

Edgar Filing: Wayside Technology Group, Inc. - Form 10-Q

Wayside Technology Group, Inc.  
Form 10-Q  
November 13, 2008

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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 September 30, 2008

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 No. 000-26408

Wayside Technology Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

13-3136104

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

1157 Shrewsbury Avenue, Shrewsbury, New Jersey 07702

(Address of principal executive offices)

(732) 389-8950

Registrant's Telephone Number

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 and 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Check One:

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

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

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There were 4,685,031 outstanding shares of Common Stock, par value \$.01 per share, as of November 6, 2008, not including 599,469 shares classified as treasury stock.

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**PART I – FINANCIAL INFORMATION**  
**WAYSIDE TECHNOLOGY GROUP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share amounts)

|  | September 30,<br>2008 | December 31,<br>2007 |
|--|-----------------------|----------------------|
|  | (Unaudited)           |                      |
| <b>ASSETS</b>  |                       |                      |
| <b>Current assets</b>  |                       |                      |
| Cash and cash equivalents  | \$ 13,171             | \$ 14,241            |
| Marketable securities  | 9,686                 | 9,641                |
| Accounts receivable, net of allowances of \$864 and \$908, respectively  | 25,608                | 24,824               |
| Inventory – finished goods   | 1,058                 | 1,116                |
| Prepaid expenses and other current assets  | 703                   | 927                  |
| Deferred income taxes  | 788                   | 830                  |
| <b>Total current assets</b>  | <b>51,014</b>         | <b>51,579</b>        |
| Equipment and leasehold improvements, net  | 625                   | 619                  |
| Other assets   | 4,417                 | 3,469                |
| Deferred income taxes  | 874                   | 1,086                |
| <b>Total assets</b>  | <b>\$ 56,930</b>      | <b>\$ 56,753</b>     |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                      |
| <b>Current liabilities</b>   |                       |                      |
| Accounts payable and accrued expenses  | \$ 32,727             | \$ 32,100            |
| Other liabilities  | 129                   | 161                  |
| <b>Total liabilities</b>   | <b>32,856</b>         | <b>32,261</b>        |
| <b>Commitments and contingencies</b>   |                       |                      |
| <b>Stockholders' equity</b>  |                       |                      |
| Common stock, \$.01 par value; 10,000,000 shares authorized, 5,284,500 shares issued; 4,679,169 and 4,708,498 shares outstanding, respectively | 53                    | 53                   |
| Additional paid-in capital   | 27,171                | 28,860               |
| Treasury stock, at cost, 605,331 and 576,002 shares, respectively  | (3,130)               | (2,283)              |
| Accumulated deficit  | (336)                 | (2,599)              |
| Accumulated other comprehensive income   | 316                   | 461                  |
| <b>Total stockholders' equity</b>  | <b>24,074</b>         | <b>24,492</b>        |

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|  |           |           |
|--|-----------|-----------|
| Total liabilities and stockholders' equity | \$ 56,930 | \$ 56,753 |
|--|-----------|-----------|

The accompanying notes are an integral part of these condensed consolidated financial statements.

**WAYSIDE TECHNOLOGY GROUP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**  
(Unaudited)  
(In thousands, except per share data)

|  | Nine months ended<br>September 30, |            | Three months ended<br>September 30, |           |
|--|------------------------------------|------------|-------------------------------------|-----------|
|  | 2008                               | 2007       | 2008                                | 2007      |
| Net sales  | \$ 133,994                         | \$ 132,752 | \$ 45,392                           | \$ 41,790 |
| Cost of sales                                      | 121,698                            | 119,834    | 41,139                              | 37,664    |
| Gross profit                                       | 12,296                             | 12,918     | 4,253                               | 4,126     |
| Selling, general and administrative expenses       | 9,059                              | 8,998      | 3,043                               | 2,962     |
| Income from operations                             | 3,237                              | 3,920      | 1,210                               | 1,164     |
| Interest income, net                               | 549                                | 749        | 173                                 | 257       |
| Realized foreign exchange gain (loss)              | 6                                  | 1          | (1)                                 | 1         |
| Income before income tax provision                 | 3,792                              | 4,670      | 1,382                               | 1,422     |
| Provision for income taxes                         | 1,529                              | 1,898      | 571                                 | 600       |
| Net income   | \$ 2,263                           | \$ 2,772   | \$ 811                              | \$ 822    |
| Net income per common share - Basic                | \$ 0.51                            | \$ 0.63    | \$ 0.18                             | \$ 0.19   |
| Net income per common share – Diluted              | \$ 0.50                            | \$ 0.59    | \$ 0.18                             | \$ 0.18   |
| Weighted average common shares outstanding-Basic   | 4,422                              | 4,395      | 4,408                               | 4,426     |
| Weighted average common shares outstanding-Diluted | 4,491                              | 4,682      | 4,438                               | 4,674     |

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|                                 |    |      |    |      |    |      |    |      |
|---------------------------------|----|------|----|------|----|------|----|------|
| Cash dividends per common share | \$ | 0.45 | \$ | 0.43 | \$ | 0.15 | \$ | 0.15 |
|---------------------------------|----|------|----|------|----|------|----|------|

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Wayside Technology Group, Inc. and Subsidiaries  
 Condensed Statement of Stockholders' Equity and Comprehensive Income  
 (Dollars in thousands, except share amounts)  
 (Unaudited)

|   | Common Stock |        | Additional<br>Paid-In<br>Capital | Treasury |            | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income | Total     |
|---|--------------|--------|----------------------------------|----------|------------|------------------------|---|-----------|
|   | Shares       | Amount |                                  | Shares   | Amount     |                        |   |           |
| Balance at January 1, 2008                        | 5,284,500    | \$ 53  | \$ 28,860                        | 576,002  | \$ (2,283) | \$ (2,599)             | \$ 461  | \$ 24,492 |
| Net income  |              |        |                                  |          |            | 2,263                  |   | 2,263     |
| Other comprehensive income:                       |              |        |                                  |          |            |                        |   |           |
| Translation adjustment                            |              |        |                                  |          |            |                        |   |           |
| Unrealized loss on available- for-sale securities |              |        |                                  |          |            |                        | (141)   | (141)     |
| Comprehensive income                              |              |        |                                  |          |            |                        | (4)   | (4)       |
| Dividends paid                                    |              |        |                                  |          |            |                        |   | 2,118     |
| Exercise of stock options                         |              |        | (2,114)                          |          |            |                        |   | (2,114)   |
|   |              |        | 59                               | (45,000) | 164        |                        |   | 223       |
| Share-based compensation expense                  |              |        | 551                              |          |            |                        |   | 551       |
| Restricted stock grants                           |              |        | (185)                            | (54,000) | 185        |                        |   | —         |
| Treasury shares repurchased                       |              |        |                                  | 128,329  | (1,196)    |                        |   | (1,196)   |
| Balance at September 30, 2008                     | 5,284,500    | \$ 53  | \$ 27,171                        | 605,331  | \$ (3,130) | \$ (336)               | \$ 316  | \$ 24,074 |

The accompanying notes are an integral part of the consolidated financial statements.

