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

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FORM 10-K

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FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2002

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES AND EXCHANGE COMMISSION

Commission File Number 0-23827

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**PC CONNECTION, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**02-0513618**

(I.R.S. Employer Identification No.)

**Rt. 101A, 730 Milford Road  
Merrimack, New Hampshire**

(Address of principal executive offices)

**03054**

(Zip Code)

**(603) 423-2000**

Registrant's telephone number, including area code

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Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.01 par value

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer as defined by Rule 12b-2 of the Securities Exchange Act of 1934, as amended.

YES  NO

The aggregate market value of the voting and non-voting stock held by non-affiliates of the Registrant, based upon the closing price of the Registrant's Common Stock as reported on the NASDAQ National Market on June 28, 2002, was \$22,856,057. Although directors and executive officers of the registrant were assumed to be "affiliates" of the registrant for the purposes of this calculation, this classification is not to be interpreted as an admission of such status.

The number of outstanding shares of the Registrant's Common Stock on March 20, 2003 was 24,659,997.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the 2003 Annual Meeting of Shareholders for the fiscal year ended December 31, 2002, which is to be filed within 120 days of the end of the Company's fiscal year, are incorporated by reference into Part III of this Form 10-K. The incorporation by reference herein of portions of the Proxy Statement shall not be deemed to specifically incorporate by reference the information referred to in Item 402(a) (8) of Regulation S-K.

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PC CONNECTION, INC. AND SUBSIDIARIES

FORM 10-K ANNUAL REPORT  
YEAR ENDED DECEMBER 31, 2002

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## PART I

### Item 1. Business

*This section contains forward-looking statements based on management's current expectations, estimates and projections about the industry in which we operate, management's beliefs and certain assumptions made by management. All statements, trends, analyses and other information contained in this report relative to trends in net sales, gross margin and anticipated expense levels, as well as other statements, including words such as "anticipate", "believe", "plan", "estimate" and "intend" and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth under the caption "Factors That May Affect Future Results and Financial Condition" included in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations." Particular attention should be paid to the cautionary statements involving 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. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission.*

#### General

We are a direct marketer of information technology products and solutions, including brand-name personal computers and related peripherals, software, accessories and networking products through our three primary sales subsidiaries, PC Connection Sales Corporation, GovConnection, Inc. and MoreDirect, Inc. Our principal customers are small- and medium-sized businesses, known as SMBs, comprised of 20 to 1,000 employees, governmental agencies and educational organizations and medium-to-large corporate accounts. We sell our products through a combination of targeted direct mail catalogs, outbound telemarketing, field sales, our Internet Web sites and advertisements on the Internet and in selected computer magazines. We offer a broad selection of approximately 100,000 products targeted for business use at competitive prices, including products from Hewlett-Packard, Toshiba, IBM, Microsoft, Sony, Acer, Fujitsu, Canon, Iomega and Apple. Our most frequently ordered products are carried in inventory and are typically shipped to customers the same day that the order is received.

We maintain a website with the address [www.pcconnection.com](http://www.pcconnection.com). We are not including the information contained in our website as part of, or incorporating it by reference into, this annual report on Form 10-K. We make available free of charge through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file these materials with, or otherwise furnish them to, the Securities and Exchange Commission.

Since our founding in 1982, we have served our customers' needs by providing innovative, reliable and timely service and technical support, and by offering an extensive assortment of branded products, through knowledgeable, well-trained sales and support teams. Our strategy's effectiveness is reflected in the recognition we have received, including being named to the Forbes Platinum 400, the Fortune 1000 and Information Week's list of Top 500 leading IT Innovators.

We believe that our consistent customer focus has also resulted in the development of strong brand name recognition and a broad and loyal customer base. At December 31, 2002, our mailing list consisted of approximately 3,560,000 customers and potential customers, of which approximately 469,000 had purchased

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products from us within the last twelve months. Approximately 86% of our net sales in the year ended December 31, 2002 were made to customers who had previously purchased products from us. We believe we also have strong relationships with vendors, resulting in favorable product allocations and marketing assistance.

Enterprise network infrastructure products, such as PC-based servers, routers and switches, accounted for 22.4% of our total net sales in 2002, up from 19.8% of our total net sales in 2001. Over the next few years, we anticipate that an increasing share of our revenues will come from the sale of enterprise network infrastructure products and services, including network-based storage solutions, versus the current sales concentration in desktop and portable computers.

Our business-to-business marketing efforts include SMBs, government and educational organizations and medium-to-large corporate accounts. As of December 31, 2002, we employed 479 account managers, including 166 new account managers with less than 12 months of outbound telemarketing experience with us. Account managers are responsible for managing corporate accounts and focus on outbound sales calls to prospective customers. We are focusing on increasing the productivity of our account managers.

We publish several catalogs, including PC Connection<sup>®</sup>, focused on PCs and compatible products, and MacConnection<sup>®</sup>, focused on Apple Macintosh personal computers, known as Macs, and compatible products. With colorful illustrations, concise product descriptions, relevant technical information, along with toll-free telephone numbers for ordering, our catalogs are recognized as a leading source for personal computer hardware, software and other related products. We distributed approximately 29 million catalogs during the year ended December 31, 2002.

We also market our products and services through our Internet Web sites, [www.pcconnection.com](http://www.pcconnection.com), [www.govconnection.com](http://www.govconnection.com), [www.macconnection.com](http://www.macconnection.com), and [www.moredirect.com](http://www.moredirect.com). Our Web sites provide customers and prospective customers with product information and enable customers to place electronic orders for products. For the fiscal year 2002, Internet sales processed directly online were \$181.7 million, or 15.2% of net sales, compared to 8.7% in 2001, due largely to our acquisition of MoreDirect, Inc. in April 2002. These sales during the fourth quarter of 2002 were \$58.2 million, or 18.1% of that quarter's net sales.

The Internet supports three key business initiatives for us:

- **Customer choice** — We have built our business on the premise that our customers should be able to choose how they interact with us, be it by mail, telephone, fax, e-mail or over the Web.
- **Lowering transactions costs** — Our Web site tools, including robust product search features, Smart Selectors<sup>™</sup>, Internet Business Accounts<sup>™</sup> and special interest pages, allow customers to quickly and easily find information about products of interest to them. If they still have questions, our Telesales Representatives and Outbound Account Managers are just a phone call away. Such phone calls are typically shorter and have higher close rates than calls from customers who have not first visited our Web sites.
- **Leveraging the time of experienced Account Managers** — Our investments in technology-based sales and service programs demonstrate the power of technology at its best — leveraging our Account Managers to do what they do best: building and maintaining relationships with our customers and helping them to solve their business problems.

### **Acquisition of MoreDirect, Inc.**

On April 5, 2002, we completed the acquisition of MoreDirect, Inc. (MoreDirect). The acquisition of MoreDirect provides PC Connection a premier e-procurement supplier of information technology (IT) products for medium-to-large corporate and government organizations nationwide. MoreDirect's Internet-based system enables corporate and government customers to efficiently source, evaluate, purchase and track a wide variety of IT products.

## Market and Competition

We generate approximately 59% of our sales from the small- and medium-sized business market, approximately 25% from governmental agencies and educational organizations, and 16% from large corporate accounts (Fortune 1000). The overall U.S. Information Technology (IT) market that we serve is estimated at \$250 billion. Our consolidated sales represents only approximately .50% of the IT market, providing us with ample growth opportunities. The largest segment of the market is served by local “value added resellers” (VARs), many of whom are actively exiting the hardware and software business as margins have become too small.

We are transitioning from an end-user or desktop-centric computing supplier to a network or enterprise-wide computing supplier, as well as partnered with third-party technology and telecommunications service providers. We now offer access to the same services and technical expertise to our customers as local VARs, but with more extensive product selection at lower prices and are, therefore, well positioned to increase our market share.

Intense competition for customers has led manufacturers of PCs and related products to use all available channels, including direct marketers, to distribute products. Although certain manufacturers who have traditionally used resellers to distribute their products have established or attempted to establish their own direct marketing operations, including sales through the Internet, to our knowledge, only one has replaced its traditional indirect selling channels as the principal means of distribution. Accordingly, we believe that these manufacturers will continue to provide us and other third-party direct marketers favorable product allocations and marketing support.

We believe new entrants to the direct marketing channel must overcome a number of obstacles, including:

- the substantial time and resources required to build a customer base of meaningful size, quality and responsiveness for cost-effective circulation;
- the high costs of developing the information and operating infrastructure required by direct marketers;
- the advantages enjoyed by larger and more established competitors in terms of purchasing and operating efficiencies;
- the difficulty of building relationships with manufacturers to achieve favorable product allocations and attractive pricing terms; and
- the difficulty of identifying and recruiting management personnel with significant direct marketing experience in the industry.

## Business Strategies

Our objective is to become the leading supplier of information technology products and solutions, including personal computers and related products and services, to our customers. The key elements of our business strategies include:

- ***Providing award-winning customer service before, during and after the sale.*** We believe that we have earned a reputation for providing superior customer service by consistently focusing on our customers’ needs. We deliver value to our customers through high quality service and technical support provided by our knowledgeable, well-trained personnel. We have efficient delivery programs, and we also offer our customers competitive prices and reasonable return policies.
- ***Offering a broad product selection at competitive prices.*** We offer our customers a wide assortment of information technology products and solutions, including personal computers and related products and networking products, at competitive prices. Our merchandising programs feature products that provide customers with aggressive price and performance and the convenience of one-stop shopping for their personal computer and related needs.

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- **Maintaining a strong brand name and customer awareness.** Since our founding in 1982, we have built a strong brand name and customer awareness. In July 1999, we were the only direct reseller included in the “100 Most Influential Companies in the Computer Industry” by PC Magazine. In 2001, we were named to the Forbes Platinum 400, the Fortune 1000 and Information Week’s list of top 500 Leading IT Innovators. Our mailing list includes approximately 3,560,000 names, of which approximately 469,000 have purchased products from us during the last 12 months.
- **Maintaining long-standing vendor relationships.** We have a history of strong relationships with vendors, and were among the first direct marketers qualified by manufacturers to market computer systems to end users. We provide our vendors with both information concerning customer preferences and an efficient channel for the advertising and distribution of their products.

### **Growth Strategies**

Our growth strategies are to increase revenues derived from our penetration of our existing customers, broaden our product offerings and expand our customer base. The key elements of our growth strategies include:

- **Targeting customer segments.** Through targeted mailings, we seek to expand the number of our active customers and generate additional sales from our existing customers. We have developed specialty catalogs, as well as standard catalogs with special cover pages, featuring product offerings designed to address the needs of specific customer populations, including new product inserts targeted to purchasers of graphics, server and networking products. Our account managers take time to understand their customers’ technology environments, thereby allowing us to focus on products and services that meet their needs.
- **Expanding product and service offerings.** We continually evaluate information technology products and services focused on business users, adding new products and services as they become available or in response to customer demand. We work closely with vendors to identify and source first-to-market product offerings at aggressive prices, and believe that the expansion of our corporate outbound marketing program will enhance our access to such product offerings. In addition to using our own inventories, we utilize our distribution and manufacturing suppliers to drop ship products directly to our customers. In 2002 we drop shipped 34.8% of our sales compared to 21.9% in 2001. We will continue to look for other products and services we can effectively provide.
- **Focusing on enterprise server and networking opportunities.** We are accelerating our transition from an end-user or desktop-centric computing supplier to a network or enterprise-wide computing supplier. In 2002, sales of enterprise server and networking products accounted for 22.4% of our total net sales compared to 19.8% of our total net sales in 2001. Sales of enterprise products typically have larger average order sizes and higher gross margins than do sales of desktop computing products.
- **Expanding electronic commerce channel.** Our Internet Web-based catalog provides detailed product descriptions, product search capabilities and online order processing. This channel provides our customers with a convenient means of shopping with us at their convenience, and it also allows us to leverage our account managers more effectively. During 2002, the number of Internet Business Account™ users grew to approximately 35,000 at December 31, 2002. We plan to further improve online sales capabilities, customer service and product information and customer support available on our Internet Web site. We also plan to expand our online affinity sales programs with major customers and thereby solidify our long-term relationship with these customers.
- **Increasing outbound telemarketing productivity.** We believe that higher sales productivity is the key to leveraging our expense structure and driving future profitability improvements. We plan to expand and focus our training and evaluation programs, system enhancements and sales tools more towards assisting our sales personnel in improving their productivity. As we increase our productivity, we plan to increase the number of our corporate account managers and assign them a greater number of our customers.

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- ***Pursuing strategic acquisitions and alliances.*** Through our acquisition program, we seek to acquire new customers, strengthen our product offerings, add management talent and produce operating results which are accretive to our core business earnings. In 2002, we acquired MoreDirect, a premier e-procurement supplier of IT products for medium-to-large corporate and government organizations nationwide.

### **Service And Support**

Since our founding in 1982, our primary objective has been to provide products that meet the demands and needs of customers and to supplement those products with up-to-date product information and excellent customer service and support. We believe that offering our customers superior value, through a combination of product knowledge, consistent and reliable service and leading products at competitive prices, differentiates us from other direct marketers and provides the foundation for developing a broad and loyal customer base.

We invest in training programs for our service and support personnel, with an emphasis on putting customer needs and service first. We provide toll-free technical support from 9 a.m. through 5 p.m., Eastern time, Monday through Friday. Product support technicians assist callers with questions concerning compatibility, installation, determination of defects and more difficult questions relating to product use. The product support technicians authorize customers to return defective or incompatible products to either the manufacturer or to us for warranty service. In-house technicians perform both warranty and non-warranty repair on most major systems and hardware products.

Using our customized information system, we send our customer orders to our distribution center for processing immediately after a customer receives credit approval. Through our Everything Overnight<sup>®</sup> service, we guarantee that all orders accepted up until 2:00 a.m. Eastern time, (until midnight on most custom-configured systems) will be shipped for overnight delivery via Airborne Express. We also configure approximately 23% of the computer systems we sell. Configuration typically consists of the installation of memory, accessories and/or software.

### **Marketing And Sales**

We sell our products through our direct marketing channels to SMBs, governmental agencies and educational organizations and medium-to-large corporate accounts. We seek to be the primary supplier of information technology products and solutions, including personal computers and related products, to our existing customers and to expand our customer base. We use multiple marketing approaches to reach existing and prospective customers, including:

- outbound telemarketing and field sales;
- catalogs and inbound telesales;
- Web and print media advertising; and
- marketing programs targeted to specific customer populations.

All of our marketing approaches emphasize our broad product offerings, fast delivery, customer support, competitive pricing and multiple payment options.

We believe that our ability to establish and maintain long-term customer relationships and to encourage repeat purchases is largely dependent on the strength of our telemarketing personnel and programs. Because our customers' primary contact with us is through our telemarketers, we are committed to maintaining a qualified, knowledgeable and motivated sales staff with its principal focus on customer service.

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The following table sets forth our percentage of net sales by sales channel:

Sales Channel	Years Ended December 31,		
	2002	2001	2000
Outbound Telemarketing and Field Sales	78%	79%	76%
Inbound Telesales	7	12	16
Online Internet	15	9	8
Total	100%	100%	100%

**Outbound Telemarketing and Field Sales.** We seek to build loyal relationships with our potential high-volume customers by assigning them to individual account managers. We believe that customers respond favorably to a one-on-one relationship with personalized, well-trained account managers. Once established, these one-on-one relationships are maintained and enhanced through frequent telecommunications and targeted catalogs and other marketing materials designed to meet each customer's specific computing needs. We pay most of our account managers a base annual salary plus incentive compensation. Incentive compensation is tied to gross profit dollars produced by the individual account manager. Account managers historically have significantly increased productivity after approximately 12 months of training and experience. At December 31, 2002, we employed 479 account managers, including 166 with less than 12 months of outbound telemarketing experience with us.

**Catalogs and Inbound Telesales.** Our two principal catalogs are PC Connection® for the PC market and MacConnection® for the Mac market. We publish eleven editions of each of these catalogs annually. We distribute catalogs to purchasers on our in-house mailing list as well as to other prospective customers. We send our two principal catalogs to our best customers twice each month. The initial mailing each month, labeled an "early edition," is sent simultaneously to the best customers throughout the United States and features special offers, such as first-to-market product offerings, highlighted on the cover.

In addition, we mail specialty catalogs or customized versions of our catalogs to selected customers. We distribute specialty catalogs to educational and governmental customers and prospects on a periodic basis. We also distribute our monthly catalogs customized with special covers and inserts, offering a wider assortment of special offers on products in specific areas such as graphics, server/netcom and mobile computing, or for specific customers, such as developers. These customized catalogs are distributed to targeted customers included in our customer database using past identification or purchase history, as well as to outside mailing lists.

Our inbound sales representatives answer customer telephone calls generated by our catalog, magazine and other advertising programs. These representatives also assist customers in making purchasing decisions, process product orders and respond to customer inquiries on order status, product pricing and availability. We have been a pioneer in using caller identification for the instant retrieval of customer records. Using our proprietary information systems, sales representatives can quickly access customer records which detail purchase history and billing and shipping information, expediting the ordering process. In addition to receiving orders through our toll-free numbers, orders are also received via fax, mail and electronic mail.

**Online Internet.** ([www.pcconnection.com](http://www.pcconnection.com), [www.govconnection.com](http://www.govconnection.com), [www.macconnection.com](http://www.macconnection.com), and [www.moredirect.com](http://www.moredirect.com)) We provide product descriptions and prices of all products online. We also provide updated information for over 55,000 items and on screen images available for over 35,000 items. We offer, and continuously update, selected product offerings and other special buys. We believe that in the future our Internet Web site will be an important sales source and communication tool for improving customer service.

**Business Segments.** We conduct our business operations through three primary business segments: (1) consumer, small- and medium-size business customers ("SMB"); (2) federal, state and local governments and

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education institutions (“Public Sector”); and (3) large corporate (Fortune 1000) and governmental organizations (“Large Accounts”).

**SMB Segment.** While we continue to generate credit card sales to consumers, our principal target customers in this segment are small-to-medium-size business customers with 20 to 1,000 employees. Our primary means of marketing to this segment incorporate all three sales channels—catalog and inbound telesales, particularly to our consumer group, outbound telemarketing and online Internet sales, primarily to our business customers.

**Public Sector Segment.** We use a combination of outbound telemarketing, including some on-site sales solicitation by field sales account managers, and online Internet sales through Internet Business Accounts, to reach these customers. Through our GovConnection subsidiary, we target each of the four distinct market sectors within this segment—federal government, higher educational institutions, school grades K through 12, and state and local governments.

**Large Account Segment.** Through our MoreDirect subsidiary’s custom designed Internet-based system, we are able to offer our larger corporate and government customers an efficient and effective method of sourcing, evaluating, purchasing and tracking a wide variety of IT products. Our account managers typically have 10 to 12 years of experience and are located strategically across the United States. This allows them to work directly with the customers, often on site. MoreDirect does not own any inventory; we place all product orders with manufacturers and/or distribution companies for drop shipment directly to customers.

The following table sets forth our net sales by business segment:

Business Segment	Years Ended December 31,		
	2002	2001	2000
SMB	59%	76%	83%
Public Sector	25	24	17
Large Accounts	16	—	—
Total	100%	100%	100%

**Specialty Marketing.** Our specialty marketing activities include direct mail, other inbound and outbound telemarketing services, bulletin board services, “fax on demand” services, package inserts, fax broadcasts and electronic mail. We also market call-answering and fulfillment services to certain of our product vendors.

**Customers.** We currently maintain an extensive database of customers and prospects aggregating approximately 3,560,000 names. During the year ended December 31, 2002, we received orders from approximately 469,000 customers. Approximately 86% of our net sales in the year ended December 31, 2002 were made to customers who had previously purchased products from us. Except for sales to the federal government, no single customer accounted for 10% or more of our consolidated revenue.

### Products And Merchandising

We continuously focus on expanding the breadth of our product offerings. We currently offer our customers approximately 100,000 information technology products designed for business applications from more than 1,000 manufacturers, including hardware and peripherals, accessories, networking products and software. We select the products that we sell based upon their technology and effectiveness, market demand, product features, quality, price, margins and warranties. As part of our merchandising strategy, we also offer products related to PCs, such as digital cameras.

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The following table sets forth our percentage of net sales (in dollars) of notebooks, desktops and servers, storage devices, software, networking communications equipment, printers, video and monitors, memory, accessories and other products during the years ended December 31, 2002, 2001, and 2000.

	PERCENTAGE OF NET SALES		
	Years Ended December 31,		
	2002	2001	2000
Notebooks	15%	22%	25%
Desktops/Servers	15	12	15
Storage Devices	9	10	10
Software	14	13	10
Networking Communications	8	9	8
Printers	9	8	7
Video & Monitors	10	9	8
Memory	4	3	4
Accessories/Other	16	14	13
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

We offer a 30-day right of return generally limited to defective merchandise. Returns of non-defective products are subject to restocking fees. Substantially all of the products marketed by us are warranted by the manufacturer. We generally accept returns directly from the customer and then either credit the customer's account or ship the customer a similar product from our inventory. Backlog is not material to our business.

### **Purchasing And Vendor Relations**

For the year ended December 31, 2002, we purchased approximately 46% of our products directly from manufacturers and the balance from distributors and aggregators. We ship the majority of our products directly to our distribution facility in Wilmington, Ohio. During the years ended December 31, 2002, 2001 and 2000, product purchases from Ingram Micro, our largest vendor, accounted for approximately 28%, 25%, and 26%, respectively, of our total product purchases. Purchases from Tech Data Corporation comprised 14% of our total purchases in both the years ended December 31, 2002 and 2001 and 11% in the year ended December 31, 2000. Effective May 3, 2002, Hewlett-Packard Company (HP) completed its acquisition of Compaq Computer Corporation. Had this acquisition been completed at the beginning of the periods presented, our purchases made directly from HP, on a pro forma basis, would have constituted 15%, 12%, and 4% of our total product purchases in the years ended December 31, 2002, 2001, and 2000, respectively. No other vendor accounted for more than 10% of our total product purchases in the years ended December 31, 2002, 2001, and 2000. We believe that alternative sources for products obtained from Ingram Micro, Tech Data, and HP are available.

Many product suppliers reimburse us for advertisements or other cooperative marketing programs in our catalogs or advertisements in personal computer magazines that feature a manufacturer's product. Reimbursements may be in the form of discounts, advertising allowances, and/or rebates. We also receive reimbursements from certain vendors based upon the volume of purchases or sales of the vendors' products by us.

Some of our vendors offer limited price protection in the form of rebates or credits against future purchases. We may also participate in end-of-life-cycle and other special purchases which may not be eligible for price protection.

We believe that we generally have excellent relationships with vendors. We generally pay vendors within stated terms and take advantage of all appropriate discounts. We believe that because of our volume purchases we are able to obtain product pricing and terms that are competitive with those available to other major direct marketers. Although brand names and individual product offerings are important to our business, we believe that competitive sources of supply are available in substantially all of the merchandise categories offered by us.

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### **Distribution**

At our approximately 205,000 square foot distribution and fulfillment complex in Wilmington, Ohio, we receive and ship inventory, configure computer systems and process returned products. Orders are transmitted electronically from our New Hampshire, Massachusetts and Maryland sales facilities to our Wilmington distribution center after credit approval, where packing documentation is printed automatically and order fulfillment takes place. Through our Everything Overnight® service, we guarantee that all orders accepted up until 2:00 a.m. Eastern time, (until midnight on custom-configured systems) will be shipped for overnight delivery via Airborne Express. We ship approximately 70% of our orders through Airborne Express. Upon request, orders may also be shipped by other common carriers.

We also place product orders directly with manufacturers and/or distribution companies for drop shipment by those manufacturers and/or suppliers directly to customers. MoreDirect places all product orders with manufacturers and/or distribution companies for drop shipment directly to customers. Order status with distributors is tracked online and in all circumstances, a confirmation of shipment from manufacturers and/or distribution companies is received prior to recording revenue. Products drop shipped by suppliers accounted for 34.8% of net sales in 2002 and 21.9% of net sales in 2001. In future years, we expect that products drop shipped from suppliers will increase, both in dollars and as a percentage of net sales, as we seek to lower our overall inventory and distribution costs while maintaining excellent customer service.

### **Management Information Systems**

All of the PC Connection companies, except for MoreDirect, use management information systems, principally comprised of applications software running on IBM AS/400 and RS6000 computers and Microsoft NT-based servers, which we have customized for our use. These systems permit centralized management of key functions, including order taking and processing, inventory and accounts receivable management, purchasing, sales and distribution, and the preparation of daily operating control reports on key aspects of the business. We also operate advanced telecommunications equipment to support our sales and customer service operations. Key elements of the telecommunications systems are integrated with our computer systems to provide timely customer information to sales and service representatives, and to facilitate the preparation of operating and performance data.

Our MoreDirect subsidiary has developed a custom designed Internet-based system, Traxx, which is comprised of applications software running on Linux and Sun Solaris servers. This system is an integrated application of Internet sales order processing; integrated supply chain visibility and full EDI links with major manufacturers and distribution partners for product information, availability, pricing, ordering, delivery, and tracking, including related accounting functions.

We believe that our customized information systems enable us to improve our productivity, ship customer orders on a same-day basis, respond quickly to changes in our industry and provide high levels of customer service.

Our success is dependent in large part on the accuracy and proper use of our information systems, including our telephone systems, to manage our inventory and accounts receivable collections, to purchase, sell and ship our products efficiently and on a timely basis, and to maintain cost-efficient operations. We expect to continually upgrade our information systems to more effectively manage our operations and customer database.

### **Competition**

The direct marketing and sale of information technology products, including personal computers and related products, is highly competitive. PC Connection competes with other direct marketers of information technology products, including CDW Computer Centers, Inc. and Insight Enterprises, Inc. We also compete with:

- certain product manufacturers that sell directly to customers, such as Dell Computer Corporation and Gateway, Inc., and more recently Hewlett-Packard, IBM and Apple;

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- distributors that sell directly to certain customers;
- various cost-plus aggregators, franchisers, and national computer retailers; and
- companies with more extensive Internet Web sites and commercial online networks.

Additional competition may arise if other new methods of distribution, such as broadband electronic software distribution, emerge in the future.

We compete not only for customers, but also for favorable product allocations and cooperative advertising support from product manufacturers. Several of our competitors are larger and have substantially greater financial resources than us.

We believe that price, product selection and availability, and service and support are the most important competitive factors in our industry.

### **Intellectual Property Rights**

Our trademarks include PC Connection<sup>®</sup>, GovConnection<sup>®</sup>, MacConnection<sup>®</sup>, and MoreDirect<sup>®</sup> and their related logos; Everything Overnight<sup>®</sup>, The Connection<sup>®</sup>, Raccoon Character<sup>®</sup>, Service Connection<sup>™</sup>, Graphics Connection<sup>™</sup>, and Memory Connection<sup>™</sup>, Your Brands, Your Way, Next Day<sup>®</sup>, and Epiq PC Systems<sup>®</sup>. We intend to use and protect these and our other marks, as we deem necessary. We believe our trademarks and service marks have significant value and are an important factor in the marketing of our products. We do not maintain a traditional research and development group, but we work closely with computer product manufacturers and other technology developers to stay abreast of the latest developments in computer technology, both with respect to the products we sell and use.

### **Employees**

As of December 31, 2002, we employed 1,338 persons, of whom 653 were engaged in sales related activities, 95 were engaged in providing customer service and support, 329 were engaged in purchasing, marketing and distribution related activities, 82 were engaged in the operation and development of management information systems, and 179 were engaged in administrative and accounting functions. We consider our employee relations to be good. Our employees are not represented by a labor union, and we have never experienced a work stoppage since our inception.

### **Item 2. Properties**

In November 1997, we entered into a fifteen year lease for our corporate headquarters and telemarketing center located at Route 101A, 730 Milford Road, Merrimack, New Hampshire 03054-4631, with an affiliated entity, G&H Post, which is related to PC Connection through common ownership. The total lease is valued at approximately \$7.0 million, based upon an independent property appraisal obtained at the date of lease, and interest is calculated at an annual rate of 11%. The lease requires us to pay our proportionate share of real estate taxes and common area maintenance charges as additional rent and also to pay insurance premiums for the leased property. We have the option to renew the lease for two additional terms of five years each. The lease has been recorded as a capital lease in the financial statements.

