

CONVERSION SERVICES INTERNATIONAL INC
Form 10-Q
May 20, 2009

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2009

OR

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

For the Transition Period From _____ to _____

Commission File Number: 001-32623

CONVERSION SERVICES INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-0101495
(I.R.S. Employer
Identification No.)

100 Eagle Rock Avenue, East Hanover, New Jersey
(Address of principal executive offices)

07936
(Zip Code)

(973) 560-9400
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes
No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

Edgar Filing: CONVERSION SERVICES INTERNATIONAL INC - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at May 7, 2009
Common Stock, \$0.001 par value per share	119,855,907 shares

CONVERSION SERVICES INTERNATIONAL, INC.

FORM 10-Q

For the three months ended March 31, 2009

INDEX

		Page
Part I.	Financial Information	
	Item 1. Financial Statements	1
	a) Condensed Consolidated Balance Sheets as of March 31, 2009 (unaudited) and December 31, 2008 (unaudited)	2
	b) Condensed Consolidated Statements of Operations for the three months ended March 31, 2009 (unaudited) and 2008 (unaudited)	3
	c) Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2009 (unaudited) and 2008 (unaudited)	4
	d) Notes to Condensed Consolidated Financial Statements (unaudited)	6
	Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
	Item 4T. Controls and Procedures	19
Part II.	Other Information	
	Item 1. Legal Proceedings	20
	Item 6. Exhibits	20
	Signature	21

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

1

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2009	December 31, 2008
ASSETS		
CURRENT ASSETS		
Cash	\$ 104,333	\$ 338,240
Accounts receivable, net	3,141,875	3,440,810
Accounts receivable from related parties, net	509,670	284,028
Prepaid expenses	88,906	140,493
TOTAL CURRENT ASSETS	3,844,784	4,203,571
PROPERTY AND EQUIPMENT, at cost, net	62,890	68,536
OTHER ASSETS		
Other assets	156,055	306,778
Total Assets	\$ 4,063,729	\$ 4,578,885
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Line of credit	\$ 2,736,932	\$ 2,349,920
Short term notes payable	1,490,714	1,384,811
Accounts payable and accrued expenses	1,292,804	1,503,145
Deferred revenue	889,205	159,177
Related party note payable	104,838	102,796
TOTAL CURRENT LIABILITIES	6,514,493	5,499,849
Convertible preferred stock, \$0.001 par value, \$100 stated value, 20,000,000 shares authorized		
Series A convertible preferred stock, 19,000 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	1,203,332	1,108,332
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Common stock, \$0.001 par value, 300,000,000 shares authorized; 120,972,955 and 119,594,463 issued and outstanding at March 31, 2009 and December 31, 2008, respectively		
	120,973	119,594
Series B convertible preferred stock, 20,000 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively		
	1,352,883	1,352,883
Additional paid in capital		
	68,536,396	68,575,918
Treasury stock, at cost, 1,145,382 shares in treasury as of March 31, 2009 and December 31, 2008, respectively		
	(423,869)	(423,869)
Accumulated deficit		
	(73,240,479)	(71,653,822)

Total Stockholders' Deficit	(3,654,096)	(2,029,296)
Total Liabilities and Stockholders' Deficit	\$ 4,063,729	\$ 4,578,885

See Notes to Condensed Consolidated Financial Statements

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31,
(Unaudited)

	2009	2008
REVENUE:		
Services	\$ 3,104,093	\$ 3,959,588
Related party services	542,768	591,869
Reimbursable expenses	146,578	138,971
Other	17,000	15,033
	3,810,439	4,705,461
COST OF REVENUE:		
Services	2,850,100	2,896,423
Related party services	498,865	555,367
Consultant expenses	189,608	221,703
	3,538,573	3,673,493
GROSS PROFIT	271,866	1,031,968
OPERATING EXPENSES		
Selling and marketing	802,688	914,428
General and administrative	643,577	1,074,749
Depreciation and amortization	27,125	91,024
	1,473,390	2,080,201
LOSS FROM OPERATIONS	(1,201,524)	(1,048,233)
OTHER INCOME (EXPENSE)		
Equity in (losses) earnings from investments	(103,298)	7,929
Loss on extinguishment of debt	-	(553,846)
Interest income (expense), net	(281,835)	(150,273)
	(385,133)	(696,190)
LOSS BEFORE INCOME TAXES	(1,586,657)	(1,744,423)
INCOME TAXES	-	-
NET LOSS	(1,586,657)	(1,744,423)
Accretion of issuance costs associated with convertible preferred stock	(95,000)	(95,000)
Dividends on convertible preferred stock	(45,000)	(59,705)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (1,726,657)	\$ (1,899,128)
Basic and diluted loss per common share	\$ (0.01)	\$ (0.02)
Basic and diluted loss per common share attributable to common stockholders	\$ (0.01)	\$ (0.02)
Weighted average shares used to compute net loss per common share:		
Basic and diluted	119,692,762	110,213,822

See Notes to Condensed Consolidated Financial Statements

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31,
(Unaudited)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (1,586,657)	\$ (1,744,423)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property and equipment and amortization of leasehold improvements	12,396	28,773
Amortization of intangible assets	-	37,251
Amortization of debt discounts	41,447	78,948
Amortization of relative fair value of warrants issued	105,903	20,625
Amortization of deferred financing costs	14,729	-
Stock based compensation	33,107	190,185
Loss on extinguishment of debt	-	553,846
(Decrease) increase in allowance for doubtful accounts	(54,103)	21,681
Losses (income) from equity investments	103,298	(7,929)
Changes in operating assets and liabilities:		
Decrease in accounts receivable	368,383	638,733
Increase in accounts receivable from related parties	(240,987)	(102,337)
Decrease in prepaid expenses	42,838	34,254
(Decrease) increase in accounts payable and accrued expenses	(184,553)	275,838
(Decrease) increase in deferred revenue	730,027	113,854
Net cash (used in) provided by operating activities	(614,172)	139,299
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(6,747)	(18,117)
Net cash used in investing activities	(6,747)	(18,117)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings (repayments) under line of credit	387,012	(1,072,745)
Deferred financing costs	-	(20,000)
Principal payments on capital lease obligations	-	(5,152)
Principal payments on related party notes	-	(3,629)
Net cash provided by (used in) financing activities	387,012	(1,101,526)
NET DECREASE IN CASH	(233,907)	(980,344)
CASH, beginning of period	338,240	1,506,866
CASH, end of period	\$ 104,333	\$ 526,522

See Notes to Condensed Consolidated Financial Statements

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31,
(Unaudited)

	2009	2008
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	\$ 112,186	\$ 37,286
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:		
Common stock issued in conversion of long-term debt to equity	-	600,000

See Notes to Condensed Consolidated Financial Statements.