**WAYSIDE TECHNOLOGY GROUP, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In thousands)

|   | Nine months ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2008                               | 2007     |
| Net income  | \$ 2,263                           | \$ 2,772 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                                    |          |
| Depreciation and amortization   | 255                                | 234      |
| Bad debt expense  | 58                                 | 31       |
| Deferred income taxes   | 253                                | 1,032    |
| Share-based compensation expense  | 551                                | 448      |
| Changes in operating assets and liabilities:  |                                    |          |
| Accounts receivable   | (2,003)                            | 8,689    |
| Inventory   | 55                                 | 16       |
| Prepaid expenses and other current assets   | 222                                | (241)    |
| Accounts payable and accrued expenses   | 831                                | (13,613) |
| Net change in other assets and liabilities  | (36)                               | (23)     |
| Net cash provided by (used in) operating activities   | 2,449                              | (655)    |
| Cash flows from investing activities:   |                                    |          |
| Purchases of available-for-sale securities  | (14,844)                           | (16,473) |
| Redemptions of available-for-sale securities  | 14,795                             | 14,088   |
| Capital expenditures  | (259)                              | (358)    |
| Net cash used in investing activities   | (308)                              | (2,743)  |
| Cash flows from financing activities:   |                                    |          |
| Dividend paid   | (2,114)                            | (1,983)  |
| Proceeds from exercise of stock options   | 223                                | 994      |
| Treasury stock repurchased  | (1,196)                            | (915)    |
| Tax benefit from stock option exercises   | —                                  | 501      |
| Net cash used in financing activities   | (3,087)                            | (1,403)  |
| Effect of foreign exchange rate on cash   | (124)                              | 239      |
| Net decrease in cash and cash equivalents   | (1,070)                            | (4,562)  |



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|  |           |          |
|--|-----------|----------|
| Cash and cash equivalents at beginning of period | 14,241    | 13,832   |
| Cash and cash equivalents at end of period       | \$ 13,171 | \$ 9,270 |

Supplementary disclosure of cash flow information:

|                   |       |     |
|-------------------|-------|-----|
| Income taxes paid | 1,318 | 494 |
|-------------------|-------|-----|

The accompanying notes are an integral part of these condensed consolidated financial statements.

**WAYSIDE TECHNOLOGY GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED**  
**FINANCIAL STATEMENTS**  
**September 30, 2008**

1. The accompanying unaudited condensed consolidated financial statements of Wayside Technology Group, Inc. and its subsidiaries (collectively, the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, investments, intangible assets, income taxes, stock-based compensation and costs associated with exit or disposal activities, contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. In the opinion of the Company's management, all adjustments that are of a normal recurring nature, considered necessary for fair presentation, have been included. Actual results may differ from these estimates under different assumptions or conditions. The unaudited consolidated statements of earnings for the interim periods are not necessarily indicative of results for the full year. For further information, refer to the consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K filed with the Securities Exchange Commission for the year ended December 31, 2007.

2. In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"), which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ("GAAP") in the United States. The FASB believes that the GAAP hierarchy should be directed to entities because it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company does not expect the adoption of SFAS No. 162 to have a material effect on its condensed consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities" ("EITF 03-6-1"). EITF 03-6-1 applies to the calculation of earnings per share for share-based payment awards with rights to dividends or dividend equivalents under Statement No. 128, Earnings Per Share. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents will be considered participating securities and will be included in the computation of earnings per share pursuant to the two-class method. The effective date of EITF 03-6-1 is for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those years. Early adoption is not permitted. Once effective, all prior period earnings per share data presented will be adjusted retrospectively. The Company is currently evaluating the potential impact, if any, the adoption of EITF 03-6-1 may have on its condensed consolidated financial statements.

3. Assets and liabilities of the Company's Canadian subsidiary have been translated at current exchange rates, and related revenues and expenses have been translated at average rates of exchange in effect during

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the period. The revenue from our Canadian operations in the first nine months of 2008 was \$16.1 million as compared to \$16.6 million for the first nine months of 2007. The revenue from our Canadian operations for the third quarter of 2008 was \$4.3 million as compared to \$5.1 million for the third quarter of 2007.

4. Cumulative translation adjustments and unrealized gains (losses) on available-for-sale securities have been classified within accumulated other comprehensive income, which is a separate component of stockholders' equity in accordance with FASB Statement No. 130, "Reporting Comprehensive Income."
5. The Company records revenues from sales transactions when title to products sold passes to the customer. Usual sales terms are FOB shipping point, at which time title and risk of loss has passed to the customer and delivery has occurred. Revenue is recognized in accordance with Statements of Position ("SOP") 97-2 "Software Revenue Recognition," Staff Accounting Bulletin ("SAB") No. 101 and No. 104, "Revenue Recognition" and Emerging Issues Task Force ("EITF") 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." The majority of the Company's revenues relates to physical products and is recognized on a gross basis with the selling price to the customer recorded as net sales with the acquisition cost of the product to the Company recorded as cost of sales. At the time of sale, the Company also records an estimate for sales returns based on historical experience. Certain software maintenance products, third party services and extended warranties sold by the Company (for which the Company is not the primary obligor) are recognized on a net basis. Accordingly, such revenues are recognized in net sales either at the time of sale or over the contract period, based on the nature of the contract, at the net amount retained by the Company, with no cost of goods sold.
6. Vendor rebates and price protection are recorded when earned as a reduction to cost of sales or merchandise inventory, as applicable. Cooperative reimbursements from vendors, which are earned and available, are recorded in the period the related advertising expenditure is incurred. Cooperative reimbursements are recorded as net sales in accordance with EITF 02-16 "Accounting by a Customer (including reseller) for Certain Consideration Received from a Vendor."
7. Investments in available-for-sale securities at September 30, 2008 were (in thousands):

|                            | Cost            | Market value    | Unrealized Gain (Loss) |
|----------------------------|-----------------|-----------------|------------------------|
| U.S. Government Securities | \$ 8,961        | \$ 8,970        | \$ 9                   |
| Certificates of Deposit    | 721             | 716             | (5)                    |
|                            | <u>\$ 9,682</u> | <u>\$ 9,686</u> | <u>\$ 4</u>            |