We also lease 205,000 square feet in two facilities in Wilmington, Ohio, which houses our distribution and order fulfillment operations. We also operate telemarketing centers in Dover and Keene, New Hampshire, as well as Marlborough, Massachusetts, Rockville, Maryland and Boca Raton, Florida. We believe that existing distribution facilities in Wilmington, Ohio will be sufficient to support our anticipated needs through the next twelve months.

### **Item 3. Legal Proceedings**

On February 12, 2002, Microsoft Corporation filed a complaint against PC Connection in New Hampshire Federal District Court alleging that we had sold counterfeit shrinkwrapped, packaged software and, in the

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process, infringing on Microsoft's trademarks and copyrights. While we never counterfeited Microsoft products, nor knowingly resold counterfeit Microsoft products, we believe that it was in our best interest to settle the dispute rather than to litigate.

While denying the allegations, we agreed to pay Microsoft \$625,000 to settle the case. The settlement costs and related legal fees of approximately \$125,000 is included as a special charge in our first quarter 2002 financial results.

We also agreed in the settlement to acquire Microsoft products only through distributors identified as authorized by Microsoft, codifying a policy that we have had in place since early 2001.

On March 20, 2002, The Lemelson Medical, Education & Research Foundation, L.P. filed a complaint in federal district court in the State of Arizona naming us as an additional defendant in the so-called "Federal Express" case. The Federal Express case involves approximately eighty-eight defendants and pertains to claims made by the foundation relating to its right to royalties for the use of bar code scanners that allegedly utilize technology covered by patents now owned by the foundation. The foundation has previously filed claims against manufacturers of bar code scanners and has now also filed claims against users of bar code scanners, including PC Connection. The manufacturers of bar code scanners and the foundation are currently engaged in litigation in Nevada Federal District Court relating to the validity of the patents at issue. The defendants in the Arizona litigation have requested the federal district court to stay the proceedings pending the outcome of the Nevada litigation, which the Court granted. Until the Nevada patent litigation is resolved, we will expend little, if any, legal fees in the Arizona case. If the bar code manufacturers are successful in the Nevada case, we expect the Arizona court to dismiss the action against us.

The foundation has not specified the amount of damages it seeks in its complaint, but such damages may be material. If the foundation ultimately prevails in the Arizona litigation, the damages assessed against us may be material and may have a material adverse effect on our financial condition. In addition, we may be required to modify the methods by which we track inventories and ship products which may have a material adverse effect on our results of operations. We intend to vigorously defend this claim and, to the extent we are found liable, we believe we have indemnification claims against certain manufacturers of bar code scanners.

While we may ultimately decide to seek indemnity from certain manufacturers of bar code scanners, we can provide no assurance that we would be successful in obtaining such indemnity. At a minimum, if the Nevada or Arizona litigation proceeds, we may incur material legal fees in the defense of the foundation's claims or in seeking indemnity from certain manufacturers of bar code scanners.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

There were no matters submitted during the fourth quarter of 2002 to a vote of security holders.

#### **Executive Officers of PC Connection**

The executive officers of PC Connection and their ages as of March 20, 2003 are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Patricia Gallup	48	Chairman and Chief Executive Officer*
Kenneth Koppel	60	President*
Robert F. Wilkins	41	Executive Vice President
Mark A. Gavin	41	Senior Vice President of Finance and Chief Financial Officer
Bradley G. Mousseau	51	Vice President of Human Resources

\* Mr. Koppel resigned as President, effective March 21, 2003, and Ms. Gallup assumed the duties of that office, along with her existing duties as Chief Executive Officer and Chairman of the Board.

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**Patricia Gallup** is a co-founder of the Company and has served as Chief Executive Officer and Chairman of the Board since September 2002. Ms. Gallup also assumed the role of President of the Company upon the resignation of Mr. Koppel on March 21, 2003. Ms. Gallup has served as a member of the Corporation's Executive Management Team since its inception in 1982.

**Kenneth Koppel** has served as President of the Company since September 2002. Mr. Koppel resigned as President, effective March 21, 2003. From June 2001 to August 2002, Mr. Koppel served as Chief Executive Officer of the Company. Prior to joining the Company, Mr. Koppel served as a principal in or a consultant to several news media and marketing companies. From 1972 to 1992, Mr. Koppel served in a variety of roles at Ziff-Davis Publishing Company, including President of Ziff-Davis Publishing and President of Ziff Communications.

**Robert F. Wilkins** has served as Executive Vice President of the Company since January 2000. Mr. Wilkins served as Senior Vice President of Sales and Marketing from January 1999 to January 2000 and Senior Vice President of Merchandising and Product Management of the Company from January 1998 to January 1999. From December 1995 to January 1998, Mr. Wilkins served as Vice President of Merchandising and Product Management of the Company. From September 1994 to December 1995 he was a consultant to the Company and certain of its affiliates.

**Mark A. Gavin** has served as Senior Vice President of Finance and Chief Financial Officer since January 2000 and as Vice President of Finance and Chief Financial Officer of the Company since March 1998. Prior to joining PC Connection, Mr. Gavin held the position of Executive Vice President and Chief Operating Officer at CFX Corporation, a bank holding company in Keene, New Hampshire from April 1989 to March 1998. Prior to CFX, Mr. Gavin worked as a Manager for Ernst & Young, LLP.

**Bradley G. Mousseau** has served as Vice President of Human Resources since January 2000. Prior to joining PC Connection, Mr. Mousseau served as Vice President of Global Workforce Strategies for Systems & Computer Technology Corporation (SCT) from April 1997 to January 2000. Prior to SCT, Mr. Mousseau served as Vice President of Human Resources for Gabreili Medical Info Systems.

**PART II**

**Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters**

*Market Information*

PC Connection's Common Stock commenced trading on March 3, 1998 on the Nasdaq National Market under the symbol "PCCC". As of March 20, 2003, there were 24,659,997 shares outstanding of the Common Stock of PC Connection held by approximately 100 stockholders of record.

The following table sets forth for the fiscal periods indicated the range of high and low bid prices for our Common Stock on the Nasdaq National Market.

<u>2002</u>	<u>High</u>	<u>Low</u>
Quarter Ended:		
December 31	\$ 7.49	\$ 3.72
September 30	6.27	3.86
June 30	10.90	3.83
March 31	15.36	8.33
<u>2001</u>		
Quarter Ended:		
December 31	\$ 17.79	\$ 6.85
September 30	16.30	6.00
June 30	16.77	8.50
March 31	20.56	8.13

We have never declared or paid cash dividends on our capital stock. We currently anticipate that we will retain all future earnings, if any, to fund the development and growth of our business, and we do not anticipate paying any cash dividends on our Common Stock in the foreseeable future. Our secured credit agreement contains restrictions that may limit our ability to pay dividends in the future.

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**Item 6. Selected Financial and Operating Data**

The following selected financial and operating data should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other financial information included elsewhere in this Form 10-K.

	Years Ended December 31,				
	2002	2001	2000	1999	1998
	<i>(dollars in thousands, except per share and selected operating data)</i>				
<b>Statement of Operations Data:</b>					
Net sales	\$ 1,191,497	\$ 1,186,217	\$ 1,440,227	\$ 1,079,348	\$ 749,905
Cost of sales	1,062,311	1,054,631	1,264,573	950,165	656,631
Gross profit	129,186	131,586	175,654	129,183	93,274
Selling, general and administrative expenses	121,964	117,610	123,834	91,322	68,521
Additional stockholder/officer compensation <sup>(1)</sup>	—	—	—	—	2,354
Restructuring costs and other special charges <sup>(2)</sup>	1,636	2,204	—	—	—
Income from operations	5,586	11,772	51,820	37,861	22,399
Interest expense	(1,152)	(1,179)	(2,086)	(1,392)	(415)
Other, net	513	1,307	589	116	565
Income before income taxes	4,947	11,900	50,323	36,585	22,549
Income tax provision <sup>(3)</sup>	(1,700)	(4,521)	(19,126)	(13,905)	(3,905)
Income before cumulative effect of change in accounting principle	3,247	7,379	31,197	22,680	18,644
Cumulative effect of change in accounting principle <sup>(4)</sup>	—	—	—	(305)	—
Net income	\$ 3,247	\$ 7,379	\$ 31,197	\$ 22,375	\$ 18,644
	<b>Pro Forma Data<sup>(5)</sup></b>				
Basic net income per share before cumulative effect of change in accounting principle <sup>(6)</sup>	\$ .13	\$ .30	\$ 1.30	\$ .97	\$ .61
Cumulative effect of change in accounting principle on basic net income per share	—	—	—	(.02)	—
Basic net income per share after cumulative effect of change in accounting principle	\$ .13	\$ .30	\$ 1.30	\$ .95	\$ .61
Diluted net income per share before cumulative effect of change in accounting principle <sup>(6)</sup>	\$ .13	\$ .30	\$ 1.22	\$ .94	\$ .59
Cumulative effect of change in accounting principle on diluted net income per share	—	—	—	(.01)	—
Diluted net income per share after cumulative effect of change in accounting principle	\$ .13	\$ .30	\$ 1.22	\$ .93	\$ .59
<b>Selected Operating Data:</b>					
Active customers <sup>(7)</sup>	469,000	471,000	626,000	732,000	684,000
Catalogs distributed	28,765,000	41,683,000	45,028,000	47,325,000	42,150,000
Orders entered <sup>(8)</sup>	1,243,000	1,265,000	1,521,000	1,622,000	1,510,000
Average order size <sup>(8)</sup>	\$ 1,135	\$ 1,116	\$ 1,115	\$ 781	\$ 580
	<b>December 31,</b>				
	2002	2001	2000	1999	1998
	<i>(dollars in thousands)</i>				
<b>Balance Sheet Data:</b>					
Working capital	\$ 91,289	\$ 120,442	\$ 111,048	\$ 71,899	\$ 53,768
Total assets	268,682	243,645	249,514	223,040	164,510
Short-term debt	200	1,171	1,153	1,137	123
Long-term debt (less current maturities):					
Capital lease obligations	6,421	6,621	6,792	6,945	7,081
Note payable	—	—	1,000	2,000	—
Total stockholders' equity	150,144	146,762	138,066	93,872	69,676

<sup>(1)</sup> Represents amounts accrued or distributed in excess of aggregate annual base salaries approved by the Board of Directors prior to the Company's Initial Public Offering and generally represented Company-related federal income tax obligations payable by the stockholders.

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- (2) Includes \$886 for the cost of reductions in the Company workforce and \$750 for costs relating to the Microsoft settlement in 2002 and includes \$1,510 for the cost of reductions in the Company's workforce and \$694 for costs relating to a proposed acquisition that was abandoned during the year in 2001.
- (3) For all periods prior to March 6, 1998, the Company had been an S Corporation and, accordingly, had not been subject to federal income taxes.
- (4) Represents cumulative effect of change in accounting principle for the adoption of Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements."
- (5) Pro forma adjustments have been made to the historical results of operations to make the pro forma presentation comparable to what would have been reported had the Company operated as a C Corporation for 1998. The computation of income tax expense was made assuming an effective tax rate of approximately 39%.
- (6) All per share data has been adjusted for a 3-for-2 stock split distributed on May 23, 2000.
- (7) Represents estimates of all customers included in the Company's mailing list who have made a purchase within the last twelve month period.
- (8) Does not reflect cancellations or returns.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the Company's consolidated financial statements.*

*The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements based on management's current expectations, estimates and projections about the Company's industry, management's beliefs and certain assumptions made by management. All statements, trends, analyses and other information contained in this report relative to trends in net sales, gross margin and anticipated expense levels, as well as other statements, including words such as "anticipate", "believe", "plan", "estimate" and "intend" and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth under the caption "Factors That May Affect Future Results and Financial Condition" included within this section. Particular attention should be paid to the cautionary statements involving 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. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission.*

#### ***Application of Significant Accounting Policies and Estimates***

The consolidated financial statements of PC Connection are prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses during the periods presented. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

#### **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

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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 to the customer at the point of shipment or (ii) have FOB – destination specifically set out in our arrangements with federal agencies, 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 No. 48 (“SFAS No. 48”), “Revenue Recognition When Right of Return Exists”, based on significant historical experience. Should such returns no longer prove estimable, we believe that the impact on our financials would not necessarily be significant since the return privilege expires 30 days after shipment.

### **Accounts Receivable**

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and customers’ current credit worthiness. Our allowance is generally computed by (1) applying specific percentage reserves on accounts that are past due; and (2) specifically reserving for customers known to be in financial difficulty. Therefore, if the financial condition of certain of our customers were to deteriorate, or if we noted there was a lengthening of the timing of the settlement of receivables that was symptomatic of a general deterioration in the ability of our customers to pay, we would have to increase our allowance for doubtful accounts. This would negatively impact our earnings and our cash flows.

In addition to accounts receivable from customers, we record receivables from our vendors/suppliers for cooperative advertising, price protection, supplier reimbursements, rebates and other similar arrangements. A portion of such receivables is estimated based on information available from our vendors at discrete points in time. While such estimates have historically approximated actual cash received, an unanticipated change in a promotional program could give rise to a reduction in the receivable. This could negatively impact our earnings and our cash flows.

Considerable judgment is used in assessing the ultimate realization of customer receivables and vendor/supplier receivables, including reviewing the financial stability of a customer, vendor information and gauging current market conditions. If our evaluations are incorrect, we may incur future charges to our income statement.

### **Inventories – Merchandise**

Inventories (all finished goods) consisting of software packages, computer systems and peripheral equipment are stated at cost (determined under the first-in, first-out method) or market, whichever is lower. Inventory quantities on hand are reviewed regularly, and provisions are made for obsolete, slow moving and nonsalable inventory, based primarily on management’s forecast of customer demand for those products in inventory. The PC industry is characterized by rapid technological change and new product development that could result in increased obsolescence of inventory on hand. Increased obsolescence or decreased customer demand beyond management’s expectations could require additional provisions. This could negatively impact our earnings and our cash flows. Our obsolescence charges have historically approximated \$5 million per annum. There have been no unusual charges precipitated by specific technological or forecast issues.

### **Value of Long-Lived Assets, Including Intangibles**

We carry a variety of long-lived assets on our balance sheet. These are all currently classified as held for use. These include property and equipment, identifiable intangibles and goodwill. An impairment review is undertaken on (1) an annual basis for assets such as goodwill and indefinite lived intangible assets; and (2) on an event-driven basis for all long-lived assets (including indefinite lived intangible assets and goodwill) when facts and circumstances suggest that cash flows emanating from such assets may be diminished. We may review the carrying value of all these assets based partly on our projections of anticipated cash flows — projections which

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are, in part, dependent upon anticipated market conditions, operational performance and legal status. Any impairment charge that is recorded negatively impacts our earnings. Cash flows are generally not impacted.

Over the last several years, we have incurred no significant impairment charges. While we believe that our future estimates are reasonable, different assumptions regarding items such as future cash flows and the volatility inherent in markets which we serve could materially effect our valuations and result in impairment charges against the carrying value of those assets.

### **Employee Compensation Benefits**

Our employee compensation model has several elements that we would consider variable. These include our obligation to our employees for health care. We have selected a plan that results in our being self-insured up to certain stop-loss limits. Accordingly, we have to estimate the amount of health care claims outstanding at a given point in time. These estimates are based on historical experience and could be subject to change. Such change could negatively impact both our earnings and our cash flows.

We also provide stock option grants to our employees. In general, such grants have been made at the current fair value of our stock and accordingly, given that we account for option awards under APB Opinion 25, "Accounting for Stock Issued to Employees," no compensation charge has been recorded. In previous years, most specifically those years prior to our initial public offering, there was a difference between the strike price of the option and the then current fair value of the stock. This difference resulted in a fixed and determinable compensation charge. We have not modified option grants in a manner that would cause either re-measurement of the awards or the commencement of variable accounting.

We have also engaged in workforce reduction actions in 2002 and 2001. These actions included formula driven termination benefits. These benefits were or are being paid relatively quickly and have not been subject to change. We do not foresee a circumstance where there could be significant variability in our workforce reduction estimates. However, if we did experience significant variability, such change could negatively impact our cash flows.

### ***Overview***

PC Connection was founded in 1982 as a mail-order business offering a broad range of software and accessories for IBM and IBM-compatible personal computers. The founders' goal was to provide consumers with superior service and high quality branded products at competitive prices. Currently, we offer a wide range of information technology products and services – including computer systems, software and peripheral equipment, networking communications and other products and accessories. We operate through three primary business segments (a) consumers and small- to medium size businesses through our PC Connection Sales subsidiary, (b) federal, state and local government and educational institutions through our GovConnection subsidiary and (c) in 2002, large corporate accounts through our newly acquired subsidiary, MoreDirect, Inc. We generate sales through (i) outbound telemarketing and field sales by account managers focused on the business, education and government markets, (ii) inbound calls from customers responding to our catalogs and other advertising and (iii) our Internet Web sites.

Sales of computer systems result in a relatively high dollar sales order, as reflected in the increase in our average order size from \$580 in the year ended December 31, 1998 to \$1,135 in the year ended December 31, 2002. Computer systems generally provide the largest gross profit dollar contribution per order of all our products, although they usually yield the lowest gross margin percentage. The weakness in demand for information technology products experienced by us in 2001, however, continued through 2002, resulting in overall conservative buying patterns, order deferrals and longer sales cycles, as well as greater competition and slightly lower profit margins.

Our profit margins are also influenced by, among other things, industry pricing and the relative mix of SMB versus Public Sector and large corporate account sales, and within the SMB segment, inbound versus outbound

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sales. Generally, pricing in the computer and related products market is very aggressive, and we intend to maintain prices at competitive levels. The gross margin on sales to corporate accounts that purchase at volume discounts is generally lower than gross margins on consumer or smaller business sales. However, the gross profit dollar contribution per order is generally higher as average order sizes of orders to such corporate accounts are usually larger. We believe that sales to larger businesses will continue to represent a growing portion of our business mix in future periods.

The direct marketing of personal computers and related products is highly competitive. In addition to other direct marketers and manufacturers who sell direct, such as Dell and Gateway, manufacturers of PCs sold by us, such as Apple, Hewlett-Packard and IBM, have also implemented varying plans to sell PCs directly to end users. We currently believe that direct sales by Hewlett-Packard and IBM will not have a significant adverse effect upon our net sales.

Most product manufacturers provide us with co-op advertising support in exchange for product coverage in our catalogs. Although the level of co-op advertising support available to us from certain manufacturers has declined, and may decline further in the future, the overall level of co-op advertising programs has remained consistent with our levels of spending for catalog and other advertising programs. We believe that the overall levels of co-op advertising programs available over the next twelve months will be consistent with our planned advertising programs.

### ***Results of Operations***

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

	Years Ended December 31,		
	2002	2001	2000
Net sales (in millions)	\$1,191.5	\$1,186.2	\$1,440.2
Net sales	100.0%	100.0%	100.0%
Gross profit	10.8	11.1	12.2
Selling, general and administrative expenses	10.2	9.9	8.6
Restructuring costs and other special charges	0.1	0.2	0.0
Income from operations	0.5	1.0	3.6

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

	Years Ended December 31,		
	2002	2001	2000
<b>Business Segment</b>			
SMB	59%	76%	83%
Public Sector	25	24	17
Large Accounts	16	—	—
Total	100%	100%	100%
<b>Sales Channel</b>			
Outbound Telemarketing and Field Sales	78%	79%	76%
Inbound Telesales	7	12	16
Online Internet	15	9	8
Total	100%	100%	100%
<b>Product Mix</b>			
Notebooks	15%	22%	25%
Desktop/Servers	15	12	15
Storage Devices	9	10	10
Software	14	13	10
Networking Communications	8	9	8
Printers	9	8	7
Video & Monitors	10	9	8
Memory	4	3	4
Accessories/Other	16	14	13
Total	100%	100%	100%

Sales of enterprise server and networking products (included in the above product mix) were 22.4%, 19.8%, and 17.4% of net sales for the years ended December 31, 2002, 2001, and 2000, respectively.

### **Year Ended December 31, 2002 Compared to Year Ended December 31, 2001**

Net sales increased marginally to \$1,191.5 million in 2002 from \$1,186.2 million in 2001. The increase was due primarily to our acquisition of MoreDirect, Inc. ("MoreDirect") in early April 2002, which accounted for \$194.1 million of our 2002 sales. Absent that acquisition, net sales would have decreased by \$188.8 million, due to the continuing weakness in demand for information technology products, especially with our small- and medium-size business customers.

Net changes in sales by business segment were as follows:

- Net sales for our SMB segment decreased by \$192.7 million, or 21.5%, to \$703.5 million in 2002 from \$896.2 million in 2001. Our sales to consumers and small businesses, which make up a large portion of this segment, were negatively impacted during the continuing economic slowdown. We believe that sales to consumers and small businesses will continue to be more heavily impacted than sales to larger business customers if the economic slowdown continues.
- Net sales for our Public Sector segment remained relatively flat at \$293.9 million in 2002, as compared to \$290.1 million in 2001. The increased level of our sales to federal government agencies in the fourth quarter of 2001 after the September 11<sup>th</sup> disaster extended into the first quarter of 2002.

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- Net sales for our Large Account segment, newly established in 2002 with our acquisition of MoreDirect, Inc., were \$194.1 million.

Net changes in sales by sales channel were as follows:

- Outbound sales, which include MoreDirect and GovConnection sales, decreased \$20.0 million, or 2.1%, to \$922.7 million from \$942.7 million in 2001. Excluding MoreDirect, our outbound sales decreased by \$147.0 million, or 15.6%, reflecting the economic slowdown affecting the SMB customers referred to above.
- Inbound sales, which primarily serve our consumer and very small business customers in our SMB segment, decreased \$53.4 million, or 38.0%, to \$87.1 million from \$140.5 million in 2001 for the reasons stated above.
- Online Internet sales increased \$78.7 million, or 76.4%, to \$181.7 million from \$103.0 million in 2001, due primarily to the acquisition of MoreDirect, which accounted for \$67.0 million of the increase. Excluding MoreDirect, the increase in our online Internet sales was \$11.7 million, or 11.4%, as more of our corporate and public sector customers migrated to placing orders online through our Internet website.

We believe that the inbound sales channel will continue to produce a declining percentage of our total sales as we migrate to larger business and public sector customers. We also expect the migration of customers to our website to continue, which will increase the percentage of online Internet sales.

Net sales of enterprise server and networking products increased 13.9% to \$267.3 million in 2002 as compared to \$234.7 million in 2001. Enterprise server and networking products represented 22.4% of overall net sales for the year, up from 19.8% for the year ended 2001. MoreDirect sales of enterprise products, however, accounted for \$50.8 million of our 2002 sales; excluding MoreDirect, our sales of these products decreased by 7.8%, comparable to the overall decrease in sales explained above. We believe that sales of these product categories will grow as a percentage of our net sales, as customers further upgrade their network and communication infrastructures. However, if economic conditions do not improve in the near term, the sales growth of these types of products will not likely grow as we anticipate.

As of December 31, 2002, the number of outbound sales account managers totaled 479, compared to 464 account managers at the end of 2001. The 2002 total includes 72 MoreDirect account managers. Excluding MoreDirect, our outbound sales account managers decreased by 12.3%. The decrease is the result of staff reductions relating to our ongoing evaluation of sales productivity. We are continuing to focus on evaluating and improving the productivity and success rate of our account managers as well as recruiting more experienced account managers.

*Gross profit* decreased \$2.4 million to \$129.2 million in 2002 from \$131.6 million in 2001. MoreDirect accounted for \$21.0 million of our 2002 gross margin; excluding MoreDirect, the decrease in gross margin was \$23.4 million, or 17.8%. The decrease in gross profit dollars was attributable to the changes in net sales described above, together with a decrease in gross profit margin. Gross profit margin decreased from 11.1% in 2001 to 10.8% in 2002 due to a more competitive pricing environment and other market conditions. Our gross profit margins are influenced by, among other things, industry pricing, customer segment and relative product mix. Generally pricing in the computer and related products market is very aggressive, and we intend to maintain prices at competitive levels. Sales to our SMB customers generally carry higher gross margins than our sales to Large Accounts or Public Sector customers. Additionally, sales of enterprise server and networking products generally carry higher gross margins than sales of desktops and notebook computers. Our gross margin may vary based upon vendor support programs, product mix, pricing strategies, market conditions and other factors.

*Selling, general and administrative expenses* increased \$4.4 million to \$122.0 million in 2002 from \$117.6 million in 2001 and increased as a percentage of sales to 10.2% in 2002 from 9.9% in 2001. MoreDirect's selling, general and administrative expenses accounted for \$10.7 million of the 2002 total, or 5.5% of its sales. Personnel costs generally account for approximately two-thirds of our selling, general and administrative ("SG&A")

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expenses. SG&A expense continues to increase as a percentage of sales because we have implemented additional sales growth initiatives and improved marketing programs. While we plan to increase our focus on controlling discretionary expenditures, we expect that our SG&A expense may vary depending on changes in sales volume, as well as the levels of continued investments in key growth initiatives such as hiring more experienced outbound sales account managers, improving marketing programs, and deploying next generation Internet Web technology to support the sales organization.

*Restructuring costs and other special charges* totaled \$1.6 million and \$2.2 million for the years ended December 31, 2002 and 2001, respectively. On March 15, 2002, we announced that we had settled litigation commenced by Microsoft Corporation involving alleged trademark and copyright infringement. While denying these allegations, we recorded \$0.8 million in settlement costs and legal fees related to this matter. We also recognized \$0.9 million in charges related to staff reductions in 2002. In 2001 we recognized \$1.5 million in charges related to staff reductions and \$0.7 million for costs associated with proposed acquisitions abandoned during the year.

A roll forward of restructuring costs and other special charges for the two years ended December 31, 2002 is shown below. There were no changes in estimates in any of the periods presented.

	Workforce Reductions	Litigation Settlement	Abandoned Acquisition	Total
	(in thousands)			
Balance January 1, 2001	\$ —	\$ —	\$ —	\$ —
Charges	1,510	—	694	2,204
Cash payments	(1,085)	—	(694)	(1,779)
Balance December 31, 2001	425	—	—	425
Charges	886	750	—	1,636
Cash payments	(1,103)	(750)	—	(1,853)
Balance December 31, 2002	\$ 208	\$ —	\$ —	\$ 208

*Income from operations* decreased by \$6.2 million, or 52.5%, to \$5.6 million for the year ended December 31, 2002 from \$11.8 million for the comparable period in 2001. MoreDirect accounted for \$10.3 million of our income from operations in 2002. Excluding MoreDirect, our income from operations decreased by \$16.5 million, to a loss of \$4.7 million. Income from operations as a percentage of net sales decreased from 1.0% in 2001 to 0.5% in 2002. These decreases were attributable to the changes in net sales as discussed above.

*Interest expense* of \$1.2 million was recorded in both 2002 and 2001. Interest expense remained flat due to higher average borrowings outstanding offset by lower interest rates in 2002 as compared to 2001.

Our effective tax rate was 34.4% for 2002 and 38.0% for 2001. This year-over-year decrease was due to our recognition of a New Hampshire business enterprise tax credit in 2002. The relative size of our tax provision, \$1,700, tends to magnify the beneficial impact of such credit on a percentage basis. However, we anticipate that our effective tax rate will approximate a 40% level in 2003 due to the expected changes and mix of state income taxes.

*Net income* decreased by \$4.2 million, or 56.8%, to \$3.2 million in 2002 from \$7.4 million in 2001, principally as a result of the decrease in income from operations. MoreDirect's net income was \$6.3 million in 2002. Excluding MoreDirect, our operations incurred a net loss of \$3.1 million.

### **Year Ended December 31, 2001 Compared to Year Ended December 31, 2000**

*Net sales* decreased \$254.0 million, or 17.6%, to \$1,186.2 million in 2001 from \$1,440.2 million in 2000. The decrease in net sales was due to the weakness in demand for information technology products. This weakness intensified in the SMB segment by the impact of the September 11<sup>th</sup> disaster in 2001.