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Accounting Policies

Organization and Business

Conversion Services International, Inc. (“CSI” or the “Company”) was incorporated in the State of Delaware and has been conducting business since 1990. CSI and its wholly owned subsidiaries (together the “Company”) are principally engaged in the information technology services industry in the following areas: strategic consulting, business intelligence/data warehousing and data management to its customers principally located in the northeastern United States.

CSI was formerly known as LCS Group, Inc. (“LCS”). In January 2004, CSI merged with and into a wholly owned subsidiary of LCS. In connection with this transaction, among other things, LCS changed its name to “Conversion Services International, Inc.”

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by the Company and are unaudited. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for any future period or for the full fiscal year. In the opinion of management, all adjustments (consisting of normal recurring adjustments unless otherwise indicated) necessary to present fairly the financial position, results of operations and cash flows at March 31, 2009, and for all periods presented, have been made. Footnote disclosure has been condensed or omitted as permitted by Securities and Exchange Commission rules over interim financial statements.

These condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008 and other reports filed with the Securities and Exchange Commission.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated in the consolidation. Investments in business entities in which the Company does not have control, but has the ability to exercise significant influence (generally 20-50% ownership), are accounted for by the equity method.

Revenue recognition

Revenue from consulting and professional services is recognized at the time the services are performed on a project by project basis. For projects charged on a time and materials basis, revenue is recognized based on the number of hours worked by consultants at an agreed-upon rate per hour. For large services projects where costs to complete the contract could reasonably be estimated, the Company undertakes projects on a fixed-fee basis and recognizes revenue as activities are performed by the Company over the estimated performance period. Revenue recognized in excess of billings is recorded as cost in excess of billings. Billings in excess of revenue recognized are recorded as deferred revenue until revenue recognition criteria are met. Reimbursements, including those relating to travel and other

out-of-pocket expenses, are included in revenue, and an equivalent amount of reimbursable expenses are included in cost of services.

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104. As a result, in the event that collectability from a client is not reasonably assured, revenue is recognized on the cash basis. During the March 2009 quarter, approximately \$838,000 of billings to National Digital Medical Archives (“NDMA”) has been deferred and will be recognized as revenue upon collection of the receivable.

Extinguishment of debt

In March 2008, the Company and TAG Virgin Islands, Inc. executed a Note Conversion Agreement whereby certain investors represented by TAG Virgin Islands, Inc. converted debt due to them under an Unsecured Convertible Line of Credit Note dated June 7, 2004 into Company Common Stock. A loss of \$553,846 on this transaction was recorded as an early extinguishment of debt.

Fair value of financial instruments

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements”. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. The standard utilizes a fair value hierarchy which is categorized into three levels based on the inputs to the valuation techniques used to measure fair value. The standard does not require any new fair value measurements, but discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flows) and the cost approach (cost to replace the service capacity of an asset or replacement cost).

The Company estimates that the carrying value of its financial instruments which includes cash, line of credit and notes payable approximates fair value, as all financial instruments are short term in nature or bear interest at variable rates.

Concentrations of credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk are cash and accounts receivable arising from its normal business activities. The Company routinely assesses the financial strength of its customers, based upon factors surrounding their credit risk, establishes an allowance for doubtful accounts, and as a consequence believes that its accounts receivable credit risk exposure beyond such allowances is limited. At March 31, 2009, receivables related to National Digital Medical Archives (“NDMA”) comprised approximately 23.0% of the Company’s accounts receivable balance, services performed for Bank of America comprised approximately 17.5% of the Company’s accounts receivable balance, which is comprised of receivables directly from Bank of America (4.9%) and receivables from a vendor management company that is issued invoices for the Company’s work at Bank of America, ZeroChaos (12.6%). Additionally, receivables related to Church & Dwight comprised approximately 17.2% of the Company’s accounts receivable balance and receivables from LEC, a related party, comprised 14.1% of the accounts receivable balance.

Cash balances in banks are secured by the Federal Deposit Insurance Corporation subject to certain limitations.

Income taxes

The Company accounts for income taxes, in accordance with SFAS No. 109, “Accounting for Income Taxes” (“SFAS 109”) and related interpretations, under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company’s financial statements or tax returns. In estimating future tax consequences, the Company generally considers all expected future events other than enactments of changes in the tax laws or rates.

The Company records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not to be realized. The Company’s current valuation allowance primarily relates to benefits from the Company’s net operating losses.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2 - Going Concern

The Company has incurred net losses for the quarter ended March 31, 2009 and the years ended December 31, 2004 through 2008, negative cash flows from operating activities for the quarter ended March 31, 2009 and the years ended December 31, 2004 through 2008, and had an accumulated deficit of \$73.2 million at March 31, 2009. The Company has relied upon cash from its financing activities to fund its ongoing operations as it has not been able to generate sufficient cash from its operating activities in the past, and there is no assurance that it will be able to do so in the future. Due to this history of losses and operating cash consumption, the Company cannot predict how long it will continue to incur further losses or whether it will become profitable again, or if the Company's business will improve. These factors raise substantial doubt as to its ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As of March 31, 2009, the Company had a cash balance of approximately \$0.1 million, compared to \$0.3 million at December 31, 2008, and a working capital deficiency of \$2.7 million.

The liquidity issues that have resulted from the Company's history of losses have been addressed in the past through the sale of Company common stock, preferred stock and by entering into various debt instruments. During 2008, the Company issued 10% Convertible Unsecured Notes and warrants to purchase Company common stock in exchange for \$450,000 cash. Additionally, in 2008 the Company and TAG Virgin Islands, Inc. executed a Stock Purchase Agreement whereby an investor represented by TAG Virgin Islands, Inc. purchased 2,500,000 shares of Company common stock for a total investment of \$200,000.

The Company executed a revolving line of credit agreement in March 2008 with Access Capital, Inc. (“Access Capital” or “Access”). As of March 31, 2009, the Company was in default of the Loan and Security Agreement. As a result of the default, Access has increased the interest rate payable on borrowings under the line of credit to 18% per annum, has notified the Company’s clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital. Refer to footnote 4 of the Notes to Condensed Consolidated Financial Statements for further discussion on the Line of Credit.

On June 7, 2004, the Company issued a five-year \$2,000,000 Unsecured Convertible Line of Credit Note. \$950,000 of the original principal balance has previously been converted to Company common stock and the remaining \$1,050,000 balance which is outstanding at March 31, 2009, matures on June 6, 2009. As of March 31, 2009, the Company does not have the ability to repay this note upon maturity.