The cost and market value of the Company's investments at September 30, 2008 by contractual maturity were (in thousands):

|                         | Cost     | Estimated Fair Value |
|-------------------------|----------|----------------------|
| Due in one year or less | \$ 9,682 | \$ 9,686             |

Investments in available-for-sale securities at December 31, 2007 were (in thousands):

|                            | Cost     | Market value | Unrealized Gain |
|----------------------------|----------|--------------|-----------------|
| U.S. Government Securities | \$ 9,633 | \$ 9,641     | \$ 8            |

The cost and market value of the Company's investments at December 31, 2007 by contractual maturity were (in thousands):

|                         | Cost     | Estimated Fair Value |
|-------------------------|----------|----------------------|
| Due in one year or less | \$ 9,633 | \$ 9,641             |

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8. Balance Sheet Detail – (in thousands):

Other assets consisted of the following at September 30, 2008 and December 31, 2007:

|                                 | September 30,<br>2008       | December 31,<br>2007        |
|---------------------------------|-----------------------------|-----------------------------|
|                                 | <u>                    </u> | <u>                    </u> |
| Accounts Receivable - long-term | \$ 4,350                    | \$ 3,402                    |
| Security Deposits               | 56                          | 56                          |
| Trademarks                      | 11                          | 11                          |
|                                 | <u>                    </u> | <u>                    </u> |
| Total                           | \$ 4,417                    | \$ 3,469                    |
|                                 | <u>                    </u> | <u>                    </u> |

Accounts receivable—long-term result from product sales with extended payment terms that are discounted to their present values at the prevailing market rates. In subsequent periods, the accounts receivable are increased to the amounts due and payable from the customers through the accretion of interest income on the unpaid accounts receivable due in future years. The amounts due under these long-term accounts receivable due within one year are reclassified to the current portion of accounts receivable. The current portion of these long-term accounts receivable included in the current portion of accounts receivable at September 30, 2008 and December 31, 2007 is \$4,038 and \$3,702 respectively.

Accounts payable and accrued expenses consist of the following as of September 30, 2008 and December 31, 2007:

|                        | September 30,<br>2008       | December 31,<br>2007        |
|------------------------|-----------------------------|-----------------------------|
|                        | <u>                    </u> | <u>                    </u> |
| Trade accounts payable | \$ 31,391                   | \$ 30,597                   |
| Other accrued expenses | 1,336                       | 1,503                       |
|                        | <u>                    </u> | <u>                    </u> |
|                        | \$ 32,727                   | \$ 32,100                   |
|                        | <u>                    </u> | <u>                    </u> |

9. Basic EPS is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted EPS is computed considering the potentially dilutive effect of outstanding stock options and nonvested shares of restricted stock. A reconciliation of the numerators and denominators of the basic and diluted per share computations follows (in thousands, except per share data):

|   | Nine months ended<br>September 30, |                             | Three months<br>ended<br>September 30, |                             |
|---|------------------------------------|-----------------------------|--|-----------------------------|
|   | 2008                               | 2007                        | 2008                                   | 2007                        |
|   | <u>                    </u>        | <u>                    </u> | <u>                    </u>            | <u>                    </u> |
| Numerator:  |                                    |                             |  |                             |
| Net income  | \$ 2,263                           | \$ 2,772                    | \$ 811                                 | \$ 822                      |
| Denominator:  |                                    |                             |  |                             |
| Weighted average shares (Basic)   | 4,422                              | 4,395                       | 4,408                                  | 4,426                       |
| Dilutive effect of outstanding options and nonvested shares of restricted stock | 69                                 | 287                         | 30                                     | 248                         |
|   | <u>                    </u>        | <u>                    </u> | <u>                    </u>            | <u>                    </u> |

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Weighted average shares including assumed conversions (Diluted) | 4,491             | 4,682             | 4,438             | 4,674             |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Basic net income per share                                      | \$ 0.51           | \$ 0.63           | \$ 0.18           | \$ 0.19           |
| Diluted net income per share                                    | \$ 0.50           | \$ 0.59           | \$ 0.18           | \$ 0.18           |

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The diluted earnings per share calculation for the nine months ended September 30, 2008 excluded 55,640 shares related to options as the exercise prices of these options were greater than the weighted average of the closing prices of our Common Stock for each trading day during the nine months ended September 30, 2008, and also excluded 278,875 shares of nonvested restricted stock as the grant prices of such shares were greater than the weighted average closing price for the period ended September 30, 2008. For the nine months ended September 30, 2007, no shares were excluded.

10. The Company had two major vendors that accounted for 26.6% and 10.8% of total purchases during the nine months ended September 30, 2008 and 21.5% and 12.0%, respectively, for the three months then ended. The Company had two major vendors that accounted for 37.8% and 8.6% of total purchases during the nine months ended September 30, 2007 and 31.9% and 10.6%, respectively, for the three months then ended. The Company had no major customers that accounted for more than 10% of total net sales, respectively, during the nine and three months ended September 30, 2008. The Company had two major customers that accounted for 12.0% and 9.3% of total net sales during the nine months ended September 30, 2007 and 8.6% and 12.2% respectively during the three months ended September 30, 2007.

11. The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, and in various state and foreign jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to 2005. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as operating expenses. Accrued interest is insignificant and there are no penalties accrued at September 30, 2008. The Company believes that it has appropriate support for the income tax positions taken and to be taken on its tax returns and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors, including past experience and interpretations of tax law applied to the facts of each matter.

