** | **2008** | **2009** | **2008** |
| Net sales *(in millions)* | $ 403.1 | $ 441.4 | $1,106. 5 | $1,314.6 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Gross margin | 11.5 | 12.1 | 12.0 | 12.4 |
| Selling, general and administrative expenses | 10.2 | 10.6 | 11.5 | 10.7 |
| Special charges | — | 0.4 | 1.2 | 0.1 |
| Income (loss) from operations | 1.3% | 1.1% | (0.7)% | 1.6% |

Net sales in the third quarter of 2009 decreased by $38.4 million, or 8.7%, compared to the third quarter of 2008. The year-over-year decrease in sales experienced by both our SMB and Large Account segments was partially offset by increased public sector sales in the third quarter of 2009. We generated approximately $5.0 million in operating income in both the third quarter of 2009 and 2008 as the cost savings implemented earlier in 2009 and the avoidance of special charges in the third quarter of 2009 largely offset the year-over-year decrease in gross profit dollars that resulted from decreased revenues and gross profit margins.

Net sales in the nine months ended September 30, 2009 decreased by $208.0 million, or 15.8%, compared to the nine months ended September 30, 2008. The year-over-year decrease in sales experienced by both our SMB and Large Account segments was partially offset by increased public sector sales in the nine months ended September 30, 2009. Our income from operations in 2008 decreased to a loss from operations in 2009 due to the significant year-over-year decline in sales and the special charges incurred in the nine months ended September 30, 2009.

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### *Net Sales Distribution*

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

| September 30, | Three Months Ended 2009 | Three Months Ended 2008 | Nine Months Ended 2009 | Nine Months Ended 2008 |
|---|---|---|---|---|
| *Business Segment* | | | | |
| SMB | 45% | 49% | 48% | 53% |
| Large Account | 26 | 27 | 28 | 27 |
| Public Sector | 29 | 24 | 24 | 20 |
| **Total** | **100%** | **100%** | **100%** | **100%** |
| *Product Mix* | | | | |
| Notebooks and PDAs | 15% | 16% | 15% | 15% |
| Desktop/Servers | 14 | 13 | 14 | 14 |
| Software | 14 | 13 | 14 | 13 |
| Videos, Imaging and Sound | 13 | 15 | 13 | 15 |
| Net/Com Products | 11 | 11 | 10 | 10 |
| Printers and Printer Supplies | 9 | 9 | 9 | 9 |
| Storage Devices | 8 | 8 | 8 | 9 |
| Memory and System Enhancements | 3 | 3 | 3 | 4 |
| Accessories/Other | 13 | 12 | 14 | 11 |
| Total | 100% | 100% | 100% | 100% |

### *Gross Profit Margins*

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

| September 30, | Three Months Ended 2009 | Three Months Ended 2008 | Nine Months Ended 2009 | Nine Months Ended 2008 |
|---|---|---|---|---|
| *Business Segment* | | | | |
| SMB | 13.6% | 14.2% | 13.9% | 14.0% |
| Large Account | 10.6 | 11.1 | 10.5 | 11.2 |
| Public Sector | 9.0 | 8.9 | 9.7 | 9.6 |
| Total | 11.5% | 12.1% | 12.0% | 12.4% |

Consolidated gross profit dollars for the third quarter of 2009 decreased by $7.0 million compared to third quarter of 2008, due to lower net sales and gross profit margins. Consolidated gross profit dollars for the nine month ended September 30, 2009 decreased by $30.6 million compared to the nine months ended September 30, 2008, due to lower net sales and gross profit margins. Additionally, gross profit margins in the three and nine months ended September 30, 2009 both decreased year over year due to a year-over-year increase in public sector sales, which generally have lower gross profit margins compared to sales of our SMB and Large Account segments.