The Company needs additional capital in order to survive. Additional capital will be needed to fund current working capital requirements, ongoing debt service and to repay the obligations that are maturing over the upcoming 12 month period. Our primary sources of liquidity are cash flows from operations, borrowings under our revolving credit facility, and various short and long term financings. We plan to continue to strive to increase revenues and to control operating expenses in order to reduce, or eliminate, the operating losses. Additionally, we will continue to seek equity and/or debt financing in order to enable us to continue to meet our financial obligations until we achieve profitability. There can be no assurance that any such funding will be available to us on favorable terms, or at all. Failure to obtain sufficient financing would have substantial negative ramifications to the Company.

Note 3 - Recently Issued Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (“FASB”) issued FASB No. 141(R), “Business Combinations”. FASB 141(R) was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. This Statement applies to a transaction or other event that meets the definition of a business combination. It does not apply to the formation of a joint venture, the acquisition of an asset or a group of assets that do not constitute a business, or the combination between entities or businesses under common control. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The Company does not anticipate that adoption of this Issue will have a material affect on the Company’s financial condition, results of operations, cash flows or disclosures.

In June 2008, the Emerging Issues Task Force (“EITF”) issued EITF 07-5, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock”. EITF 07-5 clarifies how to determine whether certain instruments or features were indexed to an entity’s own stock under EITF 01-6, “The Meaning of “Indexed to a Company’s Own Stock”. It also resolves issues related to proposed Statement 133 Implementation Issue No. C21, Scope Exceptions: “Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity’s Own Stock and Currency Exchange Rates”. EITF 07-5 will become effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The consensus must be applied to all instruments outstanding on the date of adoption and the cumulative effect of applying the consensus must be recognized as an adjustment to the opening balance of retained earnings at transition. Adoption of this Issue did not have a material affect on the Company’s financial condition, results of operations, cash flows or disclosures.

In November 2008, the Emerging Issues Task Force (“EITF”) issued EITF 08-6, “Equity Method Investment Accounting Considerations”. EITF 08-6 clarifies the accounting for certain transactions and impairment consideration involving equity method investments. This Issue applies to all investments accounted for under the equity method and is effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. This Issue will only be applied prospectively. Adoption of this Issue did not have a material affect on the Company’s

financial condition, results of operations, cash flows or disclosures.

Note 4 - Line of credit

The Company executed a replacement revolving line of credit agreement in March 2008 with Access Capital. This line of credit provides for borrowing up to a maximum of \$3,500,000, based upon collateral availability, a 90% advance rate against eligible accounts receivable, has a three year term, and an interest rate of prime (which was 3.25% as of March 31, 2009) plus 2.75% prior to a default, but 18% upon default. The Company must comply with a minimum working capital covenant which requires the Company to maintain minimum monthly working capital of \$400,000. The Company was not in compliance with this covenant as of March 31, 2009. Additionally, during the first year of the three year term the Company must maintain an average minimum monthly borrowing of \$2,000,000 which increases to \$2,250,000 in the second year and to \$2,500,000 in the third year. The Company must also pay an annual facility fee equal to 1% of the maximum available under the facility and a \$1,750 per month collateral management fee. Further debt incurred by the Company may need to be subordinated to Access Capital, Inc.

The Company was in default of the Loan and Security Agreement as of March 31, 2009 since its working capital was below the minimum required working capital of \$400,000. In the event of a default under the Loan and Security Agreement, Access Capital's remedies include, but are not limited to, the following:

- Access may perform or observe such covenant on behalf and in the name, place and stead of the Company and may take actions which they deem necessary to cure or correct such failure, including, but not limited to, payment of taxes, satisfaction of liens, performance of obligations owed to debtors, procurement of insurance, execution of assignments, security agreements and financing statements and the endorsement of instruments;
- upon the occurrence of, and for so long as any event of default exists, the interest rate is increased to one and one-half percent (1.5%) per month;
- Access may notify the Company's account debtors of their security interest in the accounts, collect them directly and charge the collection costs and expenses to the Company's account;
- at Access Capital's election, following the occurrence of an event of default, they may terminate the Loan and Security Agreement. In the event of early termination after the occurrence of default, the Company would be liable for various early payment fees, penalties and interest;
- Access shall have the right to demand repayment in full of all obligations, whether or not otherwise due, including required prepayment fees, interest, and penalties.

As a result of this default, to date, Access has increased the interest rate payable on borrowings under the line of credit to 18% per annum, has notified the Company's clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital.

As of March 31, 2009, \$2.7 million was outstanding under the line of credit and the annual interest rate remained at 18%.

Note 5 - Stock Based Compensation

The 2003 Incentive Plan ("2003 Plan") authorizes the issuance of up to 10,000,000 shares of common stock for issuance upon exercise of options. It also authorizes the issuance of stock appreciation rights, however, none have been issued. The options granted may be a combination of both incentive and nonstatutory options, generally vest over a three year period from the date of grant, and expire ten years from the date of grant.

To the extent that CSI derives a tax benefit from options exercised by employees, such benefit will be credited to additional paid-in capital when realized on the Company's income tax return. There were no tax benefits realized by the Company during the three months ended March 31, 2009 or during the years ended December 31, 2008 or 2007.

The following summarizes the stock option transactions under the 2003 Plan during 2009:

	Shares	Weighted average exercise price
Options outstanding at December 31, 2008	5,204,997	\$ 0.76
Options granted	-	-
Options exercised	-	-
Options canceled	(191,668)	0.83
Options outstanding at March 31, 2009	5,013,329	\$ 0.76

The following table summarizes information concerning outstanding and exercisable Company common stock options at March 31, 2009:

Range of exercise prices	Options outstanding	Weighted average	Weighted average remaining	Options exercisable	Weighted average
--------------------------	---------------------	------------------	----------------------------	---------------------	------------------

Edgar Filing: CONVERSION SERVICES INTERNATIONAL INC - Form 10-Q

		exercise price	contractual life		exercise price
\$0.25-\$0.30	2,104,998	\$ 0.260	7.4	1,293,314	\$ 0.255
\$0.46-\$0.60	1,005,000	0.461	6.8	1,005,000	0.461
\$0.83	1,269,000	0.830	5.3	1,269,000	0.830
\$2.475-\$3.45	634,331	2.758	4.9875	634,331	2.758
	5,013,329			4,201,645	

In accordance with SFAS 123(R), the Company recorded approximately \$33,100 and \$190,200 of expense related to stock options which vested during the three months ended March 31, 2009 and 2008, respectively.