The provision consists of the following (in thousands):

|                      | Nine months ended<br>September 30, |                 | Three months ended<br>September 30, |               |
|----------------------|------------------------------------|-----------------|-------------------------------------|---------------|
|                      | 2008                               | 2007            | 2008                                | 2007          |
| <b>Current:</b>      |                                    |                 |                                     |               |
| Federal              | \$ 1,009                           | \$ 638          | \$ 470                              | \$ 328        |
| State                | 103                                | 75              | 7                                   | 21            |
| Canada               | 164                                | 153             | 36                                  | 38            |
|                      | <u>1,276</u>                       | <u>866</u>      | <u>513</u>                          | <u>387</u>    |
| Deferred tax expense | 253                                | 1,032           | 58                                  | 213           |
|                      | <u>\$ 1,529</u>                    | <u>\$ 1,898</u> | <u>\$ 571</u>                       | <u>\$ 600</u> |
| Effective tax rate   | <u>40.3%</u>                       | <u>40.6%</u>    | <u>41.3%</u>                        | <u>42.2%</u>  |

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

|  | <b>Federal, State<br/>and Foreign Tax</b> |
|--|---|
| Balance at January 1, 2008                               | \$ 230                                    |
| Additions based on tax positions related to current year | —   |
| Gross Unrecognized Tax Benefit at September 30, 2008     | <u>\$ 230</u>                             |
| Net Unrecognized Tax Benefit at September 30, 2008       | <u>\$ 78</u>                              |



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The net Unrecognized Tax Benefit is included as a component of Other Liabilities within the Consolidated Balance Sheet.

12. In accordance with SFAS No. 123(R), "Share-Based Payment," recognized compensation cost for the nine months ended September 30, 2008 and 2007 includes 1) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123(R); and 2) compensation cost for all share-based payments granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with Statement 123(R).

At the annual stockholders' meeting held on June 14, 2006, the Company's stockholders approved the 2006 Stock-Based Compensation Plan (the "2006 Plan"). The 2006 Plan authorizes the grant of stock options, stock units, stock appreciation rights, restricted stock, deferred stock, stock bonuses, and other equity-based awards. The total number of shares of Common Stock initially available under the 2006 Plan was 800,000. As of September 30, 2008, the number of shares of common stock available for future award grants to employees and directors under this plan is 413,500.

During 2006, the Company granted a total of 315,000 shares of restricted common stock to officers, directors and employees. Included in this grant were 200,000 restricted shares granted to the Company's Chief Executive Officer in accordance with his employment agreement. These 200,000 restricted shares vest over 120 months. The remaining 115,000 shares granted vest over 60 months.

During 2007, the Company granted a total of 30,000 shares of restricted stock to officers, directors and employees. These shares vest over 60 months. A total of 12,500 shares of restricted common stock were forfeited as a result of employees and officers terminating employment with the Company.

In February 2008, the Company granted a total of 57,500 shares of restricted stock to officers and directors. These shares vest over 60 months. A total of 3,500 shares of restricted common stock were forfeited as a result of employees terminating employment with the Company.

In July 2008, the Company approved the increase of its common stock repurchase program by 500,000 shares. The company expects to purchase shares from time to time in the market or otherwise subject to market conditions.

Changes during 2008 in options outstanding for the Company's combined plans were as follows:

|                                   | Number of<br>Options | Weighted Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual Life | Aggregate Intrinsic<br>Value (\$000's)(1) |
|-----------------------------------|----------------------|------------------------------------|--|---|
| Outstanding at January 1, 2008    | 442,890              | \$ 7.85                            |  |   |
| Granted in 2008                   | —                    | —                                  |  |   |
| Forfeited in 2008                 | (5,000)              | \$ 12.85                           |  |   |
| Exercised in 2008                 | (45,000)             | \$ 4.96                            |  | \$ 0.2                                    |
| Outstanding at September 30, 2008 | 392,890              | \$ 8.12                            | 5.4  | \$ 0.2                                    |
| Exercisable at September 30, 2008 | 392,890              | \$ 8.12                            | 5.4  | \$ 0.2                                    |

(1) The intrinsic value is calculated as the difference between the market value on the last trading day of the quarter September 30, 2008 and the exercise price of the shares. The market value as of September 30, 2008 was \$7.52 as reported by The NASDAQ Global Market.



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A summary of nonvested shares of restricted stock awards outstanding under the Company's 2006 Plan as of September 30, 2008, and changes during the nine months then ended is as follows:

|                                     | Shares   | Weighted Average<br>Grant Date<br>Fair Value |
|-------------------------------------|----------|--|
| Nonvested shares at January 1, 2008 | 267,250  | \$ 13.47                                     |
| Granted in 2008                     | 57,500   | 10.68  |
| Vested in 2008                      | (42,375) | 13.00  |
| Forfeited in 2008                   | (3,500)  | 14.85  |
|                                     | 278,875  | \$ 12.80                                     |

As of September 30, 2008, there is approximately \$3.6 million of total unrecognized compensation costs related to nonvested share-based compensation arrangements. The unrecognized compensation cost is expected to be recognized over a weighted-average period of 5.98 years.

For the nine months ended September 30, 2008 and 2007, the Company recognized share-based compensation cost of approximately \$551,000 and \$448,000, respectively, which is included in general and administrative expense.

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

The Company is organized into two reportable operating segments — the "Programmer's Paradise" segment, which sells technical software, hardware and services directly to end-users (such as individual programmers, corporations, government agencies, and educational institutions) and the "Lifeboat" segment, which distributes technical software to corporate resellers, VARs, consultants and systems integrators.

As permitted by SFAS No. 131, the Company has utilized the aggregation criteria in combining its operations in Canada with the domestic segments as they provide the same products and services to similar clients and are considered together when the CODM decides how to allocate resources.

Segment income is based on segment revenue less the respective segment's cost of revenues as well as segment direct costs (including such items as payroll costs and payroll related costs, such as profit sharing, incentive awards and insurance) and excluding general and administrative expenses not attributed to a business unit. The Company only identifies accounts receivable and inventory by segment as shown below as "Selected Assets"; it does not allocate its other assets, including capital expenditures by segment.