### *Cost of Sales and Certain Other Costs*

Cost of sales includes the invoice cost of the product, direct costs of packaging, inbound and outbound freight, and provisions for inventory obsolescence, adjusted for discounts, rebates, and other vendor allowances. 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:

| September 30, | Three Months Ended 2009 | Three Months Ended 2008 | Nine Months Ended 2009 | Nine Months Ended 2008 |
|---|---|---|---|---|
| Purchasing/Distribution Center | 0.72% | 0.68% | 0.78% | 0.69% |

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***Operating Expenses***

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

| September 30, | Three Months Ended 2009 | Three Months Ended 2008 | Nine Months Ended 2009 | Nine Months Ended 2008 |
|---|---|---|---|---|
| Personnel costs | $ 27.9 | $ 30.8 | $ 84.2 | $ 94.0 |
| Advertising, net | 3.9 | 4.8 | 12.3 | 14.5 |
| Facilities operations | 2.1 | 2.4 | 6.9 | 7.2 |
| Credit card fees | 1.6 | 1.8 | 5.0 | 5.7 |
| Depreciation and amortization | 1.7 | 1.7 | 5.2 | 5.2 |
| Bad debts | 0.4 | 0.1 | 1.4 | 1.1 |
| Other, net | 3.7 | 5.3 | 11.7 | 12.7 |
| Total | $ 41.3 | $ 46.9 | $ 126.7 | $ 140.4 |
| Percentage of net sales | 10.2% | 10.6% | 11.5% | 10.7% |

Personnel costs represent the majority of our operating expenses, with sales personnel representing the largest portion of these costs. Personnel costs decreased year over year due to lower variable compensation associated with reduced gross profits, as well as headcount reductions implemented in the first half of 2009.

**Year-Over-Year Comparisons**

***Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008***

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

| | Three Months Ended September 30, 2009 Amount | 2009 % of Net Sales | 2008 Amount | 2008 % of Net Sales | % Change |
|---|---|---|---|---|---|
| Sales: | | | | | |
| SMB | $182.6 | 45.3% | $217.4 | 49.2% | (16.0)% |
| Large Account | 103.9 | 25.8 | 117.3 | 26.6 | (11.4) |
| Public Sector | 116.6 | 28.9 | 106.7 | 24.2 | 9.3 |
| Total | $403.1 | 100.0% | $441.4 | 100.0% | (8.7)% |
| Gross Profit: | | | | | |
| SMB | $ 24.8 | 13.6% | $ 30.8 | 14.2% | (19.5)% |
| Large Account | 11.0 | 10.6 | 13.0 | 11.1 | (15.4) |
| Public Sector | 10.5 | 9.0 | 9.5 | 8.9 | 10.5 |
| Total | $ 46.3 | 11.5% | $ 53.3 | 12.1% | (13.1)% |

*Net sales* for the third quarter of 2009 decreased compared to the third quarter of 2008, as explained below:

- Net sales for the SMB segment declined as both consumer and corporate sales decreased year over year by 16% in the third quarter of 2009, reflecting the continued softness in demand. Average annualized sales productivity in the third quarter of 2009 however increased by 3% year over year due to a reduction of sales representatives. Sales representatives for our SMB segment totaled 372 at September 30, 2009, compared to 453 at September 30, 2008 and 371 at June 30, 2009. We have reduced headcount to better align expenses with lower sales volumes.

- Net sales for the Large Account segment decreased year over year as large enterprises continued to be cautious in their IT spending in the third quarter of 2009. Average annualized sales productivity in the third quarter of 2009 decreased by 6% year over year, consistent with the year-over-year decline in revenues. Sales representatives for our Large Account segment totaled 90 at September 30, 2009, compared to 92 at September 30, 2008 and 87 at June 30, 2009.
- Net sales for the Public Sector segment increased in the third quarter of 2009 due to increased federal government contract sales and Kindergarten through 12th grade education sales compared to the prior year quarter. Education sales increased primarily due to the sales representatives added at our new sales facility late in 2008. Overall average annualized sales productivity however decreased by 9% year over year in the third quarter of 2009 due to the increased number of new hires. Sales representatives for our Public Sector segment totaled 139 at September 30, 2009, an increase from 121 at September 30, 2008 but down slightly from 145 at June 30, 2009.

