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

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**FORM 10-Q**

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(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, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-23827

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**PC CONNECTION, INC.**

(Exact name of registrant as specified in its charter)

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**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

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

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

**03054**  
(Zip Code)

**(603) 683-2000**

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

YES  NO

The number of shares outstanding of the issuer's common stock as of November 9, 2007 was 26,857,770.

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PC CONNECTION, INC. AND SUBSIDIARIES  
FORM 10-Q

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

	<u>Page</u>
ITEM 1.	Unaudited Condensed Consolidated Financial Statements:
	<a href="#">Report of Independent Registered Public Accounting Firm</a> 1
	<a href="#">Condensed Consolidated Balance Sheets—September 30, 2007 and December 31, 2006</a> 2
	<a href="#">Condensed Consolidated Statements of Income—Three and nine months ended September 30, 2007 and 2006</a> 3
	<a href="#">Condensed Consolidated Statement of Changes in Stockholders' Equity—Nine months ended September 30, 2007</a> 4
	<a href="#">Condensed Consolidated Statements of Cash Flows—Nine months ended September 30, 2007 and 2006</a> 5
	<a href="#">Notes to Unaudited Condensed Consolidated Financial Statements</a> 6
ITEM 2.	<a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a> 18
ITEM 3.	<a href="#">Quantitative and Qualitative Disclosures About Market Risk</a> 30
ITEM 4.	<a href="#">Controls and Procedures</a> 31
<b>PART II OTHER INFORMATION</b>	
ITEM 1A.	<a href="#">Risk Factors</a> 32
ITEM 2.	<a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a> 37
ITEM 6.	<a href="#">Exhibits</a> 38
	<a href="#">SIGNATURES</a> 39

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have reviewed the accompanying condensed consolidated balance sheet of PC Connection, Inc. and subsidiaries (the "Company") as of September 30, 2007, and the related condensed consolidated statements of income for the three-month and nine-month periods ended September 30, 2007 and 2006, and the condensed consolidated statement of changes in stockholders' equity for the nine-month period ended September 30, 2007, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2007 and 2006. These interim financial statements are the responsibility of the Company's management.

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

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of PC Connection, Inc. and subsidiaries as of December 31, 2006, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 28, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2006 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

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

DELOITTE & TOUCHE LLP  
Boston, Massachusetts  
November 12, 2007

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

	September 30, 2007 <i>(unaudited)</i>	December 31, 2006
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 23,685	\$ 17,582
Accounts receivable, net	187,020	170,222
Inventories—merchandise	75,537	69,407
Deferred income taxes	4,403	3,837
Income taxes receivable	675	627
Prepaid expenses and other current assets	3,578	3,882
<b>Total current assets</b>	<b>294,898</b>	<b>265,557</b>
Property and equipment, net	20,319	19,542
Goodwill	56,867	56,867
Other intangibles, net	3,559	4,363
Other assets	264	355
<b>Total Assets</b>	<b>\$ 375,907</b>	<b>\$ 346,684</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Current maturities of capital lease obligations:		
To affiliate	\$ 504	\$ 464
To third party	73	395
Accounts payable	117,013	110,977
Accrued expenses and other liabilities	18,527	17,389
Accrued payroll	7,874	9,367
<b>Total current liabilities</b>	<b>143,991</b>	<b>138,592</b>
Capital lease obligation to affiliate, less current maturities	4,453	4,836
Other liabilities	2,883	—
Deferred income taxes	7,430	6,352
<b>Total Liabilities</b>	<b>158,757</b>	<b>149,780</b>
Stockholders' Equity:		
Common stock	272	269
Additional paid-in capital	93,145	89,537
Retained earnings	125,798	109,321
Treasury stock at cost	(2,065)	(2,223)
<b>Total Stockholders' Equity</b>	<b>217,150</b>	<b>196,904</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 375,907</b>	<b>\$ 346,684</b>

See notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net sales	\$456,470	\$415,213	\$1,295,772	\$1,203,785
Cost of sales	398,940	364,070	1,134,287	1,055,481
<b>Gross profit</b>	<b>57,530</b>	<b>51,143</b>	<b>161,485</b>	<b>148,304</b>
Selling, general and administrative expenses	45,572	43,291	134,770	129,780
Special charges	—	1,050	—	2,391
<b>Income from operations</b>	<b>11,958</b>	<b>6,802</b>	<b>26,715</b>	<b>16,133</b>
Interest expense	(218)	(394)	(668)	(1,475)
Other, net	192	38	653	34
<b>Income before taxes</b>	<b>11,932</b>	<b>6,446</b>	<b>26,700</b>	<b>14,692</b>
Income tax provision	(4,247)	(2,058)	(9,877)	(5,487)
<b>Net income</b>	<b>\$ 7,685</b>	<b>\$ 4,388</b>	<b>\$ 16,823</b>	<b>\$ 9,205</b>
Weighted average common shares outstanding:				
Basic	26,814	25,446	26,765	25,330
Diluted	27,017	25,667	27,009	25,459
Earnings per common share:				
Basic	\$ .29	\$ .17	\$ .63	\$ .36
Diluted	\$ .28	\$ .17	\$ .62	\$ .36

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, 2007**  
**(Unaudited)**  
*(amounts in thousands)*

	<u>Common Shares</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Treasury Shares</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>			<u>Shares</u>	<u>Amount</u>	
<b>Balance—January 1, 2007</b>	26,862	\$ 269	\$ 89,537	\$ 109,321	(352)	\$ (2,223)	\$ 196,904
Cumulative effect of change in accounting principle	—	—	—	(346)	—	—	(346)
Stock compensation expense	—	—	202	—	—	—	202
Exercise of stock options, including income tax benefits	305	3	3,430	—	—	—	3,433
Issuance of stock under Employee Stock Purchase Plan	10	—	134	—	—	—	134
Nonvested stock awards	—	—	(158)	—	25	158	—
Net income	—	—	—	16,823	—	—	16,823
<b>Balance—September 30, 2007</b>	<u>27,177</u>	<u>\$ 272</u>	<u>\$ 93,145</u>	<u>\$ 125,798</u>	<u>(327)</u>	<u>\$ (2,065)</u>	<u>\$ 217,150</u>

See notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2007	2006
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 16,823	\$ 9,205
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,158	5,227
Provision for doubtful accounts	1,482	2,094
Deferred income taxes	512	1,536
Loss on disposal of fixed assets	53	63
Stock compensation expense	202	277
Excess tax benefit from exercise of stock options	(359)	(1)
Income tax benefit from exercise of stock options	889	231
Changes in assets and liabilities:		
Accounts receivable	(18,280)	1,415
Inventories	(6,130)	6,945
Prepaid expenses and other current assets	256	1,142
Other non-current assets	91	36
Accounts payable	6,036	(14,723)
Accrued expenses and other liabilities	2,182	5,533
Net cash provided by operating activities	<u>8,915</u>	<u>18,980</u>
<b>Cash Flows from Investing Activities:</b>		
Purchases of property and equipment	(5,184)	(6,401)
Proceeds from sale of property and equipment	—	20
Net cash used for investing activities	<u>(5,184)</u>	<u>(6,381)</u>
<b>Cash Flows from Financing Activities:</b>		
Proceeds from short-term borrowings	3,313	317,280
Repayment of short-term borrowings	(3,313)	(330,159)
Repayment of capital lease obligations	(665)	(614)
Exercise of stock options	2,544	2,822
Excess tax benefit from exercise of stock options	359	1
Issuance of stock under Employee Stock Purchase Plan	134	120
Net cash provided by (used for) financing activities	<u>2,372</u>	<u>(10,550)</u>
Increase in cash and cash equivalents	6,103	2,049
Cash and cash equivalents, beginning of period	17,582	9,770
Cash and cash equivalents, end of period	<u>\$ 23,685</u>	<u>\$ 11,819</u>

See notes to unaudited condensed consolidated financial statements.

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

**Note 1—Basis of Presentation**

The accompanying condensed consolidated financial statements of PC Connection, Inc. and its subsidiaries (the “Company,” “we,” “us,” or “our”) have been prepared in accordance with accounting principles generally accepted in the United States of America. Such principles were applied on a basis consistent with those of the financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the “SEC”). The accompanying condensed consolidated financial statements should be read in conjunction with the financial statements contained in our Annual Report on Form 10-K. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the results of operations for the interim periods reported and of the Company’s financial condition as of the date of the interim balance sheet. The operating results for the three and nine months ended September 30, 2007 may not be indicative of the results expected for any succeeding quarter or the entire year ending December 31, 2007.

**Revenue Recognition**

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

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

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

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

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

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

such transactions. We do not take title to the products in these transactions; title is passed directly from the supplier to our customer.

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

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

	<u>Three Months Ended</u>	<u>Nine Months Ended</u>
September 30, 2007	\$ 2,862	\$ 8,378
September 30, 2006	2,760	8,166

***Advertising Costs and Allowances***

Costs of producing and distributing catalogs are charged to expense in the month the respective catalog is issued. Other advertising costs are expensed as incurred.

Vendors have the ability to place advertisements in the catalogs for which we receive advertising allowances. These vendor allowances, to the extent that they represent specific reimbursements of such incremental and identifiable costs, are offset against SG&A expenses. Advertising allowances that cannot be associated with a specific program funded by an individual vendor or that exceed the fair value of advertising expense associated with that program are classified as offsets to cost of sales or inventory in accordance with EITF 02-16.

Gross advertising allowances received from vendors were \$8,753 and \$8,660 for the three months ended September 30, 2007 and 2006, respectively. We classified \$8,753 and \$6,938 of these allowances as offsets to cost of sales or inventory for the three months ended September 30, 2007 and 2006, respectively. Gross advertising allowances received from vendors were \$24,637 and \$24,305 for the nine months ended September 30, 2007 and 2006, respectively. We classified \$24,637 and \$18,771 of these allowances as offsets to cost of sales or inventory for the nine months ended September 30, 2007 and 2006, respectively.

As advertising programs with our vendor partners have become more comprehensive, we have classified substantially all vendor consideration as a reduction of cost of inventory purchases rather than a reduction of advertising expense.

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

**Goodwill and Other Intangible Assets**

We have designated January 1 of each year as the date we perform our annual impairment tests relative to goodwill. We completed the impairment review in January 2007 and determined that our goodwill and trademarks were not impaired.

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

Intangible assets subject to amortization at September 30, 2007 consisted of customer lists of \$2,131 and a licensing agreement of \$238 (net of accumulated amortization of \$3,089 and \$237, respectively). Intangible assets subject to amortization at December 31, 2006 consisted of customer lists of \$2,846 and a licensing agreement of \$327 (net of accumulated amortization of \$2,374 and \$148, respectively). For each of the three-month periods ended September 30, 2007 and 2006, we recorded amortization expenses of \$268. For the nine-month periods ended September 30, 2007 and 2006, we recorded amortization expenses of \$804 and \$797, respectively.

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

<u>For the Year Ended December 31,</u>	
2007	\$ 268(A)
2008	1,071
2009	942
2010	88
2011 and thereafter	—

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

**Use of Estimates**

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

**Share-Based Compensation**

Effective January 1, 2006, we adopted Financial Accounting Standards Board (“FASB”) Statement No. 123 (revised), “Share-Based Payment,” or SFAS 123(R), using the modified prospective application method. SFAS 123(R) requires a company to measure the grant date fair value of equity awards given to employees and recognize that cost adjusted for forfeitures over the period that such services are performed in its consolidated financial statements. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures experienced differ from these estimates. See Note 5, “Share-Based Compensation” of this Quarterly Report on Form 10-Q to review the effect of adoption of SFAS 123(R) on our financial statements.

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

**Note 2—Earnings Per Share**

Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per common share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to nonvested shares and options outstanding to purchase common stock under the treasury stock method.

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

September 30,	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
<b>Numerator:</b>				
Net income	\$ 7,685	\$ 4,388	\$16,823	\$ 9,205
<b>Denominator:</b>				
Denominator for basic earnings per share	26,814	25,446	26,765	25,330
Dilutive effect of equity awards	203	221	244	129
Denominator for diluted earnings per share	<u>27,017</u>	<u>25,667</u>	<u>27,009</u>	<u>25,459</u>
<b>Earnings per share:</b>				
Basic	\$ .29	\$ .17	\$ .63	\$ .36
Diluted	<u>\$ .28</u>	<u>\$ .17</u>	<u>\$ .62</u>	<u>\$ .36</u>

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

September 30,	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
Anti-dilutive stock options	<u>296</u>	<u>1,526</u>	<u>238</u>	<u>1,924</u>

**Note 3—Recently Issued Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect SFAS 157 to have a material impact on our results of operation or financial position.

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

**PC CONNECTION, INC. AND SUBSIDIARIES**

**PART I—FINANCIAL INFORMATION**

**Item 1—Financial Statements**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**(Unaudited)**

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

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

**Note 4—Segment and Related Disclosures**

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

Our operations are organized under three reportable operating segments—the “SMB” segment, which serves small- and medium-sized businesses, as well as consumers; the “Large Account” segment, which serves medium-to-large corporations; and the “Public Sector” segment, which serves federal, state, and local government entities and educational institutions—together with our Headquarters/Other group that supports our operating segments.