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The following segment reporting information of the Company is provided (in thousands):

|   | Nine months<br>ended<br>September 30, |                | Three months ended<br>September 30, |               |
|---|---------------------------------------|----------------|-------------------------------------|---------------|
|   | 2008                                  | 2007           | 2008                                | 2007          |
| <b>Revenue:</b>                               |                                       |                |                                     |               |
| Programmer's Paradise                         | \$ 39,562                             | \$ 32,217      | \$ 15,318                           | \$ 11,021     |
| Lifeboat                                      | 94,432                                | 100,535        | 30,074                              | 30,769        |
|   | <u>133,994</u>                        | <u>132,752</u> | <u>45,392</u>                       | <u>41,790</u> |
| <b>Gross Profit:</b>                          |                                       |                |                                     |               |
| Programmer's Paradise                         | \$ 4,471                              | \$ 4,302       | \$ 1,644                            | \$ 1,421      |
| Lifeboat                                      | 7,825                                 | 8,616          | 2,609                               | 2,705         |
|   | <u>12,296</u>                         | <u>12,918</u>  | <u>4,253</u>                        | <u>4,126</u>  |
| <b>Direct Costs:</b>                          |                                       |                |                                     |               |
| Programmer's Paradise                         | \$ 2,147                              | \$ 2,197       | \$ 727                              | \$ 739        |
| Lifeboat                                      | 2,176                                 | 2,133          | 673                                 | 733           |
|   | <u>4,323</u>                          | <u>4,330</u>   | <u>1,400</u>                        | <u>1,472</u>  |
| <b>Segment Income:</b>                        |                                       |                |                                     |               |
| Programmer's Paradise                         | \$ 2,324                              | 2,104          | \$ 917                              | 682           |
| Lifeboat                                      | 5,649                                 | 6,484          | 1,936                               | 1,972         |
|   | <u>7,973</u>                          | <u>8,588</u>   | <u>2,853</u>                        | <u>2,654</u>  |
| <b>Segment Income</b>                         |                                       |                |                                     |               |
| Corporate general and administrative expenses | \$ 4,736                              | 4,668          | \$ 1,643                            | 1,490         |
| Interest income                               | 549                                   | 749            | 173                                 | 257           |
| Foreign currency translation gain (loss)      | 6                                     | 1              | (1)                                 | 1             |
|   | <u>3,792</u>                          | <u>4,670</u>   | <u>1,382</u>                        | <u>1,422</u>  |
| Income before taxes                           | \$ 3,792                              | \$ 4,670       | \$ 1,382                            | \$ 1,422      |
| <b>Selected Assets By Segment:</b>            |                                       |                |                                     |               |
| Programmer's Paradise                         | \$ 13,279                             | \$ 7,694       |                                     |               |
| Lifeboat                                      | 13,387                                | 13,705         |                                     |               |
| Corporate assets                              | 30,264                                | 24,308         |                                     |               |
|   | <u>56,930</u>                         | <u>45,707</u>  |                                     |               |
| <b>Segment Select Assets</b>                  | \$ 56,930                             | \$ 45,707      |                                     |               |

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

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The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under the heading "Certain Factors Affecting Operating Results" and elsewhere in this report. The following discussion should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2007.

### **Overview**

The Company is organized into two reportable operating segments — the "Programmer's Paradise" segment, which sells technical software, hardware and services directly to end-users (such as individual programmers, corporations, government agencies, and educational institutions) and the "Lifeboat" segment, which distributes technical software to corporate resellers, VARs, consultants and systems integrators.

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The Company's sales and results of operations have fluctuated and are expected to continue to fluctuate on a quarterly basis as a result of a number of factors, including: the loss of any major vendor, condition of the software industry in general; shifts in demand for software products; industry shipments of new software 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; and changes in the Company's product offerings. The Company's operating expenditures are based on sales forecasts. If revenues do not meet expectations in any given quarter, operating results may be materially adversely affected.

### Results of Operations

The following table sets forth for the periods indicated certain financial information derived from the Company's consolidated statements of earnings expressed as a percentage of net sales. This comparison of financial results is not necessarily indicative of future results:

|  | Nine months<br>ended<br>September 30, |        | Three months<br>ended<br>September 30, |        |
|--|---------------------------------------|--------|--|--------|
|  | 2008                                  | 2007   | 2008                                   | 2007   |
| Net sales                                      | 100.0%                                | 100.0% | 100.0%                                 | 100.0% |
| Cost of sales                                  | 90.8                                  | 90.3   | 90.6                                   | 90.1   |
| Gross profit                                   | 9.2                                   | 9.7    | 9.4                                    | 9.9    |
| Selling, general and administrative expenses   | 6.8                                   | 6.7    | 6.7                                    | 7.1    |
| Income from operations                         | 2.4                                   | 3.0    | 2.7                                    | 2.8    |
| Interest income, net                           | 0.4                                   | 0.5    | 0.4                                    | 0.6    |
| Realized foreign currency exchange gain (loss) | 0.0                                   | 0.0    | 0.0                                    | 0.0    |
| Income before income taxes                     | 2.8                                   | 3.5    | 3.1                                    | 3.4    |
| Provision for income taxes                     | 1.1                                   | 1.4    | 1.3                                    | 1.4    |
| Net income                                     | 1.7%                                  | 2.1%   | 1.8%                                   | 2.0%   |

### Net Sales

Net sales for the third quarter of 2008 increased 8.6% or \$3.6 million to \$45.4 million compared to \$41.8 million for the comparable period in 2007. Total sales for the third quarter of 2008 for our Lifeboat segment were \$30.1 million compared to \$30.8 million in the third quarter of 2007, representing a 2.3% decrease. Total sales for the third quarter of 2008 for our Programmer's Paradise segment were \$15.3 million compared to \$11.0 million in the third quarter of 2007, representing a 39% increase.

For the nine months ended September 30, 2008, net sales increased 1% or \$1.2 million to \$134.0 million compared to \$132.8 million for the comparable period in 2007. Sales for the nine months ended September 30, 2008 for our Lifeboat segment were \$94.4 million compared to \$100.5 million for the comparable period last year. Sales for the nine months ended September 30, 2008 for our Programmer's Paradise segment were \$39.6 million compared to \$32.2 million for the comparable period last year. The growth in revenue for our Programmer's Paradise segment in the third quarter of 2008 was mainly due to our aggressive pricing and flexible payment options used to win large orders during the quarter.