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Net changes in sales by business segment were as follows:

- Net sales for our SMB segment decreased by \$301.3 million, or 25.2%, to \$896.2 million in 2001 from \$1,197.5 million in 2000. Our sales to consumers and small businesses were more negatively impacted during the 2001 economic slowdown than were sales to our larger business customers.
- Net sales for our Public Sector segment increased by \$47.4 million, or 19.5%, to \$290.1 million in 2001 from \$242.7 million in 2000. Sales to federal government agencies increased significantly in the fourth quarter of 2001 in the aftermath of the September 11<sup>th</sup> disaster, as federal agencies were in desperate need of additional information technology products to handle the emergency.

Net changes in sales by sales channel were as follows:

- Outbound sales decreased \$148.0 million, or 13.6%, to \$942.7 million from \$1,090.7 million in 2000. While there was an overall decrease in outbound sales, this channel increased as an overall component of our business. Outbound sales increased by 3% as a percentage of overall net sales to 79% in 2001 as compared to 76% in 2000.
- Inbound sales, which primarily serve our consumer and very small business customers decreased \$96.1 million, or 40.6%, to \$140.5 million, from \$236.6 million in 2000.
- Online Internet sales decreased \$10.0 million, or 8.8%, to \$103.0 million from \$113.0 million in 2000, however online Internet sales increased to 9% of total net sales in 2001, as compared to 8% of total net sales in 2000.

Net sales of enterprise server and networking products decreased 6.6% to \$234.7 million in 2001 as compared to \$251.3 million in 2000. Enterprise server and networking products represented 19.8% of overall net sales for the year, up from 17.4% for the year ended 2000. While sales of these products declined in absolute dollar amounts in 2001, we believe that sales of these product categories will continue to grow as a percentage of our net sales, as customers further upgrade their network and communication infrastructures. If economic conditions do not improve in the near term, the anticipated growth of these types of products will not likely occur as expected.

As of December 31, 2001, the number of outbound sales account managers totaled 464, a 19.3% decrease, compared to 575 account managers at the end of 2000. The decrease is primarily the result of staff reductions relating to our continuing evaluation of sales productivity, particularly in our SMB segment. The number of sales account managers at December 31, 2001 in our Public Sector segment increased to 88, compared to 75 at December 31, 2000.

*Gross profit* decreased \$44.1 million, or 25.1%, to \$131.6 million in 2001 from \$175.7 million in 2000. The decrease in gross profit dollars was attributable to the net changes in net sales described above. Gross profit margin decreased from 12.2% in 2000 to 11.1% in 2001 due to a more competitive pricing environment, and other market conditions. Our gross profit margins are influenced by, among other things, industry pricing, customer segment and relative product mix. Generally pricing in the computer and related products market is very aggressive, and we intend to maintain prices at competitive levels. Sales to our SMB customers generally carry higher gross margins than our sales to Public Sector customers. Our profit margins are also influenced by the relative mix of sales by channel (inbound, outbound and online Internet sales). Our gross margin may vary based upon vendor support programs, product mix, pricing strategies, market conditions and other factors.

*Selling, general and administrative expenses* decreased \$6.2 million, or 5.0%, to \$117.6 million in 2001 from \$123.8 million in 2000 but increased as a percentage of sales to 9.9% in 2001 from 8.6% in 2000. SG&A varies depending on changes in sales volume, as well as the levels of continued investments in key growth initiatives such as hiring more experienced outbound sales account managers, improving marketing programs, and deploying next generation Internet Web technology to support the sales organization.

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*Restructuring costs and other special charges* totaling \$2.2 million, were recorded in the year 2001. These costs related to staff reductions of \$1.5 million, and \$0.7 million of costs associated with proposed acquisitions abandoned during the year.

A rollforward of restructuring costs and other special charges for the twelve months ended December 31, 2001 is shown below. There were no changes in estimates in the interim periods.

	<u>Workforce Reductions</u>	<u>Litigation Settlement</u>	<u>Abandoned Acquisition</u>	<u>Total</u>
	(in thousands)			
Balance January, 2001	\$ —	\$ —	\$ —	\$ —
Charges	1,510	—	694	2,204
Cash payments	(1,085)	—	(694)	(1,779)
Balance December 31, 2001	<u>\$ 425</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 425</u>

*Income from operations* decreased by \$40.0 million, or 77.2%, to \$11.8 million for the year ended December 31, 2001 from \$51.8 million for the comparable period in 2000. Income from operations as a percentage of net sales decreased from 3.6% in 2000 to 1.0% in 2001 for the reasons net sales decreased as discussed above.

*Interest expense* decreased by \$0.9 million, or 42.9%, to \$1.2 million in 2001 from \$2.1 million in 2000. This decrease in interest expense was attributed to lower average borrowings outstanding in 2001 as compared to 2000 and to lower interest rates.

Our effective tax rate was 38% for both 2001 and 2000.

*Net income* decreased by \$23.8 million, or 76.3%, to \$7.4 million in 2001 from \$31.2 million in 2000, principally as a result of the decrease in income from operations.

### ***Liquidity and Capital Resources***

We have historically financed our operations and capital expenditures through cash flow from operations and bank borrowings. We believe that funds generated from operations, together with available credit under our bank line of credit, will be sufficient to finance our working capital and capital expenditure requirements at least for the next twelve calendar months. 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 continues to decline, our cash flows from operations may be substantially affected. See also those risks listed below under "Factors That May Affect Future Results and Financial Condition."

At December 31, 2002, we had cash and cash equivalents of \$1.8 million and working capital of \$91.3 million.

Net cash provided by operating activities was \$5.0 million in the year ended December 2002, compared to \$34.2 million provided by operating activities and \$4.0 million used for operating activities for the years ended December 31, 2001, and 2000, respectively. The primary factors historically affecting cash flows from operations are net income and changes in the levels of accounts receivable, inventories and accounts payable.

At December 31, 2002, we had \$85.5 million in outstanding accounts payable. Such accounts are generally paid within 30 days of incurrence and will be financed by cash flows from operations or short-term borrowings

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under the line of credit. This amount includes \$9.9 million payable to two financial institutions under security agreements to facilitate the purchase of inventory. 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.

Capital expenditures were \$5.1 million, \$6.1 million and \$12.6 million in the years ended December 31, 2002, 2001, and 2000, respectively. We expect capital expenditures, primarily for the purchase of computer hardware and software and other fixed assets, to be approximately \$3.6 million for the year ending December 31, 2003 and anticipate funding these capital expenditures from cash flows from operations.

In May 2002, we entered into a \$45 million credit facility secured by substantially all of our business assets. In July 2002, as required under the terms of the credit facility, an additional lender committed to fund \$10.0 million of the \$45 million facility. Had we not secured this additional lender, the credit facility would have been reduced to \$35 million in July. Amounts outstanding under this facility bear interest at the prime rate (4.25% at December 31, 2002). The credit facility includes various customary financial and operating covenants, minimum net worth and maximum funded debt ratio requirements, including restrictions on the payment of dividends, none of which we believe significantly restricts our operations. The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at December 31, 2002 was only 0.19 to 1.0. Funded debt ratio is the ratio of average outstanding advances under the facility to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation and Amortization). Borrowing availability under the agreement is further limited to twice the amount of EBITDA for the trailing four quarters; such availability was \$37.9 million at December 31, 2002.

No borrowings were outstanding under this credit facility at December 31, 2002. The credit facility matures on June 30, 2004, at which time amounts outstanding become due.

The merger agreement with MoreDirect contemplates an earn-out period of three years following the closing whereby if MoreDirect maintains certain earnings before income tax, or EBIT, levels, additional payments will be made to MoreDirect's shareholder. Under the merger agreement, earn-out payments are tied to EBIT levels targeted to grow at a 15% rate per year. The maximum payments we will make under the earn-out provisions of the merger agreement are \$67.1 million, assuming MoreDirect maintains 200% of targeted EBIT levels for all three years. If MoreDirect maintains less than 60% of targeted EBIT levels for all three years, no payment would be required under the earn-out provisions of the merger agreement. At any time during the earn-out period, we may "buy-out" the remaining earn-out payments for amounts which vary during the term of the earn-out. We accrued a liability to MoreDirect's shareholder for \$10.8 million in earn-out consideration for the year ended December 31, 2002. We also escrowed \$10.0 million at closing to fund a portion of these contingent payments, of which \$5.0 million will be used to satisfy a portion of the liability at December 31, 2002. We believe we will be able to meet our obligations to MoreDirect and its shareholder under the merger agreement.

### Contractual Obligations

The following summarizes our contractual obligations at December 31, 2002 and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

December 31, 2002	Total	Less Than 1 Year	1 - 3 Years	After 3 Years
		<i>(in thousands)</i>		
<b>Contractual Obligations:</b>				
Capital lease obligation to affiliate	\$ 6,621	\$ 200	\$ 1,121	\$ 5,300
Non-cancelable operating lease obligations	7,785	3,963	3,577	245
<b>Total Contractual Obligations</b>	<b>\$14,406</b>	<b>\$ 4,163</b>	<b>\$ 4,698</b>	<b>\$ 5,545</b>

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We also have potential contractual liabilities based on the MoreDirect earn-out. These are described above.

In November 1997, we entered into a fifteen-year lease for our corporate headquarters with an affiliated company, G&H Post, which is related to PC Connection through common ownership. The lease requires us to pay our proportionate share of real estate taxes and common area maintenance charges as additional rent and also to pay insurance premiums for the leased property. We have the option to renew the lease for two additional terms of five years each. The lease has been recorded as a capital lease in the financial statements.

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.

**Other Related Parties Transactions**

We have other transactions with affiliate companies including G&H, LLP, G&H Post, LLC, En Technology Corporation, and PCTV, Inc. all related to PC Connection through common ownership. Such transactions are determined using the fair market values of such services or products.

	Year Ended December 31,		
	2002	2001	2000
	<i>(in thousands)</i>		
<b>Revenue:</b>			
Sales of various products	\$ 3	\$ 3	\$ 3
Sales of services to affiliated companies	132	148	300
<b>Costs:</b>			
Purchase of services from affiliated companies	1	1	9

**Recently Issued Financial Accounting Standards**

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and replaces Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." It requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The restructuring activities undertaken by us prior to the issuance of this statement have been appropriately accounted for under EITF 94-3.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently in a tabular format. Additionally, SFAS No. 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of SFAS No. 148 are effective for the fiscal year ended December 31, 2002. We do not expect to change to the fair value based method, therefore, SFAS No. 148 will not have a material effect on our results of operations or financial position. The disclosure provisions of SFAS No. 148 have been adopted currently.

In November 2001, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer," which addresses the income statement characterization of consideration given by a vendor to a customer and provides guidance on recognizing and measuring sales incentives. EITF Issue No. 01-09 is effective for fiscal year 2003. We have not yet determined the impact, if any, of adopting this guidance.

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In November 2002, the EITF reached a final consensus on Issue No. 02-16, "Accounting by a Reseller for Cash Consideration Received from a Vendor," which addresses how a reseller of a vendor's product should account for cash consideration received from a vendor. The EITF issued guidance on the following two issues, as follows: (1) cash consideration received from a vendor should be recognized as a reduction of cost of sales in the reseller's income statement, unless the consideration is a reimbursement for selling costs or payment for assets or services delivered to the vendor, and (2) performance-driven vendor rebates or refunds (e.g., minimum purchase or sales volumes) should be recognized as a reduction of cost of sales only if the payment is considered probable, and the method of allocating such payments in the financial statements should be systematic and rational based on the reseller's progress in achieving the underlying performance targets. The provisions of EITF 02-16 will be effective for our fiscal year beginning January 1, 2003. We have not yet determined the impact, if any, of adopting this newly issued guidance.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which requires that, for guarantees within the scope of FIN 45 issued or amended after December 31, 2002, a liability for the fair value of the obligation undertaken in issuing the guarantee be recognized. FIN 45 also requires additional disclosures in financial statements for periods ending after December 15, 2002. Accordingly, these new disclosures are included in Note 13 to the consolidated financial statements. It is not expected that the recognition and measurement provisions of FIN 45 will have a material effect on our results of operations or financial position.

### ***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.

### ***Factors That May Affect Future Results and Financial Condition***

Our future results and financial condition are dependent on our ability to continue to successfully market, sell and distribute information technology products and services, including computers, hardware and software. Inherent in this process are a number of factors that we must successfully manage in order to achieve a favorable financial condition and favorable operating results. Potential risks and uncertainties that could affect our future financial condition and operating results include, without limitation, the following factors:

#### **There has been a decrease in demand throughout the industry for the products we sell.**

The general decline in the economy over the past two years, has resulted in a decrease in demand for personal computer products throughout the industry. This decrease adversely affected our sales and results of operations in 2002. If our net sales do not increase in proportion to our operating expenses or if we experience a decrease in net sales for an extended period of time, there would be a material adverse effect on our results of operations in future periods.

#### **We have experienced rapid growth in recent years followed by a decline in sales in 2002 and 2001, and there is no assurance that we will be able to regain such growth.**

Our net sales grew from \$749.9 million for the year ended December 31, 1998 to \$1.44 billion for the year ended December 31, 2000. In the year ended December 31, 2001 and 2002, our net sales declined to \$1.19 billion. We believe we would have experienced a greater decline in our net sales for 2002 if it had not been for our acquisition of MoreDirect. Our growth in previous years placed increasing demands on our administrative, operational, financial and other resources. Our staffing levels and operating expenses increased substantially in recent years due to our sales forecasts. If our revenues continue to decline, we may not be able to reduce our

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staffing levels and operating expenses in a timely manner to meet our needs. Moreover, we can provide no assurance that we will be able to regain rapid growth in the near future.

### **We may also experience quarterly fluctuations and seasonality which could impact our business.**

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

We base our operating expenditures on sales forecasts. If revenues do not meet expectations in any given quarter, our operating results could suffer.

In addition, customer response rates for our catalogs and other marketing vehicles are subject to variations. The first and last quarters of the year generally have higher response rates while the two middle quarters typically have lower response rates.

### **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, to place larger than typical inventory stocking orders, and increase 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 also taking steps to reduce their inventory exposure by supporting “build to order” programs authorizing distributors and resellers to assemble computer hardware under the manufacturers’ brands. These trends reduce the costs to manufacturers and shift the burden of inventory risk to resellers like us which could negatively impact our business.

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

We acquire products for resale both directly from manufacturers and indirectly through distributors and other sources. The five vendors supplying the greatest amount of goods to us constituted 67%, 63%, and 55% of our total product purchases in the years ended December 31, 2002, 2001, and 2000, respectively. Among these five vendors, purchases from Ingram Micro, Inc. represented 28%, 25%, and 26% of our total product purchases in the years ended December 31, 2002, 2001, and 2000, respectively. Purchases from Tech Data Corporation comprised 14% of our total product purchases in both the years ended December 31, 2002 and 2001 and 11% in the year ended December 31, 2000. Effective May 3, 2002, Hewlett-Packard Company (HP) completed its acquisition of Compaq Computer Corporation. Had this acquisition been completed at the beginning of the periods presented, our purchases made directly from HP, on a pro forma basis, would have constituted 15%, 12%, and 4% of our total product purchases in the years ended December 31, 2002, 2001, and 2000, respectively. No other vendor supplied more than 10% of our total product purchases in the years ended December 31, 2002, 2001, and 2000. If we were unable to acquire products from Ingram, Tech Data or HP, we could experience a short-term disruption in the availability of products and such disruption could have a material adverse effect on our results of operations and cash flows.

Substantially all of our contracts and arrangements with our vendors that supply significant quantities of products are terminable by such vendors or us without notice or upon short notice. Most of our product vendors provide us with trade credit, of which the net amount outstanding at December 31, 2002 was \$85.5 million. Termination, interruption or contraction of relationships with our vendors, including a reduction in the level of trade credit provided to us, could have a material adverse effect on our financial position.

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

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

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

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

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

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

The direct marketing industry and the computer products retail business, in particular, are highly competitive. We compete with consumer electronics and computer retail stores, including superstores. We also

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compete with other direct marketers of hardware and software and computer related products, including an increasing number of Internet retailers. Certain hardware and software vendors are selling their products directly through their own catalogs and over the Internet. We compete not only for customers, but also for co-op advertising support from personal computer product manufacturers. Some of our competitors have greater financial, marketing and larger catalog circulations and customer bases 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 more aggressive pricing policies than us. We expect competition to increase as retailers and direct marketers who have not traditionally sold computers and related products enter the industry.

We cannot assure you that we can continue to compete effectively against our current or future competitors. In addition, price is an important competitive factor in the personal computer hardware and software market and we cannot assure you that we will not face increased price competition. If we encounter new competition or fail to compete effectively against our competitors, our business may be harmed.

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 rely on key government contracts, the loss of which could harm our financial condition.**

We are a party to several significant contracts with state and federal government agencies. Sales to state and federal government agencies represented 25% of our net sales in 2002. We expect that our sales to state and federal government agencies will increase as a percentage of our consolidated revenues for the foreseeable future. Our current arrangements with these government agencies allow them to cancel orders with little or no notice and do not require them to purchase products from us in the future. Moreover, any and all orders relating to the federal government may be subject to renegotiation of profits or termination at the election of the federal government. The loss of one or more of these significant contracts with state and federal government agencies could negatively affect our results of operations and financial condition.

### **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

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various manufacturers. Some of our vendors, including Apple, Hewlett-Packard and IBM, 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.

### **Interruptions could result from natural disasters as well as power loss, telecommunications failure and similar events.**

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 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 amount of sales made over the Internet in part because of the growing use and acceptance of the Internet by end-users. No one can be certain that acceptance and use of the Internet will continue to develop or that a sufficiently broad base of consumers will adopt and continue to use the Internet and other online services as a medium of commerce. Sales of computer products over the Internet do not currently represent a significant 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 infrastructure for providing Internet access and services. If the number of Internet users or their use of Internet resources continues to grow rapidly, such growth may overwhelm the existing Internet infrastructure. Our ability to increase the speed with which we provide services to customers and to increase the scope of such services ultimately is limited by and reliant upon the speed and reliability of the networks operated by third parties and these networks may not continue to be developed.

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

We ship approximately 70% of our products to customers by Airborne Freight Corporation D/B/A "Airborne Express", with the remainder being shipped by United Parcel Service of America, Inc. and other overnight delivery and surface services. A strike or other interruption in service by these shippers could adversely affect our ability to market or deliver products to customers on a timely basis.

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**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 Airborne Express whereby Airborne ships products to our customers. We believe that we have negotiated favorable shipping rates with Airborne. 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 Airborne.

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 or use tax.**

We presently collect sales tax on sales of products to residents in many states. Taxable sales to customers were approximately 27% of our net sales during the year ended December 31, 2002. Various states have sought to impose on direct marketers the burden of collecting state sales taxes on the sales of products shipped to their residents. In 1992, the United States Supreme Court affirmed its position that it is unconstitutional for a state to impose sales or use tax collection obligations on an out-of-state mail order company whose only contacts with the state are limited to the distribution of catalogs and other advertising materials through the mail and the subsequent delivery of purchased goods by United States mail or by interstate common carrier. However, legislation that would expand the ability of states to impose sales tax collection obligations on direct marketers has been introduced in Congress on many occasions. Due to its presence on various forms of electronic media and other factors, our contact with many states may exceed the contact involved in the Supreme Court case. We cannot predict the level of contact that is sufficient to permit a state to impose on us a sales tax collection obligation. If the Supreme Court changes its position or if legislation is passed to overturn the Supreme Court's decision, the imposition of a sales or use tax collection obligation on us in states to which we ship products would result in additional administrative expenses to us, could result in 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 71% of the outstanding shares of our common stock. Because of their beneficial stock ownership, these stockholders can continue to elect the members of the Board of Directors and decide all matters requiring stockholder approval at a meeting or by a written consent in lieu of a meeting. Similarly, such stockholders can control decisions to adopt, amend or repeal our charter and our bylaws, or take other actions requiring the vote or consent of our stockholders and prevent a takeover of us by one or more third parties, or sell or otherwise transfer their stock to a third party, which could deprive our stockholders of a control premium that might otherwise be realized by them in connection with an acquisition of us. Such control may result in decisions that are not in the best interest of our public stockholders. In connection with our initial public offering, the principal stockholders placed substantially all shares of common stock beneficially owned by them into a voting trust, pursuant to which they are required to agree as to the manner of voting such shares in order for the shares to be voted. Such provisions could discourage bids for our common stock at a premium as well as have a negative impact on the market price of our common stock.

**Item 7A. Quantitative and Qualitative Disclosure 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. We had no borrowings outstanding pursuant to the credit agreement as of December 31, 2002. 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, there were no borrowings outstanding on the credit agreement at December 31, 2002, and the average outstanding borrowings during the year were not material. Accordingly, the change in earnings resulting from a hypothetical 10% increase or decrease in interest rates is not material.

**Item 8. Consolidated Financial Statements and Supplementary Data**

The information required by this Item is included in this Report beginning at page F-1.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

The information included under the caption, "Executive Officers of PC Connection" in Item 4 of Part I hereof and the captions "Information Concerning Directors, Nominees and Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" in PC Connection's definitive Proxy Statement for our 2003 Annual Meeting of Stockholders to be held on June 3, 2003 (the "Proxy Statement") is incorporated herein by reference. We anticipate filing the Proxy Statement within 120 days after December 31, 2002. With the exception of the foregoing information and other information specifically incorporated by reference into this Form 10-K, the Proxy Statement is not being filed as a part hereof.

**Item 11. Executive Compensation**

The information under the caption, "Executive Compensation" in the Proxy Statement is incorporated herein by reference.

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**Item 12. Security Ownership of Certain Beneficial Owners and Management**

The information included under the heading “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in the Proxy Statement is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions**

The information under the heading “Certain Transactions and Relationships” in the Proxy Statement is incorporated herein by reference.

**Item 14. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

Based on their evaluation of PC Connection’s disclosure controls and procedures (as defined in Rules 13a-14(c) and 15(d)-14(c) under the Securities Exchange Act of 1934) as of a date within 90 days of filing this Annual Report on Form 10-K, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and are operating in an effective manner.

(b) Changes in Internal Controls

There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their most recent evaluation.

**PART IV**

**Item 15. Exhibits, Consolidated Financial Statements, Schedule, and Reports on Form 8-K**

(a) List of Documents Filed as Part of This Report:

(1) Consolidated Financial Statements

The consolidated financial statements listed below are included in this document.

<u>Consolidated Financial Statements</u>	<u>Page References</u>
Report of Management	F-2
Independent Auditors’ Report	F-3
Consolidated Balance Sheets	F-4
Consolidated Statements of Income	F-5
Consolidated Statement of Changes in Stockholders’ Equity	F-6
Consolidated Statements of Cash Flows	F-7
Notes to Consolidated Financial Statements	F-8

(2) Consolidated Financial Statement Schedule:

The following Consolidated Financial Statement Schedule, as set forth below, is filed with this report:

<u>Schedule</u>	<u>Page Reference</u>
Schedule II-Valuation and Qualifying Accounts	S-1

All other schedules have been omitted because they are either not applicable or the relevant information has already been disclosed in the financial statements.

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(3) Supplementary Data

Not applicable.

(b) Reports on Form 8-K

Current Report on Form 8-K, filed with the SEC on December 10, 2002 providing information to be disclosed at an investor meeting.

(c) Exhibits

The exhibits listed below are filed herewith or are incorporated herein by reference to other filings.

**EXHIBIT INDEX**

**Exhibits**

- \*3.2 Amended and Restated Certificate of Incorporation of Registrant.
- \*3.4 Bylaws of Registrant.
- \*4.1 Form of specimen certificate for shares of Common Stock, \$0.01 par value per share, of the Registrant.
- \*9.1 Form of 1998 PC Connection Voting Trust Agreement among the Registrant, Patricia Gallup individually and as a trustee, and David Hall individually and as trustee.
- \*10.1 1993 Incentive and Non-Statutory Stock Option Plan, as amended.
- \*10.2 1997 Stock Incentive Plan.
- \*10.3 Lease between the Registrant and Miller-Valentine Partners, dated September 24, 1990, as amended, for property located at 2870 Old State Route 73, Wilmington, Ohio.
- \*10.4 Lease between the Registrant and Gallup & Hall partnership, dated May 1, 1997, for property located at 442 Marlboro Street, Keene, New Hampshire.
- \*10.5 Lease between the Registrant and Gallup & Hall partnership, dated June 1, 1987, as amended, for property located in Marlow, New Hampshire.
- \*10.6 Lease between the Registrant and Gallup & Hall partnership, dated July 22, 1998, for property located at 450 Marlboro Street, Keene, New Hampshire.
- \*10.7 Amended and Restated Lease between the Registrant and G&H Post, LLC, dated December 29, 1997 for property located at Route 101A, Merrimack, New Hampshire.
- \*10.8 Employment Agreement between the Registrant and Wayne L. Wilson, dated August 16, 1995.
- \*10.9 Employment Agreement between the Registrant and Robert F. Wilkins, dated December 23, 1995.
- \*10.10 Letter Agreement between the Registrant and Airborne Freight Corporation D/B/A "Airborne Express," dated April 30, 1990, as amended.
- \*10.11 Agreement between the Registrant and Ingram Micro, Inc., dated October 30, 1997, as amended.
- \*10.12 Employment Agreement, dated as of January 1, 1998, between the Registrant and Patricia Gallup.
- \*10.13 Form of Registration Rights Agreement among the Registrant, Patricia Gallup, David Hall and the 1998 PC Connection Voting Trust.
- \*\*10.14 Amendment No. 1 to Amended and Restated Lease between the Registrant and G&H Post, LLC, dated December 29, 1998 for property located at Route 101A, Merrimack, New Hampshire.
- \*\*10.15 Employment Agreement between the Registrant and John L. Bomba, dated March 28, 1997.
- \*\*10.16 Employment Agreement between the Registrant and Mark A. Gavin, dated February 5, 1998.
- \*\*\*10.17 Agreement for Wholesale Financing, dated as of March 25, 1998, between the Registrant and Deutsche Financial Services Corporation.
- \*\*\*10.18 Amendment to Agreement for Wholesale Financing, dated as of March 25, 1998, between the Registrant and Deutsche Financial Services Corporation.
- \*\*\*10.19 Amendment to Agreement for Wholesale Financing, dated as of November 5, 1999, between the Registrant and Deutsche Financial Services Corporation.

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### Exhibits

- \*\*\*10.20 Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000 between the Registrant and Deutsche Financial Services Corporation.
- \*\*\*10.21 Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc. in connection with the Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between the Registrant and Deutsche Financial Services Corporation.
- \*\*\*10.22 Agreement for Inventory Financing, dated as of August 17, 1999, between the Registrant and IBM Credit Corporation.
- \*\*\*10.23 Amendment to Agreement for Inventory Financing, dated as of February 25, 2000, between the Registrant and IBM Credit Corporation.
- \*\*\*10.24 Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc., PC Connection Sales of Massachusetts, Inc., Merrimack Services Corp. and ComTeq Federal, Inc., in connection with the Amendment to Agreement for Inventory Financing, dated as of February 25, 2000, between the Registrant and IBM Credit Corporation.
- \*\*\*10.25 Agreement for Wholesale Financing, dated as of October 12, 1993, between ComTeq Federal, Inc. and IBM Credit Corporation.
- \*\*\*10.26 Amendment to Agreement for Wholesale Financing, dated as of December 23, 1999, between ComTeq Federal, Inc. and IBM Credit Corporation.
- \*\*\*10.27 Amendment to Addendum to Agreement for Wholesale Financing, dated as of December 23, 1999, between ComTeq Federal, Inc. and IBM Credit Corporation.
- \*\*\*10.28 Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and IBM Credit Corporation.
- \*\*\*10.29 Guaranty, dated as of February 25, 2000, entered into by the Registrant, PC Connection, Inc., PC Connection Sales of Massachusetts, Inc. and Merrimack Services Corp., in connection with the Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and IBM Credit Corporation.
- \*\*\*10.30 Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and Deutsche Financial Services Corporation.
- \*\*\*10.31 Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc. in connection with the Agreement for Wholesale Financing, dated as of February 25, 2000, between ComTeq Federal, Inc. and Deutsche Financial Services Corporation.
- \*\*\*10.32 Assignment of Lease Agreements, dated as of December 13, 1999, between Micro Warehouse, Inc. (assignor) and the Registrant (assignee).
- \*\*\*10.33 Amended and Restated Credit Agreement, dated February 25, 2000, between PC Connection, Inc., the Lenders Party hereto and Citizens Bank of Massachusetts.
- \*\*\*\*\*10.34 Amendment, dated January 1, 1999, to the Lease Agreement between the Registrant and Gallup & Hall Partnership, dated June 1, 1987, as amended for property located in Marlow, New Hampshire.
- \*\*\*\*10.35 Lease between Merrimack Services Corporation and White Knight Realty Trust, dated October 19, 2000 for property located at 7 Route 101A, Amherst, New Hampshire.
- \*\*\*\*\*10.36 Amendment to Employment Agreement between the Registrant and Robert Wilkins dated December 23, 1995.
- \*\*\*\*\*10.37 Lease between Merrimack Services Corporation and Schleicher & Schuell, Inc., dated November 16, 2000 for property located at 10 Optical Avenue, Keene, New Hampshire.
- \*\*\*\*\*10.38 Lease between PC Connection Sales and Dover Mills L.P., dated May 1, 2000 for property located at 100 Main Street, Dover, New Hampshire.
- \*\*\*\*\*10.39 Lease between ComTeq Federal, Inc. and Rockville Office/Industrial Associates dated December 14, 1993 for property located at 7503 Standish Place, Rockville, Maryland.
- \*\*\*\*\*10.40 Amendment, dated November 1, 1996 to the Lease Agreement between ComTeq Federal, Inc. and Rockville Office/Industrial Associates for property located in Rockville, Maryland.