Note 6 - Loss Per Share

Basic loss per share is computed on the basis of the weighted average number of common shares outstanding. Diluted loss per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options using the "treasury stock" method and the effect of convertible debt instruments as if they had been converted at the beginning of each period presented.

Basic and diluted loss per share was determined as follows:

	For the three months ended March 31,	
	2009	2008
Net loss before income taxes (A)	\$ (1,586,657)	\$ (1,744,423)
Net loss (B)	\$ (1,586,657)	\$ (1,744,423)
Net loss attributable to common stockholders (C)	\$ (1,726,657)	\$ (1,899,128)
Weighted average outstanding shares of common stock (D)	119,692,762	110,213,822
Basic and diluted income (loss) per common share:		
Before income taxes (A/D)	\$ (0.01)	\$ (0.02)
Net loss per common share (B/D)	\$ (0.01)	\$ (0.02)
Net loss per common share attributable to common stockholders (C/D)	\$ (0.01)	\$ (0.02)

For the three months ended March 31, 2009 and 2008, 5,013,329 and 5,740,830 shares attributable to outstanding stock options were excluded from the calculation of diluted loss per share because the effect was antidilutive, respectively. Additionally, the effect of warrants to purchase 60,932,687 shares of common stock which were issued between June 7, 2004 and March 31, 2008, and outstanding as of March 31, 2009, were excluded from the calculation of diluted loss per share for the three months ended March 31, 2008, and the effect of 69,432,687 warrants which were issued between June 7, 2004 and March 31, 2009, and were outstanding as of March 31, 2009, were excluded from the calculation of diluted loss per share for the three months ended March 31, 2009 because the effect was antidilutive. Also excluded from the calculation of loss per share because their effect was antidilutive were 666,667 shares of common stock underlying the \$1,050,000 convertible line of credit note to Taurus as of March 31, 2008 and 2009, 6,000,000 shares underlying the short-term notes to TAG Virgin Islands, Inc. issued in 2008, 7,800,000 shares underlying the Series A and Series B convertible preferred stock, and options to purchase 36,596 shares of common stock outstanding to Laurus as of March 31, 2008 and 2009.

Note 7 - Major Customers

During the three months ended March 31, 2009, the Company had sales relating to three major customers, Bank of America, Church & Dwight and LEC, a related party, comprising 22.0%, 19.9% and 14.2% of revenues, respectively, and totaling approximately \$838,200, 757,600 and \$542,768, respectively. Amounts due from services provided to these customers included in accounts receivable was approximately \$1,779,530 at March 31, 2009. As of March 31, 2009, receivables related to services performed for Bank of America, Church & Dwight and LEC accounted for approximately 17.5%, 17.2% and 14.1% of the Company's accounts receivable balance, respectively.

During the three months ended March 31, 2008, the Company had sales relating to two major customers, Bank of America and LEC, a related party, comprising 18.3% and 12.6% of revenues, and totaling approximately \$862,219 and \$591,869, respectively. Amounts due from services provided to these customers included in accounts receivable was approximately \$1,019,888 at March 31, 2008. As of March 31, 2008, receivables related to services performed for Bank of America and LEC accounted for approximately 21.6% and 14.4% of the Company's accounts receivable

balance, respectively.

Note 8 - Commitments and Contingencies

Legal Proceedings

From time to time, the Company is either a defendant or the plaintiff in various claims and lawsuits. Although there can be no assurances, management believes that the disposition of such matters will not have a material adverse impact on the results or operations or financial position of the Company.

10

Lease Commitments

Years Ending March 31	Office	Sublease	Net
2010	\$ 360,404	\$ 116,252	\$ 244,152
2011	280,366	107,310	173,056
Thereafter	-	-	-
	\$ 640,770	\$ 223,562	\$ 417,208

Effective February 2007, the Company subleased a portion of its East Hanover, New Jersey corporate office space for the remainder of the lease term. 7,154 square feet of the Company's 16,604 square feet of rented office space were subleased from February 15, 2007 to December 31, 2010. The sublease provides for three months of free rent to the sublessee, monthly rent equal to \$5,962 per month from May 15, 2007 to December 31, 2007, \$8,942 per month from January 1, 2008 to December 31, 2009, and \$11,923 per month from January 1, 2010 to December 31, 2010. Additionally, the Company will receive a fixed rental for electric of \$10,731 per annum payable in equal monthly installments throughout the term of the lease.

Note 9 - Related Party Transactions

Refer to footnote 7 for the related party transaction disclosure as a major customer.

As of March 31, 2009, the balance outstanding with respect to the loan from Glenn Peipert, our Executive Vice President and Chief Operating Officer, to the Company was approximately \$0.1 million, which accrues interest at a simple rate of 8% per annum.

Note 10 - Subsequent Events

Scott Newman, President and Chief Executive Officer of the Company, provided written notice to the Company resigning from the positions of President and Chief Executive Officer, effective April 10, 2009. Mr. Newman will continue to serve the Company as Chairman of the Board of Directors, and will also serve as Chief Strategy Officer, a newly created position that allows Mr. Newman to focus on corporate strategy and identifying growth opportunities. Mr. Newman is the brother of Ms. Cohen, our President and Chief Executive Officer.

Lori Cohen has been appointed to be the President and Chief Executive Officer of the Company. Over the past thirteen years, Ms. Cohen has been Vice President of Technology for the Company and served on the Company's technical advisory committee. She has been instrumental in developing the best practices for information management development currently in use at the Company. Ms. Cohen is the sister of Mr. Newman, our Chief Strategy Officer. Ms. Cohen holds a bachelor's degree in computer science from State University of New York Oswego.

On July 28, 2008, the Company issued 10% Convertible Unsecured Notes (the "Notes") to certain investors represented by TAG Virgin Islands, Inc. for \$200,000. These notes were originally due on December 27, 2008 and are convertible into 2,500,000 shares of common stock at the option of the holders. The maturity dates of the Notes have been extended to May 31, 2009.

On October 2, 2008, the Company issued a 10% Convertible Unsecured Note (the "Note") to certain investors represented by TAG Virgin Islands, Inc. for \$50,000. This note was originally due on April 1, 2009 and is convertible into 1,000,000 shares of common stock at the option of the holders. The maturity date of the Note has been extended to May 31, 2009.