*Gross profit* in the third quarter of 2009 decreased in dollars and as a percentage of net sales on a consolidated basis compared to the third quarter of 2008, as explained below:

- Gross profit for the SMB segment decreased year over year in dollars and as a percentage of net sales in the third quarter of 2009. The decrease in sales discussed above and the 58 basis-point decline in gross profit margins led to the year-over-year decline in gross profit dollars. Gross profit margins declined largely because of increased competitive pricing pressures, which led to reduced invoice margins and lower freight revenues.
- Gross profit for the Large Account segment decreased year over year in dollars and as a percentage of net sales in the third quarter of 2009. Reduced freight revenues and lower agency fees contributed to the year-over-year decline in gross profit margins in the third quarter of 2009. Agency fees are recognized as revenue on a net basis with no associated cost of goods sold and as a result can significantly affect gross profit rates even though total dollars may be small.
- Gross profit for the Public Sector segment increased year over year in dollars and as a percentage of net sales in the third quarter of 2009. The dollar increase was largely attributable to the sales increase as gross profit margins increased by 16 basis-points as lower invoice margins were offset by increased freight revenues and vendor consideration in the third quarter of 2009.

*Selling, general and administrative expenses* in the third quarter of 2009 decreased in dollars and as a percentage of net sales on a consolidated basis compared to the third quarter of 2008.

SG&A expenses attributable to our operating segments and the Headquarters/Other group are summarized below (dollars in millions):

| | Three Months Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 2009 | | 2008 | | |
| | Amount | % of Net Sales | Amount | % of Net Sales | % Change |
| SMB | $ 22.1 | 12.1% | $ 26.8 | 12.3% | (17.5)% |
| Large Account | 6.8 | 6.5 | 7.6 | 6.5 | (10.5) |
| Public Sector | 9.9 | 8.5 | 9.4 | 8.8 | 5.3 |
| Headquarters/Other | 2.5 | | 3.1 | | (19.4) |
| Total | $ 41.3 | 10.2% | $ 46.9 | 10.6% | (11.9)% |

- SG&A expenses for the SMB segment decreased year over year in dollars and as a percentage of net sales in the third quarter of 2009. Reduced advertising expense and headcount contributed to the year-over-year decreases; in addition, lower variable compensation associated with decreased gross profits contributed to the dollar decrease in the third quarter of 2009.

- SG&A expenses for the Large Account segment decreased year over year in dollars but was unchanged as a percentage of net sales. Lower variable compensation associated with decreased gross profits as well as headcount reductions implemented earlier in 2009 reduced SG&A expenses in the third quarter of 2009.
- SG&A expenses for the Public Sector segment increased slightly in dollars as cost savings implemented in the first half of 2009 largely offset increased variable compensation associated with higher gross profits.
- SG&A expenses for the Headquarters/Other group in the third quarter of 2009 decreased year over year due to management's cost reductions. These included headcount reductions and year-over-year decreases in facilities costs and professional fees. The "Headquarters/Other" group provides services to the three reportable operating segments in areas such as finance, human resources, IT, product management, and marketing. Most of the operating costs associated with such corporate headquarters functions are charged to the operating segments based on their estimated usage of the underlying functions. The amounts shown above represent the remaining unallocated costs.

We did not record any special charges in the three months ended September 30, 2009. In the three months ended September 30, 2008, we recorded a charge of $1.4 million related to workforce reduction and management restructuring costs.

*Income from operations* for the third quarter of 2009 was $5.1 million, compared to operating income of $5.0 million for the third quarter of 2008. Income from operations as a percentage of net sales was 1.3% for the third quarter of 2009 compared to income from operations of 1.1% as a percentage of net sales for the third quarter of 2008. Our operating income in the third quarter of 2009 increased due to management's cost reductions and the absence of special charges in the third quarter of 2009.

Our effective tax rate was 43.1% for the third quarter of 2009 compared to the effective tax rate of 36.7% for the third quarter of 2008. Our tax rate will continue to vary based on variations in state tax levels for certain subsidiaries, valuation reserves, and accounting for uncertain tax positions.

*Net income* for the third quarter of 2009 decreased by $0.3 million to $2.9 million, compared to $3.2 million for the third quarter of 2008, as the year-over-year increase in effective tax rate offset the slight increase in operating income in the third quarter of 2009.

***Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008***

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

| | Nine Months Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 2009 | | 2008 | | |
| | Amount | % of Net Sales | Amount | % of Net Sales | % Change |
| Sales: | | | | | |
| SMB | $ 531.7 | 48.1% | $ 694.0 | 52.8% | (23.4)% |
| Large Account | 304.3 | 27.5 | 361.9 | 27.5 | (15.9) |
| Public Sector | 270.5 | 24.4 | 258.7 | 19.7 | 4.6 |
| Total | $1,106.5 | 100.0% | $1,314.6 | 100.0% | (15.8)% |
| Gross Profit: | | | | | |
| SMB | $ 74.0 | 13.9% | $ 97.4 | 14.0% | (24.0)% |
| Large Account | 32.0 | 10.5 | 40.7 | 11.2 | (21.4) |
| Public Sector | 26.3 | 9.7 | 24.8 | 9.6 | 6.0 |
| Total | $ 132.3 | 12.0% | $ 162.9 | 12.4% | (18.8)% |

*Net sales* for the nine months ended September 30, 2009 decreased compared to the nine months ended September 30, 2008, as explained below:

- Net sales for the SMB segment decreased in the nine months ended September 30, 2009 as both corporate and consumer sales declined year over year, reflecting the industry-wide softness in IT demand. Sales representatives for our SMB segment totaled 372 at September 30, 2009, a decrease from 453 at September 30, 2008.
- Net sales for the Large Account segment decreased in the nine months ended September 30, 2009 as large enterprise customers continued to defer purchases and redeploy excess equipment resulting from recent corporate layoffs. Sales representatives for our Large Account segment totaled 90 at September 30, 2009, a decrease from 92 at September 30, 2008.
- Net sales for the Public Sector segment increased in the nine months ended September 30, 2009 due to increased federal government and education sales in that period. The increased federal government sales were generated under several federal contracts, and education sales increased in the Kindergarten through 12$^{th}$ grade sector. Sales representatives for our Public Sector segment totaled 139 at September 30, 2009, an increase from 121 at September 30, 2008.

*Gross profit* for the nine months ended September 30, 2009 decreased in dollars and as a percentage of net sales on a consolidated basis compared to the nine months ended September 30, 2008, as explained below:

- Gross profit for the SMB segment decreased year over year in dollars due to lower sales in the nine months ended September 30, 2009. Despite increased competitive pricing pressures, gross profit margins decreased by only 7 basis-points in the nine months ended September 30, 2009 as increased vendor consideration as a percentage of net sales largely offset lower invoice margins.
- Gross profit for the Large Account segment decreased in the nine months ended September 30, 2009 due to year-over-year declines in both revenues and gross profit margins. Lower invoice margins associated with increased pricing pressures reduced gross profit margins in the nine months ended September 30, 2009.
- Gross profit for the Public Sector segment increased in the nine months ended September 30, 2009 in both dollars and as a percentage of net sales compared to the prior year period. Gross profit margins increased by 11 basis-points year over year as increased freight contribution and higher agency fee revenues offset increased competitive pricing pressures.

*Selling, general and administrative expenses* in the nine months ended September 30, 2009 decreased in dollars but increased as a percentage of net sales on a consolidated basis compared to the nine months ended September 30, 2008.

SG&A expenses attributable to our operating segments and the Headquarters/Other group are summarized below (dollars in millions):

| | Nine Months Ended September 30, | | | | |
|---|---|---|---|---|---|
| | 2009 | | 2008 | | |
| | Amount | % of Net Sales | Amount | % of Net Sales | % Change |
| SMB | $ 70.7 | 13.3% | $ 80.5 | 11.6% | (12.2)% |
| Large Account | 21.3 | 7.0 | 23.3 | 6.4 | (8.6) |
| Public Sector | 27.6 | 10.2 | 26.1 | 10.1 | 5.7 |
| Headquarters/Other | 7.1 | | 10.5 | | (32.4) |
| Total | $126.7 | 11.5% | $140.4 | 10.7% | (9.8)% |

- SG&A expenses for the SMB segment decreased year over year in dollars but increased as a percentage of net sales in the nine months ended September 30, 2009. Lower advertising expense, headcount, and variable compensation associated with reduced gross profits resulted in the year-over-year dollar decrease in the nine months ended September 30, 2009. SG&A expense also decreased due to decreased usage of corporate headquarters functions as a result of lower sales levels and reduced expenses in the Headquarters/Other group. SG&A expense as a percentage of net sales increased due to the decrease in net sales.