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### Exhibits

*****10.41	Amendment, dated March 31, 1998 to the Lease Agreement between ComTeq Federal, Inc. and Rockville Office/Industrial Associates, dated November 1, 1996, as amended for property located in Rockville, Maryland.
*****10.42	Amendment, dated August 31, 2000 to the Lease Agreement between ComTeq Federal, Inc. and Rockville Industrial Associates, dated March 31, 1998, as amended for property located in Rockville, Maryland.
*****10.43	Amendment dated June 26, 2000 to the Lease Agreement between Merrimack Services Corporation and EWE Warehouse Investments V, LTD., dated July 31, 1998 for property located at 2840 Old State Route 73, Wilmington, Ohio.
*****10.44	Lease between PC Connection, Inc. and The Hillsborough Group, dated January 5, 2000 for property located at 706 Route 101A, Merrimack, New Hampshire.
*****10.45	Amendment, dated December 27, 2000 to the Amended and Restated Credit Agreement, dated February 25, 2000, between PC Connection, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
*****10.46	Amendment, dated May 4, 2001 to the Amended and Restated Credit Agreement, dated December 27, 2000, between PC Connection, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
*****10.47	Amendments, dated June 19, 2001 to the Assignment of Lease Agreements, dated as of December 13, 1999, between Micro Warehouse Inc. (assignor) and the Registrant (assignee).
*****10.48	Employment Agreement between the Registrant and Kenneth Koppel, dated June 25, 2001.
*****10.49	Amendment, dated August 22, 2001 to the Amended and Restated Credit Agreement, dated May 4, 2001, between PC Connection, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
*****10.50(+)	National Account Agreement between Airborne Express Inc. and Merrimack Services Corporation d/b/a/ PC Connection Services, dated September 10, 2001.
*****10.51	Agreement and Plan of Merger, dated March 25, 2002, by and among PC Connection, Inc., Boca Acquisition Corp., MoreDirect, Inc. and the stockholders of MoreDirect, Inc. set forth on Schedule 1 thereto.
*****10.52	Separation Agreement between Registrant and Wayne Wilson, dated September 19, 2002.
10.53	Amendment, dated July 31, 2002 to the Lease Agreement between Merrimack Services and EWE Warehouse Investments V, LTD, dated June 26, 2000 for property located at Old State Route 73, Wilmington, Ohio.
10.54	Lease between Merrimack Services Corporation and Audio Accessories, Inc., dated November 1, 2002 for property located at Mill Street, Marlow, New Hampshire.
10.55	Amendment, dated November 20, 2002 to the Lease Agreement between GovConnection (formerly known as ComTeq Federal, Inc.) and Rockville Office/Industrial Associates, dated March 31, 1998, as amended for property located in Rockville, Maryland.
10.56	Amendment dated June 1, 2002 to the Lease Agreement between Merrimack Services Corporation and Gallup & Hall, dated May 1, 1997 for property located at 442 Marlboro Street, located in Keene, New Hampshire.
10.57	Lease between MoreDirect.com, Inc. and Bryam Hill Realty Corporation, dated February 2001, for property located at 7300 N. Federal Highway, Boca Raton, FL.
10.58	Lease between MoreDirect.com, Inc. and Bryam Hill Realty Corporation, dated April 1, 2000, for property located at 7300 N. Federal Highway, Boca Raton, FL.
10.59	Assignment of lease dated August 27, 2002, between MoreDirect, Inc. and Robert Leone Trust, for property located at 7300 N. Federal Highway, Boca Raton, FL.
21.1	Subsidiaries of Registrant.
23.1	Consent of Deloitte & Touche LLP.
99.1	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.

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**Exhibits**

99.2	Certification of the Company's Senior Vice President of Finance 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.
*	Incorporated by reference from the exhibits filed with the Company's registration statement (333-41171) on Form S-1 filed under the Securities Act of 1933.
**	Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 31, 1999.
***	Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K/A Amendment No. 1, File Number 0-23827, filed on April 4, 2000.
****	Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed on November 14, 2000.
*****	Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 30, 2001.
*****	Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed on August 14, 2001.
*****	Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on April 1, 2002.
*****	Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed on November 14, 2002.
(+)	Confidential treatment requested for this agreement.



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I, Patricia Gallup, certify that:

1. I have reviewed this annual report on Form 10-K of PC Connection, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: March 31, 2003

/s/ PATRICIA GALLUP

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**Patricia Gallup**  
**President and**  
**Chief Executive Officer**

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I, Mark Gavin, certify that:

1. I have reviewed this annual report on Form 10-K of PC Connection, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Dated: March 31, 2003

/s/ MARK GAVIN

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**Mark Gavin**  
**Senior Vice President of Finance and Chief**  
**Financial Officer**

**PC CONNECTION, INC. AND SUBSIDIARIES**  
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## REPORT OF MANAGEMENT

Responsibility for the integrity and objectivity of the financial information presented in this Annual Report on Form 10-K rests with PC Connection, Inc. and its subsidiaries (“the Company”) management. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, applying certain estimates and judgments as required.

The Company maintains an effective internal control structure. It consists, in part, of an organization with clearly defined lines of responsibility and delegation of authority, comprehensive systems and control procedures. We believe this structure provides reasonable assurance that transactions are executed in accordance with management authorization and accounting principles generally accepted in the United States of America.

To assure the effective administration of internal control, we carefully select and train our employees, develop and disseminate written policies and procedures, provide appropriate communication channels and foster an environment conducive to the effective functioning of controls. We believe that it is essential for the Company to conduct its business affairs in accordance with the highest ethical standards.

Deloitte & Touche LLP, the independent auditing firm, is retained to audit the Company’s consolidated financial statements. Its accompanying report is based on an audit conducted in accordance with auditing standards generally accepted in the United States of America.

The Audit Committee of the Board of Directors is composed solely of outside directors and is responsible for recommending to the Board of Directors the independent accounting firm to be retained for the coming year. The Audit Committee meets periodically and privately with the independent auditors, as well as with Company management, to review accounting, auditing, internal control structure and financial reporting matters.

Patricia Gallup  
President and  
Chief Executive Officer

Mark A. Gavin  
Sr. Vice President of Finance  
and Chief Financial Officer

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**INDEPENDENT AUDITORS' REPORT**

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

We have audited the accompanying consolidated balance sheets of PC Connection, Inc. and subsidiaries as of December 31, 2002 and 2001 and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of PC Connection, Inc. and subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, in 2002 the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

Deloitte & Touche LLP

Boston, Massachusetts  
January 30, 2003

PC CONNECTION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(amounts in thousands, except per share data)

	December 31,	
	2002	2001
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 1,797	\$ 35,605
Restricted cash	5,000	—
Accounts receivable, net	135,314	107,163
Inventories – merchandise	52,479	57,456
Deferred income taxes	741	2,559
Income taxes receivable	1,294	1,312
Prepaid expenses and other current assets	3,278	3,013
	<u>199,903</u>	<u>207,108</u>
Property and equipment, net	25,995	27,472
Goodwill, net	33,704	8,807
Other intangibles, net	3,746	—
Restricted cash	5,000	—
Other assets	334	258
	<u>334</u>	<u>258</u>
<b>Total Assets</b>	<b>\$ 268,682</b>	<b>\$ 243,645</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Current maturities of capital lease obligation to affiliate	\$ 200	\$ 171
Current maturities of long-term debt	—	1,000
Accounts payable	85,493	75,399
Accrued expenses and other liabilities	12,121	10,096
Acquisition earn-out obligation	10,800	—
	<u>108,614</u>	<u>86,666</u>
Total current liabilities	108,614	86,666
Capital lease obligation to affiliate, less current maturities	6,421	6,621
Deferred income taxes	3,503	3,523
Other liabilities	—	73
	<u>118,538</u>	<u>96,883</u>
<b>Total Liabilities</b>	<b>118,538</b>	<b>96,883</b>
Commitments and Contingencies (Note 13)		
Stockholders' Equity:		
Preferred Stock, \$.01 par value, 10,000 shares authorized, none issued	—	—
Common Stock, \$.01 par value, 100,000 shares authorized, 24,997 and 24,748 issued, 24,635 and 24,543 outstanding at December 31, 2002 and December 31, 2001, respectively	250	247
Additional paid-in capital	75,274	74,393
Retained earnings	76,906	73,659
Treasury stock at cost	(2,286)	(1,537)
	<u>150,144</u>	<u>146,762</u>
<b>Total Stockholders' Equity</b>	<b>150,144</b>	<b>146,762</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 268,682</b>	<b>\$ 243,645</b>

See notes to consolidated financial statements.

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
*(amounts in thousands, except per share data)*

	Years Ended December 31,		
	2002	2001	2000
Net sales	\$ 1,191,497	\$ 1,186,217	\$ 1,440,227
Cost of sales	1,062,311	1,054,631	1,264,573
Gross Profit	129,186	131,586	175,654
Selling, general and administrative expenses	121,964	117,610	123,834
Restructuring costs and other special charges	1,636	2,204	—
Income from operations	5,586	11,772	51,820
Interest expense	(1,152)	(1,179)	(2,086)
Other, net	513	1,307	589
Income before taxes	4,947	11,900	50,323
Income taxes	(1,700)	(4,521)	(19,126)
Net income	\$ 3,247	\$ 7,379	\$ 31,197
Earnings per common share:			
Basic	\$ .13	\$ .30	\$ 1.30
Diluted	\$ .13	\$ .30	\$ 1.22
Shares used in computation of earnings per common share:			
Basic	24,555	24,453	24,054
Diluted	24,860	24,947	25,572

See notes to consolidated financial statements.

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**  
*(amounts in thousands)*

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Shares		Total
	Shares	Amount			Shares	Amount	
<b>Balance, December 31, 1999</b>	<u>23,653</u>	<u>\$ 237</u>	<u>\$ 58,548</u>	<u>\$ 35,083</u>	<u>—</u>	<u>\$ —</u>	<u>\$ 93,868</u>
Exercise of stock options, including income tax benefits	687	6	12,012	—	—	—	12,018
Issuance of stock under employee stock purchase plan	76	1	931	—	—	—	932
Compensation under nonstatutory stock option agreements	—	—	51	—	—	—	51
Net income and comprehensive income	—	—	—	31,197	—	—	31,197
<b>Balance, December 31, 2000</b>	<u>24,416</u>	<u>244</u>	<u>71,542</u>	<u>66,280</u>	<u>—</u>	<u>—</u>	<u>138,066</u>
Exercise of stock options, including income tax benefits	197	2	1,379	—	—	—	1,381
Issuance of stock under employee stock purchase plan	135	1	1,472	—	—	—	1,473
Net income and comprehensive income	—	—	—	7,379	—	—	7,379
Repurchase of common stock for Treasury	—	—	—	—	(205)	(1,537)	(1,537)
<b>Balance, December 31, 2001</b>	<u>24,748</u>	<u>247</u>	<u>74,393</u>	<u>73,659</u>	<u>(205)</u>	<u>(1,537)</u>	<u>146,762</u>
Exercise of stock options, including income tax benefits	108	1	371	—	—	—	372
Issuance of stock under employee stock purchase plan	141	2	510	—	—	—	512
Net income and comprehensive income	—	—	—	3,247	—	—	3,247
Repurchase of common stock for Treasury	—	—	—	—	(157)	(749)	(749)
<b>Balance, December 31, 2002</b>	<u>24,997</u>	<u>\$ 250</u>	<u>\$ 75,274</u>	<u>\$ 76,906</u>	<u>(362)</u>	<u>\$(2,286)</u>	<u>\$150,144</u>

See notes to consolidated financial statements.

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(amounts in thousands)*

	Years Ended December 31,		
	2002	2001	2000
<b>Cash Flows from Operating Activities:</b>			
Net income	\$ 3,247	\$ 7,379	\$ 31,197
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Depreciation and amortization	8,145	7,815	6,566
Deferred income taxes	1,475	(375)	927
Compensation under nonstatutory stock option agreements	—	—	51
Provision for doubtful accounts	7,238	10,680	9,868
(Gain)/loss on disposal of fixed assets	1	(174)	(13)
Changes in assets and liabilities:			
Accounts receivable	(6,478)	6,237	(39,926)
Inventories	5,295	11,508	555
Prepaid expenses and other current assets	83	3,621	(3,295)
Other non-current assets	(48)	139	(263)
Accounts payable	(12,808)	(10,817)	(19,077)
Income tax benefits from exercise of stock options	117	242	8,193
Accrued expenses and other liabilities	(1,279)	(2,082)	1,209
Net cash provided by (used for) operating activities	4,988	34,173	(4,008)
<b>Cash Flows from Investing Activities:</b>			
Purchases of property and equipment	(5,075)	(6,122)	(12,581)
Proceeds from sale of property and equipment	17	269	2,074
Payment for acquisitions, net of cash acquired	(22,585)	—	(2,158)
Cash escrow funded for acquisition	(10,000)	—	—
Net cash used for investing activities	(37,643)	(5,853)	(12,665)
<b>Cash Flows from Financing Activities:</b>			
Proceeds from short-term borrowings	69,836	44,955	583,042
Repayment of short-term borrowings	(69,836)	(44,955)	(583,042)
Repayment of notes payable	(1,000)	(1,000)	(1,000)
Repayment of capital lease obligation to affiliate	(171)	(153)	(137)
Exercise of stock options	255	1,139	3,825
Issuance of stock under employee stock purchase plan	512	1,473	932
Purchase of treasury shares	(749)	(1,537)	—
Net cash (used for) provided by financing activities	(1,153)	(78)	3,620
(Decrease) increase in cash and cash equivalents	(33,808)	28,242	(13,053)
Cash and cash equivalents, beginning of year	35,605	7,363	20,416
Cash and cash equivalents, end of year	\$ 1,797	\$ 35,605	\$ 7,363
<b>Supplemental Cash Flow Information:</b>			
Interest paid	\$ 901	\$ 1,092	\$ 1,923
Income taxes paid	1,734	2,818	13,242

See notes to consolidated financial statements.

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

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

PC Connection, Inc. and subsidiaries (the “Company”) is a direct marketer of information technology products and solutions, including brand-name personal computers and related peripherals, software, and networking products to business, education, government, and consumer end users located primarily in the United States. The following is a summary of significant accounting policies.

***Principles of Consolidation***

The Consolidated Financial Statements include the accounts of PC Connection, Inc. and subsidiaries. Intercompany transactions and balances are eliminated in consolidation.

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

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

***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, 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. Should such returns no longer prove estimable, we believe that the impact on our financials would not necessarily be significant since the return privilege expires 30 days after shipment.

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 have been classified as “net sales.” Costs related to such shipping and handling billings are classified as “cost of sales.”

***Cash and Cash Equivalents***

We consider all highly liquid short-term investments with original maturities of 90 days or less to be cash equivalents. The carrying value of the Company’s cash equivalents approximates fair value.

***Accounts Receivable***

Ongoing credit evaluations of our customers are performed, and credit limits are adjusted, based on payment history and customer credit-worthiness. An allowance for estimated doubtful accounts is maintained based on the

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Company's historical experience and the customer credit issues identified. Collections are monitored regularly, and the allowance is adjusted as necessary to recognize any changes in credit exposure.

### ***Inventories—Merchandise***

Inventories (all finished goods) consisting of software packages, computer systems and peripheral equipment, are stated at cost (determined under the first-in, first-out method) or market, whichever is lower. Inventory quantities on hand are reviewed regularly, and provisions are made for obsolete, slow moving and nonsalable inventory.

### ***Advertising Costs and Revenues***

Costs of producing and distributing catalogs are deferred and charged to expense over the period that each catalog remains the most current selling vehicle (generally one to two months) which approximate the period of probable benefits. Other advertising costs are expensed as incurred. Vendors have the ability to place advertisements in the catalogs for which we receive advertising allowances and incentives. These revenues are recognized on the same basis as the catalog costs and are offset against selling, general and administrative expense on the consolidated statements of income.

Advertising costs charged to expense were \$19,871, \$25,847, and \$27,159 for the years ended December 31, 2002, 2001, and 2000, respectively. Deferred advertising costs at December 31, 2002 exceeded deferred advertising revenues by \$74, however, deferred advertising revenues at December 31, 2001 and 2000 exceeded deferred advertising costs by \$228 and \$110 at those respective dates.

### ***Comprehensive Income***

There are no other elements of comprehensive income in the three years ended December 31, 2002 apart from net income as reported.

### ***Business Combinations***

In June 2001, we adopted Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations." The principles set forth in this standard were applied to our acquisition of MoreDirect described in Note 3 to the consolidated financial statements. Previous business combinations had been accounted for under Accounting Principles Board Opinion No. 16.

### ***Property and Equipment***

Property and equipment are stated at cost. Depreciation and amortization is provided for both financial and income tax reporting purposes over the estimated useful lives of the assets ranging from three to seven years. Computer software, including licenses and internally developed software is capitalized and amortized over lives ranging from three to five years, except that certain internally developed software is generally expensed for income tax reporting purposes. Depreciation is and has been provided using accelerated methods for property acquired prior to 1996 and on the straight-line method for property acquired thereafter. Leasehold improvements and facilities under capital leases are amortized over the terms of the related leases or their useful lives, whichever is shorter, whereas for income tax reporting purposes, they are amortized over the applicable tax lives. We periodically evaluate the carrying value of property and equipment based upon current and anticipated undiscounted cash flows, and recognize an impairment when it is probable that such estimated future cash flows will be less than the asset carrying value.

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We adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," on January 1, 2002. SFAS No. 144, among other things, modifies and updates the methodology for recognizing impairment in long-lived assets. The adoption of this standard did not have a significant impact on either the balance sheet or the statement of income.

### ***Goodwill and Other Intangible Assets***

Our intangible assets consist of (1) goodwill, which is not being amortized commencing in 2002 and beyond; (2) indefinite lived intangibles, which consist of certain trademarks that are not subject to amortization; and (3) amortizing intangibles, which consist of customer lists, which are being amortized over their useful lives. All intangible assets are subject to impairment tests on a periodic basis.

Note 2 describes the impact of accounting for the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," and the annual impairment methodology that we will employ on January 1<sup>st</sup> of each year in calculating the recoverability of goodwill. This same impairment test will be performed at other times during the course of a year should an event occur which suggests that the recoverability of goodwill should be challenged. Non-amortizing intangibles are also subject to annual impairment tests. However, the methodology employed is as described in APB Opinion No. 17, "Intangible Assets." Amortizing intangibles are currently evaluated for impairment using the methodology set forth in SFAS No. 144.

Recoverability of these assets is assessed only when events have occurred that may give rise to an impairment. When a potential impairment has been identified, forecasted undiscounted net cash flows of the operations to which the asset relates are compared to the current carrying value of the long-lived assets present in that operation. If such cash flows are less than such carrying amounts, long-lived assets including such intangibles, are written down to their respective fair values.

Prior to 2002, we employed the impairment methodologies set forth in SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." These methodologies did not differ substantially from SFAS No. 144 as they related to amortizing intangibles. Goodwill was also previously evaluated for impairment under SFAS No. 121 in 2001 and 2000. There were no impairments recorded in either year.

### ***Income Taxes***

Deferred income tax assets and liabilities are computed for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized. "Income taxes" as presented on the Consolidated Statements of Income comprise the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

### ***Concentrations***

Concentrations of credit risk with respect to trade account receivables are limited due to the large number of customers comprising our customer base. Ongoing credit evaluations of customers' financial condition are performed by management on a regular basis.

During the years ended December 31, 2002, 2001, and 2000 product purchases from Ingram Micro, Inc., our largest vendor, accounted for approximately 28%, 25%, and 26%, respectively, of our total product purchases. Purchases from Tech Data Corporation comprised 14% of our total product purchases in both years ended December 31, 2002 and 2001, and 11% in the year ended December 31, 2000. Effective May 3, 2002, Hewlett-Packard Company (HP) completed its acquisition transaction involving Compaq Computer Corporation.

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Had this acquisition been completed at the beginning of the periods presented, our purchases made directly from HP, on a pro forma basis, would have constituted 15%, 12%, and 4% of our total product purchases in the years ended December 31, 2002, 2001, and 2000, respectively. No other vendor supplied more than 10% of our total product purchases in the years ended December 31, 2002, 2001, and 2000.

### Earnings Per Share

Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to outstanding options to purchase common stock where such options have a dilutive effect on earnings per share.

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

	2002	2001	2000
<b>Numerator:</b>			
Net income	\$ 3,247	\$ 7,379	\$ 31,197
<b>Denominator:</b>			
Denominator for basic earnings per share	24,555	24,453	24,054
<b>Effect of dilutive securities:</b>			
Employee stock options	305	494	1,518
Denominator for diluted earnings per share	24,860	24,947	25,572
<b>Earnings per share:</b>			
Basic	\$ .13	\$ .30	\$ 1.30
Diluted	\$ .13	\$ .30	\$ 1.22

The following options to purchase Common Stock were excluded from the computation of diluted earnings per share for years ended December 31, 2002, 2001, and 2000 because the effect of the options on the calculation would have been anti-dilutive:

	2002	2001	2000
Anti-dilutive stock options	2,447	868	97

### Stock-Based Compensation

Compensation expense associated with awards of stock or options to employees and directors is measured using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Information concerning the impact of the utilization of the fair market value model prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," is shown below:

Had we recorded compensation expense using the fair value method under SFAS No. 123, pro forma net income and diluted net income per share for the years ended December 31 would have been as follows:

	2002	2001	2000
Compensation expense under intrinsic value method	\$ 0	\$ 0	\$ 51
Net income, as reported	3,247	7,379	31,197
Compensation expense, under SFAS No. 123	3,021	3,747	3,304
Net income, under SFAS No. 123	1,265	5,056	29,148
Basic net income per share, as reported	.13	.30	1.30
Basic net income per share, under SFAS No. 123	.05	.21	1.21
Diluted net income per share, as reported	.13	.30	1.22
Diluted net income per share, under SFAS No. 123	.05	.20	1.14

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The fair value of options granted prior to the consummation of the Company's initial public offering in 1998 was estimated using the minimum value method and risk-free interest rates and expected option lives of 6% and seven years, respectively. The minimum value pricing method was designed to value stock options of non-public companies; accordingly, the minimum value method assumed zero volatility.

The Black-Scholes model was used to value options granted subsequent to the Offering using a volatility factor of 125.5%, 98.8%, and 69.0%, for 2002, 2001, and 2000, respectively, estimated option lives of four years, and a risk-free interest rate of 2.8% for 2002, 4.0% for 2001, and 6.4% for 2000. We believe that the assumptions used and the models applied to value the awards yield a reasonable estimate of the fair value of the grants made under the circumstances, given the alternatives under SFAS No. 123.

### ***Share Repurchase Authorization***

We announced on March 28, 2001 that our Board of Directors authorized the spending of up to \$15,000 to repurchase the Company's common stock. Share purchases will be made in the open market from time to time depending on market conditions. We have repurchased 362,267 shares for \$2,286 as of December 31, 2002 and 205,000 shares for \$1,537 as of December 31, 2001, which are reflected as treasury stock on the consolidated balance sheet.

### ***Recently Issued Financial Accounting Pronouncements***

In June 2002, the Financial Accounting Standards board issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and replaces Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." It requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, rather than at the date of a commitment to an exit or disposal plan. The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. The restructuring activities undertaken by us prior to the issuance of this statement have been appropriately accounted for under EITF 94-3.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently in a tabular format. Additionally, SFAS No. 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of SFAS No. 148 are effective for the fiscal year ended December 31, 2002. We do not expect to change to the fair value based method, therefore, SFAS No. 148 will not have a material effect on our results of operations or financial position. The disclosure provisions of SFAS No. 148 have been adopted currently.

In November 2001, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer," which addresses the income statement characterization of consideration given by a vendor to a customer and provides guidance on recognizing and measuring sales incentives. EITF Issue No. 01-09 is effective for fiscal year 2003. We have not yet determined the impact, if any, of adopting this guidance.

In November 2002, the EITF reached a final consensus on Issue No. 02-16, "Accounting by a Reseller for Cash Consideration Received from a Vendor," which addresses how a reseller of a vendor's product should account for cash consideration received from a vendor. The EITF issued guidance on the following two issues, as

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follows: (1) cash consideration received from a vendor should be recognized as a reduction of cost of sales in the reseller's income statement, unless the consideration is a reimbursement for selling costs or payment for assets or services delivered to the vendor, and (2) performance-driven vendor rebates or refunds (e.g., minimum purchase or sales volumes) should be recognized as a reduction of cost of sales only if the payment is considered probable, and the method of allocating such payments in the financial statements should be systematic and rational based on the reseller's progress in achieving the underlying performance targets. The provisions of EITF 02-16 will be effective for our fiscal year beginning January 1, 2003. We have not yet determined the impact, if any, of adopting this newly issued guidance.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"), which requires that, for guarantees within the scope of FIN 45 issued or amended after December 31, 2002, a liability for the fair value of the obligation undertaken in issuing the guarantee be recognized. FIN 45 also requires additional disclosures in financial statements for periods ending after December 15, 2002. Accordingly, these new disclosures are included in Note 13 to the consolidated financial statements. It is not expected that the recognition and measurement provisions of FIN 45 will have a material effect on our results of operations or financial position.

### **Reclassifications**

Certain amounts in the 2001 and 2000 financial statements have been reclassified to conform to the 2002 presentation.

## **2. GOODWILL AND OTHER INTANGIBLE ASSETS**

We adopted SFAS No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002. SFAS No. 142 required, among other things, the discontinuance of the amortization of goodwill and certain other identified intangibles. It also required a January 1, 2002 reassessment of the recoverability of the goodwill that was carried on our financial statements. SFAS No. 142 also includes provisions for the reassessment of the value and useful lives of existing recognized intangibles (including goodwill), reclassification of certain intangibles both in and out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill and other intangibles. We completed the initial impairment review required by SFAS No. 142 in June 2002 and have determined that our goodwill and intangible assets were not impaired.

We ceased amortization of goodwill and indefinite-lived intangibles in 2002 in connection with our adoption of SFAS No. 142. The following is a reconciliation of reported net income to adjusted net income for 2002 and 2001, taking into account the cessation of goodwill amortization:

	Year Ended December 31,		
	2002	2001	2000
Reported net income	\$ 3,247	\$ 7,379	\$ 31,197
Add back goodwill amortization (net of taxes)	—	457	436
Adjusted net income	\$ 3,247	\$ 7,836	\$ 31,633
<b>Diluted earnings per share:</b>			
Reported net income	\$ .13	\$ .30	\$ 1.22
Add back goodwill amortization (net of taxes)	—	.01	.02
Adjusted net income	\$ .13	\$ .31	\$ 1.24

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Intangible assets subject to amortization, consisting of customer lists were \$2,556 and \$0 at December 31, 2002 and December 31, 2001 (net of accumulated amortization of \$264 and \$0, respectively). Intangible assets not subject to amortization are as follows:

	December 31,	
	2002	2001
Goodwill	\$ 33,704	\$ 8,807(1)
Trademarks	1,190	0

(1) Amortization of goodwill ceased with the adoption of SFAS No. 142 on January 1, 2002.