In the Lifeboat segment, sales for the third quarter of 2008 decreased by 2%, compared to the third quarter of 2007, primarily due to price competition for VMware products, offset, in part, by strong sales growth for our remaining distribution lines. VMware-labeled sales for our Lifeboat segment decreased \$3.2 million as compared to the third quarter of 2007. Excluding VMware, sales increased by \$2.5 million or 13%.

On July 30, 2008, the Company received a notice from VMware to terminate the VMware Distributor Agreement, dated September 20, 2004, between VMware and Lifeboat, effective as of December 31, 2008.



Further, such notice provided that as of October 1, 2008, Lifeboat will cease distributing VMware-labeled products but VMware will accept orders for distributions of products through Programmer's Paradise. Total VMware-labeled distribution sales for Lifeboat amounted to \$8.2 million, or 18% of our overall third quarter 2008 revenue, product gross margin for Lifeboat amounted to \$249,000, or 6% of our overall third quarter 2008 gross margin. VMware-labeled distribution sales for Lifeboat amounted to \$11.4 million, or 27% of our overall third quarter 2007 revenue; product gross margin for Lifeboat amounted to \$527,000, or 13% of our overall third quarter 2007 gross margin. Although VMware will expand its relationship with Programmer's Paradise and TechXtend, we do expect our sales and gross margins to be negatively impacted as a result of this change. We cannot currently estimate the exact impact of this change.

### **Gross Profit**

Gross profit for the quarter ended September 30, 2008 was \$4.3 million compared to \$4.1 million in the third quarter of 2007. Total gross profit for our Lifeboat segment for the quarter ended September 30, 2008 was \$2.6 million compared to \$2.7 million in the third quarter of 2007, representing a 3.5% decrease. Total gross profit for our Programmer's Paradise segment for the quarter ended September 30, 2008 was \$1.6 million compared to \$1.4 million in the third quarter of 2007, representing a 15.7% increase.

For the nine months ended September 30, 2008, gross profit decreased by \$0.6 million to \$12.3 million compared to \$12.9 million in the comparable period in 2007. Programmer's Paradise's gross profit for the nine months ended September 30, 2008 was \$4.5 million compared to \$4.3 million for the first nine months of 2007. Lifeboat's gross profit for the nine months ended September 30, 2008 was \$7.8 million compared to \$8.6 million for the first nine months of 2007. This decrease in gross profit was due to competitive pricing pressures and lower sales volume.

Gross profit margin, as a percentage of net sales, for the quarter ending September 30, 2008 was 9.4% compared to 9.9% in the third quarter of 2007. Gross profit margin for our Programmer's Paradise segment for the third quarter of 2008 was 10.7% compared to 12.9% in the third quarter of 2007. Gross profit margin for our Lifeboat segment for the third quarter of 2008 was 8.7% compared to 8.8% in the third quarter of 2007. Gross profit margin as a percentage of net sales, for the nine months ended September 30, 2008 was 9.2% compared to 9.7% in the comparable period last year.

The decrease in gross profit margin for both segments as a percentage of net sales was primarily caused by continued competitive pricing pressure as well as several large orders won at lower margins.

### **Selling, General and Administrative Expenses**

Total selling, general, and administrative ("SG&A") expenses for the third quarter of 2008 were \$3.0 million compared to \$3.0 million in the third quarter of 2007. As a percentage of net sales, SG&A expenses for the third quarter of 2008 were 6.7% compared to 7.1% in the third quarter of 2007. For the nine months ended September 30, 2008, SG&A expenses were \$9.1 million compared to \$9.0 million in the comparable period last year. As a percentage of net sales, SG&A expenses were 6.8% for the nine months ended September 30, 2008 compared to 6.7% in the same period last year.

The Company expects that its SG&A expenses, as a percentage of net sales, may vary by quarter depending on changes in sales volume, as well as the levels of continuing investments in key growth initiatives.

Direct selling costs for the third quarter of 2008 was \$1.4 million compared to \$1.5 million in the third quarter of 2007. Total direct selling costs for our Programmer's Paradise division for the third quarter of 2008 were \$0.7 million compared to \$0.7 million in the third quarter of 2007. Total direct selling costs for our Lifeboat division for the third quarter of 2008 were \$0.7 million compared to \$0.7 million in the third quarter of 2007.

### **Foreign Currency Transactions Gain (Loss)**

The realized foreign exchange loss for the quarter ended September 30, 2008 was \$1,000 compared to a gain of \$1,000 for the comparable period in 2007. For the nine months ended September 30 2008 the realized foreign exchange gain was \$6,000 compared to \$1,000 in the comparable period last year. Foreign exchange gains and losses primarily result from our trade activity with our Canadian subsidiary. Although the Company does maintain bank accounts in Canadian currencies to reduce currency exchange fluctuations, the Company is, nevertheless, subject to risks associated with such fluctuations.

### **Income Taxes**

For the quarter ended September 30, 2008, the Company recorded a provision for income taxes of \$571,000, which consists of a provision of \$470,000 for U.S. federal income taxes as well as \$7,000 for state and local taxes and \$36,000 for Canadian taxes, and a deferred tax expense of \$58,000. For the quarter ended September 30, 2007, the Company recorded a provision for income taxes of \$600,000, which consisted of a provision of \$328,000 for U.S. federal income taxes as well as a \$21,000 provision for state and local taxes and \$38,000 for Canadian taxes, and a deferred tax expense of \$213,000.

For the nine months ended September 30, 2008 the Company recorded a provision for income taxes of \$1,529,000 which consists of a provision of \$1,009,000 for U.S. federal income taxes as well as a \$103,000 provision for state and local taxes and \$164,000 for Canadian taxes, and a deferred tax expense of \$253,000. For the nine months ended September 30, 2007 the Company recorded a provision for income taxes of \$1,898,000, which consisted of a provision of \$638,000 for U.S. federal income taxes as well as a \$75,000 provision for state and local taxes and \$153,000 for Canadian taxes, and a deferred tax expense of \$1,032,000.

### **Liquidity and Capital Resources**

During the first nine months of 2008 our cash and cash equivalents decreased by \$1.0 million to \$13.2 million at September 30, 2008, from \$14.2 million at December 31, 2007. During the first nine months of 2008, net cash provided by operating activities amounted to \$2.4 million; net cash used in investing activities amounted to \$0.3 million and net cash used in financing activities amounted to \$3.1 million.