- SG&A expenses for the Large Account segment decreased year over year in dollars but increased as a percentage of net sales in the nine months ended September 30, 2009. Lower headcount and variable compensation associated with decreased gross profits led to the year-over-year dollar decrease in the nine months ended September 30, 2009. SG&A expense as a percentage of net sales increased due to the decrease in net sales.
- SG&A expenses for the Public Sector segment increased year over year in both dollars and as a percentage of net sales in the nine months ended September 30, 2009. The year-over-year increases resulted from greater usage of corporate headquarters functions as well as headcount added at a new sales facility in the fourth quarter of 2008.
- SG&A expenses for the Headquarters/Other group decreased year over year in dollars due to reduced headcount and professional fees, in addition to other cost reductions implemented by management.

*Special charges* totaled $13.0 million in the nine months ended September 30, 2009 and consisted of a non-cash asset write-off of $11.6 million and $1.4 million of workforce reduction and management restructuring charges. We recognized the asset write-off after we determined to stop further development of an internally developed CRM module. The asset write-off represented the capitalized costs of the CRM module, and as a result, the charge had no impact on our cash flows. Management is evaluating alternative solutions to the internally developed CRM software and will consider future implementation solutions, including purchased software. We recorded $1.4 million in special charges in the nine months ended September 30, 2008 related to workforce reduction and management restructuring charges.

*Loss from operations* for the nine months ended September 30, 2009 was $7.3 million, compared to operating income of $21.0 million for the nine months ended September 30, 2008. Loss from operations as a percentage of net sales was 0.7% for the nine months ended September 30, 2009 compared to income from operations of 1.6% as a percentage of net sales for the nine months ended September 30, 2008. Our operating loss in the nine months ended September 30, 2009 was largely attributable to the significant decline in sales and special charges incurred in that period.

Our effective tax benefit rate was 28.5% for the nine months ended September 30, 2009 compared to the effective tax rate of 38.0% for the nine months ended September 30, 2008. Our tax rate for the third quarter of 2009 was unfavorably affected by unrealized state tax loss benefits, which decrease the benefit rate in loss periods and increase the tax rate in profitable periods.

*Net loss* for the nine months ended September 30, 2009 was $5.2 million compared to net income of $13.1 million for the nine months ended September 30, 2008, due to the operating loss and the year-over-year decrease in our effective tax benefit rate experienced in the nine months ended September 30, 2009.

**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 and 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 September 30, 2009, we had approximately $65.7 million in cash.
- *Cash Generated from Operations*. We expect to generate cash flows from operations in excess of operating cash needs by generating earnings (net of non cash charges) 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 September 30, 2009, our entire $50.0 million bank line of credit was available for borrowing. This line of credit can be increased, at our option, to $80.0 million for approved acquisitions or other uses authorized by the bank. Borrowings are limited, however, by certain minimum collateral and earnings requirements, as described more fully below.

Our ability to continue funding our operations, 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):

| | Nine Months Ended | |
|---|---|---|
| **September 30,** | **2009** | **2008** |
| Net cash provided by operating activities | $ 24.4 | $ 43.0 |
| Net cash used for investing activities | (5.0) | (8.7) |
| Net cash used for financing activities | (0.7) | (1.2) |
| Increase in cash and cash equivalents | $ 18.7 | $ 33.1 |

*Cash provided by operating activities* decreased by $18.6 million in the nine months ended September 30, 2009 compared to the nine months ended September 30, 2008. Cash flow provided by operations in the nine months ended September 30, 2009 resulted from an increase in accounts payable as well as the net of our $5.2 million operating loss adjusted for $11.6 million in special charges that did not impact cash flows. Inventory decreased by $0.8 million from the prior year-end balance largely due to reduced stocking requirements associated with lower sales levels. Inventory turns increased to 24 turns for the third quarter of 2009 compared to 22 turns for the prior year period. Accounts receivable decreased by $5.0 million from December 31, 2008 levels due to the year-over-year decline in sales in the third quarter of 2009. DSOs were 45 days at September 30, 2009, compared to 43 days at September 30, 2008. We attribute the increase in DSOs to the year-over-year increase in public sector sales in the third quarter of 2009 whose customers generally have longer bill-to-cash cycles.