For the years ended December 31, 2002, 2001, and 2000, the Company recorded amortization expense of \$264, \$738, and \$704, respectively.

A rollforward of goodwill is as follows:

Balance, January 1, 2001, net	\$	9,509
Amortization expense		(702)
Balance, December 31, 2001		8,807
MoreDirect acquisition April 5, 2002		14,097
MoreDirect contingent consideration		10,800
Balance, December 31, 2002	\$	33,704

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

For the Year Ended December 31,	
2003	\$ 353
2004	353
2005	353
2006	353
2007	353
2008 and thereafter	791

### 3. ACQUISITIONS

On April 5, 2002, we completed the acquisition of MoreDirect, Inc. (MoreDirect). The acquisition of MoreDirect provides PC Connection a premier e-procurement supplier of information technology (IT) products for medium-to-large corporate and government organizations nationwide. MoreDirect's Internet-based system enables corporate and government customers to efficiently source, evaluate, purchase, and track a wide variety of IT products.

Under the terms of the agreement, all outstanding stock options of MoreDirect were cashed out for approximately \$4,100, which was funded by us, and we paid the sole shareholder of MoreDirect approximately \$18,000 in cash at closing. MoreDirect also distributed approximately \$7,900 to its sole shareholder from available cash balances for previously taxed but undistributed S Corporation earnings. In addition we will pay additional cash to the MoreDirect shareholder based upon MoreDirect achieving targeted levels of annual earnings before income taxes through December 31, 2004. Under the merger agreement, earn-out payments are

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tied to earnings before income tax (EBIT) levels targeted to grow at a 15% rate per year. The maximum payments we will make under the earn-out provisions of the merger agreement are \$67,106 assuming MoreDirect maintains 200% of targeted EBIT levels for all three years. If MoreDirect maintains less than 60% of targeted EBIT levels for all three years, no payments would be required under the earn-out provisions of the merger agreement. At any time during the earn-out period, we may “buy-out” the remaining earn-out payments for amounts which vary during the term of the earn-out. We accrued a liability to the MoreDirect shareholder for \$10,800 in earn-out consideration for the year ended December 31, 2002. Certain portions of the contingent payments may be converted into our common stock at specified conversion prices between \$20.90 and \$40.00 per share. We also escrowed \$10,000 in cash at closing to fund a portion of these contingent payments, of which \$5,000 will be used to satisfy a portion of the liability at December 31, 2002. Acquisition costs of \$600 have been included in the purchase price.

The transaction was accounted for by the purchase method, and accordingly, MoreDirect’s results of operations are included in our consolidated financial statements only for periods after April 5, 2002.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of the acquisition. The fair values of certain intangible assets were determined through a third party valuation.

At April 5, 2002	
Current assets	\$ 29,675
Property, plant and equipment and other assets	1,587
Intangible assets	4,010
Goodwill	14,097
<b>Total acquired</b>	<b>49,369</b>
Less current liabilities	26,669
<b>Net assets acquired</b>	<b>22,700</b>
Less cash acquired	115
<b>Purchase price for acquisition, net of cash acquired</b>	<b>\$ 22,585</b>

Of the \$4,010 of acquired intangible assets, \$1,190 was assigned to registered trademarks that are not subject to amortization. The remaining \$2,820 of acquired intangible assets represents customer relationships (8 year weighted-average useful life).

The \$14,097 of goodwill was assigned to the Large Corporate Accounts segment. All of this goodwill is expected to be deductible for tax purposes as a result of this acquisition.

The following unaudited pro forma information presents the results of our operations as if the acquisition of MoreDirect had taken place as of the beginning of the periods presented:

	Twelve Months Ended December 31,	
	2002	2001
Net revenue	\$ 1,246,007	\$ 1,405,220
Net income	4,657	11,667
Earnings per share:		
Basic	\$ 0.19	\$ 0.48
Diluted	\$ 0.19	\$ 0.47

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**4. ACCOUNTS RECEIVABLE**

Accounts receivable consisted of the following:

	December 31,	
	2002	2001
Trade	\$ 131,024	\$ 105,441
Co-op advertising	4,111	6,242
Vendor returns, rebates and other	6,788	4,657
<b>Total</b>	<b>141,923</b>	<b>116,340</b>
Less allowances for:		
Sales returns	(1,467)	(1,745)
Doubtful accounts	(5,142)	(7,432)
<b>Accounts receivable, net</b>	<b>\$ 135,314</b>	<b>\$ 107,163</b>

**5. PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following:

	December 31,	
	2002	2001
Facilities under capital lease	\$ 7,215	\$ 7,215
Leasehold improvements	5,799	5,406
Furniture and equipment	28,595	27,166
Computer software, including licenses and internally-developed software	26,730	22,050
Automobiles	140	269
<b>Total</b>	<b>68,479</b>	<b>62,106</b>
Less accumulated depreciation and amortization	42,484	34,634
<b>Property and equipment, net</b>	<b>\$ 25,995</b>	<b>\$ 27,472</b>

**6. RESTRUCTURING COSTS AND OTHER SPECIAL CHARGES**

On March 15, 2002, we announced that we had settled litigation commenced by Microsoft Corporation involving alleged trademark and copyright infringement. While denying the allegations, we recorded a \$750 charge in settlement costs and legal fees related to this matter. In 2002, we reduced our staff by approximately 24 individuals, or less than 2% of our workforce. We recorded a charge of \$886 related to these staff reductions. This staff reduction was completed in September 2002. Liabilities at December 31, 2002 and 2001 are included in accrued expenses and other liabilities on the balance sheet.

In 2001, we recorded a charge of \$1,510 related to staff reductions and took a charge of \$694 associated with proposed acquisitions abandoned during the year.

A rollforward of restructuring costs and other special charges for the twelve months ended December 31, 2002 and 2001 is shown below. There were no changes in estimates in the interim periods.

	Workforce Reductions	Litigation Settlement	Abandoned Acquisition	Total
Balance January 1, 2001	\$ —	\$ —	\$ —	\$ —
Charges	1,510	—	694	2,204
Cash payments	(1,085)	—	(694)	(1,779)
<b>Balance December 31, 2001</b>	<b>425</b>	<b>—</b>	<b>—</b>	<b>425</b>
Charges	886	750	—	1,636
Cash payments	(1,103)	(750)	—	(1,853)
<b>Balance December 31, 2002</b>	<b>\$ 208</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 208</b>

## 7. BANK BORROWINGS

In May 2002, we entered into a \$45 million credit facility secured by substantially all of our business assets. In July 2002, as required under the terms of the credit facility, an additional lender committed to fund \$10 million of the \$45 million facility. Amounts outstanding under this facility bear interest at the prime rate (4.25% at December 31, 2002). The credit facility includes various customary financial and operating covenants, minimum net worth and maximum funded debt ratio requirements, including restrictions on the payment of dividends, none of which we believe significantly restricts our operations. The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at December 31, 2002 was only 0.19 to 1.0. Funded debt ratio is the ratio of average outstanding advances under the facility to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation and Amortization). Borrowing availability under the agreement is further limited to twice the amount of EBITDA for the trailing four quarters; such availability was \$37.9 million at December 31, 2002.

No borrowings were outstanding under this credit facility at December 31, 2002. The credit facility matures on June 30, 2004, at which time amounts outstanding become due.

Certain information with respect to short-term borrowings were as follows:

Year ended December 31,	Weighted Average Interest Rate	Maximum Amount Outstanding	Average Amount Outstanding
2002	4.1%	\$ 10,408	\$ 1,038
2001	5.9	6,267	197
2000	8.2	55,000	9,567

## 8. TRADE CREDIT ARRANGEMENTS

At December 31, 2002 and 2001, we had security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. The agreements allow a collateralized position in inventory financed by the financial institutions up to an aggregated amount of \$45,000. The cost of such financing under these agreements is borne by the suppliers by discounting their invoices to the financial institutions as an incentive for us to purchase their products. We do not pay any interest or discount fees on such inventory financing. At December 31, 2002 and 2001, accounts payable included \$3,559 and \$6,374, respectively, owed to these financial institutions.

## 9. CAPITAL LEASE

In November 1997, we entered into a fifteen-year lease for our corporate headquarters with an affiliated company related to the Company through common ownership. We occupied the facility upon completion of construction in late November 1998, and the lease payments commenced in December 1998.

Annual lease payments under the terms of the lease, as amended, are approximately \$911 for the first five years of the lease, increasing to \$1,025 for years six through ten and \$1,139 for years eleven through fifteen. The lease requires us to pay our proportionate share of real estate taxes and common area maintenance charges as additional rent and also to pay insurance premiums for the leased property. We have the option to renew the lease for two additional terms of five years each. The lease has been recorded as a capital lease.

The net book value of capital lease assets was \$5,251 and \$5,732 as of December 31, 2002 and 2001, respectively.

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Future aggregate minimum annual lease payments under this lease at December 31, 2002 are as follows:

<u>Year Ending December 31</u>	<u>Payments</u>
2003	\$ 921
2004	1,025
2005	1,025
2006	1,025
2007	1,025
2008 and thereafter	6,637
<b>Total minimum payments (excluding taxes, maintenance and insurance)</b>	<b>11,658</b>
Less amount representing interest	5,037
<b>Present value of minimum lease payments</b>	<b>6,621</b>
Less current maturities (excluding interest)	200
<b>Long-term portion</b>	<b>\$ 6,421</b>

## 10. STOCKHOLDERS' EQUITY

### *Preferred Stock*

The Company's Amended and Restated Certificate of Incorporation (the "Restated Certificate") authorized the issuance of up to 10,000,000 shares of preferred stock, \$.01 par value per share (the "Preferred Stock"). Under the terms of the Restated Certificate, the Board is authorized, subject to any limitations prescribed by law, without stockholder approval, to issue by a unanimous vote such shares of Preferred Stock in one or more series. Each such series of Preferred Stock shall have such rights, preferences, privileges and restrictions, including voting rights, dividend rights, redemption privileges and liquidation preferences, as shall be determined by the Board. There were no preferred shares outstanding at 2002 and 2001.

### *Incentive and Non-Statutory Stock Option Plans*

In December 1993, the Board adopted and the stockholders approved the 1993 Incentive and Non-Statutory Stock Option Plan (the "1993 Plan"). Under the terms of the 1993 Plan, the Company is authorized to make awards of restricted stock and to grant incentive and non-statutory options to employees of, and consultants and advisors to, the Company to purchase shares of the Company's stock. A total of 1,686,245 shares of the Company's Common Stock was authorized for issuance upon exercise of options granted or awards made under the 1993 Plan. Options vest over varying periods up to four years and have contractual lives up to ten years.

In November 1997, the Board adopted and the stockholders approved the 1997 Stock Incentive Plan (the "1997 Plan"), which became effective on the closing of the Company's initial public offering in 1998. The 1997 Plan provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, performance shares and awards of restricted stock and unrestricted stock. A total of 3,600,000 shares have been reserved for issuance under this Plan.

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Information regarding the 1993 and 1997 Plans is as follows:

	Option Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding, December 31, 1999	2,822,610	7.93	
Granted	626,415	30.27	15.78
Exercised	(687,653)	5.56	
Forfeited	(111,864)	13.35	
Outstanding, December 31, 2000	2,649,508	13.61	
Granted	776,367	13.01	9.14
Exercised	(197,134)	5.78	
Forfeited	(334,929)	18.53	
Outstanding December 31, 2001	2,893,812	13.40	
Granted	485,300	6.63	5.36
Exercised	(108,421)	5.52	
Forfeited	(721,115)	14.42	
Outstanding December 31, 2002	2,549,576	12.29	

The following table summarizes the status of outstanding stock options as of December 31, 2002:

Exercise Price Range	Options Outstanding			Options Exercisable	
	No. of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	No. of Shares	Weighted Average Exercise Price
\$ .51	255,693	1.40	\$ .51	255,693	\$ .51
\$3.81—\$5.44	376,995	8.31	4.64	76,395	3.81
\$6.80	17,500	9.90	6.80	0	0
\$8.92	178,001	6.73	8.92	127,604	8.92
\$9.71—\$10.99	359,952	8.85	10.30	50,722	10.59
\$11.67	455,006	5.23	11.67	427,442	11.67
\$11.83—\$16.83	533,749	8.31	14.07	140,374	14.00
\$18.33—\$34.83	255,445	7.17	20.04	130,176	20.03
\$51.81	99,235	7.54	51.81	49,940	51.81
\$52.75—\$62.19	18,000	7.64	53.54	9,000	53.54
\$ .51—\$62.19	2,549,576	6.97	\$ 12.29	1,267,346	\$ 11.62

**1997 Employee Stock Purchase Plan**

In November 1997, the Board adopted and the stockholders approved the 1997 Employee Stock Purchase Plan (the "Purchase Plan"), which became effective on February 1, 1999. The Purchase Plan authorizes the issuance of Common Stock to participating employees. Under the terms of the Purchase Plan, the purchase price is an amount equal to 85% of the fair market value per share of the Common Stock on either the first day or the last day of the offering period, whichever is lower. An aggregate of 537,500 shares of Common Stock has been reserved for issuance under the Purchase Plan, of which 420,536 shares were purchased.

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**11. INCOME TAXES**

The 2002, 2001, and 2000 provision for income taxes consisted of the following:

	Years Ended December 31,		
	2002	2001	2000
<b>Paid or currently payable:</b>			
Federal	\$ (142)	\$ 4,510	\$ 16,673
State	367	386	1,526
<b>Total current</b>	<b>225</b>	<b>4,896</b>	<b>18,199</b>
<b>Deferred:</b>			
Federal	1,567	(345)	853
State	(92)	(30)	74
<b>Net deferred</b>	<b>1,475</b>	<b>(375)</b>	<b>927</b>
<b>Net provision</b>	<b>\$ 1,700</b>	<b>\$ 4,521</b>	<b>\$ 19,126</b>

The components of the deferred taxes at December 31, 2002 and 2001 are as follows:

	2002	2001
<b>Current:</b>		
Provisions for doubtful accounts	\$ 1,256	\$ 2,824
Inventory costs capitalized for tax purposes	160	93
Inventory and sales returns reserves	463	586
Deductible expenses, primarily employee-benefit related	75	120
Other	(1,213)	(1,064)
<b>Net deferred tax asset</b>	<b>741</b>	<b>2,559</b>
<b>Non-Current:</b>		
Compensation under non-statutory stock option agreements	339	409
State tax credit carryforward	600	—
Excess of book value over the basis of goodwill and other intangibles	(462)	—
Excess of book basis over tax basis of property and equipment	(3,980)	(3,932)
<b>Net deferred tax liability</b>	<b>(3,503)</b>	<b>(3,523)</b>
<b>Net deferred tax liability</b>	<b>\$ (2,762)</b>	<b>\$ (964)</b>

The reconciliation of the Company's 2002, 2001, and 2000 income tax provision to the statutory federal tax rate is as follows:

	2002	2001	2000
Statutory tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	4.8	3.0	2.5
State tax credits carried forward, net of federal tax	(5.9)	—	—
Nondeductible expenses	0.2	0.1	0.4
Other—net	0.2	(0.1)	0.1
<b>Effective income tax rate</b>	<b>34.3%</b>	<b>38.0%</b>	<b>38.0%</b>

State tax credit carryforwards are offsettable against future state income taxes and expire as follows:

2006	\$	150
2007		450
	<b>\$</b>	<b>600</b>



## 12. EMPLOYEE BENEFIT PLAN

We have a contributory profit-sharing and employee savings plan covering all qualified employees. No contributions to the profit-sharing element of the plan were made by the Company in 2002, 2001, or 2000. The Company made matching contributions to the employee savings element of the plan of \$614, \$513, and \$592 in 2002, 2001, and 2000, respectively.

## 13. COMMITMENTS AND CONTINGENCIES

### *Operating Leases*

We lease certain office facilities from our principal stockholders under 20-year noncancelable operating leases. The lease agreement for one facility requires the Company to pay all real estate taxes and insurance premiums related thereto. We also lease several other buildings from our principal stockholders on a month-to-month basis.

In addition, we lease office, distribution facilities and equipment from unrelated parties with remaining terms of one to six years.

Future aggregate minimum annual lease payments under these leases at December 31, 2002 are as follows:

<u>Year Ending December 31</u>	<u>Related Parties</u>	<u>Others</u>	<u>Total</u>
2003	\$ 150	\$ 3,813	\$ 3,963
2004	150	2,542	2,692
2005	150	492	642
2006	150	93	243
2007	146	—	146
2008 and thereafter	99	—	99

Total rent expense aggregated \$5,732, \$5,656, and \$3,936 for the years ended December 31, 2002, 2001, and 2000, respectively, under the terms of the leases described above. Such amounts included \$173, \$179, and \$169 in 2002, 2001, and 2000, respectively, paid to related parties.

### *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 audit by various government agencies relating to sales under certain government contracts. Currently, an audit is being conducted on our General Services Administration ("GSA") contract for the period May 1, 1997 to March 31, 2002. Where appropriate, we provide accruals for resolution of certain known and estimable disputes. We believe that these accruals are sufficient to cover these governmental audit exposures.

On April 5, 2002, we completed the acquisition of MoreDirect, Inc. (MoreDirect). Under the terms of the agreement, we will pay additional cash to the MoreDirect shareholder based upon MoreDirect achieving targeted levels of annual earnings before income taxes through December 31, 2004. Under the merger agreement, earn-out payments are tied to earnings before income tax (EBIT) levels targeted to grow at a 15% rate per year. The maximum payments we will make under the earn-out provisions of the merger agreement are \$67,106, assuming MoreDirect maintains 200% of targeted EBIT levels for all three years. If MoreDirect maintains less than 60% of targeted EBIT levels for all three years, no payments would be required under the earn-out provision of the merger agreement. At any time during the earn-out period, we may "buy-out" the remaining earn-out

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payments for amounts which vary during the term of the earn-out. We accrued a liability to the MoreDirect shareholder for \$10,800 in earn-out consideration for the year ended December 31, 2002. Certain portions of the contingent payments may be converted into our common stock at specified conversion prices between \$20.90 and \$40.00 per share. We also escrowed \$10,000 in cash at closing to fund a portion of these contingent payments, of which \$5,000 will be used to satisfy a portion of the liability at December 31, 2002.

**14. OTHER RELATED PARTY TRANSACTIONS**

As described in Notes 9 and 13, we have leased certain facilities from related parties. Other related-party transactions include the transactions summarized below. Related parties consist primarily of affiliated companies related to the Company through common ownership.

	Years Ended December 31		
	2002	2001	2000
Revenue:			
Sales of various products	\$ 3	\$ 3	\$ 3
Sales of services to affiliated companies	132	148	300
Costs:			
Purchase of services from affiliated companies	1	1	9

**15. 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.

In January 2002 we reorganized our operations to create two reportable operating segments — the "Public Sector" segment, which serves federal, state and local governmental organizations and educational institutions, and the "SMB" segment which services small- and medium-sized businesses, as well as consumers. In April 2002, we acquired MoreDirect, Inc.—the "Large Corporate Accounts" segment, which serves medium-to-large corporations.

Segment information applicable to our reportable operating segments for the year ended December 31, 2002 is shown below:

	Year Ended December 31, 2002				
	SMB Segment	Public Sector Segment	Large Corp. Accts. Segment	Eliminations	Consolidated
Sales to external customers	\$ 703,505	\$ 293,938	\$ 194,054	\$ —	\$1,191,497
Transfers between segments	203,199	—	—	(203,199)	—
Net sales	\$ 906,704	\$ 293,938	\$ 194,054	\$(203,199)	\$1,191,497
Operating income (loss)	\$ (1,085)	\$ (3,619)	\$ 10,290	\$ —	\$ 5,586
Interest and other—net	(696)	24	33	—	(639)
Income (loss) before taxes	\$ (1,781)	\$ (3,595)	\$ 10,323	\$ —	\$ 4,947
Total assets	\$ 187,161	\$ 83,389	\$ 76,144	\$ (78,012)	\$ 268,682
Goodwill, net	\$ 1,173	\$ 7,634	\$ 24,897	\$ —	\$ 33,704

General and administrative expenses were charged to the reportable operating segments, based on their estimated usage of the underlying functions. Interest and other expense was charged to the segments, based on the actual costs incurred by each segment, net of interest and other income generated. The amount shown above

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representing total assets eliminated consists of inter-segment receivables, resulting primarily from inter-segment sales and transfers reported above and from inter-segment service charges.

In 2001 we had only one reportable operating segment. It is impractical for us to restate prior year balances, except for sales, into the operating segments established in 2002. Senior management monitored revenue in 2002, 2001, and 2000 by sales channel (Outbound Telemarketing and Field Sales, Inbound Telesales, and Online Internet) and product mix (Notebooks, Desktops and Servers, Storage Devices, Software, Networking Communications, Printers, Video and Monitors, Memory, and Accessories and Other).

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

	Years Ended December 31,		
	2002	2001	2000
<b>Segment (excludes transfers between segments)</b>			
SMB	\$ 703,505	\$ 896,164	\$ 1,197,482
Public Sector	293,938	290,053	242,745
Large Accounts	194,054	—	—
<b>Total</b>	<b>\$ 1,191,497</b>	<b>\$ 1,186,217</b>	<b>\$ 1,440,227</b>
<b>Sales Channel</b>			
Outbound Telemarketing and Field Sales	\$ 922,694	\$ 942,735	\$ 1,090,704
Inbound Telesales	87,085	140,463	236,557
Online Internet	181,718	103,019	112,966
<b>Total</b>	<b>\$ 1,191,497</b>	<b>\$ 1,186,217</b>	<b>\$ 1,440,227</b>
<b>Product Mix</b>			
Notebooks	\$ 184,204	\$ 256,259	\$ 362,090
Desktop/Servers	179,437	146,590	210,005
Storage Devices	111,893	116,308	138,688
Software	162,932	159,199	149,098
Networking Communications	100,335	107,513	112,346
Printers	108,844	97,632	102,439
Video & Monitors	115,603	106,601	116,922
Memory	42,241	33,682	58,108
Accessories/Other	186,008	162,433	190,531
<b>Total</b>	<b>\$ 1,191,497</b>	<b>\$ 1,186,217</b>	<b>\$ 1,440,227</b>

Included in the product mix sales are enterprise networking product sales of \$267,000, \$235,000, and \$251,000 for the years ended December 2002, 2001, and 2000, respectively.

Substantially, all of our net sales in 2002, 2001, and 2000 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 2% in 2002, 2001, and 2000. All of our assets at December 31, 2002 and 2001 were located in the United States. Our primary target customers are small- to medium-size businesses ("SMBs") comprised of 20 to 1,000 employees, federal, state and local governmental agencies, educational institutions and medium-to-large corporate accounts. No single customer other than federal government accounted for more than 4% of total net sales in 2002. Net sales to the federal government in 2002, 2001, and 2000 were \$156,400, \$164,500, and \$129,000, or 13.1%, 13.9%, and 9.0% of total net sales, respectively.

## 16. SELECTED UNAUDITED QUARTERLY FINANCIAL RESULTS

The following table sets forth certain unaudited quarterly data of the Company for each of the quarters since January 2001. This information has been prepared on the same basis as the annual financial statements and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the selected quarterly information when read in conjunction with the annual

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financial statements and the notes thereto included elsewhere in this document. The quarterly operating results are not necessarily indicative of future results of operations. See “Factors That May Affect Future Results and Financial Condition—Historical Net Losses; Variability of Quarterly Results.”

	Quarters Ended			
	March 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002
Net sales	\$ 237,120	\$ 291,188	\$ 341,039	\$ 322,150
Cost of sales	212,170	259,864	303,869	286,408
Gross profit	24,950	31,324	37,170	35,742
Selling, general and administrative expenses	27,478	30,609	32,625	31,252
Restructuring costs and other special charges	813	105	718	—
Income (loss) from operations	(3,341)	610	3,827	4,490
Interest expense	(242)	(296)	(297)	(317)
Other, net	195	132	94	92
Income (loss) before income taxes	(3,388)	446	3,624	4,265
Income tax (provision) credit	1,288	(169)	(1,418)	(1,401)
Net income (loss)	\$ (2,100)	\$ 277	\$ 2,206	\$ 2,864
Weighted average common shares outstanding:				
Basic	24,551	24,553	24,533	24,583
Diluted	24,551	24,833	24,789	24,850
Earnings per common share:				
Basic	\$ (.09)	\$ .01	\$ .09	\$ .12
Diluted	\$ (.09)	\$ .01	\$ .09	\$ .12

	Quarters Ended			
	March 31, 2001	June 30, 2001	Sept. 30, 2001	Dec. 31, 2001
Net sales	\$ 303,310	\$ 296,386	\$ 312,885	\$ 273,636
Cost of sales	267,896	263,625	279,352	243,758
Gross profit	35,414	32,761	33,533	29,878
Selling, general and administrative expenses	30,476	30,617	29,117	27,400
Restructuring costs and other special charges	851	—	1,200	153
Income from operations	4,087	2,144	3,216	2,325
Interest expense	(377)	(277)	(264)	(261)
Other, net	288	396	357	266
Income before income taxes	3,998	2,263	3,309	2,330
Income tax provision	(1,518)	(861)	(1,257)	(885)
Net income	\$ 2,480	\$ 1,402	\$ 2,052	\$ 1,445
Weighted average common shares outstanding:				
Basic	24,417	24,422	24,506	24,467
Diluted	24,931	24,994	24,921	24,931
Earnings per common share:				
Basic	\$ .10	\$ .06	\$ .08	\$ .06
Diluted	\$ .10	\$ .06	\$ .08	\$ .06

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**

*(amounts in thousands)*

<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions- Write-Offs</u>	<u>Other</u>	<u>Balance at End of Period</u>
<b>Allowance for Sales Returns</b>					
Year Ended December 31, 2000	\$ 3,717	\$ 67,321	\$ (67,446)	\$ —	\$ 3,592
Year Ended December 31, 2001	3,592	52,969	(54,816)	—	1,745
Year Ended December 31, 2002	1,745	34,722	(35,459)	459 <sup>(2)</sup>	1,467
<b>Allowance for Doubtful Accounts</b>					
Year Ended December 31, 2000	3,933	9,868 <sup>(1)</sup>	(8,265)	—	5,536
Year Ended December 31, 2001	5,536	10,680 <sup>(1)</sup>	(8,784)	—	7,432
Year Ended December 31, 2002	7,432	7,238 <sup>(1)</sup>	(10,525)	997 <sup>(2)</sup>	5,142
<b>Inventory Valuation Reserve</b>					
Year Ended December 31, 2000	1,841	5,651	(5,792)	—	1,700
Year Ended December 31, 2001	1,700	5,808	(6,308)	—	1,200
Year Ended December 31, 2002	1,200	4,877	(4,827)	20 <sup>(2)</sup>	1,270

<sup>(1)</sup> Additions to the provision for doubtful accounts include charges to advertising and cost of sales aggregating \$665, \$1,981, and \$2,863 for the years ended December 31, 2002, 2001, and 2000, respectively. Such allowances relate to receivables under cooperative arrangements with vendors.

<sup>(2)</sup> Acquisition of MoreDirect subsidiary on April 5, 2002.

[LOGO] Miller-Valentine Group 4000  
Miller-Valentine Court Dayton,  
Ohio 45439-1487  
P.O. Box 744  
Dayton, Ohio 45401-0744  
  
937-293-0900 937-299-1564  
FAX www.mvg.com

July 31, 2002

Via U.S. Mail  
-----

Steve Markiewicz  
PC Connection  
730 Milford Road Route 101A  
Merrimack, NH 03054-4631

Re: Executed Lease Amendment #4 for  
Approximately 102,400 Square Feet of Space for  
2780-2880 Old State Route 73, Wilmington, OH 45177

Dear Steve:

Enclosed is a fully executed copy of the above referenced Lease  
Amendment and a copy of the State of Ohio Agency Disclosure Form for  
your files.

Should you need any additional information, please contact me at  
937-293-0900.

Sincerely,

MILLER-VALENTINE REALTY, INC.

/s/ Chuck McCosh

Chuck McCosh  
Senior Vice President of Sales

CM/ts

Enclosure

cc: Robert Pratt

For more information about Miller-Valentine services and products,  
please visit our web site at [www.mvg.com](http://www.mvg.com).