In the third quarter of 2007, we revised the reporting of operating segments to reflect the basis for making operating decisions and assessing performance. Under this revised reporting structure, logistics and centralized headquarters functions that were formerly provided by the SMB segment to the Public Sector and Large Account segments were separated from the SMB segment. The logistics functions include purchasing, distribution, and fulfillment services to support all three sales segments, and costs and intercompany charges associated with the logistics function are allocated to operating segments based on utilization by those segments. The centralized headquarters functions provide services in areas such as finance, human services, information technology, legal, communications, and marketing. Most of the operating costs associated with the corporate headquarters functions are charged to the reportable operating segments based on their estimated usage of the underlying functions. Certain of the headquarters costs relating to executive oversight functions no longer being 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

Item 1—Financial Statements

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

(amounts in thousands, except per share data)

We have restated the prior year segment information to conform to our revised segment reporting structure. Net sales represent net sales to external customers. Segment information applicable to our reportable operating segments for the three and nine months ended September 30, 2007 and 2006 is shown below:

	Three Months Ended September 30, 2007				
	SMB Segment	Large Account Segment	Public Sector Segment	Headquarters/Other	Consolidated
Net Sales	\$ 234,850	\$ 130,027	\$ 91,593		\$ 456,470
Operating income (loss) before allocations	\$ 17,764	\$ 7,821	\$ 4,028	\$ (17,655)	\$ 11,958
Allocations	(9,403)	(439)	(3,080)	12,922	—
Operating income (loss)	\$ 8,361	\$ 7,382	\$ 948	\$ (4,733)	\$ 11,958
Interest and other—net	27	(16)	(20)	(17)	(26)
Income (loss) before taxes	\$ 8,388	\$ 7,366	\$ 928	\$ (4,750)	\$ 11,932

	Three Months Ended September 30, 2006				
	SMB Segment	Large Account Segment	Public Sector Segment	Headquarters/Other	Consolidated
Net Sales	\$ 221,330	\$ 113,690	\$ 80,193		\$ 415,213
Operating income (loss) before allocations	\$ 14,860	\$ 6,393	\$ 2,586	\$ (17,037)	\$ 6,802
Allocations	(11,788)	(207)	(3,967)	15,962	—
Operating income (loss)	\$ 3,072	\$ 6,186	\$ (1,381)	\$ (1,075)	\$ 6,802
Interest and other—net	(1)	20	3	(378)	(356)
Income (loss) before taxes	\$ 3,071	\$ 6,206	\$ (1,378)	\$ (1,453)	\$ 6,446
Selected Operating Expenses:					
Special charges	—	—	\$ 1,050	—	\$ 1,050

	Nine Months Ended September 30, 2007				
	SMB Segment	Large Account Segment	Public Sector Segment	Headquarters/Other	Consolidated
Net Sales	\$ 700,718	\$ 373,944	\$ 221,110		\$ 1,295,772
Operating income (loss) before allocations	\$ 48,123	\$ 21,170	\$ 8,826	\$ (51,404)	\$ 26,715
Allocations	(30,356)	(669)	(8,775)	39,800	—
Operating income (loss)	\$ 17,767	\$ 20,501	\$ 51	\$ (11,604)	\$ 26,715
Interest and other—net	29	25	(29)	(40)	(15)
Income (loss) before taxes	\$ 17,796	\$ 20,526	\$ 22	\$ (11,644)	\$ 26,700
<i>Balance Sheet Data:</i>					
Total assets	\$ 151,690	\$ 159,754	\$ 48,097	\$ 16,366	\$ 375,907
Goodwill	1,173	48,060	7,634	—	56,867

## PC CONNECTION, INC. AND SUBSIDIARIES

## PART I—FINANCIAL INFORMATION

## Item 1—Financial Statements

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

(amounts in thousands, except per share data)

	Nine Months Ended September 30, 2006				
	SMB Segment	Large Account Segment	Public Sector Segment	Headquarters/Other	Consolidated
Net Sales	\$ 655,559	\$ 350,385	\$ 197,841		\$ 1,203,785
Operating income (loss) before allocations	\$ 45,546	\$ 18,167	\$ 5,182	\$ (52,762)	\$ 16,133
Allocations	(34,204)	(641)	(10,293)	45,138	—
Operating income (loss)	\$ 11,342	\$ 17,526	\$ (5,111)	\$ (7,624)	\$ 16,133
Interest and other—net	5	59	(45)	(1,460)	(1,441)
Income (loss) before taxes	\$ 11,347	\$ 17,585	\$ (5,156)	\$ (9,084)	\$ 14,692
Selected Operating Expenses:					
Special charges	\$ 44	\$ 9	\$ 1,384	\$ 954	\$ 2,391
<i>Balance Sheet Data:</i>					
Total assets	\$ 153,956	\$ 154,582	\$ 39,522	\$ (18,738)	\$ 329,322
Goodwill	1,173	48,060	7,634	—	56,867

As noted earlier, under this revised reporting structure, logistics and corporate headquarters functions were separated from the SMB reporting segment and are reported above under the Headquarters/Other group. Most of the operating costs associated with these functions are charged to the reportable operating segments based on their estimated usage. We report these charges to the above segments as “Allocations.” Interest and other expense is charged to the segments, based on the actual costs incurred by each segment, net of interest and other income generated.

Our operating segments’ assets presented above are primarily accounts receivables, intercompany receivables, and goodwill and other intangibles. 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 are presented net of intercompany balances eliminations of \$72,299 and \$100,326 for the nine months ended September 30, 2007 and 2006, respectively. Our capital expenditures are largely comprised of IT hardware and software purchased to maintain or upgrade our management information systems. These systems serve all of our subsidiaries, to varying degrees, and as a result, capital expenditures and depreciation expense are immaterial on a segment basis.

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

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

<u>September 30,</u> <i>Segment</i>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
SMB	\$ 234,850	\$ 221,330	\$ 700,718	\$ 655,559
Large Account	130,027	113,690	373,944	350,385
Public Sector	91,593	80,193	221,110	197,841
Total	<u>\$ 456,470</u>	<u>\$ 415,213</u>	<u>\$ 1,295,772</u>	<u>\$ 1,203,785</u>
<i>Product Mix</i>				
Notebooks and PDAs	\$ 71,730	\$ 72,123	\$ 217,747	\$ 210,043
Desktop/Servers	65,776	56,545	185,783	168,933
Storage Devices	41,233	34,508	115,690	102,596
Software	58,104	51,692	162,595	151,271
Net/Com Products	37,924	34,610	103,373	97,409
Printers and Printer Supplies	43,449	43,535	126,845	124,253
Video, Imaging, and Sound	65,236	57,250	172,483	155,521
Memory and System Enhancements	20,460	19,028	64,441	57,776
Accessories/Other	52,558	45,922	146,815	135,983
Total	<u>\$ 456,470</u>	<u>\$ 415,213</u>	<u>\$ 1,295,772</u>	<u>\$ 1,203,785</u>

Substantially all of our net sales for the nine months ended September 30, 2007 and 2006 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 2% in each of those respective periods. All of our assets at September 30, 2007 and December 31, 2006 were located in the United States. Our primary target customers are SMBs comprised of 20 to 1,000 employees, federal, state, and local governmental agencies, educational institutions, and medium-to-large corporate accounts. Except for the federal government, no single customer accounted for more than 3% of total net sales in the three and nine months ended September 30, 2007 and 2006. Net sales to the federal government accounted for \$26,753, or 5.9%, of total net sales for the three months ended September 30, 2007, and \$21,666, or 5.2%, of total net sales for the three months ended September 30, 2006. Net sales to the federal government accounted for \$58,402, or 4.5%, of total net sales for the nine months ended September 30, 2007, and \$47,569, or 4.0%, of total net sales for the nine months ended September 30, 2006.

**Note 5—Share Based Compensation**

On January 1, 2006, we adopted SFAS 123(R) which requires a company to measure the grant date fair value of equity awards given to employees in exchange for services and recognize that cost adjusted for forfeitures over the period that such services are performed. We recognize share-based compensation as a component of SG&A expense. Total share-based compensation for the periods reported is shown below:

<u>September 30,</u>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Share-based compensation	<u>\$225</u>	<u>\$75</u>	<u>\$202</u>	<u>\$277</u>

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

For the nine months ended September 30, 2007, share-based compensation included a \$167 benefit as a result of equity award forfeitures related to the resignation of a former executive.

Effective July 2007, our Board of Directors approved the award of stock options and nonvested shares to certain executives under our 1997 Amended and Restated Stock Incentive Plan (“1997 Plan”). We granted the stock options at exercise prices equal to the market price of our common stock on the date of the grants. No other equity awards were made in the nine months ended September 30, 2007.

The following table is a summary of the July 2007 awards made under the 1997 Plan:

	<u>2007 Grants</u>	
	<u>Shares</u>	<u>Fair Value</u>
Stock options	190	\$ 1,475
Nonvested shares	25	\$ 328

The fair value of the nonvested share awards is determined by the market price of our common stock on the date of the grant. We used the Black-Scholes option valuation model to assess the grant date fair value of the stock option awards and elected to value each grant as a single award. The application of this model requires certain key input assumptions, including expected volatility, option term, and risk-free interest rates. Expected volatility is based on the historical volatility of our common stock. The expected term of options is estimated using the historical option exercise behavior of employees and directors. The risk-free interest rate is based on U.S. Treasury yield rates with maturities approximating the expected term of each option grant. The key weighted-average assumptions we used to apply this pricing model were as follows:

	<u>2007</u>
	<u>Awards</u>
Risk-free interest rates	4.87%
Volatility	62.9%
Expected term of option grants	5.3 years
Dividend yield	0%

We have historically settled stock option exercises with newly issued common shares and expect to continue this practice. The following table summarizes our stock option exercises in the nine months ended September 30, 2007 and 2006:

<u>Nine Months Ended September 30,</u>	<u>2007</u>	<u>2006</u>
Options exercised	305	413
Cash proceeds from exercised options	\$2,545	\$2,822
Intrinsic value of exercised options	\$2,419	\$ 615

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

The following table sets forth our stock option activity for the nine months ended September 30, 2007:

	<u>Option Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Fair Value</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding, December 31, 2006	1,239	\$ 11.61			
Granted	190	13.13	\$ 7.76		
Exercised	(305)	8.35			
Forfeited or expired	(210)	15.19			
Outstanding, September 30, 2007	<u>914</u>	<u>\$ 12.19</u>		<u>6.21</u>	<u>\$ 3,052</u>
Vested and expected to vest	<u>784</u>	<u>\$ 12.75</u>		<u>5.81</u>	<u>\$ 2,541</u>
Exercisable, September 30, 2007	<u>502</u>	<u>\$ 14.51</u>		<u>4.10</u>	<u>\$ 1,643</u>

Unrecognized compensation cost related to the unvested portion of outstanding stock options as of September 30, 2007 was \$2,215 and is expected to be recognized over a weighted-average period of approximately 2.3 years.

As stated above, we awarded nonvested shares in the nine months ended September 30, 2007 to an executive officer under our 1997 Plan. We are recognizing expense associated with this stock award ratably over the vesting periods. Recipients of nonvested shares possess the rights of shareholders, including voting rights and the right to receive dividends.

The following table summarizes the status of our nonvested shares as of September 30, 2007:

	<u>Shares</u>	<u>Weighted- Average Grant Date Fair Value</u>
Nonvested at December 31, 2006	10	\$ 9.92
Granted	25	13.13
Vested	—	—
Forfeited	—	—
Nonvested at September 30, 2007	<u>35</u>	<u>\$ 12.21</u>

Unrecognized compensation costs related to the nonvested portion of outstanding nonvested shares as of September 30, 2007 was \$370 and is expected to be recognized over a weighted-average period of approximately 1.8 years.

**Note 6—Special Charges**

We did not record any special charges in the nine months ended September 30, 2007. In the nine months ended September 30, 2006, we recorded a charge of \$1,500 related to our settlement with the Department of

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

Justice on our 2003 General Services Administration (“GSA”) audit matter and a charge of \$371 related to the temporary retention of facilities subsequent to our purchase of certain assets of Amherst Technologies, LLC (“Amherst transaction”). We also recorded a charge of \$520 in the nine months ended September 30, 2006 related to management restructuring costs, classified as workforce reductions in the table below.

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

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

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

**Note 7—Income Taxes**

We file one consolidated United States federal income tax return that includes all of our subsidiaries as well as several consolidated, combined, and separate company returns in many U.S. state tax jurisdictions. The tax years 2004-2006 remain open to examination by the major taxing jurisdictions in which we file. We have been notified that an Internal Revenue Service audit of the 2005 tax year will commence.

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

We have elected to continue our historic treatment for interest and penalties, recognizing potential interest and penalties related to unrecognized income tax benefits as a component of income tax expense, and the corresponding accrual is included as a component of our liability for unrecognized income tax benefits. Pursuant to our adoption of FIN 48, \$711 and \$236 of this liability as of January 1, 2007 related to interest and penalties, respectively. During the nine months ended September 30, 2007, we recognized an additional \$414 liability for unrecognized income tax positions relating to tax positions taken in the current and prior periods. Of this amount, \$218 relates to additional interest and penalties associated with unrecognized tax benefits for total interest and penalties at September 30, 2007 of \$1,165. As of September 30, 2007, unrecognized tax benefits of \$1,844 would favorably affect our effective tax rate, if recognized.