Net cash provided by operating activities in the first nine months of 2008 was \$2.4 million and primarily resulted from a \$0.8 million increase in accounts payable and net income excluding non-cash charges of \$3.4 million offset partially by a \$2.0 million increase in accounts receivable and an increase of \$0.2 million in prepaid expenses.

Net cash used in investing activities in the first nine months of 2008 amounted to \$0.3 million. This primarily resulted from \$0.3 million of capital expenditures. The balance was made up of net purchases of available-for-sale securities. These securities are highly rated and highly liquid. These securities are classified as available-for-sale securities in accordance with SFAS 115 "Accounting for Certain Investments in Debt and Equity Securities," and as a result, unrealized gains and losses are reported as part of accumulated other comprehensive income (loss).

Net cash used in financing activities in the first nine months of 2008 amounted to \$3.1 million. This consisted of dividends paid of \$2.1 million and treasury share buy-backs of \$1.2 million partially offset by proceeds from stock option exercises of \$0.2 million.

The Company's current and anticipated use of its cash and cash equivalents is, and will continue to be, to fund working capital, operational expenditures, the stock buyback program and dividends if declared by the board of directors. Our business plan, furthermore, contemplates continuing to use our cash to pay vendors promptly in order to obtain more favorable conditions.

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We believe that the funds held in cash and cash equivalents will be sufficient to fund our working capital and cash requirements for at least the next 12 months. We currently do not have any credit facility and, in the foreseeable future, we do not plan to enter into an agreement providing for a line of credit.

Contractual Obligations as of September 30, 2008 were summarized as follows:

(Dollars in thousands)

| Contractual Obligations                  | Total           | Payment due by Period |                 |              |                   |
|--|-----------------|-----------------------|-----------------|--------------|-------------------|
|  |                 | Less than 1 year      | 1-3 years       | 3-5 years    | More than 5 years |
| Long-Term Debt                           | —               | —                     | —               | —            | —                 |
| Capital Lease Obligations                | —               | —                     | —               | —            | —                 |
| Operating Leases (1)                     | \$ 1,484        | \$ 336                | \$ 1,079        | \$ 69        | —                 |
| Purchase Obligations                     | —               | —                     | —               | —            | —                 |
| Other Long Term Obligations              | —               | —                     | —               | —            | —                 |
| <b>Total Contractual Obligations (2)</b> | <b>\$ 1,484</b> | <b>\$ 336</b>         | <b>\$ 1,079</b> | <b>\$ 69</b> | <b>\$ —</b>       |

(1) Operating leases primarily relates to the leases of the space used for our operations in Shrewsbury, New Jersey, and Mississauga, Canada and our former sales office (net of sublease income), in Hauppauge, New York. The commitments for operating leases include the minimum rent payments and a proportionate share of operating expenses and property taxes.

(2) In addition to the contractual obligations disclosed in this table, we have net unrecognized tax benefits totaling \$78,000 with respect to which, based on uncertainties associated with the items, we are unable to make reasonably reliable estimates of the period of potential cash settlements, if any, with taxing authorities. As a result, such potential liabilities are not listed in the table.

The Company is not committed by lines of credit or standby letters of credit, and has no standby repurchase obligations or other commercial debt commitments. The Company is not engaged in any transactions with related parties.

As of September 30, 2008, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

### Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Company recognizes revenue from the sale of software and hardware for microcomputers, servers and networks upon shipment or upon electronic delivery of the product. The Company expenses the advertising costs associated with producing its catalogs. The costs of these catalogs are expensed in the same month the catalogs are mailed.

On an on-going basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, investments, intangible assets, income taxes, stock-based compensation and costs associated with exit or disposal activities, contingencies and litigation.

The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.



The Company records revenues from sales transactions when title to products sold passes to the customer. Usual sales terms are FOB shipping point, at which time title and risk of loss has passed to the customer and delivery has occurred. Revenue is recognized in accordance with Statements of Position (“SOP”) 97-2 “Software Revenue Recognition”, Staff Accounting Bulletin (“SAB”) No. 101 and No. 104, “Revenue Recognition” and Emerging Issues Task Force (“EITF”) 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent”. The majority of the Company’s revenues relates to physical products and is recognized on a gross basis with the selling price to the customer recorded as net sales with the acquisition cost of the product to the Company recorded as cost of sales. At the time of sale, the Company also records an estimate for sales returns based on historical experience. Certain software maintenance products, third party services and extended warranties sold by the Company (for which the Company is not the primary obligor) are recognized on a net basis. Accordingly, such revenues are recognized in net sales either at the time of sale or over the contract period, based on the nature of the contract, at the net amount retained by the Company, with no cost of goods sold.

Vendor rebates and price protection are recorded when earned as a reduction to cost of sales or merchandise inventory, as applicable. Cooperative reimbursements from vendors, which are earned and available, are recorded in the period the related advertising expenditure is incurred. Cooperative reimbursements are recorded as net sales in accordance with EITF 02-16, “Accounting for Consideration Received from a Vendor by a Customer (Including a Reseller of the Vendor’s Products)”.

The Company believes the following critical accounting policies used in the preparation of its consolidated financial statements affect its more significant judgments and estimates. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of the Company’s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-offs may be required. The Company has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance related to deferred tax assets. In the event the Company were to determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made. We make certain assumptions in order to value and expense our various share-based payment awards. In connection with valuing stock options, we use the Black-Scholes model, which requires us to estimate certain subjective assumptions. The key assumptions we make are: the expected volatility of our stock; the expected term of the award; and the expected forfeiture rate. In connection with our restricted stock programs we make assumptions principally related to the forfeiture rate. We review our valuation assumptions periodically and, as a result, we may change our valuation assumptions used to value stock based awards granted in future periods. Such changes may lead to a significant change in the expense we recognize in connection with share-based payments.