NAIOP National Developer of the Year

Disclosure of-Agency Relationship

(THIS FORM IS NOT A CONTRACT)

This real estate agent who is providing you with this form is required to do so  
by Ohio law. It does not, by itself, obligate you to work with this agent or  
his/her brokerage; nor will you be bound to pay any compensation to the agent or  
the agent's brokerage by merely signing this form.

Instead, the purpose of this form is to make sure you have the necessary  
information you need to know about the role of this agent if you choose to work

together. By signing, you acknowledge that you have been provided this information and agree to it. If you do not, you can consult with an attorney for further advice.

As a potential seller/landlord or buyer/tenant of real estate I understand and agree that

Chuck McCosh and Miller-Valentine Realty, Inc. will:
-----
(Agent) (Brokerage)

- [X] Represent the seller/landlord
[] Represent the buyer/tenant

I also understand and agree that the following may also possibly occur in a real estate transaction in which I may be involved with this agent:

- [X] The same agent who represents me could potentially represent the other party in a transaction involving me. The agent and brokerage would then both be dual agents.
[X] A different agent in the same brokerage could potentially represent the other party in a transaction involving me. Each agent would represent the interests of their separate client. The brokerage would be dual agent. A management level licensee is also a dual agent if representing a client in an in-com y transaction.

I have reviewed the information on the reverse side of this form and I have been given a completed copy of this Disclosure of Agency Relationship.

Merrimack Service Corp. dba PC Connection, Inc. FIVE WAREHOUSE INVESTMENTS, V LTD.
By Miller-Valentine Realty, Inc.,

/s/ Robert A. Pratt 7/30/02 /s/ Robert A. Gallinis 7/31/02
-----
(Buyer or Tenant) (Date) (Seller or PRESIDENT) (Date)
(Buyer or Tenant) (Date) By \_\_\_\_\_ 7/31/02
(Seller or landlord) (Date)
Robert A. Gallinis. President

To be completed only in an in-company transaction involving two agents ("Split" Agency)

Both buyer/tenant and seller/landlord acknowledge and agree that in a contemplated transaction involving property located at \_\_\_\_\_ the buyer/tenant is represented by \_\_\_\_\_ and the seller/landlord is represented by \_\_\_\_\_

By initialing below both parties acknowledge and agree that they are aware that both agents are affiliated with the same brokerage; that each agent will represent the separate interests of their separate client, (unless a management level licensee is one of the agents involved in the transaction); that it was previously disclosed that this could occur; and that they consent to the brokerage acting as a dual agent.

Buyer/Tenant's Initials: Seller/Landlord's Initials:
Date: Date:

[SEAL] Any questions regarding the role or responsibilities of the brokerage or its agents can be directed to an attorney or to: [SEAL]
Ohio Division of Real Estate and Professional Licensing
77 S. High Street, 20th Floor
Columbus, OH 43266-0547
(614)466-4100

AMENDMENT NO. 4 TO LEASE

THIS AGREEMENT made this 31 day of 2002 July, 2002, by and between EWE WAREHOUSE INVESTMENTS V, LTD., as Lessor and MERRIMACK SERVICES CORPORATION dba PC CONNECTION SERVICES, as Lessee located at 2780-2880 Old State Route 73, Wilmington, Ohio 45177.

WITNESSETH:

WHEREAS, Lessor and Lessee entered into a Lease dated September 27, 1990 as amended June 28, 1996, July 31, 1998, and June 26, 2000, and

WHEREAS, the Lessor and Lessee desire to amend the Lease of approximately 102,400 square feet to extend the term, revise the rent and delete the Option to Renew.

NOW THEREFORE, the Lease is amended as follows.

1. Article 1. TERM. shall be revised as follows.

Effective January 1, 2003, the term of this Lease shall be extended for an additional two (2) years, two (2) months for a total term of fourteen (14) years, two (2) months, commencing January 1, 1991 and ending February 28, 2006, both dates inclusive.

2. Lessee warrants that Lessee has accepted and is now in possession of the Premises and that the Lease is valid and presently in full force and effect. Lessee accepts the Premises in its present "as is" condition.

3. Article 4. RENT. shall be revised as follows.

For the two (2) month period commencing January 1, 2003 and ending February 28, 2003, the Lessee shall occupy the Leased Premises "rent free".

For the ten (10) month period commencing March 1, 2003 and ending December 31, 2003 the Lessee shall pay to the Lessor as Rent for the Leased Premises the sum of FOUR HUNDRED FORTY-EIGHT THOUSAND AND 00/100 DOLLARS (\$448,000.00) which shall be paid in equal monthly installments of FORTY-FOUR THOUSAND EIGHT HUNDRED AND 00/100 DOLLARS (\$44,800.00), due and payable on the first day of each month, in advance, without demand.

Checks should be made payable to Easton & Associates Management Account c/o The Easton Group, 10165 N. W. 19th St., Miami, FL 33172

The Basic Annual Rent of \$537,600.00 shall be adjusted annually based on any increases in the Consumer Price Index beginning January 1, 2004 and at the end of each year thereafter, whether during the term of this Lease or any renewal or extension thereof. Increases in the Annual Rent shall be made in accordance with the following procedure:

a. The index to be used for this adjustment shall be the Consumer Price Index (U.S. City Average, All Urban Consumers, All Items, 1982-1984 equaling a base of 100, from the U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C.).

b. The Consumer Price Index of 2002 for the month of September shall be the "Base Period Consumer Price Index". The Consumer Price Index for the month of September in each adjustment year shall be the "Adjustment Period Consumer Price Index".

c. The Base Period Consumer Price Index shall be subtracted from the Adjustment Period Consumer Price Index; the difference shall be divided by the Base Period Consumer Price Index. This quotient shall then be multiplied by the

Basic Annual Rent, and the result shall then be added to the Basic Annual Rent. The resulting sum shall be the adjusted Annual Rent for such immediately succeeding leasehold period which shall be paid in equal monthly installments.

All calculations of said procedure shall be provided to the Lessee in their entirety directly from EWE Warehouse Investments V, Ltd., the Lessor.

d. If the said Consumer Price Index is, at any time during the term of this Lease, discontinued by the Government, then the most nearly comparable index shall be substituted for the purpose of the aforesaid calculations.

4. Amendment No. 3, Item 6. OPTION TO RENEW. shall be amended as follows.

Lessee is hereby granted an option to renew this Lease for an additional term of two (2) years on the same terms and conditions contained herein except for the rental and the length of the term, upon the conditions that:

a. written notice of the exercise of such option shall be given by Lessee to Lessor not less than one hundred eighty (180) days prior to the end of the term of this Lease (by August 31, 2005); and

b. at the time of the giving of such notice and at the expiration of the term of this Lease, there are no defaults in the covenants, agreements, terms and conditions on the part of Lessee to be kept and performed, and all rents are and have been fully paid. Provided also, that the rent to be paid during each year of the said renewal period shall be as determined in accordance with the following procedure:

(1) The index to be used for this adjustment shall be the Consumer Price Index (U.S. City Average, All Urban Consumers, All Items, 1982-1984 equaling a base of 100, from the U.S. Department of Labor, Bureau of Labor Statistics, Washington, D.C.).

(2) The Consumer Price Index of 2002 for the month of September shall be the "Base Period Consumer Price Index".

(3) The Consumer Price Index for the month of September each succeeding year shall be determined from the published figures and shall be the "Adjustment Period Consumer Price Index".

(4) The Base Period Consumer Price Index shall be subtracted from the Adjustment Period Consumer Price Index; the difference shall be divided by the Base Period Consumer Price Index. This quotient shall then be multiplied by \$537,600.00 and the result shall then be added to \$537,600.00. This arithmetical sum shall then be the adjusted Basic Annual Rent for such immediately succeeding leasehold year which shall be paid in equal monthly installments.

(5) If the said Consumer Price Index is, at any time during the term of this Lease, discontinued by the Government, then the most nearly comparable index shall be substituted for the purpose of the aforesaid calculations.

All calculations of said procedure shall be provided to the Lessee in their entirety directly from EWE Warehouse Investments V, Ltd., the Lessor.

5. ARTICLE 21. NOTICE. shall be revised as follows.

All notices under this Lease may be personally delivered sent by courier service, with receipt; or mailed to the address shown by certified mail, return receipt requested. The effective date of any mailed notice shall be one (1) day after delivery of the same to the United States Postal Service.

Lessor: EWE Warehouse Investments V, Ltd.  
Mail: Easton & Associates  
Management Account  
c/o The Easton Group 10165 N.  
W. 19<sub>th</sub> St. Miami, FL 33172

Lessee: MERRIMACK SERVICES CORPORATION  
dba PC CONNECTION SERVICES

Mail: Attn: Legal Counsel  
730 Milford Road  
Merrimack, NH 03054-4631

Either party may from time to time designate in writing other addresses.

6. Except as expressly amended herein, all other terms and conditions of the Lease remain in full force and effect.

IN WITNESS WHEREOF, the Lessor' and Lessee have affixed their signatures to duplicates of this Amendment, this 30 day of July, 2002, as to Lessee and this 31 day of July, 2002, as to Lessor.

Signed and acknowledged  
in the presence of:

LESSOR: EWE WAREHOUSE INVESTMENTS V, LTD.  
BY MILLER-VALENTINE REALTY, INC.  
ITS MANAGING AGENT

/s/ Rita A Hughes  
-----

Rita A Hughes  
-----

Print Name

By: /s/ Robert A. Gallinis  
-----

Robert A. Gallinis

Title: President

/s/ Kelli L. Wilson  
-----

Kelli L. Wilson  
-----

Print Name

LESSEE: MERRIMACK SERVICES CORPORATION dba  
PC CONNECTION SERVICES

/s/ Robert A. Pratt  
-----

Robert A. Pratt  
-----

Print Name

By: /s/ Wayne L. Wilson  
-----

Wayne L. Wilson

Title: President

/s/ Barbara J. Jaus  
-----

Barbara J. Jaus  
-----

Print Name

STATE OF OHIO, COUNTY OF MONTGOMERY, SS:

The foregoing instrument was acknowledged before me this 31 day of July, 2002, by Robert A. Gallinis,

President of MILLER-VALENTINE REALTY, INC.

/s/ Rita A. Hughes  
-----

NOTARY PUBLIC

RITA A. HUGHES, Notary Public  
In and for the State of Ohio  
My Commission Expires May 4, 2006

STATE OF New Hampshire County of Hillsborough, SS:

The foregoing instrument was acknowledged before me this 30 day of July, 2002, by Wayne L. Wilson, the President of MERRIMACK SERVICES CORPORATION, a corporation on behalf of said corporation.

/s/ Dolores R. Collins  
-----

NOTARY PUBLIC

DOLores R. COLLINS, NOTARY PUBLIC  
NEW HAMPSHIRE  
My Commission Expires Jan. 20, 2004

LEASE

LEASE made as of November 1, 2002 by and between Audio Accessories, Inc., a NH corporation with offices at Mill Street, Marlow, NH 03456 (Landlord) and Merrimack Services Corporation, a DE corporation with offices at 730 Milford Road, Merrimack, NH 03054 (Tenant).

In consideration of the mutual covenants herein contained, Landlord agrees to lease to Tenant and Tenant agrees to lease from Landlord, the following described premises under the following conditions:

1. PREMISES. The premises are situated in the Town of Marlow, County of Cheshire and State of New Hampshire and consist of approximately 3,000 total square feet consisting of:

(a) Approximately 990 square feet on the first floor of the Mill Building, known as Room #1;

(b) Approximately 1200 square feet on the first floor of the Mill Building, known as Room #2; and

(c) The remaining approximately 810 square feet on the second floor of the Mill Building, in the area known as the former "Sales Floor";

(d) Together with such common areas of said building and land as necessary for access.

2. TERM. This Lease shall commence on November 1, 2002 and shall continue in force on a month-to-month basis, subject to the rights of the parties to terminate sooner as set forth in Section 13.

3. RENT. Tenant shall pay monthly rent to Landlord in the amount of \$375.00 payable in advance on the first day of every month during the duration of the Lease (rent based on \$1.50 per square foot annually). Rent includes all utilities and taxes.

4. POSSESSION. Tenant shall obtain possession of the premises on November 1, 2002 and shall continue in possession until such time as the Lease is terminated.

5. COMMON AREAS / PARKING. Tenant shall have access to the premises via common entrance and hallways. Tenant may use a reasonable number of parking spaces in the common parking lot and walks. Tenant shall have the use of a restroom.

6. UTILITIES AND SERVICE. The rental payment includes all utilities, including heat, water, sewer, electric, and snow removal. Landlord shall dispose of trash provided Tenant places its trash in the area so designated by Landlord.

7. TAX. Landlord shall pay all real property taxes assessed against the premises.

8. IMPROVEMENTS. Tenant shall take occupancy of the Premises as is. Any additional facilities requirements will be the responsibility of Tenant. Tenant shall make no alterations to the Premises without the written authorization of Landlord.

9. COVENANTS.

(a) Landlord warrants that it is the true owner of record of the Premises. Landlord covenants that so long as Tenant pays the rent and performs its covenants, Tenant shall peaceably and quietly have, hold, enjoy and have the exclusive use of the premises for the term provided.

(b) Tenant covenants that it will undertake only lawful business on the premises and that it will comply with all applicable laws and regulations, including environmental laws and regulations, and that it will not operate any business so as to constitute a nuisance. Tenant covenants that at the end of the Lease term, or the renewal period, it will return the premises to the Landlord in its original condition, subject to reasonable wear and tear and subject to

such improvements that Tenant does not remove.

10. ASSIGNMENT. Tenant shall not assign or sublet this Lease without the Landlord's prior written consent, except to its affiliated corporations. Landlord may assign this Lease to banks or other financial institutions for the purpose of securing loans made by it.

11. REPAIR. Landlord shall keep the building's roof, structure, heating, electrical and plumbing systems, and common areas in good repair. Landlord shall keep the premises' driveways and parking areas in good repair. In the event Tenant or any of its employees, agents or invitees causes, through negligence or misconduct, any damage to the Premises which is not normal wear and tear, Tenant shall make necessary repairs to the premises, or if it fails to do so, Landlord shall have the right to repair same and invoice Tenant for the cost thereof, which invoice Tenant shall promptly pay.

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12. INSURANCE.

(a) Landlord shall maintain adequate fire and extended hazard insurance (all risk policy) on the building.

(b) Tenant shall maintain adequate insurance on its contents and property on the premises.

(c) Tenant and Landlord shall each maintain general liability insurance (including bodily injury and property damage) in an amount no less than \$1,000,000.

(d) Policies of insurance shall be presented for review upon request of the other party.

13. NOTICES. All notices or demands of any kind required or desired to be given by Landlord or Tenant hereunder shall be in writing and shall be deposited in the United States mail, certified or registered mail, postage prepaid, addressed to the Landlord or Tenant, as the case may be, at the address set forth above. All rent payments due under this Lease shall be made by Tenant at the same address.

14. TERMINATION.

(a) If Tenant defaults in the payment of rent, Landlord may notify Tenant, in writing, of such default. If Tenant does not cure the rent default within 15 days of such notice, then Landlord may give Tenant a 30 day written notice of termination. If at the end of the 30 days, Tenant has not cured the rent default, Landlord may declare this Lease terminated, and Tenant shall quit and surrender the premises. If after the 30 day period Tenant has not quit the premises, then Tenant shall be responsible for all costs of eviction thereafter, including attorney's fees.

(b) Either party may terminate this Lease upon written notice, to take effect at the end of the next following full month.

15. HOLD HARMLESS. Tenant shall hold harmless and indemnify Landlord from and against any and all claims, actions or damages resulting from Tenant's acts, omissions, or negligence while on the premises or common areas. Landlord shall hold harmless and indemnify Tenant from and against any and all claims actions or damages resulting from any Landlord's acts, omissions or negligence while on the premises, common areas or the remainder of the property.

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16. GENERAL. This Lease agreement represents the entire and exclusive understanding between the parties; shall be binding on the parties, their heirs, legal representatives, assigns and successors; and is subject to and shall be construed under the laws of the State of New Hampshire. Failure to exercise any rights herein shall not prejudice the parties in any future exercise of their rights.

IN WITNESS WHEREOF: The parties hereto have set their hands on the date first

written.

Audio Accessories, Inc.

By: /s/ Tim Symonds

-----  
Tim Symonds, General  
Manager

Merrimack Services Corporation

By: /s/ Bob Pratt

-----  
Bob Pratt, Director of Facilities

Exhibit 10.55

PSBUSINESSPARKS

METRO PARK NORTH  
7529 Standish Place, Suite 115 Rockville,  
MD 20855  
TEL 301340.0901  
FAX 301 340.8503  
www.psbusinessparks.com

January 3, 2003

Bob Pratt  
PC Connection, Inc.  
Route 101A, 730 Milford Road  
Merrimack, NH 03054-4631

RE: 7503 Standish Place  
Rockville, MD

Dear Bob,

Please find enclosed a long overdue fully executed copy of the Fourth Amendment to Lease Agreement for your premises in Rockville, MD. On behalf of PS Business Parks I would like to thank you for choosing to renew with us in Metro Park. If I can be of any assistance during the next three years I hope that you will not hesitate to give me a call.

Sincerely,

David

David S. Knipp  
Director of Leasing

Enclosure

FOURTH AMENDMENT TO AGREEMENT OF LEASE

THIS FOURTH AMENDMENT TO AGREEMENT OF LEASE ("Fourth Amendment") is made this 20th day of November, 2002, by and between METRO PARK I, LLC, a Delaware limited liability company ("Lessor") and GOVCONNECTION, INC., a Maryland corporation, formerly known as Comteq Federal, Inc. ("Lessee").

WITNESSETH:

WHEREAS, Rockville Office/Industrial Associates, Lessor's predecessor in interest and Comteq Federal, Inc., Lessee's predecessor in interest, entered into that certain Lease dated December 14, 1993 (the "Original Lease"), as amended by that certain First Amendment to Lease dated November 1, 1996 (the "First Amendment"), as further amended by that certain Second Amendment to Agreement of Lease and Extension of Term dated as of March 31, 1998 (the "Second Amendment"), and as further amended by that certain Third Amendment to Agreement of Lease dated as of August 31, 2000 (the "Third Amendment") (the Original Lease, First Amendment, Second Amendment and Third Amendment shall be referred to collectively as the "Lease"), pursuant to which Lessee leased that certain space in the building located at 7503 Standish Place, Rockville, Maryland (the "Building"), said leased premises containing approximately Ten Thousand One Hundred Ninety-Six (10,196) rentable square feet of space (the "Premises"); and

WHEREAS, Lessor and Lessee desire to amend the Lease to extend the Term of the Lease and modify and amend certain other terms and conditions of the Lease as herein provided.

NOW, THEREFORE, in consideration of the premises and mutual covenants

and agreements herein contained and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Lessor and Lessee hereby agree to the following:

1. Recitals. The recitals set forth above are incorporated herein by this reference with the same force and effect as if fully set forth hereinafter.

2. Capitalized Terms Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the Lease. The Lease and this Fourth Amendment shall be known collectively as the "Lease".

3. Lessee. All references in the Lease to Rockville/Office Industrial Associates as Lessor, shall now apply to Metro Park I, LLC. All references in the Lease to Comteq Federal, Inc. as Lessee, shall now apply to GovConnection, Inc.

4. Term. The Term of the Lease is hereby extended for a period of three (3) years commencing on April 1, 2003 (the "Renewal Date") and expiring on March 31, 2006 (inclusively, the "Renewal Term"), unless terminated sooner pursuant to the provisions of the Lease or hereof.

5. Rent. As of the Renewal Date, Sections 2.1, 2.2, 2.3, 2.4 and 2.5 of the Original Lease, as amended by Paragraph 2 of the First Amendment, Paragraph 5 of the Second Amendment and Paragraph 2 of the Third Amendment are hereby deleted in their entirety and the following Sections 2.1, 2.2 and 2.3 are substituted in lieu thereof:

"2.1. Base Rent. On or before the first day of each calendar month of the Lease Term, Lessee will pay to Lessor the Base Rent for such month as more particularly set forth hereinbelow. All sums payable by Lessee to Lessor hereunder shall be deemed rent. Base Rent and all other amounts required to be paid by Lessee hereunder shall be paid without deduction or offset and without prior notice or demand. All such amounts shall be paid in lawful money of the United States of America and shall be paid to Lessor at the address stated herein or to such other persons or to such other places as Lessor may designate in writing from time to time. Amounts payable hereunder shall be deemed paid when actually received by Lessor.

Lease Period	Monthly Base Rent
04/01/03-03/31/04	\$19,967.17
04/01/04-03/31/05	\$20,566.19
04/01/05-03/31/06	\$21,183.18

2.2. Additional Rent.

2.2.1 Unless otherwise specifically stated in this Lease, any charge payable by Lessee under this Lease other than Base Rent is called "Additional Rent". Except as otherwise specifically provided in this Lease, Additional Rent is to be paid concurrently with and is subject to the same terms and conditions as Base Rent. The term "rent" or "Rent" whenever used in this Lease means Base Rent, Additional Rent and/or any other monies payable by Lessee under the terms of this Lease. Monthly rent for any partial calendar month will be prorated.

2.2.2 "Operating Costs" as used herein shall include all costs and expenses related to the ownership, management, operation,

maintenance, replacement, improvement and repair of the Premises, Building, and/or Property, or any part thereof, incurred by Lessor including but not limited to: (1) Property supplies, materials, labor, equipment, and tools; (2) Lessor incurred Utility and Service Costs (as further described in Paragraph 2.2.38 below), security, janitorial, trash removal, and all applicable service and maintenance agreements; (3) Property related legal, accounting, and consulting fees, costs and expenses, including but not limited to the cost of contests of Real Property Taxes; (4) Insurance Premiums for all policies deemed necessary by Lessor and/or its lenders, and all deductible amounts under such policies (as further described in Paragraph 2.2.3C below); (5) costs and

expenses of operating, maintaining, and repairing the Property, including but not limited to all interior areas and also driving, parking, loading, and other paved or unpaved areas (including but not limited to, resurfacing and striping and any snow and ice removal Lessor elects to conduct), landscaped areas (including but not limited to, tree trimming), building exteriors (including but not limited to, painting and roof work), signs and directories, and lighting; (6) capital improvements and replacements (including but not limited to all financing costs and interest charges); (7) compensation (including but not limited to, any payroll taxes, worker's compensation for employees, and customary employee benefits) of all persons, including independent contractors, who perform duties, or render services on behalf of, or in connection with the Property, or any part thereof, including but not limited to, Property operations, maintenance, repair, and rehabilitation; (8) Property management fees and the cost of providing space used by the Property manager; and (9) Real Property Taxes (as further described in Paragraph 2.2.3A, below).

2.2.3A "Real Property Taxes" as used herein shall include any fee, license fee, tax, levy, charge, assessment, penalty or late fee (if a result of Lessee's delinquency or negligence), or surcharge (hereinafter individually and/or collectively referred to as "Tax") imposed by any authority (including but not limited to, any federal, state, county, or local government, or any school, agricultural, lighting, drainage, or other improvement district, or public or private association) having the direct or indirect power to tax and where such Tax is imposed against the Property, or any part thereof, or Lessor in connection with its ownership or operation of the Property, including but not limited to: (1) any Tax on Lessor's right to receive, or the receipt of, rent or income from the Property, or any part thereof, or Tax against Lessor's business of leasing the Property; (2) any Tax by any authority for services or maintenance provided to the Property, or any part thereof, including but not limited to, fire protection, streets, sidewalks, and utilities; (3) any Tax on real estate or personal property levied with respect to the Property, or any part thereof, and any fixtures and equipment and other property of Lessor or the Property used in connection with the operation, maintenance or repair of the Property; (4) any Tax imposed on this transaction, or based upon a reassessment of the Property, or any part thereof, due to a change in ownership or transfer of all or part of lessor's interest in the Property, or any part thereof and, (5) any Tax replacing, substituting for, or in addition to

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any Tax previously included with this definition. Real Property Taxes do not include: (a) Lessor's federal or state income, franchise, inheritance, or estate taxes; or (b) Lessee's personal property taxes (taxes charged against Lessee's trade fixtures, furnishings, equipment, or other personal property) which are the sole responsibility of Lessee, and shall be billed directly to, and paid as and when first due by Lessee.

2.2.3B "Utility and Service Costs" as used herein shall include all Lessor incurred utility and service costs and expenses including but not limited to costs related to water and plumbing, electricity, gas, lighting, steam, sewer, waste disposal, and HVAC, and all costs related to plumbing, mechanical, electrical, elevator, HVAC, and other systems.

2.2.3C "Insurance Premiums" as used herein shall include all insurance premiums for all insurance policies maintained by Lessor from time to time, including but not limited to insurance policies covering worker's compensation, fire and other casualty, commercial general liability, automobiles, and rental interruption, and any and all additional coverages, and all endorsements and riders under or attached to such policies.

2.2.4 If the Operating Costs incurred by Lessor for any "Expense Comparison Year" (defined as each calendar year after Lessee's Expense Base Year) exceed those incurred in Lessee's Expense Base Year, then Lessee will pay as Additional Rent an amount equal to the excess multiplied by Lessee's Proportionate Share of the Property or Building, as designated from time to time by Lessor. As provided herein, estimated payments of the excess shall be made monthly on or before the first day of each calendar month each in the amount of Lessor's then current estimate of the monthly amount of Lessee's Proportionate Share of such excess and additional payments shall be made as outlined below. In the event this Lease includes a partial Expense Comparison Year, Lessee's Proportionate Share for such partial Expense Comparison Year will be prorated based on the actual number of applicable days and months. All Operating Costs will be adjusted, at the election of Lessor, to reflect 100% occupancy during

any calendar year in which the Property is not fully occupied. Lessee's Expense Base Year shall be the calendar year 2003: Lessee's Proportionate Share shall be 6.1%.

2.2.5 Operating Cost payments shall be made as set forth herein. All Operating Costs estimates and payments shall reflect credit for the sum of Operating Costs of the Expense Base Year.

2.2.5A Lessee's Operating Costs estimates: On or about April 1st of each calendar year, Lessor will provide Lessee with a statement of: (1) Lessee's annual share of estimated Operating Costs for the then current calendar year; (2) Lessee's monthly Operating Cost estimate for the then current year; and, (3) Lessee's retroactive estimate correction billing (for the period of

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January 1st through the date immediately prior to the commencement date of Lessee's new monthly Operating Cost estimate) for the difference between Lessee's new and previously billed monthly Operating Cost estimates for the then current year.

2.2.5A(1) Annual estimated share: Lessee's annual share of estimated Operating Costs for the then current calendar year shall be determined by multiplying the amount by which Lessor's estimated total Operating Costs for the then current calendar year exceed the Operating Costs of the Expense Base Year, by Lessee's Proportionate Share identified in Paragraph 2.2.4.

2.2.5A(2) Monthly Operating Cost estimate: Lessee's new monthly Operating Cost estimate for the then current calendar year shall be calculated by dividing Lessee's annual share of estimated Operating Costs in excess of Operating Costs of the Expense Base Year, as determined above, by 12.

2.2.5A(3) Retroactive estimate correction: Lessee's share of the change in Operating Cost estimates retroactive to January 1st of each year shall be determined as follows: For the then current calendar year, the total of Lessee monthly Operating Cost estimates billed prior to the commencement of Lessee's new monthly Operating Cost estimate shall be subtracted from Lessee's new monthly Operating Cost estimate multiplied by the number of elapsed months within the same period.

2.2.5B Lessee's Proportionate Share of actual annual Operating Costs: On or about April 1st of each year, Lessor will provide Lessee with a statement reflecting the total Operating Costs for the calendar year just ended. If the total of Lessee's Operating Cost estimates billed for the calendar year just ended are less than Lessee's Proportionate Share of the actual Operating Costs for the calendar year just ended, the statement will indicate the payment amount and date due. If Lessee has paid more than its Proportionate Share of Operating Costs for the preceding calendar year, Lessor will credit the overpayment toward Lessee's future Operating Cost obligations. If Lessor fails to provide Lessee with an Operating Cost statement by April 1st of any calendar year, or elects not to bill Lessee its share of actual Operating Costs, and/or Operating Costs estimate(s), or estimate increase(s) for any period of time, Lessor's right to bill and collect these charges from Lessee at a later time is not waived.