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

PC CONNECTION, INC. AND SUBSIDIARIES

PART I—FINANCIAL INFORMATION

Item 1—Financial Statements

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

(amounts in thousands, except per share data)

**Note 8—Commitments and Contingencies**

We are subject to various legal proceedings and claims which have arisen during the ordinary course of business. In the opinion of management, the outcome of such matters is not expected to have a material effect on our financial position, results of operations, and cash flows.

We are also subject to audits by states on sales and income taxes, unclaimed property, and other assessments. A multi-state unclaimed property audit is in progress, and certain sales tax audits may be imminent. While management believes that known liabilities have been adequately provided for, it is too early to determine the ultimate outcome of such audits. Such outcome could have a material negative impact on our results of operations and financial condition. The unclaimed property audit is not expected to be concluded in 2007.

**Note 9—Bank Borrowing and Trade Credit Arrangements**

We have a \$50,000 credit facility collateralized by substantially all of our business assets. This facility, which was amended on October 15, 2007 and extended to five years, also gives us the option of increasing the borrowing amount by an additional \$30,000 at substantially the same terms. Amounts outstanding under this facility bear interest at the prime rate (7.75% at September 30, 2007). 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 and operating covenants, including minimum net worth and maximum funded debt ratio requirements, and restrictions on the payment of dividends, repurchase of our common stock, and default acceleration provisions, none of which we believe significantly restricts our operations. Funded debt ratio is the ratio of average outstanding advances under the facility to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation, and Amortization). The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at September 30, 2007 was 0.0 to 1.0 as our average borrowings during the three months ended September 30, 2007, were not material. The entire \$50,000 facility was available for borrowing at September 30, 2007. The credit facility matures on October 15, 2012, at which time amounts outstanding become due.

At September 30, 2007, we had security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. The agreements allow a collateralized first position in certain branded products inventory financed by these financial institutions up to an aggregate amount of \$45,000. The cost of such financing under these agreements is borne by the suppliers by discounting their invoices to the financial institutions as an incentive for us to purchase their products. We do not pay any interest or discount fees on such inventory financing. At September 30, 2007 and December 31, 2006, accounts payable included \$10,868 and \$17,421, respectively, owed to these financial institutions.

## PC CONNECTION, INC. AND SUBSIDIARIES

## PART I—FINANCIAL INFORMATION

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

Our management’s discussion and analysis of our financial condition and results of operations include the identification of certain trends and other statements that may predict or anticipate future business or financial results that are subject to important factors that could cause our actual results to differ materially from those indicated. See Item 1A, “Risk Factors” of this Quarterly Report on Form 10-Q.

**OVERVIEW**

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

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

The primary challenges we face in effectively managing our business are (1) growing our revenues in the face of increasing competition while improving our gross profit margins in all three business segments, (2) recruiting, retaining, and improving the productivity of our sales personnel, and (3) effectively managing and leveraging our SG&A expenses over a higher sales base. We believe that our future success hinges on the ability of our sales representatives to foster loyal customer relationships. Only by better understanding and anticipating our customers’ IT needs will we strengthen customer loyalty, which we believe, will result in increased productivity of sales representatives and improved operating margins.

**RESULTS OF OPERATIONS**

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

September 30,	Three Months Ended		Nine Months Ended	
	2007	2006	2007	2006
Net sales ( <i>in millions</i> )	\$ 456.5	\$ 415.2	\$1,295.8	\$1,203.8
Net sales	100.0%	100.0%	100.0%	100.0%
Gross margin	12.6	12.3	12.5	12.3
Selling, general and administrative expenses	10.0	10.4	10.4	10.8
Special charges	—	0.3	—	0.2
Income from operations	2.6%	1.6%	2.1%	1.3%

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

Gross margins benefited in the three- and nine-month periods ended September 30, 2007, from our recording of substantially all vendor consideration as a reduction to cost of inventory purchases. As advertising programs

## [Table of Contents](#)

with our vendor partners have become more comprehensive, we have classified substantially all vendor consideration as a reduction of cost of inventory purchases rather than a reduction of advertising expense. Accordingly, this additional consideration in the three and nine months ended September 30, 2007, accounted for 22 and 33 basis-point increases, respectively, in gross margin and in SG&A expenses as a percentage of net sales, compared to the prior year periods.

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

### **Net Sales Distribution**

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

<u>September 30,</u>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Business Segment</b>				
SMB	51%	53%	54%	55%
Large Account	29	28	29	29
Public Sector	20	19	17	16
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>
<b>Product Mix</b>				
Notebooks and PDAs	16%	17%	17%	17%
Desktop/Servers	14	14	14	14
Storage Devices	9	8	9	9
Software	13	12	13	13
Net/Com Products	8	8	8	8
Printers and Printer Supplies	10	11	10	10
Videos, Imaging, and Sound	14	14	13	13
Memory and System Enhancements	4	5	5	5
Accessories/Other	12	11	11	11
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

### **Gross Profit Margins**

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

<u>September 30,</u>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
<b>Business Segment</b>				
SMB	14.3%	13.3%	13.7%	13.5%
Large Account	11.5	11.4	11.2	10.9
Public Sector	9.8	10.8	10.6	11.0
Total	<u>12.6%</u>	<u>12.3%</u>	<u>12.5%</u>	<u>12.3%</u>

Consolidated gross profit dollars increased by \$6.4 million for the third quarter of 2007 from the third quarter of 2006 and increased by \$13.2 million for the nine months ended September 30, 2007, over the prior year period. The year-over-year dollar increases in the three- and nine-month periods ended September 30, 2007, were due to increased net sales and, as discussed above, additional vendor consideration recorded as a reduction to cost of sales. Increased higher-margin software agency fees were largely offset by lower back-end vendor rebates in the three- and nine-month periods ended September 30, 2007, compared to the prior year periods.

## [Table of Contents](#)

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

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

<u>September 30,</u>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Purchasing/Distribution Center	0.63%	0.66%	0.65%	0.68%

### **Operating Expenses**

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

<u>September 30,</u>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Personnel costs	\$ 30.6	\$ 28.8	\$ 90.2	\$ 87.7
Advertising, net	4.8	3.7	14.5	9.5
Facilities operations	2.3	2.4	6.8	6.9
Credit card fees	2.0	2.1	5.9	5.8
Depreciation and amortization	1.7	1.8	5.2	5.2
Bad debts	0.5	0.2	1.1	1.6
Other, net	3.7	4.3	11.1	13.1
Total	<u>\$ 45.6</u>	<u>\$ 43.3</u>	<u>\$ 134.8</u>	<u>\$ 129.8</u>
Percentage of net sales	<u>10.0%</u>	<u>10.4%</u>	<u>10.4%</u>	<u>10.8%</u>

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

**Year-Over-Year Comparisons****Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006**

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

	Three Months Ended September 30,				
	2007		2006		%
	Amount	% of Net Sales	Amount	% of Net Sales	
<b>Sales:</b>					
SMB	\$234.9	51.4%	\$221.3	53.3%	6.1%
Large Account	130.0	28.5	113.7	27.4	14.3
Public Sector	91.6	20.1	80.2	19.3	14.2
<b>Total</b>	<u>\$456.5</u>	<u>100.0%</u>	<u>\$415.2</u>	<u>100.0%</u>	<u>9.9%</u>
<b>Gross Profit:</b>					
SMB	\$ 33.6	14.3%	\$ 29.4	13.3%	14.3%
Large Account	15.0	11.5	13.0	11.4	15.4
Public Sector	8.9	9.8	8.7	10.8	2.3
<b>Total</b>	<u>\$ 57.5</u>	<u>12.6%</u>	<u>\$ 51.1</u>	<u>12.3%</u>	<u>12.5%</u>

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

- Net sales for our SMB segment increased due to a 16% growth in corporate outbound sales compared to the prior year quarter. We believe such growth is attributable to our sales representatives adding new customers and acquiring a greater share of existing customers' IT purchases. Decreased consumer sales during the third quarter of 2007 dampened overall SMB sales growth, reflecting our continued focus on more diverse marketing strategies and programs designed to reach our business customers. Sales representatives for our SMB segment totaled 436 at September 30, 2007, compared to 483 at September 30, 2006.
- Net sales for our Large Account segment increased year over year reflecting the success of this segment's seasoned sales representatives in obtaining new customers and a greater share of existing customers' business during the third quarter of 2007. Sales representatives for our Large Account segment totaled 106 at September 30, 2007, compared to 122 at September 30, 2006.
- Net sales for our Public Sector segment increased due to sales made under recently awarded federal and higher education contracts. Sales representatives for our Public Sector segment totaled 112 at September 30, 2007, compared to 108 at September 30, 2006.

*Gross profit* for the third quarter of 2007 increased compared to the third quarter of 2006 in dollars and as a percentage of sales, as explained by the following:

- Gross profit for our SMB segment increased due to larger net sales and improved gross profit margins. Gross profit margins improved by 100 basis points due to increased higher-margin agency fee revenues, as well as additional vendor consideration discussed earlier, during the third quarter of 2007 compared to the prior year period.
- Gross profit for our Large Account segment increased primarily due to higher net sales in the third quarter of 2007. Increased invoice product margins was largely offset by reduced back-end vendor rebates in the third quarter of 2007 compared to the prior year period.

## [Table of Contents](#)

- Gross profit for our Public Sector segment increased modestly due to greater net sales, as gross profit margins declined year over year in this segment. Decreases in both agency fees and invoice product margins offset lower freight costs in this segment.

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

As discussed in Note 4—Segment and Related Disclosures, we revised in the third quarter of 2007 our reporting of operating segments to reflect the basis for making operating decisions and assessing performance. Under this revised reporting structure, logistics and centralized headquarters functions that were formerly provided by the SMB segment to the Public Sector and Large Account segments were separated from the SMB segment. The centralized headquarters functions provide services in areas such as finance, human services, information technology, legal, communications, and marketing. Most of the operating costs associated with the corporate headquarters functions are charged to the reportable operating segments based on their estimated usage of the underlying functions. Certain of the headquarters costs relating to executive oversight functions no longer being allocated to the operating segments are included under the heading of “Headquarters/Other” in the table below.

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

	Three Months Ended September 30,				
	2007		2006		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
SMB	\$ 25.2	10.7%	\$ 26.4	11.9%	(4.5)%
Large Account	7.6	5.8	6.8	6.0	11.8
Public Sector	8.0	8.7	9.0	11.2	(11.1)
Headquarters/Other	4.8		1.1		
Total	<u>\$ 45.6</u>	10.0%	<u>\$ 43.3</u>	10.4%	5.3%

- SG&A expenses for our SMB segment decreased in dollars and as a percentage of net sales in the third quarter of 2007 as a reduction in allocation expense of centralized headquarter services offset increased net advertising expense. The operating costs of corporate headquarters and other support functions are charged to the reportable operating segments based on their estimated usage of the underlying functions. Net advertising expense increased due to our recording of substantially all vendor consideration as a reduction to inventory purchases, rather than a reduction of advertising expense, as discussed earlier.
- SG&A expenses for our Large Account segment increased in dollars but decreased as a percentage of net sales in the third quarter of 2007 compared to the prior year quarter. The dollar increase resulted primarily from incremental sales compensation associated with higher sales levels.
- SG&A expenses for our Public Sector segment decreased in both dollars and as a percentage of net sales in the third quarter of 2007. The year-over-year improvements are attributable to decreases in compliance expense, professional fees, and centralized headquarters expense allocation.
- SG&A expenses for our Headquarters/Other group increased in dollars year over year as a result of changes in our allocation process, which led to certain headquarters costs relating to executive oversight functions no longer being allocated to the operating segments, as discussed above.

We did not record any special charges in the three months ended September 30, 2007. In the three months ended September 30, 2006, we recorded a charge of \$1.1 million related to our settlement with the Department of Justice on our 2003 GSA audit matter. Liabilities related to special charges are included in accrued expenses and other liabilities on the consolidated balance sheet as of December 31, 2006.

## [Table of Contents](#)

*Income from operations* increased by \$5.2 million to \$12.0 million for the third quarter of 2007 from \$6.8 million for the third quarter of 2006. Income from operations as a percentage of net sales increased to 2.6% for the third quarter of 2007 from 1.6% for the third quarter of 2006. Improved expense leverage and cost reductions in the third quarter of 2007 accounted for the improvement in operating income as a percentage of net sales as compared to the third quarter of 2006.

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

Our effective tax rate was 35.6% for the third quarter of 2007 and 31.9% for the third quarter of 2006. The year-over-year increase in effective tax rate was the result of the low 2006 rate which was due to certain changes in our operations in the third quarter of 2006 that allowed us to adopt a consolidated tax filing status in certain states.

*Net income* increased to \$7.7 million for the third quarter of 2007 from \$4.4 million for the third quarter of 2006, principally because of the increase in income from operations.