#### **Recent Accounting Pronouncements**

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS No. 162”), which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The FASB believes that the GAAP hierarchy should be directed to entities because it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the Securities and Exchange Commission’s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.” The Company does not expect the adoption of SFAS No. 162 to have a material effect on its condensed consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, “Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities” (“EITF 03-6-1”). EITF 03-6-1 applies to the

calculation of earnings per share for share-based payment awards with rights to dividends or dividend equivalents under Statement No. 128, "Earnings Per Share." Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents will be considered participating securities and will be included in the computation of earnings per share pursuant to the two-class method. The effective date of EITF 03-6-1 is for financial statements issued for fiscal years beginning after December 15, 2008, and all interim periods within those years. Early adoption is not permitted. Once effective, all prior period earnings per share data presented will be adjusted retrospectively. The Company is currently evaluating the potential impact, if any, the adoption of EITF 03-6-1 may have on its condensed consolidated financial statements.

### **Certain Factors Affecting Operating Results**

This report includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Statements in this report regarding future events or conditions, including statements regarding industry prospects and the Company's expected financial position, business and financing plans, are forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. We strongly urge current and prospective investors to carefully consider the cautionary statements and risks contained in this report. Such risks include, but are not limited to, the continued acceptance of the Company's distribution channel by vendors and customers, the timely availability and acceptance of new products, contribution of key vendor relationships and support programs, as well as factors that affect the software industry in general.

The Company operates in a rapidly changing business, and new risk factors emerge from time to time. Management cannot predict every risk factor, nor can it assess the impact, if any, of all such risk factors on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those projected in any forward-looking statements.

Accordingly, forward-looking statements should not be relied upon as a prediction of actual results and readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

The statements concerning future sales and future gross profit margin are forward looking statements involving certain risks and uncertainties such as availability of products, product mix, market conditions and other factors, which could result in a fluctuation of sales below recent experience.

*Stock Volatility.* The technology sector of the United States stock markets has experienced substantial volatility in recent periods. Numerous conditions, which impact the technology sector or the stock market in general or the Company in particular, whether or not such events relate to or reflect upon the Company's operating performance, could adversely affect the market price of the Company's Common Stock.

Furthermore, fluctuations in the Company's operating results, announcements regarding litigation, the loss of a significant vendor, increased competition, reduced vendor incentives and trade credit, higher postage and operating expenses, and other developments, could have a significant impact on the market price of the Company's Common Stock.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

In addition to its activities in the United States, the Company also conducts business in Canada. We are subject to general risks attendant to the conduct of business in Canada, including economic uncertainties and foreign government regulations. In addition, the Company's Canadian business is subject to changes in demand or pricing resulting from fluctuations in currency exchange rates or other factors.

The Company's \$9.7 million investments in marketable securities are primarily in highly liquid U.S. government securities. The remaining cash balance is invested in short-term savings accounts with our primary bank, JPMorgan Chase Bank. As such, the risk of significant changes in the value of our cash invested is minimal.

#### **Item 4T. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* As required by Rule 13a-15(b) under the Exchange Act, our management carried out an evaluation of the effectiveness of the design and operation of the Company's "disclosure controls and procedures" as of September 30, 2008. This evaluation was carried out under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Accounting Officer (principal financial officer). As defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange 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 the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Accounting Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based upon that evaluation, our Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were effective as of September 30, 2008. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

*Changes in Internal Control Over Financial Reporting.* As required by Rule 13a-15(d) under the Exchange Act, our management, including our Chief Executive Officer and Chief Accounting Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any change occurred during the quarter ended September 30, 2008, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation during the quarter ended September 30, 2008, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1- Legal Proceedings**

None.

**Item 2- Unregistered Sales of Equity Securities and Use of Proceeds**

The table below sets forth the purchase of Common Stock by the Company and its affiliated purchasers during the third quarter of 2008.

**ISSUER PURCHASE OF EQUITY SECURITIES**

| Period                                | Total Number of Shares Purchased (1) | Average Price Paid Per Share (2) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Average Price Paid Per Share (3) | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (4) |
|---------------------------------------|--------------------------------------|----------------------------------|--|----------------------------------|--|
| July 1, 2008- July 31, 2008           | —                                    | —                                | —  | —                                | —  |
| August 1, 2008- August 31, 2008       | 14,316                               | \$ 8.49                          | 9,854  | \$ 8.33                          | 617,792  |
| September 1, 2008- September 30, 2008 | 12,166                               | \$ 7.65                          | 12,166   | \$ 7.65                          | 605,626  |
| <b>Total</b>                          | <b>26,482</b>                        | <b>\$ 8.10</b>                   | <b>22,020</b>  | <b>\$ 7.95</b>                   | <b>605,626</b>   |

(1) Includes 4,462 shares surrendered to the Company by employees to satisfy individual tax withholding obligations upon vesting of previously issued shares of restricted common stock.

(2) Average price paid per share reflects the closing price of Wayside Technology Group, Inc. common stock on the business date the shares were surrendered by the employee stockholder to satisfy individual tax withholding obligations upon vesting of restricted common stock or the price the stock paid on the open market purchase, as applicable.

(3) Average price paid per share reflects the price of Wayside Technology Group, Inc. common stock purchased on the open market.

(4) On October 9, 2002, our Board of Directors adopted a stock repurchase program whereby the Company was authorized to repurchase up to 500,000 shares of our common stock from time to time. On July 31, 2008, the Company approved the increase of its common stock repurchase program by 500,000 shares. The company expects to purchase shares from time to time in the market or otherwise subject to market conditions.

The stock repurchase program does not have an expiration date.

**Item 6. Exhibits**

(a) Exhibits.

31.1 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of Simon F. Nynens, the Chief Executive Officer (principal executive officer) of the Company.

31.2 Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of Kevin T. Scull, the Chief Accounting Officer (principal financial officer) of the Company.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Simon F. Nynens, the Chief Executive Officer (principal executive officer) of the Company.

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32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Kevin T. Scull, the Chief Accounting Officer (principal financial officer) of the Company.  
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**SIGNATURES**

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

WAYSIDE TECHNOLOGY GROUP, INC

November 13, 2008

By: /s/ Simon F. Nynens

\_\_\_\_\_  
Date

\_\_\_\_\_  
Simon F. Nynens, Chairman of the Board,  
President and Chief Executive Officer

November 13, 2008

By: /s/ Kevin T. Scull

\_\_\_\_\_  
Date

\_\_\_\_\_  
Kevin T. Scull, Vice President  
and Chief Accounting Officer  
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