At September 30, 2009, we had $108.9 million in outstanding accounts payable. Such accounts are generally paid within 30 days, 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 $9.4 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* decreased by $3.7 million in the nine months ended September 30, 2009 compared to the prior year period. These activities include our capital expenditures, primarily for purchases of computer equipment and software and capitalization of internally-developed software. We completed an extensive desktop upgrade in the first half of 2008 that accounted for much of the prior year's increased cash usage. We expect total capital expenditures in 2009 to be between $6.0 million and $7.0 million.

*Cash used for financing activities* decreased year over year by $0.5 million in the nine months ended September 30, 2009 due to reduced purchases of treasury shares. Our treasury stock purchases and employee net share settlements totaled $0.3 million in the nine months ended September 30, 2009 compared to $1.1 million in the prior year period.

***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 (3.25% at September 30, 2009). In addition, we may increase the facility by an additional $30.0 million for specific bank-approved purposes, based on sufficient levels of trade receivables to meet borrowing base requirements, and depending on meeting minimum EBITDA (earnings before interest, taxes, depreciation, and amortization) ), excluding non-cash special charges, 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 various short-term durations. Substantially all of our assets are collateralized as security for this facility, and all of our subsidiaries are guarantors under the line of credit. At September 30, 2009, the entire $50 million facility was available for borrowing.

This facility, which matures in October 2012, 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 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 $9.4 million as of September 30, 2009, are recorded in accounts payable, and the inventory financed is classified as inventory on the condensed consolidated balance sheet.

*Capital Leases*. We have a fifteen-year lease for our corporate headquarters with an affiliated company related through common ownership. In addition to the rent payable under the facility lease, we are required to pay real estate taxes, insurance, and common area maintenance charges. The initial term of the lease expires in 2013, and we have the option to renew the lease for two additional terms of five years each.

*Operating Leases*. We also lease facilities from our principal stockholders and facilities and equipment from third parties under non-cancelable operating leases. See "Contractual Obligations" in our Annual Report on Form 10-K for the year ended December 31, 2008 for commitments under these leases.

*Sports Marketing Commitments*. We have entered into multi-year sponsorship agreements with the Boston Red Sox and the New England Patriots that extend to 2010 and 2013, respectively. These agreements, which grant us various marketing rights and seating arrangements, require annual payments aggregating from $0.3 million to $0.4 million per year.

*Off-Balance Sheet Arrangements.* 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.

*Contractual Obligations.* The disclosures relating to our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2008 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, excluding non-cash special charges) must not be more than 2.0 to 1.0. Our actual funded debt ratio at September 30, 2009 was less than 0.01 to 1.0, as average borrowings were minimal against our credit facility during the three months ended September 30, 2009.
- 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 September 30, 2007 (loss quarters not counted). Such amount was calculated at September 30, 2009 as $171.0 million. Our actual consolidated stockholders' equity at September 30, 2009 was $230.8 million.

The borrowing base under this facility is set at 80% of qualified commercial receivables, plus 50% of qualified government receivables. As of September 30, 2009, the entire $50.0 million facility was available for borrowings.

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

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

**SUMMARY OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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, 2008. These policies include revenue recognition, accounts receivable, vendor allowances, inventories, contingencies, value of goodwill and long-lived assets, including intangibles, employee compensation and benefits, share-based compensation, and income taxes.