### **Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006**

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

	Nine Months Ended September 30,				
	2007		2006		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
<b>Sales:</b>					
SMB	\$ 700.7	54.1%	\$ 655.6	54.5%	6.9%
Large Account	374.0	28.9	350.4	29.1	6.7
Public Sector	221.1	17.0	197.8	16.4	11.8
Total	<u>\$1,295.8</u>	<u>100.0%</u>	<u>\$1,203.8</u>	<u>100.0%</u>	7.6%
<b>Gross Profit:</b>					
SMB	\$ 96.0	13.7%	\$ 88.5	13.5%	8.5%
Large Account	42.0	11.2	38.1	10.9	10.2
Public Sector	23.5	10.6	21.7	11.0	8.3
Total	<u>\$ 161.5</u>	<u>12.5%</u>	<u>\$ 148.3</u>	<u>12.3%</u>	8.9%

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

- Net sales for our SMB segment increased due to our 14% growth in corporate outbound sales compared to the prior year period. We believe such growth is attributable to our sales representatives adding new customers and acquiring a greater share of customers' IT purchases. Decreased consumer sales in the nine months ended September 30, 2007 dampened overall SMB sales growth, reflecting our continued focus on more diverse marketing strategies and programs designed to reach our business customers. Sales representatives for our SMB segment totaled 436 at September 30, 2007, compared to 483 at September 30, 2006.
- Net sales for our Large Account segment increased year over year due to the success of this segment's seasoned sales representatives in acquiring new customers and obtaining a greater share of existing

## [Table of Contents](#)

customers' IT business. Sales representatives for our Large Account segment totaled 106 at September 30, 2007, compared to 122 at September 30, 2006.

- Net sales for our Public Sector segment increased due to increased sales made under recently awarded federal and higher education contracts, as well as the acquisition of new accounts. Sales representatives for our Public Sector segment totaled 112 at September 30, 2007, compared to 108 at September 30, 2006.

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

- Gross profit for our SMB segment improved due to increased net sales and additional vendor consideration recorded as a reduction to cost of sales, as discussed earlier. Increased costs associated with certain customer rebate programs in the nine months ended September 30, 2007, partly offset this additional vendor consideration.
- Gross profit for our Large Account segment increased due to larger net sales and improved gross profit margins. Gross margins improved year over year due to increased higher margin software agency fees and increased invoice product margins.
- Gross profit for our Public Sector segment increased year over year due to larger net sales. Gross profit margins declined year over year as decreased vendor consideration offset lower freight costs.

Selling, general and administrative expenses increased for the nine months ended September 30, 2007, but decreased as a percentage of sales as compared to the nine months ended September 30, 2006. As discussed in Note 4—Segment and Related Disclosures, we revised in the third quarter of 2007 our reporting of operating segments to reflect the basis for making operating decisions and assessing performance. Under this revised reporting structure, logistics and centralized headquarters functions that were formerly provided by the SMB segment to the Public Sector and Large Account segments were separated from the SMB segment. The centralized headquarters functions provide services in areas such as finance, human services, information technology, legal, communications, and marketing. Certain of the headquarters costs relating to executive oversight functions no longer being allocated to the operating segments are included under the heading of "Headquarters/Other" in the table below.

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

	Nine Months Ended September 30,				
	2007		2006		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
SMB	\$ 78.2	11.2%	\$ 76.2	11.6%	2.6%
Large Account	21.5	5.8	20.6	5.9	4.4
Public Sector	23.5	10.6	25.4	12.8	(7.5)
Headquarters/Other	11.6		7.6		
Total	<u>\$ 134.8</u>	10.4%	<u>\$ 129.8</u>	10.8%	3.9%

- SG&A expenses for our SMB segment increased in dollars primarily due to increased net advertising expense resulting from the recording of substantially all vendor allowances as a reduction to cost of sales, as discussed earlier. Lower compliance expense and reduced allocation of corporate headquarter services partly offset the increase in net advertising expense. The operating costs of corporate headquarters and other support functions are charged to the reportable operating segments based on their estimated usage of the underlying functions.
- SG&A expenses for our Large Account segment increased in dollars but were largely level as a percentage of net sales primarily due to incremental sales compensation associated with higher sales levels in the nine months ended September 30, 2007, compared to the prior year period.

## [Table of Contents](#)

- SG&A expenses for our Public Sector segment decreased in both dollars and as a percentage of net sales in the nine months ended September 30, 2007. The year-over-year improvements are attributable to decreased state compliance expense and professional fees, as well as a reduction of allocation to this segment of centralized headquarter functions.
- SG&A expenses for our Headquarters/Other group increased in dollars year over year as a result of changes in our allocation process, which led to certain headquarters costs relating to executive oversight functions no longer being allocated to the operating segments, as discussed above.

We did not record any special charges in the nine months ended September 30, 2007. In the nine months ended September 30, 2006, we recorded a charge of \$1.5 million related to our settlement with the Department of Justice on our 2003 GSA audit matter. We also recorded a charge of \$0.4 million related to the temporary retention of certain Amherst Technologies facilities and a charge of \$0.5 million related to management restructuring costs, classified as workforce reductions in the table below. A roll forward of special charges for the period presented is shown below (in thousands of dollars).

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

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

*Income from operations* increased by \$10.6 million to \$26.7 million for the nine months ended September 30, 2007, from \$16.1 million for the nine months ended September 30, 2006. Income from operations as a percentage of net sales increased year over year to 2.1% for the nine months ended September 30, 2007, from 1.3% for the nine months ended September 30, 2006. This increase was attributable to reductions in operating expenses and special charges as discussed above.

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

Our effective tax rate was 37.0% for the nine months ended September 30, 2007, and 37.3% for the nine months ended September 30, 2006. The year-over-year decrease in effective tax rate was due primarily to a prior year state income tax settlement in the nine months ended September 30, 2007.

*Net income* increased to \$16.8 million for the nine months ended September 30, 2007, from \$9.2 million for the nine months ended September 30, 2006, principally because of the increase in income from operations.

### **Liquidity and Capital Resources**

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

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

## [Table of Contents](#)

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, 2007, we had approximately \$23.7 million in unrestricted accounts.
- *Cash Generated from Operations.* We expect to generate cash flows from operations in excess of operating cash needs by generating earnings and balancing net changes in inventories and receivables with compensating changes in payables to generate a positive cash flow. Historically, we have consistently generated positive cash flows from operations.
- *Credit Facilities.* As of September 30, 2007, our entire \$50.0 million bank line of credit was available for borrowing. This line of credit, as amended on October 15, 2007, can be increased, at our option, to \$80.0 million for approved acquisitions or other uses authorized by the bank. Borrowings are, however, limited by certain minimum collateral and earnings requirements, as described more fully below.

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

### **Summary of Sources and Uses of Cash**

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

<u>September 30,</u>	<u>Nine Months Ended</u>	
	<u>2007</u>	<u>2006</u>
Net cash provided by operating activities	\$ 8.9	\$ 19.0
Net cash used for investing activities	(5.2)	(6.4)
Net cash provided by (used for) financing activities	2.4	(10.6)
Increase in cash and cash equivalents	<u>\$ 6.1</u>	<u>\$ 2.0</u>

*Cash provided by operating activities* decreased in the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006. Cash flow from operations for the nine months ended September 30, 2007 resulted primarily from net income before depreciation and amortization, offset largely by an increase in inventory and a decrease in accounts payable. Inventory increased by \$6.1 million from December 31, 2006, due to higher levels of inventory staged for planned customer roll-outs at September 30, 2007, as compared to the December 31, 2006 balance. Inventory turns were 22 turns for the third quarter of 2007, unchanged from the third quarter of 2006. Accounts receivable increased by \$16.8 million from December 31, 2006 levels, primarily due to increased 2007 sales. Days sales outstanding increased to 45 days for the third quarter of 2007, compared to 43 days for the prior year period.

At September 30, 2007, we had \$117.0 million in outstanding accounts payable. Such accounts are generally paid within 30 days of incurrence, or earlier when favorable cash discounts are offered. This balance will be financed by cash flows from operations or short-term borrowings under the line of credit. This balance includes \$10.9 million payable to two financial institutions under inventory trade credit agreements we use to finance our purchase of certain inventory, secured by the inventory so financed. We believe we will be able to meet our obligations under our accounts payable with cash flows from operations and our existing line of credit.

*Cash used for investing activities* in the nine months ended September 30, 2007 and 2006 include our capital expenditures in the periods presented, primarily for computer equipment and capitalization of internally-developed software. We expect total capital expenditures in 2007 to be between \$6.0 million and \$7.0 million.

## [Table of Contents](#)

Cash provided by financing activities in the nine months ended September 30, 2007 benefited from proceeds of \$2.5 million from the exercise of common stock options under employee stock plans. Cash used for financing activities in the nine months ended September 30, 2006, related primarily to our \$12.9 million paydown of borrowings on our bank line of credit.

### **Debt Instruments, Contractual Agreements, and Related Covenants**

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

**Bank Line of Credit.** Our bank line of credit provides us with a borrowing capacity of up to \$50.0 million at the prime rate (7.75% at September 30, 2007). In addition, we have the option to increase the facility, as amended on October 15, 2007, by an additional \$30.0 million, based on sufficient levels of trade receivables to meet borrowing base requirements, and depending on meeting minimum EBITDA (earnings before interest expense, taxes, depreciation, and amortization) and equity requirements, described below under "Factors Affecting Sources of Liquidity." The facility also gives us the option of obtaining Eurodollar Rate Loans in multiples of \$1.0 million for 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. The entire \$50 million facility was available for borrowing at September 30, 2007.

This facility, which, as amended, 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 \$10.9 million as of September 30, 2007, are recorded in accounts payable, and the inventory financed is classified as inventory on the consolidated balance sheet.

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

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

**Operating Leases.** We also lease facilities from our principal stockholders and facilities and equipment from third parties under non-cancelable operating leases.

## [Table of Contents](#)

*Contractual Obligations.* We do not have any other off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources. The disclosures relating to our contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2006 have not materially changed since we filed that report.

### **Factors Affecting Sources of Liquidity**

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

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

- The funded debt ratio (defined as the average outstanding advances under the line for the quarter, divided by the consolidated EBITDA for the trailing four quarters) must not be more than 2.0 to 1.0. Our actual funded debt ratio at September 30, 2007 was 0.0 to 1.0, as average borrowings outstanding against our credit facility during the first nine months of 2007 were not material.
- Minimum Consolidated Net Worth must be at least \$150.0 million, plus 50% of consolidated net income for each quarter, beginning with the quarter ended March 31, 2006 (loss quarters not counted). Such amount was calculated at September 30, 2007 as \$165.3 million. Our actual consolidated stockholders' equity at September 30, 2007 was \$217.2 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, 2007, 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.

### **RECENTLY ISSUED FINANCIAL ACCOUNTING STANDARDS**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect SFAS 157 to have a material impact on our results of operation or financial position.

## [Table of Contents](#)

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

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

Our critical accounting policies have not materially changed from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2006, except as to FIN 48 as described above.

### **INFLATION**

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

**PC CONNECTION, INC. AND SUBSIDIARIES**

**PART I—FINANCIAL INFORMATION**

**Item 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We invest cash balances in excess of operating requirements in short-term securities, generally with maturities of 90 days or less. In addition, our unsecured credit agreement provides for borrowings which bear interest at variable rates based on the prime rate and Eurodollar rates. We had no borrowings outstanding pursuant to our credit agreement as of September 30, 2007. We believe that the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows should not be material. Our credit agreement exposes earnings to changes in short-term interest rates since interest rates on the underlying obligations are variable. However, as noted above, no borrowings were outstanding at September 30, 2007, and the average borrowings during the three and nine months ended September 30, 2007 were not material. Accordingly, a change in earnings resulting from a hypothetical 10% increase or decrease in interest rates is not material.

**PC CONNECTION, INC. AND SUBSIDIARIES**

**PART I—FINANCIAL INFORMATION**

**Item 4—CONTROLS AND PROCEDURES**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2007. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SECs rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives as described above. Based on the evaluation of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II—OTHER INFORMATION

### Item 1A. Risk Factors

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

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

The following discussion includes one revised risk factor (“We acquire products for resale from a limited number of vendors. The loss of any one of these vendors could have a material adverse effect on our business”) that reflects developments subsequent to the discussion of risk factors included in our most recent Annual Report on Form 10-K.

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

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

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

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

## [Table of Contents](#)

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

### **Despite our August 2004 award of an authorization to sell to the federal government under a new General Services Administration, or GSA, schedule, our sales to federal government entities may not regain prior years' sales levels, which would negatively impact our business.**

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

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

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

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

We acquire products for resale both directly from manufacturers and indirectly through distributors and other sources. The five vendors supplying the greatest amount of goods to us constituted 66% and 68% of our total product purchases in each of the nine months ended September 30, 2007 and 2006, respectively. Among these five vendors, purchases from Ingram represented 24% and 25% of our total product purchases in the nine months ended September 30, 2007 and 2006, respectively. Purchases from HP represented 14% and 15% of our total product purchases in the nine months ended September 30, 2007 and 2006, respectively. Purchases from Tech Data comprised 13% and 17% of our total product purchases in the nine months ended September 30, 2007 and 2006, respectively. No other vendor supplied more than 10% of our total product purchases in the nine months ended September 30, 2007 and 2006, respectively. If we are unable to acquire products from Ingram, HP, or Tech Data, we could experience a short-term disruption in the availability of products, and such disruption could have a material adverse effect on our results of operations and cash flows.