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2.2.6 Under this Lease, monthly Operating Cost estimates, retroactive estimate corrections, and Lessee's Proportionate Share of actual annual Operating Costs are considered Additional Rent. Monthly Operating Cost estimates are due on the 1st of each month and shall commence in the month specified by Lessor. Lessee's retroactive estimate correction, and actual annual Operating Cost charges, if any, shall be due, in full, on the date(s) specified by Lessor.

2.2.7 Lessee will not be entitled to any reduction, refund, offset, allowance or rebate should any Real Property Taxes be retroactively reduced, credited, abated or exempted by any direct or indirect taxing authority

for any prior taxation or assessment period.

2.2.8 Lessee will pay as Additional Rent its Proportionate Share (after giving effect to the Expense Base Year amount) of any duties, levies or fees resulting from any statutes or regulations, or interpretations thereof, now or hereafter enacted by any governing authority which pertains to Lessor's or Lessee's use, ownership, occupancy or alteration of the Premises or Property, or any part thereof. Lessee's Proportionate Share of such duties or fees will be based on Lessee's Proportionate Share as indicated in Paragraph 2.2.4, or other equitable method determined by Lessor in its sole discretion. In the event the Property, or any part thereof, shares common Operating Costs, commonly used areas, land or other items not exclusive to the Property, Lessor shall allocate and bill Lessee a portion of any costs and expenses attributable to such sharing on a basis determined by Lessor.

2.2.9 Unless Lessor otherwise elects, Lessee shall pay each Operating Cost in accordance with Lessee's Proportionate Share of the Property. Lessor shall have the right to make allocations ("Allocations") to Lessee of anyone or more Operating Costs on a different basis. Lessor shall have the right to make any such Allocations in any manner which Lessor deems reasonable (including use of estimates). For example, if Lessor deems it reasonable to do so, Lessor shall have the right to elect at any time and from time to time (a) to make any Allocation of one or more Operating Costs based upon Lessee's Proportionate Share of the Building and to make other Allocations on Lessee's Proportionate Share of the Property, (b) to make Allocations of certain Operating Cost items among less than all lessees and/or other than based upon the respective square footages of the lessees, (c) to make different locations for different Operating Costs, and/or (d) to alter an Allocation or the method of determining an Allocation from time to time. Lessor shall also have the right to make Allocations of cost items in the Expense Base Year. In no event shall Lessor be liable to Lessee based upon any incorrect or disputed Allocation nor shall Lessee have any right to terminate this Lease by reason of any such Allocation.

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2.2.10 In the event Lessee wishes to audit any Operating Cost charge, such an audit shall be limited to an audit of the annual statement delivered under Paragraph 2.2.58 above. Such audit shall be performed only if, at the time of the audit request and at all times thereafter to and during the course of the audit, Lessee has paid in full all Operating Costs billed and is not in default. Any audit shall be conducted at a time and location designated by Lessor. Lessor and Lessee agree that any Lessee audit must be requested by Lessee by written notice given within six (6) months of the date that Lessor provides the applicable annual statement under Paragraph 2.2.58 above, and must be completed by Lessee within thirty (30) days of its written notice requesting the audit; if Lessee does not give such written notice within the period of time allowed, or fails to complete the audit within the time allowed, Lessee's right to audit is waived, and the Operating Costs, as billed, including all calculations used as the basis for Lessor's charges (including any "Allocations" and any applicable Expense Base Year or expense stop calculations), shall be deemed conclusive and final for all purposes under this Lease. All calculations by Lessor of Operating Costs for the Expense Base Year shall be conclusive and final, and Lessee shall have no right to audit the same, except only Lessee may audit the same as part of an audit of Operating Costs for the first Expense Comparison Year. Any audit shall be conducted only by Lessee and the CPA then used by Lessee for the preparation of its tax returns and financial statements; no agent of Lessee employed in connection with the audit shall be employed on any contingent payment basis. Lessee shall maintain as strictly confidential, and shall cause its auditor to execute in favor of Lessor a confidentiality agreement (in form prepared by Lessor) regarding, all financial information audited, the results of any such audit, and the resolution of any disputed issues arising in connection with such audit. Lessor shall not be bound by the result of any such audit. If the parties do not agree upon the inclusion or amount of any Operating Cost charged by Lessor, the sole remedy of Lessee shall be to conduct an audit within the time specified in this Lease and, if still in disagreement with Lessor, to submit the matter to arbitration within thirty (30) days after completion of the audit to request an adjustment to any disputed Operating Cost item to cause the same to not exceed the amount that Lessor has the right to collect hereunder for such item. In no event will this Lease be terminable nor shall Lessor be liable for damages based upon any disagreement regarding or adjustment of Operating Costs.

2.3. Late Charges. If any sum payable by Lessee to Lessor is not received by Lessor within five (5) days after it becomes due, Lessee shall, without the necessity of notification from Lessor, pay Lessor a late charge equal to fifty dollars (\$50.00) or ten percent (10%) of the then delinquent amount, whichever is greater. The acceptance of late charges by Lessor will in no way constitute a waiver of Lessee's default with respect to any overdue amount nor prevent Lessor from exercising any of its rights or remedies resulting from such late payment"

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6. Security Deposit. Lessor currently holds a Security Deposit under the Lease in the amount of Four Thousand Eight Hundred Ninety-Nine and No/100 Dollars (\$4,899.00). Lessee shall have no obligation to supplement such security deposit.

7. Lessee Improvements. Lessee hereby accepts the Premises in its "as-is" condition existing on the Renewal Date. Lessor shall have no obligation to make any Lessee improvements to the Premises on behalf of Lessee during the Renewal Term hereof.

8. Notices. The address of the Lessor provided on the first page of the Original Lease is hereby deleted in its entirety and the following substituted in lieu thereof:

"Lessor's Notice Address:

c/o PS Business Parks, Inc.  
7529 Standish Place, Suite 115  
Rockville, Maryland 20855  
Attention: William A. McFaul

With a copy to:

PS Business Parks, Inc.  
2 North Charles Street, Suite 101  
Baltimore, Maryland 21201  
Attention: William A. McFaul"

9. Real Estate Investment Trust. The Lease is hereby amended by adding the following new Sections 17.16 and 17.17:

"17.16: Real Estate Investment Trust

If Lessor is a real estate investment trust, and if Lessor in good faith determines that its status as a real estate investment trust under the applicable provisions of the Internal Revenue Code of 1986, as heretofore or hereafter amended, will be jeopardized because of any provision of this Lease, Lessor may require reasonable amendments to this Lease and Lessee shall not unreasonably withhold or delay its consent thereto, provided that such modifications do not in any way, (i) increase the obligations of Lessee under this Lease or (ii) adversely affect any rights or benefits to Lessee under this Lease. Lessor shall pay all reasonable costs incurred by Lessee, including without limitation, legal fees incurred - for reviewing any such proposed modifications.

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17.17: Related Party Representation

Lessee represents that, to its knowledge, no person or entity who is a significant indirect owner of Lessor, owns actually or constructively a 10% or more interest in Lessee. Lessee will promptly notify Lessor if it learns that any such ownership interest exists. Significant owners of Lessor at this time include Public Storage, Inc. and New York Common Retirement Fund."

10. Option to Renew. Subject to the provisions of Paragraph 12 of this Fourth Amendment, and provided that Lessee is not in default at the time of Lessee's exercise of the Option (as defined in Paragraph 12 herein) or at the

commencement of the applicable Option term, Lessee shall have two (2) one (1) year Options to renew this Lease upon such terms and conditions then in effect for comparable space in the Project as of the commencement of the applicable Option term, except that the Base Rent payable during each month of the applicable Option term shall be an amount equal to one hundred three percent (103%) of the Base Rent payable during the last month of the applicable expiring Lease Term. All other terms and conditions of the Lease shall remain the same. All such terms, conditions and rental provisions shall, upon the exercise of the Option, be evidenced upon the form of lease then in effect for the Project. Lessee shall provide to Lessor on a date which is prior to the date that the Option period would commence (if exercised) by at least one hundred eighty (180) days, a written notice of the exercise of the Option to renew the Lease for the applicable additional Option term, time being of the essence. Such notice shall be given in accordance with Section 16 of the Lease. If notification of the exercise of this Option is not so given and received, all options granted hereunder shall automatically expire.

11. Right of First Offer. Provided that Lessee is not in default under the Lease at the time it exercises this Option or at the commencement of the lease term with respect to the Option Space, and subject to the provisions of Paragraph 12 of this Fourth Amendment, including but not limited to, Lessor's right to first offer and lease any such space to any tenant who is then occupying or leasing such space at the time the space becomes available for leasing, and subject to all other options held by tenants of the Project as of the date hereof, Lessee shall have the right of first offer with respect to any space that becomes available in the Building which is contiguous with the Premises (the "Option Space"). Prior to leasing any of the Option Space, Lessor shall give Lessee written notice of its intent to lease the Option Space and the material terms and conditions under which Lessor would agree to lease the Option Space to Lessee, including, without limitation, rent, lease term, escalations, tenant allowance, concessions and security, if applicable. The lease term with respect to the Option Space shall not be for a period of less than three (3) years, and, in the event Lessee elects to lease the Option Space, as a condition of the effectiveness of such

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election, this Lease shall be amended to extend the Term of the Lease with respect to the Premises to be coterminous with the lease term with respect to the Option Space.; Lessee may exercise such right only as to all of the Option Space described in the Lessor's notice and on all of the terms set forth in Lessor's notice, and not to merely a part of such Option Space or some of such terms. Lessee shall have five (5) business days in which to provide Lessor with written notice of its election to exercise such right. Such notice shall be given in accordance with Section 16 of the Lease, time being of the essence. If Lessee does not give Lessor written notice of its election to lease such Option Space on such terms within the five (5) business day period, Lessor shall thereafter be free to lease such Option Space to a third party on any terms and conditions that Lessor shall select, with no further obligation to Lessee. In the event that Lessor offers any space to Lessee pursuant to this right of first offer, and Lessee elects not to lease the space, the space so offered shall no longer be subject to this right of first offer, and thereafter Lessor shall not be obligated to offer said space to Lessee. In the event Lessee exercise its right to lease the Option Space in accordance with the provisions hereof, the parties hereto agree to promptly execute an amendment to this Lease incorporating the terms set forth in Lessor's notice and such other terms as are acceptable to Lessor.

12. Options Personal. The options granted to Lessee in Paragraphs 10 and 11 hereinabove (collectively, the "Options", each an "Option") are personal to the original Lessee named in this Fourth Amendment and any Permitted Transferee, as hereinafter defined, and may be exercised only by the original Lessee or Permitted Transferee while occupying the entire Premises and may not be exercised or be assigned, voluntarily or involuntarily, by or to any person or entity other than Lessee. The Options granted to Lessee are not assignable separate and apart from the Lease, nor may any Option be separated from the Lease in any manner, either by reservation or otherwise. If at any time an Option is exercisable by Lessee, the Lease has been assigned, or a sublease exists as to any portion of the Premises other than to a Permitted Transferee, the Option shall be deemed null and void and neither Lessee nor any assignee or subtenant shall have the right to exercise the Option. For purposes herein, a Permitted Transferee shall mean a sublease or assignment to (a) an entity resulting from a merger or consolidation with Lessee, (b) any

corporation succeeding to substantially all of the business and assets of Lessee, or (c) any entity that controls, is controlled by or is under common control with Lessee.

13. Brokers. Lessee represents and warrants to Lessor that Lessee has not had any dealings or entered into any agreements with any person, entity, realtor, broker, agent or finder in connection with the negotiation of this Fourth Amendment other than Transwestern Commercial Services (the "Broker"). Lessor shall pay a commission to the Broker in accordance with the terms of a separate agreement between Lessor and the

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Broker. Lessee shall indemnify and hold harmless Lessor from and against any loss, claim, damage, expense (including costs of suit and reasonable attorneys' fees) or liability for any compensation, commission or charges claimed by any other realtor, broker, agent or finder claiming to have dealt with Lessee in connection with this Fourth Amendment.

14. Reaffirmation of Terms. Except as expressly modified hereby, all of the terms, covenants and provisions of the Lease are hereby confirmed and ratified and shall remain unchanged and in full force and effect.

15. Representations. Lessee hereby represents and warrants to Lessor that Lessee (i) is not in default of any of its obligations under the Lease and that such Lease is valid, binding and enforceable in accordance with its terms, (ij) has full power and authority to execute and perform this Fourth Amendment, and (iii) has taken all action necessary to authorize the execution and performance of this Fourth Amendment.

16. Counterpart Copies. This Fourth Amendment may be executed in two or more counterpart copies, each of which shall be deemed to be an original and all of which counterparts shall have the same force and effect as if the parties hereto had executed a single copy of this Fourth Amendment.

[SIGNATURES APPEAR ON NEXT PAGE]

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IN WITNESS WHEREOF, Lessor and Lessee have executed this Fourth Amendment as of the day and year first above written.

LESSOR:  
METRO PARK I, LLC,  
a Delaware limited liability  
company

LESSEE:  
GOVCONNECTION, INC.,  
a Maryland corporation

By: PS Business Parks, LP.,  
a California limited partnership, its  
sole member

By: PS Business Parks, Inc., a  
California corporation, its  
general partner

By: /s/ Emery Geosits  
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Name: Emery Geosits  
Title: Sr. Director of Sales

By: /s/ William A. McFaul  
William A McFaul  
Vice President

Date: 11/26/02  
AMENDMENT EXECUTION DATE  
Lessor Fed. ID #:

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This LEASE made June 1, 2002 by and between Gallup & Hall, a limited liability partnership with offices at 730 Milford Road, Merrimack, NH (hereinafter "Landlord"), and Merrimack Services Corporation, a Delaware corporation with offices at 730 Milford Road, Merrimack, New Hampshire 03054 (hereinafter "Tenant").

In consideration of the mutual covenants herein contained, the Landlord agrees to lease to the Tenant and the Tenant agrees to lease from the Landlord, the following described premises under the following conditions:

1. PREMISES. The premises to be leased consist of two adjoining parcels known as 442 Marlboro Street in Keene, New Hampshire and an approximately 1,152 square foot building situated thereon together with any parking spaces thereon, further described in a deed dated May 8, 1997 and recorded at Volume 1598, Page 595 in the Cheshire County Registry of Deeds.

2. TERM. This Lease shall be on a month-to-month basis.

3. RENT. Tenant shall pay to Landlord as rent the sum of \$1,344.00 per month payable in advance on the first of the month.

4. POSSESSION. Tenant shall have possession of the premises upon execution of the lease.

5. COVENANTS. Landlord warrants that it is the true owner of record of the Premises. Landlord covenants that so long as Tenant pays the rent and performs its covenants, Tenant shall peaceably and quietly have, hold, enjoy and have the exclusive use of the of the premises for the term provided.

Tenant covenants that it will undertake only lawful business on the premises and that it will comply with all applicable laws and regulations, and that it will not operate any business so as to constitute a nuisance. Tenant covenants that at the end of the Lease term, or the renewal period, it will return the premises to the Landlord in its original condition, subject to reasonable wear and tear and subject to such improvements that Tenant does not remove.

6. IMPROVEMENTS. Tenant may make reasonable improvements to the premises including office fix-up and the erection of signs, at its expense. Tenant shall promptly pay for all material and labor for said improvements and shall have the option of removing any of the improvements at the end of the Lease period unless removal will cause damage to the premises; all removal shall take place no later than 30 days after the end of the Lease period. Tenant shall make no structural changes to the building without the prior written consent of the Landlord.

7. ASSIGNMENT. Tenant may assign this Lease to its subsidiary, sister or parent corporation; notice of which will be given to Landlord. Tenant will not otherwise assign or sublet this Lease without the Landlord's consent; which consent it will not unreasonably withhold. Landlord may assign this Lease to banks or other financial institutions for the purpose of securing loans made by it.

8. REPAIR. Landlord shall keep the buildings' roof and structure in good repair. Tenant shall make all other necessary repairs to the premises, including the heating, electrical and plumbing systems. Reasonable wear and tear shall be allowed.

9. UTILITIES. Tenant shall pay all utilities and services including water and sewer charges, snow removal, trash removal, lawn mowing, janitorial, heat electricity, telephone and any other utility.

10. TAX. Landlord shall be responsible for all real property taxes assessed against the premises.

11. INSURANCE. Tenant shall maintain adequate fire and extended hazard insurance (all risk policy) on the building and shall maintain adequate insurance on its contents and property on the premises, including improvements within the building. Tenant and Landlord shall each maintain adequate general liability insurance, with waivers of subrogation. Policies of insurance shall be presented

for review upon the reasonable request of the other party.

12. SHOWING. Landlord may show the premises from time to time, at a time agreeable to Tenant.

13. HOLD HARMLESS. Tenant agrees to save the Landlord harmless from and indemnify Landlord against, any and all claims, actions or damages resulting from any act, omission or negligence of Tenant or subtenant taking place within the building or directly caused by Tenant or its agent on the premises, or in connection with making any improvements, unless any such claim, action or damage results for any act, omission or negligence of a third party on the premises, not on business with the Tenant. Landlord agrees to save the Tenant harmless from and indemnify Tenant against any and all claims, actions or damages resulting from any act, omission or negligence of Landlord or its agent.

14. GENERAL. This Lease represents the entire and exclusive understanding between the parties. This Lease shall be binding on the parties, their heirs, legal representatives, assigns and successors. Failure to exercise any rights herein shall not prejudice the parties in any future exercise of the rights. This Lease is subject to the laws of the State of New Hampshire.

Agreed.

Merrimack Services Corporation

By: /s/ Bob Pratt

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Bob Pratt, Director of Facilities

Gallup & Hall, LLP

By: /s/ Patricia Gallup

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Patricia Gallup, Partner

BUSINESS LEASE

THIS LEASE is executed this 1st. day of February, 2001 between Byram Realty Inc., the Lessor, and MoreDirect,com Inc., the Lessee:

WITNESSETH:

1. PREMISES. The Lessor, for and in consideration of the rent herein reserved to be paid by the Lessee, and in consideration of the covenants herein to be kept and performed by the Lessee, does hereby lease and demise unto the said Lessee the following described premises, (hereinafter "Premises") situated, lying and being in the City of Boca Raton, County of Palm Beach, State of Florida, which Premises are a part of the The Haimes Centre (hereinafter "Offices"): The Haimes Centre, Suite(s)102 and 103 consisting of 1200 square feet.

2. TERM AND COMMENCEMENT OF RENT. The term of this Lease shall be for four (4) years and two (2) months following the commencement of the term as provided hereinafter and shall terminate on April 1, 2005. Lessee shall have the option to extend this agreement for an additional term of five (5) years beyond the original term by giving written notice to the Lessor of its intention to exercise such option at least six (6) months prior to the expiration of said original term.

The term of this Lease shall begin on or upon occupancy and Lessee's obligation to pay rent shall commence on February 1st. or upon the premises being vacated by the present tenant. Should the term of this lease and the Lessee's obligations to pay rent commence on the day other than the first day of a month, then the term of this Lease, for purposes of the preceding section only, shall commence on the first day of the following month.

The Lessee shall pay rent for the additional month preceding the commencement of this Lease, if the term of this Lease commences on a day other than the first day of a month, on a per diem basis (calculated on the basis of a 30 day month) payable on commencement of the term of this lease. Any rental payment hereunder for any other fractional month shall likewise be calculated and paid on such per diem basis.

3. RENT. The basic rent during the term of this Lease (Basic Rent) shall be payable in equal monthly installments on or before the first day of each month, in advance, at the office of the Lessor or at such other place as shall be designated by Lessor, without any prior notice or demand thereof and without any deduction, abatement or set-off for any reason whatsoever. The payment of Basic Rent shall begin on the commencement date. In the event that the term shall commence on a day other than the first day of each month then Lessee shall pay Lessor a proportionate

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amount for said period.

The Basic Rent payment schedule shall include annual increases of the Basic Rent commencing at the beginning of each year as follows:

	% Increase Per Year	Total Year Rent	Monthly Rent
1/st/. Year Rent	N/A	\$21,600.00	\$1800.00
2/nd/. Year Rent	5%	\$22,680.00	\$1890.00
3/rd/. Year Rent	5%	\$23,814.00	\$1984.50
4/th/. Year Rent	5%	\$25,004.70	\$2083.72

The rent schedule does not include Florida State sales tax.

4. PENALTY FOR LATE PAYMENT. In the event any rent or other payment due hereunder shall not be made within ten (10) days of the due date hereof, Tenant shall, in addition to the rent or other payment due, pay Landlord a late payment charge of ten (10%) percent of the amount of such late payment. For the purpose of this paragraph, rent shall be deemed to be received when mailed by first class mail, postage prepaid, to Landlord at the address hereinafter designated, or hand delivered to Landlord.

5. PURPOSE. The Lessee covenants and agrees to use the Premises for conducting company business and further agrees not to use or permit the Premises to be used for any other purposes without the prior written consent of the Lessor. The Lessee further covenants that the said Premises will not be used for any purpose that will invalidate any policies of insurance now or hereafter written on the offices in which said Premises are located or will increase the rate of premium therefore.

6. PAYMENT OF FIRST MONTH'S RENT AND SECURITY DEPOSIT. To secure the covenants and promises of the Lessee contained herein, the Lessee shall deposit with the Lessor first and last months rent or the sum of \$3600.00 as Security Deposit. This sum shall be returned to Lessee, without interest, at the expiration of the term provided that the Lessee has performed in accordance with the conditions hereof. The Lessor may apply any part of said sum to cure any default with the Lessor an amount equal to that applied so that the Lessor shall have the full deposit on hand at all times during the term of this Lease. If, at the end of the term, repairs are necessary to correct any condition beyond ordinary wear and tear or any payment to be made by the Lessee to the Lessor remains unpaid, then the Security, or a portion thereof, may be used by the

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Lessor to make such repair(s) or payment(s) and the balance of the remaining deposit shall be returned to the Lessee. The security deposit under this Lease shall not be mortgaged, assigned or encumbered by the Lessee without the written consent of the Lessor. Lessee hereby waives any further law or laws which may require the Lessor to segregate the aforementioned security deposit or to pay any interest on said security deposit.

Simultaneously with the execution of this Lease, the Lessee shall pay the Lessor the first month's rent of \$1800.00 plus sales tax.

7. UTILITIES. Lessee shall pay all charges of any nature for any and all utilities consumed on the Premises including, but not limited to, gas, electricity and other connection with said Premises which payment shall be made within ten (10) days after the same shall become due and payable.

8. ASSIGNMENT/CHANGE OF USE. The Lessee shall not assign Lessee's interest in this Lease, nor sublet the whole or any part of said Premises, nor shall the same be used for any other purpose than operating a health facility without first having obtained the written consent to such assignment or subletting, or to such change of purpose for the use of the Premises, from the Lessor. If the Lessor shall consent to the assignment of this Lease or to a subletting of all or a part of the Premises, or to a change of use, no further assignment or subletting or change or use shall be made without the written consent of the Lessor being first obtained.

9. PRESERVATION OF PROPERTY. The Lessee shall use the Premises in compliance with all laws and ordinances now or hereinafter applicable; and shall also exercise all reasonable care in the use of halls, stairs, corridors, toilets and other fixtures and parts of said offices used in common with other tenants to avoid damage to same.

10. NUISANCES. The Lessee shall not permit or suffer any noise, disturbance or nuisance whatsoever on said Premises detrimental to same or annoying to other tenants at the offices, and the Lessee acknowledges that the Premises have been received in thoroughly good order, tenantable condition and repair, of which execution of this Lease, and taking possession thereunder shall be conclusive evidence; and that no representation as to the condition of said premises have been made by the Lessor, or Lessor's agents, and that no obligation as to the repairing, adding to, or improving said premises has been assumed by the Lessor, and that no oral arrangements have been entered into in consideration of making this Lease and that said Lease contains a full statement of the obligation of

both parties hereto.

11. MAINTENANCE OF PREMISES. The Lessee shall keep in good

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condition during the continuation of the term herein described, the interior of said Premises, and every part thereof, including, but not limited to, the plumbing, doors and windows, and will keep the same in good, sound, clean condition and repair, ordinary wear and tear, fire, hurricane or other act of God alone excepted, and will not suffer or permit any strip or waste of said Premises. Lessee shall be responsible for any breakage that may occur from any cause whatsoever, to the plate glass windows, the air handler, the toilet & sink, and agrees to replace the same at Lessee's cost.

12. GARBAGE. Garbage removal will be the Lessors responsibility. Lessee must place their garbage inside the dumpster located at the far end of the building, in order for it to be disposed of properly. Garbage placed outside the dumpster will not be picked up.

13. PARKING. Lessee shall be allowed four (2) parking spaces located in the parking lot in front of Suite(s)102 and 103. Additional parking space is available in back of The Haimes Centre.

14. ALTERATIONS. Lessee shall not make any alterations or changes in the Premises without the written consent of the Lessor, and all additions, fixtures, or improvements, except only office furniture and fixtures which shall be readily removable without injury to the Premises, shall be and remain a part of the Premises at the expiration of the Lease.

15. ACCESS. The Lessor, or Lessor's agent, may at any reasonable time, enter and view said Premises and make repairs, if Lessor should elect to do so. However, nothing herein contained shall be construed as imposing any obligation upon the Lessor to make any such repairs. If Lessor does not have key and or alarm code, upon verbal notice tenant must make unit available for access.

16. DEFAULT. Should the Lessee not pay the rents herein reserved at the time and in the manner stated, or shall fail to keep and perform any other conditions, stipulations, covenants or agreements herein contained, on the part of the Lessee to be kept and performed, or if the Lessee shall suffer to be filed against Lessee an involuntary petition in bankruptcy or shall be adjudged voluntary or involuntary bankruptcy, or make an assignment for the benefit of creditors, or should there be appointed a receiver to take charge of the Premises, either in the State courts, or in the federal courts, then, in any of such events, the Lessor may, at Lessor's option, terminate and end this lease and reenter upon the Premises, whereupon the term hereby granted and, at the Lessor's option, all right, title and interest under it shall end and the Lessee became a Tenant at sufferance; or else said Lessor may, at Lessor's option, elect to declare the entire rent for the balance of the term, or any part thereof, due and payable forthwith, and

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may proceed to collect the same by distress or otherwise, and thereupon said term shall terminate, at the option of the Lessor, or else the said Lessor may take possession of the Premises and rent the same for the options herein contained shall not be deemed the exclusive Lessor's remedy; the expression "entire rent for the balance of the term" as used herein, shall mean all of the rent prescribed to be paid by the Lessee unto the Lessor for the full term of the Lease, whether Basic Rent or additional rent, less, however, any payments that shall have been made on account of same pursuant to the terms of said Lease.

17. FURNISHINGS. The Lessee hereby pledges with and assigns unto the Lessor all the furniture and fixtures, goods and chattels of the said Lessee, which may be brought or put on said Premises, as security for the payment of the rent herein reserved, and agrees that the Lessor's lien for the payment of said rent may be enforced by distress, foreclosure or otherwise, at the option of said Lessor, and Lessee agrees that such lien is granted to the Lessor, and vested in said Lessor, and the Lessee further agrees that, in case of the failure of the

said Lessee to pay the rent herein reserved when the same shall become due, and it becomes necessary for the Lessor to collect said rent by suit or through an attorney, the Lessee will pay the Lessor a reasonable attorney's fee, together with all costs and charges thereof. This provision of this Lease shall be deemed as creating a security interest in the personal property and fixtures of the Lessee located on the Premises and shall be further deemed as creating a security agreement between the Lessor and Lessee pursuant to the Uniform Commercial Code. The Lessee shall execute, file and refile any and all financing statements and other security agreements as Lessor shall from time to time require and hereby authorize the Lessor in its name to file such financing statement(s) as Lessor deems necessary, from time to time, to perfect all interest or right granted hereunder which authority shall not be revoked during the term of this Lease. Any such revocation shall constitute an element of default for which the Lessor shall have the right to terminate this Lease or as otherwise provided for herein.