**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 foreseeable 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 September 30, 2009. We believe 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 pursuant to the credit agreement at September 30, 2009, and average borrowings in the nine months ended September 30, 2009 were minimal. Accordingly, the change in earnings resulting from a hypothetical 10% increase or decrease in interest rates would not be 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 September 30, 2009. 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, or 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 September 30, 2009, 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 September 30, 2009 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 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 uncertainty in economic conditions and the financial markets may adversely affect our business and reduce our operating results.**

Recent economic weakness and financial markets turmoil have adversely impacted economic conditions, resulting in additional recessionary pressures and further declines in consumer confidence and spending. Businesses have in turn reacted to the decline in consumer spending by reducing staffing levels and delaying or deferring corporate spending, including their IT expenditures. Both our SMB and Large Account segments, which serve small, medium, and large businesses, have experienced significant declines in revenues and increased competitive pricing pressures, which have adversely affected our operating results. The financial markets turmoil has also resulted in a substantial tightening of the credit markets, which has increased the cost of capital and reduced the availability of credit. Further delays or reductions in IT spending could have a material adverse affect on demand for our products and consequently on our financial results. In addition, customer insolvencies could impact our ability to collect receivables and negatively impact our operating results and liquidity.

It is difficult to predict how long the uncertainty in economic conditions and the financial markets will continue, the extent, if any, to which they may deteriorate, and to which our business may be adversely affected. However, if the current conditions should worsen, we are likely to experience a further adverse impact, which may be material, on our business and our results of operations.

**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:

- shifts in customer demand for hardware and software products;
- variations in levels of competition;
- industry shipments of new products or upgrades;

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

Our results also may vary based on our ability to manage personnel levels in response to fluctuations in revenue, as well as our success in integrating acquisitions into our business, and their relative costs.

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.

**Should our financial performance not meet expectations, we may be required to record an additional significant charge to earnings for impairment of goodwill and other intangibles.**

We test goodwill for impairment on an annual basis, and more frequently if potential impairment indicators arise. We determined that the fair values of our SMB and Public Sector segments' goodwill were lower than the carrying values as of December 31, 2008, and accordingly the carrying values of those segments' goodwill were written off, resulting in a significant non-cash charge to earnings. Although we determined that the fair value of our Large Account segment's goodwill exceeded its carrying value, should this segment's financial performance not meet expectations, we would likely adjust downward expected future operating results and cash flows. Such adjustment may result in a determination that our carrying values for goodwill and other intangibles for that segment exceed fair values. This determination may in turn require that we record an additional significant non-cash charge to earnings to reduce the $50.0 million aggregate carrying amount of goodwill and other intangibles in the Large Account operating segment, resulting in a negative effect on our results of operations.

**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 earnings and 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 Hewlett-Packard Company, or HP, Lenovo, and Apple, who provide products to us, are also selling their products directly to end users through their own catalogs, stores, and via 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. 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 provide assurance 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, particularly in this current economic environment, and we expect pricing pressures to escalate if economic conditions worsen. 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 failure to comply with our public sector contracts could result in, among other things, fines or liabilities.**

Revenues from the public sector are derived from sales to federal, state, and local government departments and agencies, as well as to educational institutions, through various contracts and open market sales. Government contracting is a highly regulated area. Noncompliance with government procurement regulations or contract provisions could result in civil, criminal, and administrative liability, including substantial monetary fines or damages, termination of government contracts, and suspension, debarment, or ineligibility from doing business with the government. Our current arrangements with these government agencies allow them to cancel orders with little or no notice and do not require them to purchase products from us in the future. The effect of any of these possible actions by any government department or agency could adversely affect our financial position, results of operations, and cash flows.

**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 of selected products and increasing our participation in first-to-market purchase opportunities. We may also, from time to time, make large inventory purchases of certain end-of-life products 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 67% and 70% of our total product purchases in the nine months ended September 30, 2009 and 2008, respectively. Among these five vendors, purchases from Ingram Micro Inc., or Ingram, represented 23% and 25% of our total product purchases in the nine months ended September 30, 2009 and 2008, respectively. Purchases from Tech Data Corporation comprised 17% and 18% of our total product purchases in the nine months ended September 30, 2009 and 2008, respectively. Purchases from Synnex Corporation represented 11% and 9% of our total product purchases in the nine months ended September 30, 2009 and 2008, respectively. Purchases from HP represented 10% and 11% of our total product purchases in the nine months ended September 30, 2009 and 2008, respectively. No other vendor supplied more than 10% of our total product purchases in the nine months ended September 30, 2009 and 2008, respectively. If we were unable to acquire products from Ingram, Tech Data, Synnex, or HP, we could experience a short-term disruption in the availability of products, and such disruption could have a material adverse effect on our results of operations and cash flows.