Newman to focus on corporate strategy and identifying growth opportunities.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Special Note About Forward-Looking Statements

Certain statements in Management's Discussion and Analysis ("MD&A"), other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words "believes," "project," "expects," "anticipates," "estimates," "intends," "strategy," "plan," "may," "will," "would," "will be," "will continue," "may result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview of our Business

Conversion Services International, Inc. provides professional services to the Global 2000, as well as mid-market clientele relating to strategic consulting, business intelligence/data warehousing and data management and, through strategic partners, the sale of software. The Company's services based clients are primarily in the financial services, pharmaceutical, healthcare and telecommunications industries, although it has clients in other industries as well. The Company's clients are primarily located in the northeastern United States.

The Company began operations in 1990. Its services were originally focused on e-business solutions and data warehousing. In the late 1990s, the Company strategically repositioned itself to capitalize on its data warehousing expertise in the fast growing business intelligence/data warehousing space. The Company became a public company via its merger with a wholly owned subsidiary of LCS Group, Inc., effective January 30, 2004.

The Company's core strategy includes capitalizing on the already established in-house business intelligence/data warehousing ("BI/DW") technical expertise and its strategic consulting division. This is expected to result in organic growth through the addition of new customers.

The Company derives a majority of its revenue from professional services engagements. Its revenue depends on the Company's ability to generate new business, in addition to preserving present client engagements. The general domestic economic conditions in the industries the Company serves, the pace of technological change, and the business requirements and practices of its clients and potential clients directly affect our ability to accomplish these goals. When economic conditions decline, companies generally decrease their technology budgets and reduce the amount of spending on the type of information technology (IT) consulting provided by the Company. The Company's revenue is also impacted by the rate per hour it is able to charge for its services and by the size and chargeability, or utilization rate, of its professional workforce. If the Company is unable to maintain its billing rates or sustain appropriate utilization rates for its professionals, its overall profitability may decline. Several large clients have changed their business practices with respect to consulting services. Such clients now require that we contract with their vendor management organizations in order to continue to perform services. These organizations charge fees generally based upon the hourly rates being charged to the end client. Our revenues and gross margins are being negatively affected by this practice.

The Company will continue to focus on a variety of growth initiatives in order to improve its market share and increase revenue. Moreover, as the Company endeavors to achieve top line growth, through entry on new approved vendor lists, penetrating new vertical markets, and expanding its time and material business, the Company will concentrate its efforts on improving margins and driving earnings to the bottom line.

In addition to the conditions described above for growing the Company's current business, the Company may continue to grow through acquisitions. One of the Company's objectives is to make acquisitions of companies offering services complementary to the Company's lines of business. This is expected to accelerate the Company's business plan at lower costs than it would generate internally and also improve its competitive positioning and expand the Company's offerings in a larger geographic area. The service industry is very fragmented, with a handful of large international firms having data warehousing and/or business intelligence divisions, and hundreds of regional boutiques throughout the United States. These smaller firms do not have the financial wherewithal to scale their businesses or compete with the larger players.

The Company's most significant costs are personnel expenses, which consist of consultant fees, benefits and payroll-related expenses.

Results of Operations

The following table sets forth selected financial data for the periods indicated:

Selected Statement of Operations Data for the three
months ended March 31,
2009 2008

Net revenue	\$ 3,810,439	\$ 4,705,461
Gross profit	271,866	1,031,968
Net loss	(1,586,657)	(1,744,423)
Net loss attributable to common stockholders	(1,726,657)	(1,899,128)
Basic and diluted loss per common share:		
Net loss per common share	\$ (0.01)	\$ (0.02)
Net loss per common share attributable to common stockholders	\$ (0.01)	\$ (0.02)

Selected Statement of Financial Position
Data as of

March 31, 2009 December 31,
2008

Working capital deficiency	\$ (2,669,709)	\$ (1,296,278)
Total assets	4,063,729	4,578,885
Total stockholders' deficit	(3,654,096)	(2,029,296)

Three Months Ended March 31, 2009 and 2008

Revenue

The Company's revenue is primarily comprised of billings to clients for consulting hours worked on client projects. Revenue of \$3.8 million for the three months ended March 31, 2009 decreased by \$0.9 million, or 19.0%, as compared to revenue of \$4.7 million for the three months ended March 31, 2008.

Revenue for the Company is categorized by strategic consulting, business intelligence, data warehousing and data management. The chart below reflects revenue by line of business for the three months ended March 31, 2009 and 2008:

	For the three months ended March 31,			
	2009	2008	2009	2008
	\$	% of total revenues	\$	% of total revenues
Strategic Consulting	\$ 1,001,941	26.3%	\$ 1,129,715	24.0%
Business Intelligence / Data Warehousing	2,102,152	55.2%	2,829,873	60.1%
Data Management	542,768	14.2%	591,869	12.6%
Reimbursable expenses	146,578	3.8%	138,971	3.0%
Other	17,000	0.5%	15,033	0.3%
	\$ 3,810,439	100.0%	\$ 4,705,461	100.0%

Strategic consulting

The strategic consulting line of business includes work related to planning and assessing both process and technology for clients, performing gap analysis, making recommendations regarding technology and business process

improvements to assist clients to realize their business goals and maximize their investments in both people and technology.

Strategic consulting revenue of \$1.0 million, or 26.3% of total revenue, for the three months ended March 31, 2009 decreased by \$0.1 million, or 11.3%, as compared to revenue of \$1.1 million, or 24.0% of total revenue, for the three months ended March 31, 2008. This decrease is primarily due to a \$0.1 million reduction in revenue due to the continued decline in the Integrated Strategies revenue and a decline in revenue from Bank of America as compared to the prior year. In the strategic consulting line of business, there was a 13.8% decline in consultant headcount, resulting in a 15.3% reduction in billable hours as compared to the prior year period.

Business intelligence / Data warehousing

The business intelligence line of business includes work performed with various applications and technologies for gathering, storing, analyzing and providing clients with access to data in order to allow enterprise users to make better and quicker business decisions. The data warehousing line of business includes work performed for client companies to provide a consolidated view of high quality enterprise information. CSI provides services in the data warehouse and data mart design, development and implementation, prepares proof of concepts, implements data warehouse solutions and integrates enterprise information. Since the business intelligence and data warehousing work overlap and the Company has performed engagements which include both business intelligence and data warehousing components, the Company tracks this work as a single line of business and reports the results as a single line of business.