Substantially all of our contracts and arrangements with our vendors that supply significant quantities of products are terminable by such vendors or us without notice or upon short notice. Most of our product vendors provide us with trade credit, of which the net amount outstanding at September 30, 2007 was \$117.0 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.

## [Table of Contents](#)

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

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

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

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

Many product suppliers provide us with advertising allowances, and in exchange, we feature their products in our catalogs and other marketing vehicles. These vendor allowances, to the extent that they represent specific reimbursements of incremental and identifiable costs, are offset against SG&A expenses. Advertising allowances that cannot be associated with a specific program funded by an individual vendor or that exceed the fair value of advertising expense associated with that program are classified as offsets to cost of sales or inventory. In the past, we have experienced a decrease in the level of vendor consideration available to us from certain manufacturers. The level of such consideration we receive from some manufacturers may decline in the future. Such a decline could decrease our gross margin and have a material adverse effect on our cash flows.

### **We face many competitive risks.**

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

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

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

**We face and will continue to face significant price competition.**

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

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

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

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

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

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

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

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

We have had an increasing level of sales made over the Internet in part because of the growing use and acceptance of the Internet by end users. Sales of computer products over the Internet represent a significant and increasing portion of overall computer product sales. Growth of our Internet sales is dependent on potential customers using the Internet in addition to traditional means of commerce to purchase products. We cannot accurately predict the rate at which they will do so.

Our success in growing our Internet business will depend in large part upon the development of an increasingly sophisticated infrastructure for providing Internet access and services. If the number of Internet users or their use of Internet resources continues to grow rapidly, such growth may overwhelm the existing

## [Table of Contents](#)

Internet infrastructure. Our ability to increase the speed with which we provide services to customers and to increase the scope of such services ultimately is limited by, and reliant upon, the sophistication, speed, reliability, and cost-effectiveness of the networks operated by third parties, and these networks may not continue to be developed or be available at prices consistent with our required business model.

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

Many of our customers elect to have their purchases shipped by an interstate common carrier, such as DHL Worldwide Express, United Parcel Service, or FedEx Corporation. A strike or other interruption in service by these shippers could adversely affect our ability to market or deliver products to customers on a timely basis.

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

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

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

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

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

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

We collect and remit sales and use taxes in states in which we have either voluntarily registered or have a physical presence. Various states have sought to impose on direct marketers the burden of collecting state sales and use taxes on the sales of products shipped to their residents. In 1992, the United States Supreme Court affirmed its position that it is unconstitutional for a state to impose sales or use tax collection obligations on an out-of-state mail-order company whose only contacts with the state are limited to the distribution of catalogs and other advertising materials through the mail and the subsequent delivery of purchased goods by United States mail or by interstate common carrier. However, legislation that would expand the ability of states to impose sales and use tax collection obligations on direct marketers has been introduced in Congress on many occasions. Additionally, certain states have adopted rules that require companies and their affiliates to register in those states as a condition of doing business within those states.

Moreover, due to our presence on various forms of electronic media and other operational factors, our contacts with many states may exceed the limited contacts involved in the Supreme Court case. We cannot 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

## [Table of Contents](#)

changes its position, or if legislation is passed to overturn the Supreme Court's decision, or if a court were to determine that our contacts with a state exceed the constitutionally permitted contacts, the imposition of a sales or use tax collection obligation on us in states to which we ship products would result in additional administrative expenses to us, could result in tax liability for past sales as well as price increases to our customers, and could reduce demand for our product.

### **We are dependent on key personnel.**

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

### **We are controlled by two principal stockholders.**

Patricia Gallup and David Hall, our two principal stockholders, beneficially own or control, in the aggregate, approximately 64% of the outstanding shares of our common stock. Because of their beneficial stock ownership, these stockholders can continue to elect the members of the Board of Directors and decide all matters requiring stockholder approval at a meeting or by a written consent in lieu of a meeting. Similarly, such stockholders can control decisions to adopt, amend, or repeal our charter and our bylaws, or take other actions requiring the vote or consent of our stockholders and prevent a takeover of us by one or more third parties, or sell or otherwise transfer their stock to a third party, which could deprive our stockholders of a control premium that might otherwise be realized by them in connection with an acquisition of our Company. Such control may result in decisions that are not in the best interest of our public stockholders. In connection with our initial public offering, the principal stockholders placed substantially all shares of common stock beneficially owned by them into a voting trust, pursuant to which they are required to agree as to the manner of voting such shares in order for the shares to be voted. Such provisions could discourage bids for our common stock at a premium as well as have a negative impact on the market price of our common stock.

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

(e) The following table provides information about purchases by the Company during the quarter ended September 30, 2007 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

#### **ISSUER PURCHASES OF EQUITY SECURITIES**

<u>Period</u>	<u>(a)</u> <u>Total</u> <u>Number of</u> <u>Shares</u> <u>Purchased</u>	<u>(b)</u> <u>Average</u> <u>Price Paid</u> <u>per Share</u>	<u>(c)</u> <u>Total Number of</u> <u>Shares Purchased</u> <u>as Part of Publicly</u> <u>Announced Plans</u> <u>or Programs</u>	<u>(d)</u> <u>Maximum Approximate</u> <u>Dollar Value of Shares</u> <u>that May Yet Be</u> <u>Purchased Under the</u> <u>Program (1)</u>
07/01/07 – 07/31/07	—	—	—	\$ 12,714,000
08/01/07 – 08/31/07	—	—	—	\$ 12,714,000
09/01/07 – 09/30/07	—	—	—	\$ 12,714,000
Total	—	—	—	\$ 12,714,000

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

## [Table of Contents](#)

### Item 6—Exhibits

<u>Exhibit Number</u>	<u>Description</u>
10.1*	Third Amendment, dated October 15, 2007, to the Second Amended and Restated Credit and Security Agreement by and among the Registrant and its subsidiaries, and RBS Citizens, National Association, successor by merger to Citizens Bank of Massachusetts, as lender and agent.
15 *	Letter on unaudited interim financial information.
31.1*	Certification of the Company's President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Company's Executive Vice President, Treasurer, and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Company's President and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Company's Executive Vice President, Treasurer, and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith.

**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 13, 2007

By: \_\_\_\_\_  
/s/ PATRICIA GALLUP  
**Patricia Gallup**  
**Chairman and Chief Executive Officer**

Date: November 13, 2007

By: \_\_\_\_\_  
/s/ JACK FERGUSON  
**Jack Ferguson**  
**Executive Vice President, Treasurer, and**  
**Chief Financial Officer**

PC CONNECTION, INC.  
Route 101A (730 Milford Road)  
Merrimack, NH 03054

Dated as of: October 15, 2007

RBS Citizens, National Association  
28 State Street  
Boston, MA 02109

Re: Amendment No. 3 to Second Amended and Restated Credit and Security Agreement and related Documents

Ladies and Gentlemen:

We refer to the Second Amended and Restated Credit and Security Agreement, dated as of June 29, 2005 (as amended by that certain Amendment No. 1, dated as of August 12, 2005, and Amendment No. 2, dated as of January 3, 2007, the "Credit Agreement"), by and among PC Connection, Inc., a Delaware corporation (the "Borrower"), certain subsidiary guarantors party thereto, and RBS Citizens, National Association, successor by merger to Citizens Bank of Massachusetts, as the lender (in such capacity, the "Lender") and agent (together with its successors and assigns in such capacity, the "Agent").

We have requested that the Agent and Lender agree to make certain amendments to the Credit Agreement and we have been advised that the Agent and Lender are prepared and would be pleased to make the amendments to the Credit Agreement upon the terms and subject to the conditions set forth below.

Accordingly, in consideration of the premises, promises, mutual covenants and agreements set forth below, and fully intending to be legally bound hereby, the parties hereto agree as follows:

ARTICLE I

AMENDMENTS TO CREDIT AGREEMENT

Effective as of October 15, 2007 (the "Amendment Date"), and subject to the fulfillment of the conditions contained in Article II of this Amendment, the Credit Agreement is hereby amended in each of the following respects:

(a) The term, "Documents" shall, wherever used in the Credit Agreement or Other Documents, be deemed to also mean and include this Amendment. All capitalized terms used but not defined herein shall have the meanings given to such terms in the Credit Agreement.

(b) The Credit Agreement is amended as follows:

(i) **Section 1.2.** Section 1.2 of the Credit Agreement is amended by amending and restating the following defined terms therein to read in their entirety as follows:

“Applicable Margin” shall mean, for each of the Base Rate, the Eurodollar Rate, the LIBOR Advantage Rate and the Commitment Fee, the per annum percentage set forth below opposite the corresponding Funded Debt Ratio for the preceding fiscal quarter, as determined by the Compliance Certificate and the corresponding financial statements delivered to the Agent by the Borrower pursuant to Section 9.8 hereof:

Level	Funded Debt Ratio	Applicable Base Rate Margin	Applicable Eurodollar Rate Margin	Applicable LIBOR Advantage Rate Margin	Applicable Commitment Fee Margin
I	greater than 1.25:1	0.00%	1.50%	1.50%	0.25%
II	less than or equal to 1.25:1 but greater than 0.50:1	0.00%	1.00%	1.00%	0.20%
III	less than or equal to 0.50:1	0.00%	0.50%	0.50%	.150%

; provided, that if the Borrower shall fail to deliver a Compliance Certificate and the corresponding financial statements within the time required by such Section 9.8, then the Applicable Margin for each of the Base Rate, the Eurodollar Rate, the LIBOR Advantage Rate and the Commitment Fee shall be the respective Applicable Margin set forth in Level I for the period commencing on the first calendar day of the fiscal quarter following the fiscal quarter for which such financial statements are to be delivered pursuant to Section 9.8 until such Compliance Certificate is delivered. Subject to the last clause of the immediately preceding sentence, any increase or reduction in the Applicable Margin shall be effective on the first calendar day of the month following the month in which the Agent receives the Compliance Certificate and the corresponding financial statements pursuant to Section 9.8, accompanied in the case of any reduction in the Applicable Margin by a certificate of the Borrower requesting such reduction. In the event that the Borrower’s annual financial statements indicate that the Applicable Margin as applied in any fiscal quarter therein was lower than it should have been due to an error in the quarterly financial statements and/or

Compliance Certificate delivered by the Borrower, then the amount of additional interest that would have been due for each such fiscal quarter if the correct Applicable Margin had been applied shall be paid by the Borrower to the Agent on demand.

“Permitted Acquisitions” shall mean the acquisition by Borrower of all or a substantial portion of the assets or capital stock of any Person (the “Acquired Entity”) engaged in a business substantially similar to the Line of Business, which acquisition satisfies all of the following criteria: (a) the aggregate consideration paid or payable by Borrower in connection with such acquisition (including earn out payments, seller paper or deferred purchase price payments) shall not exceed \$15,000,000; (b) Borrower causes any new Subsidiary acquired or formed in connection with such Permitted Acquisition to comply with all of the provisions of Section 6.10; and (c) no Default or Event of Default shall have occurred or result from such Acquisition (to be demonstrated through delivery by the Borrower of a pro forma Compliance Certificate to Agent satisfactory to the Agent).

(ii) **Section 1.2.** Section 1.2 of the Credit Agreement is further amended by adding the following new defined terms in appropriate alphabetical order therein:

“LA Interest Payment Date” means, initially, November 15, 2007, and thereafter the day of each succeeding month which numerically corresponds to such date or, if a month does not contain a day that numerically corresponds to such date, the LA Interest Payment Date shall be the last day of such month.

“LA Interest Period” means, with respect to any LIBOR Advantage Rate Loan, the period commencing on (and including) October 15, 2007 (the “Start Date”) and ending on (but excluding) the date which numerically corresponds to such date one month later, and thereafter, each one month period ending on the day of such month that numerically corresponds to the Start Date. If a LA Interest Period is to end in a month for which there is no day which numerically corresponds to the Start Date, the LA Interest Period will end on the last day of such month.

“LIBOR Advantage Loan” shall mean a Revolving Advance for which the applicable rate of interest is based upon the LIBOR Advantage Rate.

“LIBOR Advantage Rate” means, relative to any LA Interest Period, the offered rate for delivery in two London Banking Days of deposits of U.S. Dollars for a term coextensive with the LA Interest Period which the British Bankers’ Association fixes as its LIBOR rate as of 11:00 a.m. London time on the day on which such LA Interest Period commences. If the first day of any LA Interest Period is not a day which is both a (i) Business Day, and (ii) a London Banking Day, the LIBOR Advantage Rate shall be determined by reference to the next preceding day which is both a Business Day and a London Banking Day. If for any reason the LIBOR Advantage Rate is unavailable and/or the Agent is unable

to determine the LIBOR Advantage Rate for any LA Interest Period, the Agent may, at its discretion, either: (a) select a replacement index based on the arithmetic mean of the quotations, if any, of the interbank offered rate by first class banks in London or New York for deposits with comparable maturities or (b) accrue interest at a rate per annum equal to the Domestic Rate as of the first day of any LA Interest Period for which the LIBOR Advantage Rate is unavailable or cannot be determined.