18. LOSS AND DAMAGE. In the event that the Premises, or any part thereof, shall at any time be destroyed or so damaged by fire or other elements as to be unfit for occupancy of use by the Lessee, then and in that event, the Lessor shall have the option (1) to terminate this Lease, or (2) to repair and rebuild the said Premises, whereas Lessee shall maintain Income Rental/Business Interruption Insurance sufficient to satisfy Lessee's obligation for payment of rent to Lessor until the said premises are reinstated and made fit for occupancy and use; and in the event the lessor elects to exercise the option to repair and rebuild, the same shall be done and completed within a reasonable time.

19. RESPONSIBILITY. The Lessee hereby agrees to assume all

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risk of any damage to Lessee's property that may occur by reason of water or the bursting or leaking of any pipes or waste about said Premises, or from any act of negligence of any co-tenant or occupants of the offices, or any other person, or fire, or hurricane, or other act of God, or from any cause whatsoever.

20. SIGNS. Lessee shall be allowed a sign at the entrance of the Premises with such lettering to be of a kind, type, character, description and adhesion to be approved by the Lessor in the interests of having a uniform system of lettering and display signs on all of the offices at the Haines Center at Tenant's expense. At lease expiration the sign must be removed. The site in which the sign was must be in the same condition as it was received.

21. HOLDING OVER. If the Lessee shall hold over, with or without the Lessor's consent, after the term, then such holding over shall be constituted as a tenancy from month to month, subject to all of the provisions, conditions and obligations of this Lease, except that the Basic Rent shall be one and one-half times the Basic Rent for the last month of the term.

22. INSURANCE AND INDEMNITY.

(a) Liability Insurance. Tenant shall, during the entire term hereof, keep in full force and effect bodily injury and public liability insurance in an amount not less than a Three Hundred Thousand (\$300,000.00) Dollars per accident and injury; property damage insurance in an amount not less than Fifty Thousand (\$50,000.00) Dollars. The policy shall name Lessor and Lessee as insured.

(b) Fire and Extended Coverage. Lessee shall at all times during the term hereof, and at its costs and expenses, maintain in effect policies of insurance covering its fixtures and equipment located on the lease Premises, in an amount not less than eighty (80%) percent of their actual cash value, providing protection against any peril included within the standard classification of "Fire and Extended Coverage", together with insurance against vandalism and malicious mischief. The proceeds of such insurance, so long as this Lease remains in effect, shall be used to repair or replace fixtures and equipment so insured. Lessor and Lessee to be named as insured.

(c) Indemnity. That Lessee shall indemnify and save harmless the said Lessor from and against any and all claims, suits, actions, damages, and/or causes of action arising during the term of this Lease for any personal injury, loss of life and/or damage to property sustained in or about the leased Premises, by reason or as a result of the Lessee's occupancy thereof, and from and against any orders, judgments, and/or decrees which may be entered thereupon, and from and against all costs, counsel fees, expenses

and liabilities incurred in and about the defense of any such claim and the investigation thereof.

(d) Waiver of Subrogation. Lessor and Lessee waive, unless said waiver should invalidate any such insurance, their right to recover damages against each other for any reason whatsoever to the extent the damaged party recovers indemnity from its insurance carrier. Any insurance policy procured by either Lessee or Lessor which does not name the other as a named insured shall, if obtainable, contain an express waiver of any right of subrogation by the insurance company, including but not limited to, Lessee's workmen's compensation carrier, against Lessor or Lessee, whichever the case may be. All public liability and property damage policies shall contain an endorsement that Lessor, although named as an insured, shall nevertheless be entitled to recover for damage caused by the negligence of Lessee.

23. SUBORDINATION. The Lessee agrees that this Lease shall be subject and subordinate to any mortgage or deed of trust now encumbering the Premises or the offices, or which may hereinafter be made on account of any proposed loan to be made against said Premises by the Lessor to the full extent of all debts and charges secured thereby; and to any renewals and extension of all or any part thereof, which said Lessor may hereafter at any time elect to place on said Premises or the offices, and said Lessee agrees upon request to hereafter execute any document(s) which the counsel for the Lessor may deem necessary to accomplish that end, and in default of the Lessee's so doing, that the Lessor is hereby empowered to execute such document(s) in the name of the Lessee and as the act and deed of said Lessee and this authority is declared to be coupled with an interest and not revocable. No estate for years is created by this Lease.

24. EXPIRATION. At the expiration of the term, the Lessee shall quietly and peaceably deliver the Premises to the Lessor in the same repair and condition in which they were received, ordinary wear and tear excepted.

25. PERFORMANCE/RE-ENTRY. The Lessor hereby covenants with the Lessee that, upon the performance of the Lessee of all conditions hereinabove set forth on the part of the Lessee to be kept and performed, Lessee may quietly have, hold, occupy and use the above described Premises without interruption by the Lessor; provided that, upon the breach of any of the covenants, conditions, and stipulations herein contained to be kept and performed by the Lessee, the Lessor may immediately without notice and without the necessity of legal process reenter said Premises, and thereupon, at the Lessor's option, said Lease shall forthwith be terminated and/or the Lessor may exercise any of the options hereinabove provided for the Lessor's benefit in case of default on the part of the Lease.

26. EXTERIOR MAINTENANCE. The Lessor covenants that lessor will keep the exterior of the offices in good repair. The Lessee shall give to the Lessor thirty (30) days written notice of any repairs to the offices, claimed by Lessee, and the Lessor shall have a reasonable time thereafter to make them.

27. CONTEXT. The term Lessor and Lessee as herein contained shall include singular and/or plural, masculine, feminine, and/or neuter, heirs, successors, personal representatives and/or assigns wherever the context so requires or admits.

28. WAIVER. The failure of the Lessor in one or more instances to insist upon strict performance or observance of one or more of the covenants or conditions or to exercise any remedy, privilege or option herein conferred upon or reserved to the Lessor, shall not operate or be construed as a relinquishment or waiver of the further exercise of such covenant or condition or of the right to enforce the same or to exercise such privileges, option, or remedy, but the same shall continue in full force and effect. The receipt by the Lessor of Basic Rent, or additional rent or any other payment required to be made by the Lessee, or any part thereof, shall not be a waiver of any other additional rent or payment then due, nor shall such receipt, though with knowledge of the breach of

any covenant or condition hereof, operate as or be deemed to have been made unless made by the Lessor in writing.

29. RULES AND REGULATIONS. Reasonable rules and regulations regarding the Premises, including the walkways and parking areas, and the use thereof, which may hereafter be promulgated by the Lessor, shall be observed by the Lessee and the Lessee's employees, agents and business invitees. The Lessor reserves the right to rescind any rules promulgated hereafter, and to make such other and further rules and regulations as in its reasonable judgement may from time to time be described for the safety, care and cleanliness of the Premises and for the preservation of good order therein, which rules when so made and reasonable notice given to the Lessee, shall have the same force and effect as if originally made a part of this Lease. Such other and further reasonable rules shall not, however, be consistent with proper and rightful enjoyment by the Lessee of the Premises in the conduct of its business. All said rules and regulations shall be uniformly applied to all Lessees at the offices of the Lessor.

30. CONDEMNATION. If the offices or any substantial part thereof, including but not limited to, the Premises or any part thereof, shall be taken by a public or quasi-public authority under any power or eminent domain, condemnation or the like, this Lease shall terminate upon the taking of possession by the condemning authority and the Lessee shall have no claim or interest in or to any award or damages for such taking. If the proceedings for such

taking are instituted or threatened to be instituted by such authority, a deed given by Lessor in lieu of condemnation shall have the same effect as if a final judgement of taking had been entered in any such proceedings. The Lessee shall have no claim, or right to claim, or be entitled to any portion of any awards or monies paid to Lessor as a result of such condemnation proceedings, and all rights of the Lessee thereto, if any shall be deemed a waiver of any independent right the Lessee may possess to institute an action for relocation of its business and trade fixtures in connection with any such taking. Notwithstanding the foregoing, the Lessee hereby irrevocably assigns to the Lessor any award which may be made for its unexpired leasehold interest.

31. NOTICES. All notices and demands, legal or otherwise, incidental to this Lease, or the occupancy of the Premises, shall be in writing. If the Lessor, its agents or nominees, desires to give or serve upon the Lessee any notice or demands, it shall be sufficient to send a copy thereof by certified mail, return receipt requested, addressed to the Lessee at:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

The date of the mailing of any notices sent by the Lessor or the Lessee shall be the date such notice is postmarked and deposited in a United States Post Office Box with postage thereon prepaid.

IN WITNESS WHEREOF, the respective parties hereto have caused these presents to be signed, sealed and delivered on the day and year written:

WITNESSES:

WITNESSES:

LESSEE:

LESSOR:

By: /s/ Scott Modist  
Name: Scott Modist  
Title: CFO  
Date: 1/31/01

By: /s/ Russell Madris  
Name: Russell Madris  
Title: CEO  
Date: 1/31/01

BUSINESS LEASE

THIS LEASE is executed this 1 day of April 1 , 2000 between Byram Hill Realty Corporation the Lessor, and MoreDirect.com, Inc. , the Lessee.

WITNESSETH:

1. PREMISES. The Lessor, for and in consideration of the rent herein reserved to be paid by the Lessee, and in consideration of the covenants herein to be kept and performed by the Lessee, does hereby lease and demise unto the said Lessee the following described premises, (hereinafter "Premises") situated, lying and being in the City of Boca Raton, County of Palm Beach, State of Florida, which Premises are a part of the Boca Bay Executive Building (hereinafter "Offices"): Boca Bay Executive Building, Suite(s) 200 - 207 consisting of 5,000 square feet. All more particularly described on Exhibits "A" attached hereto and made a part hereof.

2. TERM AND COMMENCEMENT OF RENT. The term of this Lease shall be for five (5) years following the commencement of the term as provided hereinafter. Lessee shall have the option to extend this agreement for an additional term of five (5) years beyond the original term by giving written notice to the Lessor of its intention to exercise such option at least six (6) months prior to the expiration of said original term. The annual basic rent to be paid by Lessee in each year during the extended term shall be increased by five (5%) percent per year.

The term of this Lease shall begin on or upon occupancy and Lessee's obligation to pay rent shall commence on April 1, 2000 or upon the premises being vacated by the present tenant. Should the term of this lease and the Lessee's obligations to pay rent commence on the day other than the first day of a month, then the term of this Lease, for purposes of the preceding section only, shall commence on the first day of the following month.

The Lessee shall pay rent for the additional month preceding the commencement of this Lease, if the term of this Lease commences on a day other than the first day of a month, on a per diem basis (calculated on the basis of a 30 day month) payable on commencement of the term of this lease. Any rental payment hereunder for any other fractional month shall likewise be calculated and paid on such per diem basis.

3. RENT. The basic rent during the term of this Lease (Basic Rent) shall be payable in equal monthly installments on or before the first day of each month, in advance, at the office of the Lessor or at such other place as shall be designated by Lessor,

without any prior notice or demand thereof and without any deduction, abatement or set-off for any reason whatsoever. The payment of Basic Rent shall begin on the commencement date. In the event that the term shall commence on a day other than the first day of each month then Lessee shall pay Lessor a proportionate amount for said period.

The Basic Rent payment schedule shall include annual increases of the Basic Rent commencing at the beginning of each year as follows:

	% Increase Per Year	Total Year Rent	Monthly Rent
1/st/. Year Rent	N/A	\$ 92,500.00	\$7,708.33
2/nd/. Year Rent	5%	\$ 97,125.00	\$8,093.75
3/rd/. Year Rent	5%	\$101,981.25	\$8,498.44
4/th/. Year Rent	5%	\$107,080.31	\$8,923.36
5/th/. Year Rent	5%	\$112,434.33	\$9,369.53

The premises are being taken in "as is", "where is" condition, except as set forth on Exhibit "A". The rent schedule does not include Florida State sales tax.

4. PROPORTIONATE SHARE. For the purpose of this lease, Lessor and Lessee agree that the Premises constitute 50 % of the offices. Unless the Lessee takes any additional space or the Lessor expands the offices, the Lessee's proportionate share of all costs and expenses of the offices operation shall be deemed to be included.

5. ADDITIONAL RENT. (Intentionally Deleted)

6. OPERATING COSTS. (Intentionally Deleted)

7. STATEMENT. (Intentionally Deleted)

8. NET LEASE. This Lease is a net lease and the rent shall be absolutely net to Lessor during the term.

9. PURPOSE. The Lessee covenants and agrees to use the Premises for conducting company business and further agrees not to use or permit the Premises to be used for any other purposes without the prior written consent of the Lessor. The Lessee further covenants that the said Premises will not be used for any purpose that will invalidate any policies of insurance now or hereafter written on the offices in which said Premises are located or will increase the rate of premium therefore.

10. PAYMENT OF FIRST MONTH'S RENT AND SECURITY DEPOSIT. To secure the covenants and promises of the Lessee contained herein, the Lessee shall deposit with the Lessor the sum of \$ 7,708.33 as Security Deposit. This sum shall be returned to Lessee, without

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interest, at the expiration of the term provided

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that the Lessee has performed in accordance with the conditions hereof. The Lessor may apply any part of said sum to cure any default with the Lessor an amount equal to that applied so that the Lessor shall have the full deposit on hand at all times during the term of this Lease. If, at the end of the term, repairs are necessary to correct any condition beyond ordinary wear and tear or any payment to be made by the Lessee to the Lessor remains unpaid, then the Security, or a portion thereof, may be used by the Lessor to make such repair(s) or payment(s) and the balance of the remaining deposit shall be returned to the Lessee. The security deposit under this Lease shall not be mortgaged, assigned or encumbered by the Lessee without the written consent of the Lessor. Lessee hereby waives any further law or laws which may require the Lessor to segregate the aforementioned security deposit or to pay any interest on said security deposit.

Simultaneously with the execution of this Lease, the Lessee shall pay the Lessor the first month's rent of \$7,916.67.

11. UTILITIES. Lessee shall pay all charges of any nature for any and all utilities consumed on the Premises including, but not limited to, gas, electricity and other connection with said Premises which payment shall be made within ten (10) days after the same shall become due and payable.

12. ASSIGNMENT/CHANGE OF USE. The Lessee shall not assign Lessee's interest in this Lease, nor sublet the whole or any part of said Premises, nor shall the same be used for any other purpose than operating a health facility without first having obtained the written consent to such assignment or subletting, or to such change of purpose for the use of the Premises, from the Lessor. If the Lessor shall consent to the assignment of this Lease or to a subletting of all or a part of the Premises, or to a change of use, no further assignment or subletting or change or use shall be made without the written consent of the Lessor being first obtained.

13. PRESERVATION OF PROPERTY. The Lessee shall use the Premises in compliance with all laws and ordinances now or hereinafter applicable; and shall also exercise all reasonable care in the use of halls, stairs, corridors, toilets and other fixtures and parts of said offices used in common with other tenants to avoid damage to same.

14. NUISANCES. The Lessee shall not permit or suffer any noise, disturbance or nuisance whatsoever on said Premises detrimental to same or annoying to other tenants at the offices, and the Lessee acknowledges that the Premises have been received in thoroughly good order, tenantable condition and repair, of which execution of this Lease, and taking possession thereunder shall be conclusive evidence; and that no representation as to the condition of said premises have been made by the Lessor, or Lessor's agents,

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and that no obligation as to the repairing, adding to, or improving said premises has been assumed by the Lessor, and that no oral arrangements have been entered into in consideration of making this Lease and that said Lease contains a full statement of the obligation of both parties hereto.

15. MAINTENANCE OF PREMISES. The Lessee shall keep in good condition during the continuation of the term herein described, the interior of said Premises, and every part thereof, including, but not limited to, the plumbing, doors and windows, and will keep the same in good, sound, clean condition and repair, ordinary wear and tear, fire, hurricane or other act of God alone excepted, and will not suffer or permit any strip or waste of said Premises. Lessee shall be responsible for any breakage that may occur from any cause whatsoever, to the plate glass windows, and agrees to replace the same at Lessee's cost.

16. ALTERATIONS. Lessee shall not make any alterations or changes in the Premises without the written consent of the Lessor, and all additions, fixtures, or improvements, except only office furniture and fixtures which shall be readily removable without injury to the Premises, shall be and remain a part of the Premises at the expiration of the Lease.

17. ACCESS. The Lessor, or Lessor's agent, may at any reasonable time, enter and view said Premises and make repairs, if Lessor should elect to do so. However, nothing herein contained shall be construed as imposing any obligation upon the Lessor to make any such repairs.

18. DEFAULT. Should the Lessee not pay the rents herein reserved at the time and in the manner stated, or shall fail to keep and perform any other conditions, stipulations, covenants or agreements herein contained, on the part of the Lessee to be kept and performed, or if the Lessee shall suffer to be filed against Lessee an involuntary petition in bankruptcy or shall be adjudged voluntary or involuntary bankruptcy, or make an assignment for the benefit of creditors, or should there be appointed a receiver to take charge of the Premises, either in the State courts, or in the federal courts, then, in any of such events, the Lessor may, at Lessor's option, terminate and end this lease and reenter upon the Premises, whereupon the term hereby granted and, at the Lessor's option, all right, title and interest under it shall end and the Lessee become a Tenant at sufferance; or else said Lessor may, at Lessor's option, elect to declare the entire rent for the balance of the term, or any part thereof, due and payable forthwith, and may proceed to collect the same by distress or otherwise, and thereupon said term shall terminate, at the option of the Lessor, or else the said Lessor may take possession of the Premises and rent the same for the options herein contained shall not be deemed the exclusive Lessor's remedy; the expression "entire rent for the

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balance of the term" as used herein, shall mean all of the rent prescribed to be paid by the Lessee unto the Lessor for the full term of the Lease, whether Basic Rent or additional rent, less, however, any payments that shall have been made on account of same pursuant to the terms of said Lease.

19. FURNISHINGS. The Lessee hereby pledges with and assigns unto the Lessor all the furniture and fixtures, goods and chattels of the said Lessee, which may be brought or put on said Premises, as security for the payment of the rent herein reserved, and agrees that the Lessor's lien for the payment of said rent

may be enforced by distress, foreclosure or otherwise, at the option of said Lessor, and Lessee agrees that such lien is granted to the Lessor, and vested in said Lessor, and the Lessee further agrees that, in case of the failure of the said Lessee to pay the rent herein reserved when the same shall become due, and it becomes necessary for the Lessor to collect said rent by suit or through an attorney, the Lessee will pay the Lessor a reasonable attorney's fee, together with all costs and charges thereof. This provision of this Lease shall be deemed as creating a security interest in the personal property and fixtures of the Lessee located on the Premises and shall be further deemed as creating a security agreement between the Lessor and Lessee pursuant to the Uniform Commercial Code. The Lessee shall execute, file and refile any and all financing statements and other security agreements as Lessor shall from time to time require and hereby authorize the Lessor in its name to file such financing statement(s) as Lessor deems necessary, from time to time, to perfect all interest or right granted hereunder which authority shall not be revoked during the term of this Lease. Any such revocation shall constitute an element of default for which the Lessor shall have the right to terminate this Lease or as otherwise provided for herein.

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21. RESPONSIBILITY. The Lessee hereby agrees to assume all risk of any damage to Lessee's property that may occur by reason of water or the bursting or leaking of any pipes or waste about said Premises, or from any act of negligence of any co-tenant or occupants of the offices, or any other person, or fire, or hurricane, or other act of God, or from any cause whatsoever.

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22. SIGNS. Lessee shall be allowed a sign at the entrance of the Premises with such lettering to be of a kind, type, character, and description to be approved by the Lessor in the interests of having a uniform system of lettering and display signs on all of the offices at the Boca Bay Executive Buildings at Tenant's expense.

23. HOLDING OVER. If the Lessee shall hold over, with or without the Lessor's consent, after the term, then such holding over shall be constituted as a tenancy from month to month, subject to all of the provisions, conditions and obligations of this Lease, except that the Basic Rent shall be one and one-half times the Basic Rent for the last month of the term.

24. INSURANCE AND INDEMNITY.

(a) Liability Insurance. Tenant shall, during the entire term hereof, keep in full force and effect bodily injury and public liability insurance in an amount not less than Five Hundred Thousand (\$500,000.00) Dollars per accident and injury; property damage insurance in an amount not less than Fifty Thousand (\$50,000.00) Dollars. The policy shall name Lessor and Lessee as insured.

(b) Fire and Extended Coverage. Lessee shall at all times during the term hereof, and at its costs and expenses, maintain in effect policies of insurance covering its fixtures and equipment located on the lease Premises, in an amount not less than eighty (80%) percent of their actual cash value, providing protection against any peril included within the standard classification of "Fire and Extended Coverage", together with insurance against vandalism and malicious mischief. The proceeds of such insurance, so long as this Lease remains in effect, shall be used to repair or replace fixtures and equipment so insured. Lessor and Lessee to be named as insured.

(c) Indemnity. That Lessee shall indemnify and save harmless the said Lessor from and against any and all claims, suits, actions, damages, and/or causes of action arising during the term of this Lease for any personal injury, loss of life and/or damage to property sustained in or about the leased Premises, by reason or as a result of the Lessee's occupancy thereof, and from and against any orders, judgements, and/or decrees which may be entered

thereupon, and from and against all costs, counsel fees, expenses and liabilities incurred in and about the defense of any such claim and the investigation thereof.

(d) Waiver of Subrogation. Lessor and Lessee waive, unless said waiver should invalidate any such insurance, their right to recover damages against each other for any reason whatsoever to the

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extent the damaged party recovers indemnity from its insurance carrier. Any insurance policy procured by either Lessee or Lessor which does not name the other as a named insured shall, if obtainable, contain an express waiver of any right of subrogation by the insurance company, including but not limited to, Lessee's workmen's compensation carrier, against Lessor or Lessee, whichever the case may be. All public liability and property damage policies shall contain an endorsement that Lessor, although named as an insured, shall nevertheless be entitled to recover for damage caused by the negligence of Lessee.

25. SUBORDINATION. The Lessee agrees that this Lease shall be subject and subordinate to any mortgage or deed of trust now encumbering the Premises or the offices, or which may hereinafter be made on account of any proposed loan to be made against said Premises by the Lessor to the full extent of all debts and charges secured thereby; and to any renewals and extension of all or any part thereof, which said Lessor may hereafter at any time elect to place on said Premises or the offices, and said Lessee agrees upon request to hereafter execute any document(s) which the counsel for the Lessor may deem necessary to accomplish that end, and in default of the Lessee's so doing, that the Lessor is hereby empowered to execute such document(s) in the name of the Lessee and as the act and deed of said Lessee and this authority is declared to be coupled with an interest and not revokable. No estate for years is created by this Lease.

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29. CONTEXT. The term Lessor and Lessee as herein contained shall include singular and/or plural, masculine, feminine, and/or neuter, heirs, successors, personal representatives and/or assigns wherever the context so requires or admits.

30. WAIVER. The failure of the Lessor in one or more instances to insist upon strict performance or observance of one or more of the covenants or conditions or to exercise any remedy, privilege or option herein conferred upon or reserved to the Lessor, shall not operate or be construed as a relinquishment or waiver of the further exercise of such covenant or condition or of the right to enforce the same or to exercise such privileges, option, or remedy, but the same shall continue in full force and effect. The receipt by the Lessor of Basic Rent, or additional rent or any other payment required to be made by the Lessee, or any part thereof, shall not be a waiver of any other additional rent or payment then due, nor shall such receipt, though with knowledge of the breach of

any covenant or condition hereof, operate as or be deemed to have been made unless made by the Lessor in writing.

31. RULES AND REGULATIONS. Reasonable rules and regulations regarding the Premises, including the walkways and parking areas, and the use thereof, which may hereafter be promulgated by the Lessor, shall be observed by the Lessee and the Lessee's employees, agents and business invitees. The Lessor reserves the right to rescind any rules promulgated hereafter, and to make such other and further rules and regulations as in its reasonable judgement may from time to time be described for the safety, care and cleanliness of the Premises and for the preservation of good order therein, which rules when so made and reasonable notice given to the Lessee, shall have the same force and effect as if originally made a part of this Lease. Such other and further reasonable rules shall not, however, be consistent with proper and rightful enjoyment by the Lessee of the Premises in the conduct of its business. All said rules and regulations shall be uniformly applied to all Lessees at the offices of the Lessor.

32. CONDEMNATION. If the offices or any substantial part thereof, including but not limited to, the Premises or any part thereof, shall be taken by a public or quasi-public authority under any power or eminent domain, condemnation or the like, this Lease shall terminate upon the taking of possession by the condemning authority and the Lessee shall have no claim or interest in or to any award or damages for such taking. If the proceedings for such taking are instituted or threatened to be instituted by such authority, a deed given by Lessor in lieu of condemnation shall have the same effect as if a final judgement of taking had been entered in any such proceedings. The Lessee shall have no claim, or right to claim, or be entitled to any portion of any awards or monies paid to Lessor as a result of such condemnation proceedings,

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and all rights of the Lessee thereto, if any shall be deemed a waiver of any independent right the Lessee may possess to institute an action for relocation of its business and trade fixtures in connection with any such taking. Notwithstanding the foregoing, the Lessee hereby irrevocably assigns to the Lessor any award which may be made for its unexpired leasehold interest.

33. NOTICES. All notices and demands, legal or otherwise, incidental to this Lease, or the occupancy of the Premises, shall be in writing. If the Lessor, its agents or nominees, desires to give or serve upon the Lessee any notice or demands, it shall be sufficient to send a copy thereof by certified mail, return receipt requested, addressed to the Lessee at:

The date of the mailing of any notices sent by the Lessor or the Lessee shall be the date such notice is postmarked and deposited in a United States Post Office Box with postage thereon prepaid.

IN WITNESS WHEREOF, the respective parties hereto have caused these presents to be signed, sealed and delivered on the day and year written:

WITNESSES:

LESSEE:

MoreDirect.com, Inc.

By:

Name: Scott Modist

Title: Chief Financial Officer

Date:

WITNESSES:

LESSOR:

Byram Hill Realty Corporation

By:

Name: Russell Madris

Title: Owner

Date:

EXHIBIT "A"

1.

2.

3. Current floor plans are attached hereto.

To: Tenants of 7300 N. Federal Highway

Date: August 27, 2002

RE: NOTICE OF BUILDING SALE

On August 27, 2002, the Boca Bay Executive Building, 7300 N. Federal Highway, Boca Raton (all units) was sold by Byram Hill Realty Inc. to Robert Leone Trust, Robert Leone, Trustee.

Please make future rent checks, beginning September 1, 2002 payable to "Robert Leone Trust" and send to;

Robert Leone Trust  
c/o Lavalley, Brown, Ronan & Soff  
750 South Dixie Highway  
Boca Raton, FL 33432  
Attn: Jeff Brown, Esq.

Byram Hill Realty Inc. appreciates the past relationship with you and the Robert Leone Trust looks forward to your continued occupancy. Thank you very much for being part of the Boca Bay Executive Building.

Very truly yours,

Byram Hill Realty Inc.

By: /s/ Russell Madris

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Russell Madris, President

Robert Leone Trust

By: /s/ Robert Leone

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Robert Leone, Trustee

SUBSIDIARIES OF REGISTRANT

1. PC Connection Sales Corporation, a Delaware corporation.
2. GovConnection, Inc. (formerly Comteq Federal, Inc.), a Maryland corporation.
3. MoreDirect, Inc., a Florida corporation.

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement Nos. 333-66450, 333-40172, 333-83943, 333-69981, 333-50847, 333-50845, and 333-91584 of PC Connection, Inc. on Form S-8 of our report dated January 30, 2003 (which expresses an unqualified opinion and includes an explanatory paragraph relating to the Company's adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets"), appearing in this Annual Report on Form 10-K of PC Connection, Inc. for the year ended December 31, 2002.

/s/ DELOITTE & TOUCHE LLP  
Boston, Massachusetts  
March 27, 2003

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 Annual Report on Form 10-K of PC Connection, Inc. (the "Company") for the period ended December 31, 2002 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.

/s/ PATRICIA GALLUP

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Patricia Gallup  
President and  
Chief Executive Officer

Dated: March 31, 2003

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 Annual Report on Form 10K of PC Connection, Inc. (the "Company") for the period ended December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Mark Gavin, Senior Vice President of Finance 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.

/s/ MARK GAVIN

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Mark Gavin  
Senior Vice President of Finance and  
Chief Financial Officer

Dated: March 31, 2003