Business intelligence/data warehousing (“BI/DW”) revenue of \$2.1 million, or 55.2% of total revenue, for the three months ended March 31, 2009 decreased by \$0.7 million, or 25.7%, as compared to revenue of \$2.8 million, or 60.1% of total revenue, for the three months ended March 31, 2008. The decrease in BI/DW revenue for the three months ended March 31, 2009 is primarily due to \$0.9 million of current quarter revenue relating to new projects, partially offset by \$1.4 million of prior period revenue relating to projects that were completed in the prior year and \$0.2 million of reduced revenue relating to projects that were in process in the prior period and continuing in the current quarter. Additionally, \$0.8 million of billings to NDMA for work performed during the March 2009 quarter were deferred and will be recognized in revenue upon cash receipt. Overall, the BI/DW line of business had a 9.7% increase in its average bill rate and a 11.5% decrease in consultant headcount, resulting in a 14.4% decrease in billable hours as compared to the prior year period.

Data management

The data management line of business includes such activities as Enterprise Information Architecture, Metadata Management, Data Quality/Cleansing/ Profiling. The Company performs these activities through its exclusive subcontractor agreement with its related party, LEC.

Data management revenues of \$0.5 million, or 14.2% of total revenue, for the three months ended March 31, 2009 decreased by \$0.1 million, or 8.3%, as compared to revenue of \$0.6 million, or 12.6% of total revenue, for the three months ended March 31, 2008. This reduction in revenue was due to a 13.3% reduction in headcount, which resulted in a 27.7% reduction in billable hours as compared to the prior period. Partially offsetting the revenue decline was a 27.1% increase in the average bill rate as compared to the prior year.

Cost of revenue

Cost of revenue includes payroll and benefit and other direct costs for the Company’s consultants. Cost of revenue was \$3.5 million, or 92.9% of revenue, for the three months ended March 31, 2009, representing a decrease of \$0.2 million, or 3.7%, as compared to \$3.7 million, or 78.1% of revenue for the three months ended March 31, 2008.

Cost of services was \$2.8 million, or 91.8% of services revenue for the three months ended March 31, 2009, representing a decrease of \$0.1 million, or 1.6%, as compared to \$2.9 million, or 73.1% of services revenue for the three months ended March 31, 2008. Cost of services declined during the three months ended March 31, 2009 as compared to the prior year due to a decline in services revenue in the current period as well as a reduction in stock compensation expense recorded in the current period as compared to the prior year. The increase in cost of services as a percent of services revenue is due to \$0.8 million of revenue which was invoiced for work performed during the March 2009 quarter, however, the revenue is deferred until cash is received. Billable consultant headcount declined 12.2% in the current period as compared to the prior year. The Company had an average of 79 consultants in the

current period and 90 in the prior year period. This decline in headcount is consistent with the decrease in services revenue during the current period as compared to the prior year period.

Cost of related party services was \$0.5 million, or 91.9% of related party services revenue, for the three months ended March 31, 2009, representing a decrease of \$0.1 million, or 10.2%, as compared to \$0.6 million, or 93.8% of related party services revenue, for the three months ended March 31, 2008. Cost of related party services decreased for the three month period due to a corresponding decrease in related party consulting revenue during the three months ended March 31, 2009 as compared to the prior year.

Gross profit

Gross profit was \$0.3 million, or 7.1% of revenue for the three months ended March 31, 2009, representing a decrease of \$0.8 million, or 73.7%, as compared to \$1.0 million, or 21.9% of revenue for the three months ended March 31, 2008.

Gross profit from services was \$0.3 million, or 8.2% of services revenue for the three months ended March 31, 2009, representing a decrease of \$0.8 million, or 76.1%, as compared to \$1.1 million, or 26.9% of services revenue for the three months ended March 31, 2008. The decrease in the gross profit from services as a percentage of services revenue has been outlined previously in the revenue and cost of revenue discussions.

Gross profit from related party services was \$43,900, or 8.1% of related party services revenue for the three months ended March 31, 2009, as compared to the prior year's gross profit of \$36,500, or 6.2% of related party services revenue for the three months ended March 31, 2008.

Selling and marketing

Selling and marketing expenses include payroll, employee benefits and other headcount-related costs associated with sales and marketing personnel and advertising, promotions, tradeshow, seminars and other programs. Selling and marketing expenses were \$0.8 million, or 21.1% of revenue for the three months ended March 31, 2009, compared to \$0.9 million, or 19.4% of revenue for the three months ended March 31, 2008.

Selling and marketing expense for the three months ended March 31, 2009 decreased by \$0.1 million as compared to the prior year, and increased as a percentage of total revenue by 1.7% points. The decrease in expense is primarily due to a \$0.1 million decrease in payroll and stock compensation expense in the current period as compared to the prior year. The increase as a percent of revenue is due to the deferral of \$0.8 million of NDMA revenues during the March 2009 quarter.

General and administrative

General and administrative costs include payroll, employee benefits and other headcount-related costs associated with the finance, legal, facilities, certain human resources and other administrative headcount, and legal and other professional and administrative fees. General and administrative costs were \$0.6 million, or 16.9% of revenue for the three months ended March 31, 2009, compared to \$1.1 million, or 22.8% of revenue for the three months ended March 31, 2008.

General and administrative expense for the three months ended March 31, 2009 decreased by \$0.5 million as compared to the prior year, and also decreased as a percentage of total revenue by 5.9% points. The decrease in expense is primarily due to a \$0.3 million reduction in payroll and stock compensation expense due to both a reduction in headcount and a reduction in executive salary expense as compared to the prior year. Bad debt expense declined by \$0.1 million as compared to the prior year and utilities, investor relations expense and stock exchange listing fees also declined by \$0.1 million as compared to the prior year.

Depreciation and amortization

Depreciation expense is recorded on the Company's property and equipment which is generally depreciated over a period between three to seven years. Amortization of leasehold improvements is taken over the shorter of the estimated useful life of the asset or the remaining term of the lease. The Company amortizes deferred financing costs utilizing the effective interest method over the term of the related debt instrument. Acquired software is amortized on a straight-line basis over an estimated useful life of three years. Acquired contracts are amortized over a period of time that approximates the estimated life of the contracts, based upon the estimated annual cash flows obtained from those contracts, generally five to six years. Depreciation and amortization expenses were \$27,000 for the three months ended March 31, 2009 representing a \$64,000 decline from \$91,000 for the three months ended March 31, 2008.

Other income (expense)

The Company performed an impairment analysis with respect to its investment in LEC, a related party, and determined that the investment was impaired at March 31, 2009. As a result, a charge for the impairment of the equity investment in the amount of \$103,580, was recorded in March 2009. There were no impairment charges recorded in the prior period.

In March 2008, the Company restructured its debt with TAG Virgin Islands, Inc. and issued Company common stock in repayment of \$0.6 million of the Unsecured Convertible Note dated June 7, 2004. A \$0.6 million loss on the extinguishment of this debt was recorded in March 2008.