“London Banking Day” means any day on which dealings in US dollar deposits are transacted in the London interbank market.

“Type” means a LIBOR Rate Loan, a Domestic Rate Loan or a LIBOR Advantage Loan, as the case may be.

(iii) **Section 2.1.** Section 2.1 of the Credit Agreement is amended and restated to read in its entirety as follows:

**“2.1 Revolving Advances.**

(a) Subject to the terms and conditions set forth in this Agreement including, without limitation, Section 2.1(b), each Lender, severally and not jointly, will make Revolving Advances to Borrower in aggregate amounts outstanding at any time equal to such Lender’s Commitment Percentage of the lesser of (x) the Maximum Advance Amount less (i) the aggregate amount of outstanding Letters of Credit and (ii) the Foreign Exchange Sub-Limit, or (y) an amount equal to the sum of:

- (i) up to 80%, subject to the provisions of Section 2.1(b) hereof (“Eligible Receivables Advance Rate”), of Eligible Receivables, other than Eligible Government Receivables, plus
- (ii) up to 50%, subject to the provisions of Section 2.1(b) hereof (“Eligible Government Receivables Advance Rate”), of Eligible Government Receivables (the Eligible Receivables Advance Rate and the Eligible Government Receivables Advance Rate shall be referred to collectively as the “Advance Rates”), minus
- (iii) the aggregate amount of charges outstanding and additional amounts available under Letters of Credit (other than Letters of Credit that are 105% cash collateralized), minus
- (iv) the Foreign Exchange Sub-Limit.

The amount derived from (x) the sum of Sections 2.1(a)(y)(i) and (ii) minus (y) the sum of Sections 2.1(a)(y)(iii) and (iv) at any time and from time to time shall be referred to as the “Formula Amount”. The Revolving Advances shall be evidenced by one or more secured promissory notes (collectively, the

“Revolving Credit Note”) substantially in the form attached hereto as Exhibit 2.1(a).]

(b) Discretionary Rights. The Advance Rates may be increased or decreased by Agent at any time and from time to time in the exercise of its reasonable discretion. Borrower consents to any such increases or decreases and acknowledges that decreasing the Advance Rates may limit or restrict Advances requested by Borrower.”

**Section 2.2.** Section 2.2 of the Credit Agreement is amended and restated to read in its entirety as follows:

**“2.2 Procedure for Revolving Advance Borrowing; Eurodollar Rate Loans; LIBOR Advantage Loans.**

(a) With respect to Revolving Advances, Borrower may notify Agent prior to 12:00 noon (Boston time) at least one Business Day prior to the date of the proposed borrowing of Borrower’s request to incur a Revolving Advance hereunder. Each request for a Revolving Advance shall, unless Borrower requests a loan of another Type, be deemed to be a request for a LIBOR Advantage Loan. The amount of any Revolving Advance request shall be a minimum of \$100,000. Should any amount required to be paid as interest hereunder, or as fees or other charges under this Agreement or any other agreement with Agent or Lenders, or with respect to any other Obligation, become due, same shall be deemed a request for a Revolving Advance as of the date such payment is due, in the amount required to pay in full such interest, fee, charge or Obligation under this Agreement or any other agreement with Agent or Lenders, and such request shall be irrevocable.

(b) Notwithstanding the provisions of subsection (a) above, with respect to all Advances, in the event Borrower desires to obtain a Eurodollar Rate Loan, Borrower must notify Agent prior to 10:00 a.m. (Boston time) at least two (2) Business Days’ prior to the date of the proposed borrowing specifying (i) the date of the proposed borrowing (which shall be a Business Day), (ii) the type of borrowing and the amount on the date of such Advance to be borrowed, which amount shall be a minimum of \$1,000,000 and an integral multiple of \$1,000,000, and (iii) the duration of the first Interest Period therefor. Interest Periods for Eurodollar Rate Loans shall be for one, two, three, four or six months; provided, if an Interest Period would end on a day that is not a Business Day, it shall end on the next succeeding Business Day unless such day falls in the next succeeding calendar month in which case the Interest Period shall end on the next preceding Business Day. No Eurodollar Rate Loan or LIBOR Advantage Loan shall be made available to Borrower during the continuance of a Default or an Event of Default.

(c) Each Interest Period of a Eurodollar Rate Loan shall commence on the date such Eurodollar Rate Loan is made and shall end on such date as

Borrower may elect as set forth in subsection (b)(iii) above provided that the exact length of each Interest Period shall be determined in accordance with the practice of the interbank market for offshore Dollar deposits and no Interest Period shall end after the last day of the Term. Borrower shall elect the initial Interest Period applicable to a Eurodollar Rate Loan by its notice of borrowing given to Agent pursuant to Section 2.2(b) or by its notice of conversion given to Agent pursuant to Section 2.2(d), as the case may be. Borrower shall elect the duration of each succeeding Interest Period by giving irrevocable written notice to Agent of such duration not less than three (3) Business Days prior to the last day of the then current Interest Period applicable to such Eurodollar Rate Loan. If Agent does not receive timely notice of the Interest Period elected by Borrower, Borrower shall be deemed to have elected to convert to a LIBOR Advantage Loan subject to Section 2.2(d) herein below.

(d) Borrower may, subject to the notice requirements set forth below, on any Business Day convert any Revolving Advance of one Type into a Revolving Advance of another Type in the same aggregate principal amount, provided that no Revolving Advance may be converted into a LIBOR Advantage Loan or Eurodollar Rate Loan if any Default or Event of Default shall have occurred and be continuing, and provided, further, that no Eurodollar Rate Loan may be converted into a Loan of another Type or of a different Interest Period except on the last day of the Interest Period applicable thereto. If Borrower desires to convert a Revolving Advance, Borrower shall give prior written notice to agent by 10:00 a.m. (Boston time) (i) in the case of converting to a Eurodollar Rate Loan or a LIBOR Advantage Loan, not less than two (2) nor more than five (5) Business Days' prior to the date of conversion and (ii) in the case of converting to a Domestic Rate Loan, not less than one Business Day prior to the date of conversion, which notice shall specify the proposed date of such conversion (which in the case of Eurodollar Rate Loans shall be on the last day of the Interest Period applicable thereto), the Revolving Advance and amount to be converted (which, in the case of conversions to Eurodollar Rate Loans or LIBOR Advantage Loans shall be in an aggregate minimum amount of \$1,000,000 and integral multiples of \$1,000,000), and, in the case of conversions to Eurodollar Rate Loans, the Interest Period applicable thereto. After giving effect to any borrowing or each such conversion, there shall not be outstanding more than four (4) Eurodollar Rate Loans, in the aggregate.

(e) If any Default or Event of Default shall have occurred and be continuing, at the option of the Required Lenders, each Eurodollar Rate Loan and LIBOR Advantage Loan shall be deemed to convert to a Domestic Rate Loan on the last day of the Interest Period or LA Interest Period, as applicable, in effect with respect thereto.

(f) Borrower may prepay Domestic Rate Loans and LIBOR Advantage Loans in whole at any time or in part from time to time with accrued interest on the principal being prepaid to the date of such repayment. Upon not less than two (2) Business Days' prior written notice, Borrower may (subject to

Sections 3.1 and 13.1 hereof) prepay Eurodollar Rate Loans in whole at any time or in part from time to time with accrued interest on the principal being prepaid to the date of such repayment. Borrower shall specify the date of prepayment of Advances which are Eurodollar Rate Loans and the amount of such prepayment. In the event that any prepayment of a Eurodollar Rate Loan is required or permitted on a date other than the last Business Day of the then current Interest Period with respect thereto, Borrower shall indemnify Agent and Lenders therefor in accordance with Section 2.2(g) hereof.

(g) Borrower shall indemnify Agent and Lenders and hold Agent and Lenders harmless from and against any and all losses or expenses that Agent and Lenders may sustain or incur as a consequence of any prepayment, conversion of or any default, whether voluntary or involuntary by Borrower in the payment of the principal of or interest on any Eurodollar Rate Loan or failure by Borrower to complete a borrowing of, a prepayment of or conversion of or to a Eurodollar Rate Loan after notice thereof has been given, including, but not limited to, any interest payable by Agent or the Lenders to other lenders of funds obtained by them in order to make or maintain their Eurodollar Rate Loans hereunder. A certificate or statement as to any additional amounts payable pursuant to the foregoing sentence (which shall include upon the written request of the Borrower a reasonably detailed calculation and description) submitted by Agent or any Lender to Borrower shall be conclusive absent manifest error.

(h) Notwithstanding any other provision hereof, if any applicable law, treaty, regulation or directive, or any change therein or in the interpretation or application thereof, shall make it unlawful for any Lender (for purposes of this subsection (h), the term "Lender" shall include any Lender and the office or branch where Lender or any corporation or bank controlling such Lender makes or maintains Eurodollar Rate Loans hereof) to make or maintain its Eurodollar Rate Loans, the obligation of Lenders to make Eurodollar Rate Loans hereunder shall automatically be cancelled and Borrower shall, if any affected Eurodollar Rate Loans are then outstanding, promptly upon request from Agent, either pay all such affected Eurodollar Rate Loans in full or convert such affected Eurodollar Rate Loans into loans of another type. If any such payment or conversion of any Eurodollar Rate Loan is made on a day that is not the last day of the Interest Period applicable to such Eurodollar Rate Loan, Borrower shall pay Agent, upon Agent's request, such amount or amounts as may be necessary to compensate Lenders for any loss or expense sustained or incurred by Lenders in respect of such Eurodollar Rate Loan as a result of such payment or conversion, including (but not limited to) any interest or other amounts payable by Agent or the Lenders to other lenders of funds obtained by Lenders in order to make or maintain such Eurodollar Rate Loan. A certificate or statement as to any additional amounts payable pursuant to the foregoing sentence (which shall include upon the written request of the Borrower a reasonably detailed calculation and description) submitted by Lenders to Borrower shall be conclusive absent manifest error."

**Section 2.19.** Section 2.19 of the Credit Agreement is amended and restated to read in its entirety as follows:

**“2.19 Increase of Commitments.** At any time during the Term, the Borrower shall have the right, but not the obligation, upon no less than ninety (90) days written notice to the Agent, to increase the Maximum Advance Amount by an aggregate amount not to exceed \$30,000,000 under terms and conditions identical to those of the Revolving Advances, such additional amounts to be provided by the then existing Lenders or such other persons who become Lenders in connection therewith; provided that no such existing Lender shall be obligated to provide any such Advance in connection with the increase in the Maximum Advance Amount, and this section shall not be deemed a commitment by any Lender to increase such Maximum Advance Amount.”

(v) **Section 3.1.** Section 3.1 of the Credit Agreement is amended and restated to read in its entirety as follows:

**“3.1 Interest.** Interest on Advances shall be payable in arrears, on the first day of each month with respect to Domestic Rate Loans, on each LA Interest Payment Date with respect to LIBOR Advantage Loans and, with respect to Eurodollar Rate Loans, at the end of each Interest Period or, for Eurodollar Rate Loans with an Interest Period in excess of three months, at the earlier of (a) each three months on the anniversary date of the commencement of such Eurodollar Rate Loan and (b) the end of the Interest Period. Interest charges shall be computed on the actual principal amount of Advances outstanding during the month at a rate per annum equal to (w) with respect to LIBOR Advantage Loans, the LIBOR Advantage Rate plus the Applicable Margin thereto, (x) with respect to Domestic Rate Loans, the Base Rate plus the Applicable Margin thereto and (y) with respect to Eurodollar Rate Loans, the Eurodollar Rate plus the Applicable Margin thereto (as applicable, the “Contract Interest Rate”). Whenever, subsequent to the date of this Agreement, the Base Rate is increased or decreased, the applicable Contract Interest Rate for Domestic Rate Loans shall be similarly changed without notice or demand of any kind by an amount equal to the amount of such change in the Base Rate during the time such change or changes remain in effect. The Eurodollar Rate shall be adjusted with respect to Eurodollar Rate Loans without notice or demand of any kind on the effective date of any change in the Reserve Percentage as of such effective date. Immediately upon and after the occurrence of an Event of Default under Section 10(a), and during the continuation thereof, the Obligations due under this Agreement shall bear interest at the applicable Contract Interest Rate, plus three (3%) percent per annum (the “Default Rate”). Upon and after the occurrence and during continuance of an Event of Default other than under Section 10.1(a), the Obligations due under this Agreement shall bear interest at the Default Rate if thirty (30) days after Agent gives notice to Borrower that such an Event of Default has occurred, the Event of Default continues to occur.