Substantially all of our contracts and arrangements with our vendors that supply significant quantities of products are terminable by such vendors or us without notice or upon short notice. Most of our product vendors provide us with trade credit, of which the net amount outstanding at September 30, 2009 was $108.9 million. Termination, interruption, or contraction of relationships with our vendors, including a reduction in the level of trade credit provided to us, could have a material adverse effect on our financial position.

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

**We 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 our management information systems or in our telephone communication systems, including those resulting from natural disasters as well as power loss, telecommunications failure, or similar events, would substantially hinder our ability to process customer orders and thus could have a material adverse effect on our business.

**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 representatives 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.

**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 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 UPS 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 UPS, and believe that we have negotiated favorable shipping rates with our carriers. 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.

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.

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

We have had an increasing level of sales made via the Internet in part because of the growing use and acceptance of the Internet by end users. Sales of computer products via 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 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 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 with those state agencies.

Moreover, due to our presence on various forms of electronic media and other operational factors, our contacts with many states may exceed the limited contacts involved in the Supreme Court case. We cannot predict the level of contacts that is sufficient to permit a state to impose on us a sales or use tax collection obligation. Two of our competitors have elected to collect sales and use taxes in all states. If the Supreme Court changes its position, or if legislation is passed to overturn the Supreme Court’s decision, or if a court were to determine that our contacts with a state exceed the constitutionally permitted contacts, the expansion 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 future sales.

**Privacy concerns with respect to customer 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 are controlled by two principal stockholders.**

Patricia Gallup and David Hall, our two principal stockholders, beneficially own or control, in the aggregate, approximately 63% of the outstanding shares of our common stock. Due to 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

The following table provides information about our purchases during the quarter ended September 30, 2009 of equity securities that we have registered pursuant to Section 12 of the Exchange Act:

**ISSUER PURCHASES OF EQUITY SECURITIES**

| Period | Total Number of Shares (or Units) Purchased | Average Price Paid per Share (or Unit) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plan or Programs (1) |
|---|---|---|---|---|
| 07/01/09 – 07/31/09 | — | — | — | $ 11,159,806 |
| 08/01/09 – 08/31/09 | 7,538 | $ 5.58 | 7,538 | $ 11,117,716 |
| 09/01/09 – 09/30/09 | 14,042 | 5.52 | 14,042 | $ 11,040,168 |
| Total | 21,580 | $ 5.54 | 21,580 | $ 11,040,168 |

(1) On March 28, 2001, our Board of Directors announced approval of a share repurchase program of our common stock having an aggregate value of up to $15.0 million. Share purchases are made in open market transactions from time to time depending on market conditions. The Program does not have a fixed expiration date.

### Item 6—Exhibits

| Exhibit Number | Description |
|---|---|
| 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.

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## SIGNATURES

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

| | |
|---|---|
| | **PC CONNECTION, INC. AND SUBSIDIARIES** |
| Date: November 6, 2009 | By: /s/ PATRICIA GALLUP<br>**Patricia Gallup**<br>**Chairman and Chief Executive Officer** |
| Date: November 6, 2009 | By: /s/ JACK FERGUSON<br>**Jack Ferguson**<br>**Executive Vice President, Treasurer, and Chief Financial Officer** |

**Exhibit 31.1**

# 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   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: November 6, 2009

/s/ Patricia Gallup

Patricia Gallup
President and Chief Executive Officer

**Exhibit 31.2**

# 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   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: November 6, 2009

/s/ Jack Ferguson

Jack Ferguson
Executive Vice President, Treasurer, and Chief Financial Officer

**Exhibit 32.1**

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 September 30, 2009 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: November 6, 2009

/s/ Patricia Gallup

Patricia Gallup
President and Chief Executive Officer

**Exhibit 32.2**

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 September 30, 2009 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: November 6, 2009

/s/ Jack Ferguson
Jack Ferguson
Executive Vice President, Treasurer, and Chief Financial Officer