Interest expense, which includes amortization of the discount on debt of \$41,000 and \$79,000 during the three months ended March 31, 2009 and 2008, respectively, was \$0.3 million and \$0.2 million for the three months ended March 31, 2009 and 2008, respectively. The increase in interest expense in the current period, as compared to the prior year, was primarily due to a \$0.1 million increase in interest expense on the Company's revolving line of credit as compared to the prior year. Since the Company has been in default of its working capital covenant during the current period, interest on the outstanding balance on the line of credit has been charged at annual rate of 18%. Additionally, interest expense increased due to the accretion of expense related to warrants which were issued to TAG Virgin Islands, Inc.

Liquidity and Capital Resources

The Company has incurred net losses for the quarter ended March 31, 2009 and the years ended December 31, 2004 through 2008, negative cash flows from operating activities for the quarter ended March 31, 2009 and the years ended December 31, 2004 through 2008, and had an accumulated deficit of \$73.2 million at March 31, 2009. The Company has relied upon cash from its financing activities to fund its ongoing operations as it has not been able to generate sufficient cash from its operating activities in the past, and there is no assurance that it will be able to do so in the future. Due to this history of losses and operating cash consumption, we cannot predict how long we will continue to incur further losses or whether we will become profitable again, or if the Company's business will improve. These factors raise substantial doubt as to our ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As of March 31, 2009, the Company had a cash balance of approximately \$0.1 million, compared to \$0.3 million at December 31, 2008, and a working capital deficiency of \$2.7 million.

The liquidity issues that have resulted from the Company's history of losses have been addressed in the past through the sale of Company common stock, preferred stock and by entering into various debt instruments. During 2008, the Company issued 10% Convertible Unsecured Notes and warrants to purchase Company common stock in exchange for \$450,000 cash. Additionally, the Company and TAG Virgin Islands, Inc. executed a Stock Purchase Agreement whereby an investor represented by TAG Virgin Islands, Inc. purchased 2,500,000 shares of Company common stock for a total investment of \$200,000.

The Company executed a revolving line of credit agreement in March 2008 with Access Capital, Inc. ("Access Capital" or "Access"). As of March 31, 2009, the Company was in default of the Loan and Security Agreement. As a result of the default, Access has increased the interest rate payable on borrowings under the line of credit to 18% per annum, has notified the Company's clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital. Refer to footnote 4 of the Notes to Condensed Consolidated Financial Statements for further discussion on the Line of Credit.

On June 7, 2004, the Company issued a five-year \$2,000,000 Unsecured Convertible Line of Credit Note. \$950,000 of the original principal balance has previously been converted to Company common stock and the remaining \$1,050,000 balance which is outstanding at March 31, 2009, matures on June 6, 2009. As of March 31, 2009, the Company does not have the ability to repay this note upon maturity.

The Company needs additional capital in order to survive. Additional capital will be needed to fund current working capital requirements, ongoing debt service and to repay the obligations that are maturing over the upcoming 12 month period. Our primary sources of liquidity are cash flows from operations, borrowings under our revolving credit facility, and various short and long term financings. We plan to continue to strive to increase revenues and to control operating expenses in order to reduce, or eliminate, the operating losses. Additionally, we will continue to seek equity

and/or debt financing in order to enable us to continue to meet our financial obligations until we achieve profitability. There can be no assurance that any such funding will be available to us on favorable terms, or at all. Failure to obtain sufficient financing would have substantial negative ramifications to the Company.

The Company's working capital deficit was \$2.7 million as of March 31, 2009 which represented a \$1.4 million increase in the working capital deficit when compared to the working capital deficit of \$1.3 million as of December 31, 2008. The primary reason for the decline in working capital is a \$0.2 million reduction in cash, a \$0.1 million reduction accounts receivable due to a decline in revenues, a \$0.1 million decrease in prepaid expenses, a \$0.4 million increase in the line of credit balance, a \$0.1 million increase in short term notes payable and a \$0.7 million increase in deferred revenue due to the deferral of \$0.8 million of revenue related to work performed at NDMA until payment is received for the services provided. These reductions in working capital were partially offset by a \$0.2 million reduction in accounts payable and accrued expenses primarily due to the timing of payments.

Cash used in operating activities during the three months ended March 31, 2009 was approximately \$0.6 million compared to cash provided by operating activities of \$0.1 million for the three months ended March 31, 2008. The increase in cash used in operations was primarily the result of the \$1.6 million loss for the three months ended March 31, 2009 which includes \$0.3 million of non-cash charges for items including depreciation, amortization, stock based compensation and bad debt expense, resulting in a \$1.3 million "cash based" loss. Additionally, changes in operating assets and liabilities reflect \$0.7 million of cash provided by operations.

Cash used in investing activities was \$6,700 in the current period compared to \$18,000 during the three months ended March 31, 2008. The Company purchased computer equipment during both the current period and the comparable prior year period.

Cash provided by financing activities was \$0.4 million during the three months ended March 31, 2009 and cash used by financing activities was \$1.1 million during the three months ended March 31, 2008. The cash provided by financing activities during the current period was primarily the result of additional borrowings under the Company's revolving line of credit agreement with Access Capital. The cash used in financing activities during the prior period was primarily the result of the Company's effort to reduce the balance outstanding under its former line of credit arrangement.

The Company executed a replacement revolving line of credit agreement in March 2008 with Access Capital, Inc. The Access Capital line of credit provides for borrowing up to a maximum of \$3,500,000, based upon collateral availability, a 90% advance rate against eligible accounts receivable, has a three year term, and an interest rate of prime (which was 3.25% as of March 31, 2009) plus 2.75% prior to a default, but 18% upon default. The Company must comply with a minimum working capital covenant which requires the Company to maintain minimum monthly working capital of \$400,000. Additionally, during the first year of the three year term the Company must maintain an average minimum monthly borrowing of \$2,000,000 which increases the \$2,250,000 in the second year and to \$2,500,000 in the third year. The Company must also pay an annual facility fee equal to 1% of the maximum available under the facility and a \$1,750 per month collateral management fee. Further debt incurred by the Company may need to be subordinated to Access Capital, Inc.

On July 28, 2008, the Company issued 10% Convertible Unsecured Notes (the "Notes") to certain investors represented by TAG Virgin Islands, Inc. for \$200,000. These notes were originally due on December 27, 2008 and are convertible into 2,500,000 shares of common stock at the option of the holders. The maturity dates of the Notes have been extended to May 31, 2009.