(vi) **Section 3.6.** Section 3.6 of the Credit Agreement is amended and restated to read in its entirety as follows:

**“3.6 Computation of Interest and Fees.**

Interest on Domestic Rate Loans shall be computed on the basis of a year of 365/366 days and for the actual number of days elapsed. Interest on Eurodollar Rate Loans shall be computed on the basis of a year of 360 days and for the actual number of days elapsed, including the first date of the applicable period to, but not including, the date of repayment. Interest on Libor Advantage Loans shall be calculated for the actual number of days elapsed on the basis of a 360-day year, including the first date of the applicable period to, but not including, the date of repayment. If any payment to be made hereunder becomes due and payable on a day other than a Business Day, the due date thereof shall be extended to the next succeeding Business Day and interest thereon shall be payable at the applicable Contract Interest Rate during such extension.”

(vii) **Section 3.9.** Section 3.9 of the Credit Agreement is amended and restated to read in its entirety as follows:

**“3.9 Basis for Determining Interest Rate Inadequate or Unfair.** In the event that Agent or any Lender shall have determined that:

- (a) reasonable means do not exist for ascertaining the Eurodollar Rate applicable pursuant to Section 2.2 hereof for any Interest Period; or
- (b) Dollar deposits in the relevant amount and for the relevant maturity are not available in the London interbank Eurodollar market, with respect to an outstanding Eurodollar Rate Loan, a proposed Eurodollar Rate Loan, or a proposed conversion of a Domestic Rate Loan or LIBOR Advantage Loan into a Eurodollar Rate Loan, then Agent shall give Borrower prompt written, telephonic or telegraphic notice of such determination. If such notice is given, (i) any such requested Eurodollar Rate Loan shall be made as a Domestic Rate Loan, unless Borrower shall notify Agent no later than 10:00 a.m. (Boston time) two (2) Business Days prior to the date of such proposed borrowing, that its request for such borrowing shall be cancelled or made as an unaffected Eurodollar Rate Loan or LIBOR Advantage Loan, (ii) any Domestic Rate Loan, LIBOR Advantage Loan or Eurodollar Rate Loan which was to have been converted to an affected type of Eurodollar Rate Loan shall be continued as or converted into a Domestic Rate Loan, or, if Borrower shall notify Agent, no later than 10:00 a.m. (Boston time) two (2) Business Days prior to the proposed conversion, shall be maintained as an unaffected type of Eurodollar Rate Loan or converted to a LIBOR Advantage Loan, and (iii) any outstanding affected Eurodollar Rate Loans shall be converted into a Domestic Rate Loan, or, if Borrower shall notify Agent, no later than 10:00 a.m. (Boston time) two (2) Business Days prior to the last Business Day of the then current Interest Period applicable to such affected Eurodollar Rate Loan, shall be converted into an unaffected type of Eurodollar

Rate Loan or LIBOR Advantage Loan, on the last Business Day of the then current Interest Period for such affected Eurodollar Rate Loans. Until such notice has been withdrawn, Lenders shall have no obligation to make an affected type of Eurodollar Rate Loan or maintain outstanding affected Eurodollar Rate Loans and Borrower shall not have the right to convert a Domestic Rate Loan, LIBOR Advantage Loan or an unaffected type of Eurodollar Rate Loan into an affected type of Eurodollar Rate Loan.”

(viii) **Section 4.10.** Section 4.10 of the Credit Agreement is amended and restated to read in its entirety as follows:

“**4.10 Inspection of Premises.** At reasonable times and at reasonable intervals Agent shall have access to and the right to audit, check, inspect and make abstracts and copies from Borrower’s and its Subsidiaries’ books, records, audits, correspondence and all other papers relating to the Collateral and the operation of Borrower’s or its Subsidiaries’ business (each a “Collateral Audit”). Agent and its agents may upon prior written notice enter upon any of Borrower’s and its Subsidiaries’ premises at any time during business hours and at any other reasonable time, and from time to time, for the purpose of inspecting the Collateral and any and all records pertaining thereto and the operation of Borrower’s or its Subsidiaries’ business. All reasonable costs and expenses of inspections permitted under this Section 4.10 shall be borne by Borrower.”

(ix) **Section 9.9.** Section 9.9 of the Credit Agreement is amended and restated to read in its entirety as follows:

“**9.9 Quarterly Agings and Borrowing Base Reporting.** Furnish Agent within twenty (20) days after the end of each quarter, including the last quarter of the fiscal year an accounts receivable agings and a Borrowing Base Certificate in form and substance reasonably satisfactory to Agent (which shall be calculated as of the last day of the prior quarter and which shall not be binding upon Agent or restrictive of Agent’s rights under this Agreement).”

(x) **Section 13.1.** Section 13.1 of the Credit Agreement is amended and restated to read in its entirety as follows:

“**13.1 Term.** This Agreement shall become effective on the date hereof and shall continue in full force and effect until October 15, 2012 (the “Term”) unless sooner terminated as herein provided. Borrower may terminate this Agreement at any time upon prior written notice to the Agent and the Lenders and payment in full of the Obligations.”

(xi) **Section 13.2.** Section 13.2 of the Credit Agreement is amended and restated to read in its entirety as follows:

“**13.2 Termination.** The termination of the Agreement shall not affect Borrower’s, Agent’s or any Lender’s rights, or any of the Obligations having their

inception either prior to or after the effective date of such termination, and the provisions hereof shall continue to be fully operative until all transactions entered into, rights or interests created or Obligations have been fully disposed of, concluded or liquidated. The security interests, Liens and rights granted to Agent and Lenders hereunder and the financing statements filed hereunder shall continue in full force and effect, notwithstanding the termination of this Agreement or the fact that Borrower's Account may from time to time be temporarily in a zero or credit position, until all of the Obligations of Borrower have been paid or performed in full after the termination of this Agreement or Borrower has furnished Agent and Lenders with an indemnification satisfactory to Agent and Lenders with respect thereto. Accordingly, Borrower waives any rights which it may have under the Uniform Commercial Code to demand the filing of termination statements with respect to the Collateral, and Agent shall not be required to send such termination statements to Borrower, or to file them with any filing office, unless and until this Agreement shall have been terminated in accordance with its terms and all Obligations paid in full in immediately available funds. All representations, warranties, covenants, waivers and agreements contained herein shall survive termination hereof until all Obligations are paid or performed in full."

(xii) **Exhibit 2.1(a)**. Exhibit 2.1(a) to the Credit Agreement is amended and restated as set forth on Exhibit B to this Amendment.

(xiii) ProConnection, Inc., a Delaware corporation (the "Additional Guarantor"), hereby joins in and is made a Guarantor party to the Credit Agreement for all purposes thereof, and grants to the Agent, pursuant to Section 4.1 of the Credit Agreement, a continuing security interest in its Collateral, whether now owned or existing or hereafter acquired or arising and wheresoever located, to secure the prompt payment and performance of the Obligations, and hereby acquires all other rights and assumes all other obligations and covenants of a Guarantor thereunder, as fully as if a direct signatory party thereto.

## ARTICLE II

### CONDITIONS PRECEDENT TO AMENDMENT

The Lender's and Agent's agreement herein to further amend the Credit Agreement as of the Amendment Date is subject to the fulfillment to the satisfaction of the Agent on the date hereof of the following conditions precedent:

- (a) The Borrower, Additional Guarantor and Lender shall have executed this Amendment and delivered the same to the Agent;
- (b) The Guarantors shall have executed a Consent of Guarantors in the form attached as Exhibit A to this Amendment;

- (c) The Borrowers shall have paid the Agent for the benefit of the Lenders an amendment fee in the amount of \$50,000, which fee shall be fully earned and payable to the Lenders on the Amendment Date;
- (d) All representations and warranties contained herein shall be true and correct in all material respects;
- (e) The Borrower shall have executed and delivered to the Agent for the benefit of the Lender a Third Amended and Restated Revolving Credit Note, in the form attached hereto as Exhibit B to this Amendment, in substitution for the existing Note;
- (f) No Material Adverse Effect shall have occurred since June 30, 2007;
- (g) The Additional Guarantor shall have executed and delivered to the Agent a Joinder to Amended and Restated Guaranty, in the form attached hereto as Exhibit C; and
- (h) Each condition precedent set forth in subsection (b), (e), (f) and (g) of Section 8.1 of the Credit Agreement shall have been satisfied with respect to the Additional Guarantor.

### ARTICLE III

#### REPRESENTATIONS AND WARRANTIES

The Borrower represents and warrants to the Lenders and Agent as follows:

- (a) Representations in Agreement. Each of the representations and warranties made by the Borrower and each of its Subsidiaries to the Lender in the Credit Agreement and other Documents was true and correct in all material respects when made and is true and correct in all material respects on and as of the Amendment Date with the same full force and effect as if each of such representations and warranties had been made by the Borrower and each of its Subsidiaries on the Amendment Date and in this Amendment, except to the extent that such representations and warranties relate solely to a prior date.
- (b) No Default of Events of Default. No Default or Event of Default exists on the Amendment Date.
- (c) Binding Effect of Documents. This Amendment has been duly executed and delivered by the Borrower and is in full force and effect as of the date hereof, and the agreements and obligations of the Borrower contained herein constitute legal, valid and binding obligations of the Borrower enforceable against the Borrower in accordance with their respective terms.

### ARTICLE IV

#### MISCELLANEOUS

This Amendment may be executed in any number of counterparts, each of which when executed and delivered shall be deemed an original, but all of which together shall constitute one instrument. Telecopied signatures hereto shall be of the same force and effect as an original of a

manually signed copy. In making proof of this Amendment, it shall not be necessary to produce or account for more than one counterpart thereof signed by each of the parties hereto. Except to the extent specifically amended and supplemented hereby, all of the terms, conditions and the provisions of the Credit Agreement and each of the other Documents shall otherwise remain unmodified, and the Credit Agreement and each of the other Documents, as amended and supplemented by this Amendment, are confirmed as being in full force and effect.

[Remainder of Page Intentionally Left Blank]

If you are in agreement with the foregoing, please sign the form of acceptance on the enclosed counterpart of this Amendment, and return the counterpart to the undersigned, whereupon this Amendment, as so accepted by you, shall become a binding agreement between the undersigned, the Agent and the Lender.

Very truly yours,

PC CONNECTION, INC.

By: /s/ Jack Ferguson

Name: Jack Ferguson

Title: Exec VP, Treasurer and CFO

PROCONNECTION, INC.

By: /s/ Gregory Richey

Name: Gregory Richey

Title: President, ProConnection

The foregoing Amendment is hereby accepted by the undersigned as of October 15, 2007.

RBS CITIZENS, NATIONAL ASSOCIATION, as Agent and Lender

By: /s/ Christopher J. Wickles

Name: Christopher J. Wickles

Title: Senior Vice President

CONSENT OF GUARANTORS

GovConnection, Inc., a Maryland limited liability company, Merrimack Services Corporation, a Delaware corporation, PC Connection Sales Corporation, a Delaware corporation, PCC Sales, Inc. (f/k/a PC Connection Sales of Massachusetts, Inc.), a Delaware corporation, and More Direct, Inc., a Florida corporation (collectively, the "Guarantors"), have each guaranteed the Obligations of PC Connection, Inc., a Delaware corporation (the "Borrower"), under that certain Second Amended and Restated Credit and Security Agreement, dated as of June 29, 2005 (as amended by that certain Amendment No. 1, dated as of August 12, 2005, Amendment No. 2, dated as of January 3, 2007, and Amendment No. 3 (the "Amendment"), dated as of even date herewith, the "Credit Agreement"), by and among the Borrower, the Guarantors and RBS Citizens, National Association, successor by merger to Citizens Bank of Massachusetts, as the lender and agent. By executing this consent, each of the Guarantors hereby absolutely and unconditionally reaffirms to the Lender that each such Guarantor's guaranty of the Obligations remains in full force and effect. Each of the undersigned Guarantors acknowledges and agrees to the terms and conditions of the Amendment and the Credit Agreement as amended thereby.

IN WITNESS WHEREOF, the undersigned have executed this Consent of Guarantors this 15th day of October, 2007.

**GUARANTORS:**

GOVCONNECTION, INC.

By /s/ Gary Anderson  
Name: Gary Anderson  
Title: Treasurer

MERRIMACK SERVICES  
CORPORATION

By /s/ Jack Ferguson  
Name: Jack Ferguson  
Title: Treasurer

PC CONNECTION SALES  
CORPORATION

By /s/ Gary Anderson  
Name: Gary Anderson  
Title: Treasurer

PCC SALES, INC.

By /s/ Deborah McMillan  
Name: Deborah McMillan  
Title: Treasurer

MORE DIRECT, INC.

By /s/ Gary Anderson  
Name: Gary Anderson  
Title: Treasurer

THIRD AMENDED AND RESTATED REVOLVING CREDIT NOTE

\$50,000,000.00

October 15, 2007

FOR VALUE RECEIVED, the undersigned PC CONNECTION, INC., a corporation organized under the laws of the State of Delaware (hereinafter, together with its successors in title and assigns, collectively called the "Borrower"), by this promissory note (hereinafter, called "this Note"), absolutely and unconditionally promises to pay to the order of RBS CITIZENS, NATIONAL ASSOCIATION, successor by merger to Citizens Bank of Massachusetts (hereinafter, together with its successors in title and assigns, called the "Lender"), the principal sum of FIFTY MILLION DOLLARS (\$50,000,000.00) or so much thereof as shall have been advanced by the Lender to the Borrower by way of Revolving Advances under the Loan Agreement (as hereinafter defined) and shall remain outstanding, such payment to be made as hereinafter provided, and to pay interest on the principal sum outstanding hereunder from time to

time from the date hereof until the said principal sum or the unpaid portion thereof shall have become due and payable as hereinafter provided.