On October 2, 2008, the Company issued a 10% Convertible Unsecured Note (the "Note") to certain investors represented by TAG Virgin Islands, Inc. for \$50,000. This note was originally due on April 1, 2009 and is convertible into 1,000,000 shares of common stock at the option of the holders. The maturity date of the Note has been extended to May 31, 2009.

There are currently no material commitments for capital expenditures.

As of March 31, 2009 and December 31, 2008, the Company had accounts receivable due from LEC of approximately \$0.5 million and \$0.3 million, respectively. There are no known collection problems with respect to LEC.

For the three months ended March 31, 2009 and 2008, we invoiced LEC \$0.5 million and \$0.6 million, respectively, for the services of consultants subcontracted to LEC by us. The majority of its billing is derived from Fortune 100 clients.

The following is a summary of the debt instruments outstanding as of April 30, 2009:

Lender	Type of facility	Outstanding as of April 30, 2009 (not including interest) (all numbers approximate)	Remaining Availability (if applicable)
Access Capital, Inc.	Line of Credit	\$ 3,191,000	\$ 104,000

Edgar Filing: CONVERSION SERVICES INTERNATIONAL INC - Form 10-Q

Taurus Advisory Group, LLC / TAG Virgin Islands, Inc. Investors	Convertible Promissory Notes	\$ 1,500,000	\$ -
Glenn Peipert	Promissory Note	\$ 104,000	\$ -
TOTAL		\$ 4,795,000	\$ 104,000

Additionally, the Company has two series of preferred stock outstanding as follows:

Holder	Type of Instrument	Principal amount outstanding as of April 30, 2009
Taurus Advisory Group, LLC Investors	Series A Convertible Preferred Stock	\$ 1,900,000
Matthew J. Szulik	Series B Convertible Preferred Stock	\$ 2,000,000
TOTAL		\$ 3,900,000

Recently Issued Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (“FASB”) issued FASB No. 141(R), “Business Combinations”. FASB 141(R) was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. This Statement applies to a transaction or other event that meets the definition of a business combination. It does not apply to the formation of a joint venture, the acquisition of an asset or a group of assets that do not constitute a business, or the combination between entities or businesses under common control. This Statement shall be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The Company does not anticipate that adoption of this Issue will have a material affect on the Company’s financial condition, results of operations, cash flows or disclosures.

In June 2008, the Emerging Issues Task Force (“EITF”) issued EITF 07-5, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock”. EITF 07-5 clarifies how to determine whether certain instruments or features were indexed to an entity’s own stock under EITF 01-6, “The Meaning of “Indexed to a Company’s Own Stock”. It also resolves issues related to proposed Statement 133 Implementation Issue No. C21, Scope Exceptions: “Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity’s Own Stock and Currency Exchange Rates”. EITF 07-5 will become effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The consensus must be applied to all instruments outstanding on the date of adoption and the cumulative effect of applying the consensus must be recognized as an adjustment to the opening balance of retained earnings at transition. Adoption of this Issue did not have a material affect on the Company’s financial condition, results of operations, cash flows or disclosures.

In November 2008, the Emerging Issues Task Force (“EITF”) issued EITF 08-6, “Equity Method Investment Accounting Considerations”. EITF 08-6 clarifies the accounting for certain transactions and impairment consideration involving equity method investments. This Issue applies to all investments accounted for under the equity method and is effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. This Issue will only be applied prospectively. Adoption of this Issue did not have a material affect on the Company’s financial condition, results of operations, cash flows or disclosures.

Application of Critical Accounting Policies

Revenue recognition

Our revenue recognition policy is significant because revenues are a key component of our results from operations. In addition, revenue recognition determines the timing of certain expenses, such as incentive compensation. We follow very specific and detailed guidelines in measuring revenue; however, certain judgments and estimates affect the application of the revenue policy. Revenue results are difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause operating results to vary significantly from quarter to quarter and could result in future operating losses or reduced net income.

Revenue from consulting and professional services is recognized at the time the services are performed on a project by project basis. For projects charged on a time and materials basis, revenue is recognized based on the number of hours worked by consultants at an agreed-upon rate per hour. For large services projects where costs to complete the contract could reasonably be estimated, the Company undertakes projects on a fixed-fee basis and recognizes revenue on the percentage of completion method of accounting based on the evaluation of actual costs incurred to date compared to total estimated costs. Revenue recognized in excess of billings is recorded as cost in excess of billings. Billings in excess of revenue recognized are recorded as deferred revenue until revenue recognition criteria are met. Reimbursements, including those relating to travel and other out-of-pocket expenses, are included in revenue, and an equivalent amount of reimbursable expenses are included in cost of services.

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104. As a result, in the event that collectability from a client is not reasonably assured, revenue is recognized on the cash basis.

Deferred Income Taxes

Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. We record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. We have considered future taxable income and prudent and feasible tax planning strategies in determining the need for a valuation allowance. A valuation allowance is maintained by the Company due to the impact of the current years net operating loss (NOL). In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment to the deferred tax assets would be charged to net income in the period such determination is made. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, the previously provided valuation allowance would be reversed. Our current valuation allowance relates predominately to benefits derived from the utilization of our NOL's.

Item 4T. Controls and Procedures

Evaluation of disclosure controls and procedures.

As of the end of the period covered by this Quarterly Report, the Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer ("the Certifying Officers"), conducted evaluations of the Company's disclosure controls and procedures. As defined under Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the

reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including the Certifying Officers, to allow timely decisions regarding required disclosures. Based on this evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were not effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Exchange Act and the rules and regulations promulgated thereunder.

The Chief Executive Officer's and Chief Financial Officer's conclusion regarding the Company's disclosure controls and procedures is based solely on management's conclusion that the Company's internal control over financial reporting as identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 continues to be ineffective as of March 31, 2009. In connection with our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, our management assessed the effectiveness of the Company's internal control over financial reporting was not effective based on management's identification of a lack of segregation of duties due to the small number of employees dealing with general administrative and financial matters and general controls over information security and user access. Also, the Company's Chief Financial Officer is the only person with an appropriate level of accounting knowledge, experience and training in the selection, application and implementation of generally accepted accounting principles as it relates to complex transactions and financial reporting requirements.

Changes in internal control over financial reporting.

No significant changes were made in our internal control over financial reporting during the Company's first quarter of 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is either a defendant or the plaintiff in various claims and lawsuits. Although there can be no assurances, management believes that the disposition of such matters will not have a material adverse impact on the results or operations or financial position of the Company.

Item 6. Exhibits

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934

32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350

32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350

SIGNATURE

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

Conversion Services International, Inc.

Date: May 20, 2009

By: /s/ Lori Cohen
Lori Cohen
President and Chief Executive Officer