Capitalized terms used herein without definition shall have the meanings set forth in the Loan Agreement.

The unpaid principal (not at the time overdue) under this Note shall bear interest at the rate or rates from time to time in effect under the Loan Agreement. Accrued interest on the unpaid principal under this Note shall be payable on the dates specified in the Loan Agreement.

On October 15, 2012, the date of the final maturity of this Note, there shall become absolutely due and payable by the Borrower hereunder, and the Borrower hereby promises to pay to the Lender, the balance (if any) of the principal hereof then remaining unpaid, all of the unpaid interest accrued hereon and all (if any) other amounts payable on or in respect of this Note or the indebtedness evidenced hereby.

The Borrower authorizes the Lender to make or cause to be made at or about the time of any Revolving Advance or at the time of receipt of any payment of principal of this Note, an appropriate notation on the Schedule annexed hereto reflecting the making of such Revolving Advance or the receipt of such payment. The outstanding amount of the Revolving Advance set forth on the Schedule annexed hereto shall be prima facie evidence of the principal amount thereof owing and unpaid to the Lender, but the failure to record, or any error in so recording, any such amount on the Schedule shall not limit or otherwise affect the obligations of the Borrower hereunder or under the Loan Agreement to make payments of principal of and interest on this Note when due.

Each overdue amount (whether of principal, interest or otherwise) payable on or in respect of this Note or the indebtedness evidenced hereby shall (to the extent permitted by applicable law) bear interest at the rates and on the terms provided by the Loan Agreement.

Each payment of principal, interest or other sum payable on or in respect of this Note or the indebtedness evidenced hereby shall be made by the Borrower in United States Dollars, for the account of the Lender as set forth in the Loan Agreement, on the due date of such payment, and in immediately available and freely transferable funds. All payments on or in respects of this Note or the indebtedness evidenced hereby shall be made without set-off or counterclaim and free and clear of and without any deductions, withholdings, restrictions or conditions of any nature.

This Note is made by the Borrower to the Lender pursuant to the Second Amended and Restated Credit and Security Agreement, dated as of June 29, 2005, among the Borrower, as borrower, GovConnection, Inc., a corporation organized under the laws of the State of Maryland, Merrimack Services Corporation, a corporation organized under the laws of the State of Delaware, PC Connection Sales Corporation, a corporation organized under the laws of the State of Delaware, PCC Sales, Inc. (f/k/a PC Connection Sales of Massachusetts, Inc.), a corporation organized under the laws of the State of Delaware, MoreDirect, Inc., a corporation organized under the laws of the State of Florida (each a "Guarantor" and collectively the "Guarantors"), Citizens Bank of Massachusetts, as lender and agent, and the financial institutions which are or

hereafter become a party thereto (collectively, the "Lenders") and is entitled to the benefits of said Second Amended and Restated Credit and Security Agreement (hereinafter, as originally executed, and as now or hereafter amended, modified, varied, supplemented or amended and restated called the "Loan Agreement"). This Note evidences the obligation under the Loan Agreement of the Borrower (a) to repay the principal amount of the Revolving Advances made by the Lender to the Borrower; (b) to pay interest on the principal amount hereof remaining unpaid from time to time; and (c) to pay other amounts which may become due and payable thereunder. This Note has been issued by the Borrower in replacement of the Second Amended and Restated Revolving Credit Note, dated June 29, 2005 (the "Original Note"), by the Borrower to the order of Citizens Bank of Massachusetts in the stated principal amount of \$50,000,000. The Borrower confirms that the indebtedness outstanding under and evidenced by the Original Note on the date hereof has not been repaid, satisfied or discharged but for all purposes has been continued as provided herein and that the indebtedness evidenced by this Note includes all indebtedness outstanding under the Original Note on the date hereof.

The Borrower will have an obligation to prepay principal of this Note from time to time if and to the extent required under, and upon the terms contained in, the Loan Agreement.

Pursuant to and upon the terms contained in the Loan Agreement, the entire unpaid principal of this Note, all of the interest accrued on the unpaid principal of this Note and all (if any) other amounts payable on or in respect of this Note or the indebtedness evidenced hereby may be declared to be immediately due and payable.

This Note and the obligations of the Borrower hereunder shall be governed by and interpreted and determined in accordance with the laws of the Commonwealth of Massachusetts. The Borrower hereby irrevocably waives notice of acceptance, presentment, notice of nonpayment, protest, notice of protest, suit and all other conditions precedent in connection with the delivery, acceptance, collection and/or enforcement of this Note, except for notice expressly provided for in the Loan Agreement. The Borrower hereby absolutely and irrevocably consents and submits to the jurisdiction of the courts of the Commonwealth of Massachusetts and of any federal court located in Boston, Massachusetts in connection with any actions or proceedings brought against the Borrower by the holder hereof arising out of or relating to this Note.

IN WITNESS WHEREOF, this Third Amended and Restated Revolving Credit Note has been duly executed under seal by the undersigned on the day and in the year first above written.

PC CONNECTION, INC.

By: /s/ Jack Ferguson

Name: Jack Ferguson

Title: Exec VP, Treasurer & CFO

SCHEDULE TO THIRD AMENDED AND RESTATED REVOLVING CREDIT NOTE

<u>DATED</u>	<u>AMOUNT OF LOAN</u>	<u>INTEREST RATE</u>	<u>AMOUNT PAID</u>	<u>NOTATION MADE BY</u>

## JOINDER TO AMENDED AND RESTATED GUARANTY AGREEMENT

JOINDER TO AMENDED AND RESTATED GUARANTY AGREEMENT, dated as of October 15, 2007 (the "Joinder Agreement"), by and between PROCONNECTION, INC., a Delaware corporation (the "Additional Guarantor"), and RBS CITIZENS, NATIONAL ASSOCIATION, successor by merger to Citizens Bank of Massachusetts, as agent (in capacity, the "Agent") for itself and the Lenders (as defined below).

### WITNESSETH:

WHEREAS, PC Connection, Inc., a Delaware corporation (the "Borrower"), is party to that certain Second Amended and Restated Credit and Security Agreement, dated as of June 29, 2005 (as amended by that certain Amendment No. 1, dated as of August 12, 2005, Amendment No. 2, dated as of January 3, 2007, and Amendment No. 3 ("Amendment No. 3"), dated as of even date herewith, and as the same may be further amended, restated, supplemented or otherwise modified from time to time, the "Credit Agreement"), by and among the Borrower, GovConnection, Inc., a Maryland limited liability company, Merrimack Services Corporation, a Delaware corporation, PC Connection Sales Corporation, a Delaware corporation, PC Connection Sales of Massachusetts, Inc., a Delaware corporation, and More Direct, Inc., a Florida corporation (the immediately preceding five entities, collectively, the "Existing Guarantors"), the Agent and the lenders from time to time party thereto (the "Lenders"), pursuant to which the Lenders and the Agent have agreed to make certain loans and other extensions of credit (collectively, the "Loans") to the Borrower upon the terms and subject to the conditions set forth therein;

WHEREAS, to induce the Lenders and Agent to make the Loans, the Existing Guarantors have entered into the certain Amended and Restated Guaranty, dated as of May 31, 2002 (as amended, restated, supplemented or otherwise modified from time to time, the "Guaranty Agreement"), pursuant to which the Existing Guarantors have, inter alia, guaranteed the punctual payment and performance of all Obligations;

WHEREAS, the Additional Guarantor is a wholly-owned subsidiary of the Borrower, dependent upon the Borrower for financial and other needs, and shall benefit directly and indirectly from the Loans;

WHEREAS, it is a condition precedent to the efficacy of Amendment No. 3 that the Additional Guarantor enter into this Joinder Agreement, and guarantee the prompt payment and performance of the Obligations in accordance with the terms of the Guaranty Agreement;

NOW, THEREFORE, in order to induce the Lenders to enter into Amendment No. 3 and to make the Loans pursuant to the Credit Agreement and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Additional Guarantor and the Agent hereby agrees as follows:

2 Joinder. Effective as of the date hereof, the Additional Guarantor hereby joins in and is made a Guarantor party to the Guaranty Agreement for all purposes thereof, and guarantees the prompt payment and performance of the Obligations in accordance with the terms

thereof, and shall have all of the rights and obligations of an Guarantor thereunder, as fully as if listed as a Guarantor directly therein and a direct signatory thereto.

3 Counterparts. This Joinder Agreement may be executed in any number of counterparts, and by each of the parties hereto on the same or separate counterparts, each of which shall be deemed to be an original and all of which taken together shall constitute one and the same agreement. Telecopied signatures hereto shall be of the same force and effect as an original of a manually signed copy.

4 Assignment. This Joinder Agreement is binding upon the Additional Guarantor, the Agent and their respective successors and assigns and shall inure to the benefit of the Agent and its successors and assigns. The Additional Guarantor may not assign its rights or obligations hereunder without the prior written consent of the Agent, and any such purported assignment shall be void.

5 Amendment. No provisions of this Joinder Agreement shall be waived, amended, supplemented or otherwise modified except by a written instrument executed by the Agent and the Additional Guarantor.

6 Governing Law; Jurisdiction. This Joinder Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Massachusetts applied to contracts to be performed wholly within the Commonwealth of Massachusetts. Any judicial proceeding brought by or against the Additional Guarantor with respect to this Joinder Agreement, the Documents or any Other Documents may be brought in any court of competent jurisdiction in the Commonwealth of Massachusetts, United States of America, and, by execution and delivery of this Agreement, the Additional Guarantor accepts for itself and in connection with its properties, generally and unconditionally, the non-exclusive jurisdiction of the aforesaid courts, and irrevocably agrees to be bound by any judgment rendered thereby in connection with this Joinder Agreement. The Additional Guarantor hereby waives personal service of any and all process upon it and consents that all such service of process may be made by registered mail (return receipt requested) directed to the Borrower at its address set forth in Section 15.6 of the Credit Agreement and service so made shall be deemed completed five (5) days after the same shall have been so deposited in the mails of the United States of America. Nothing herein shall affect the right to serve process in any manner permitted by law or shall limit the right of Agent or any Lender to bring proceedings against the Additional Guarantor in the courts of any other jurisdiction. The Additional Guarantor waives any objection to jurisdiction and venue of any action instituted hereunder and shall not assert any defense based on lack of jurisdiction or venue or based upon forum non conveniens. The Additional Guarantor waives the right to remove any judicial proceeding brought against the Additional Guarantor in any state court to any federal court. Any judicial proceeding by the Additional Guarantor against Agent or any Lender involving, directly or indirectly, any matter or claim in any way arising out of, related to or connected with this Joinder Agreement, the Documents or any Other Documents, shall be brought only in a federal or state court located in the County of Suffolk, Commonwealth of Massachusetts.

7 Headings. The descriptive headings of the various provisions of this Joinder Agreement are inserted for convenience of reference only and shall not affect the meaning or construction of any of the provisions of this Joinder Agreement.

[remainder of page intentionally left blank]

IN WITNESS WHEREOF, the Additional Guarantor and the Agent have duly executed and delivered this Joinder Agreement as of the date first above written.

PROCONNECTION, INC.

By: /s/ Gregory Richey  
Name: Gregory Richey  
Title: President

ACCEPTED BY:

RBS CITIZENS, NATIONAL  
ASSOCIATION, in its capacity as Agent

By: /s/ Christopher J. Wickles  
Name: Christopher J. Wickles  
Title: Senior Vice President

November 13, 2007

PC Connection, Inc.  
730 Milford Road  
Merrimack, NH

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of PC Connection, Inc. and subsidiaries for the periods ended September 30, 2007 and 2006, as indicated in our report dated November 13, 2007; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended September 30, 2007, is incorporated by reference in Registration Statement Nos. 333-40172, 333-50845, 333-50847, 333-66450, 333-69981, 333-83943, 333-91584, 333-106652, 333-130389, and 333-144065 on Form S-8.

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

Deloitte & Touché LLP  
Boston, Massachusetts

CERTIFICATIONS

I, Patricia Gallup, certify that:

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

Date: November 13, 2007

/s/ Patricia Gallup

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Patricia Gallup

President and Chief Executive Officer

CERTIFICATIONS

I, Jack Ferguson, certify that:

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

Date: November 13, 2007

/s/ Jack Ferguson

Jack Ferguson

Executive Vice President, Treasurer, and Chief Financial Officer

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

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of PC Connection, Inc. (the "Company") for the period ended September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Patricia Gallup, President and Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 13, 2007

/s/ Patricia Gallup

Patricia Gallup  
President and Chief Executive Officer

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

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of PC Connection, Inc. (the "Company") for the period ended September 30, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Jack Ferguson, Executive Vice President, Treasurer, and Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 13, 2007

/s/ Jack Ferguson

Jack Ferguson

Executive Vice President, Treasurer, and Chief Financial Officer