CSP INC /MA/
Form 10-Q
August 10, 2010

United States

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2010.

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

For the transition period from to .

Commission File Number 0-10843

CSP Inc.

(Exact name of Registrant as specified in its Charter)

Massachusetts	04-2441294
(State of incorporation)	(I.R.S. Employer Identification No.)

43 Manning Road
Billerica, Massachusetts 01821-3901
(978) 663-7598
(Address and telephone number of principal executive offices)

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 x No ¨.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨.

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

As of August 2, 2010 the registrant had 3,577,347 shares of common stock issued and outstanding.

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CSP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except par value)

	June 30, 2010 (Unaudited)	September 30, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$16,706	$18,904
Short-term investments	1,100	—
Accounts receivable, net of allowances of $303 and $298	11,725	7,410
Inventories	7,180	5,935
Refundable income taxes	1,101	1,160
Deferred income taxes	667	633
Other current assets	1,509	1,824
Total current assets	39,988	35,866
Property, equipment and improvements, net	738	832
Other assets:		
Intangibles, net	715	800
Deferred income taxes	229	275
Cash surrender value of life insurance	2,642	2,460
Other assets	243	253
Total other assets	3,829	3,788
Total assets	$44,555	$40,486
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$14,931	$10,530
Deferred revenue	1,995	2,059
Pension and retirement plans	454	447
Deferred income taxes	27	96
Income taxes payable	277	25
Total current liabilities	17,684	13,157
Pension and retirement plans	7,602	8,120
Deferred income taxes	122	146
Capital lease obligation	48	48
Other long-term liabilities	32	320
Total liabilities	25,488	21,791

Commitments and contingencies		
Shareholders' equity:		
Common stock, $.01 par; authorized, 7,500 shares; issued and outstanding 3,582 and 3,542 shares, respectively	36	36
Additional paid-in capital	11,482	11,325
Retained earnings	12,470	11,602
Accumulated other comprehensive loss	(4,921)	(4,268)
Total shareholders' equity	19,067	18,695
Total liabilities and shareholders' equity	$44,555	$40,486

See accompanying notes to unaudited consolidated financial statements.

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CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except for per share data)

	For the three months ended June 30, 2010	For the three months ended June 30, 2009	For the nine months ended June 30, 2010	For the nine months ended June 30, 2009
Sales:				
Product	$23,753	$15,346	$59,549	$52,470
Services	4,815	3,325	11,601	12,767
Total sales	28,568	18,671	71,150	65,237
Cost of sales:				
Product	21,153	13,022	50,729	44,802
Services	2,519	2,813	7,731	8,882
Total cost of sales	23,672	15,835	58,460	53,684
Gross profit	4,896	2,836	12,690	11,553
Operating expenses:				
Engineering and development	498	524	1,401	1,542
Selling, general and administrative	3,740	3,335	10,207	10,267
Total operating expenses	4,238	3,859	11,608	11,809
Operating income (loss)	658	(1,023)	1,082	(256)
Other income (expense):				
Foreign exchange gain (loss)	(6)	-	(16)	6
Other income (expense), net	(4)	(23)	(30)	81
Total other income (expense), net	(10)	(23)	(46)	87
Income (loss) before income taxes	648	(1,046)	1,036	(169)
Income tax expense (benefit)	27	(294)	168	13
Net income (loss)	$621	$(752)	$868	$(182)
Net income (loss) per share attributable to common stockholders:				
Basic	$614	$(752)	$860	$(182)
Diluted	$614	$(752)	$860	$(182)
Net income (loss) per share – basic	$0.17	$(0.21)	$0.24	$(0.05)
Weighted average shares outstanding – basic	3,548	3,531	3,545	3,628
Net income (loss) per share – diluted	$0.17	$(0.21)	$0.24	$(0.05)
Weighted average shares outstanding – diluted	3,574	3,531	3,574	3,628

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For the Nine Months Ended June 30, 2010
(Amounts in thousands)

	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated other comprehensive loss	Total Shareholders' Equity	Comprehensive Income (loss)
Balance as of September 30, 2009	3,542	$ 36	$ 11,325	$ 11,602	$ (4,268)	$ 18,695	
Comprehensive loss:							
Net income	—	—	—	868	—	868	$ 868
Other comprehensive loss:							
Effect of foreign currency translation	—	—	—	—	(653)	(653)	(653)
Total comprehensive income							$ 215
Stock-based compensation	—	—	126	—	—	126	
Issuance of shares under employee stock purchase plan	42	—	113	—	—	113	
Restricted stock shares issued	31	—	40	—	—	40	
Purchase of common stock	(33)	—	(122)	—	—	(122)	
Balance as of June 30, 2010	3,582	$ 36	$ 11,482	$ 12,470	$ (4,921)	$ 19,067	

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)

	For the nine months ended June 30, 2010	June 30, 2009
Cash flows from operating activities:		
Net income (loss)	$868	$(182)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	295	357
Amortization of intangibles	85	84
Loss on disposal of fixed assets, net	1	1
Foreign exchange loss (gain)	16	(6)
Non-cash changes in accounts receivable	8	(25)
Stock-based compensation expense on stock options and restricted stock awards	166	201
Deferred income taxes	(153)	(90)
Increase in cash surrender value of life insurance	(60)	(46)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(4,819)	2,385
(Increase) decrease in inventories	(1,281)	1,393
(Increase) decrease in refundable income taxes	(46)	868
(Increase) decrease in other current assets	132	(412)
Decrease in other assets	10	116
Increase (decrease) in accounts payable and accrued expenses	4,959	(1,279)
Increase (decrease) in deferred revenue	180	(963)
Increase in pension and retirement plans liability	159	52
Increase (decrease) in income taxes payable	252	(549)
Decrease in other long term liabilities	(309)	—
Net cash provided by operating activities	463	1,905
Cash flows from investing activities:		
Sale of investments	—	5,000
Purchase of investments	(1,100)	—
Life insurance premiums paid	(121)	(121)
Purchases of property, equipment and improvements	(288)	(244)
Net cash provided by (used in) investing activities	(1,509)	4,635
Cash flows from financing activities:		
Payments on short-term borrowings	—	(1,501)
Proceeds from issuance of shares under employee stock purchase plan	113	180
Purchase of common stock	(122)	(934)
Net cash used in financing activities	(9)	(2,255)

Effects of exchange rate on cash	(1,143)	(390)
Net increase (decrease) in cash and cash equivalents	(2,198)	3,895
Cash and cash equivalents, beginning of period	18,904	13,494
Cash and cash equivalents, end of period	$16,706	$17,389
Supplementary cash flow information:		
Cash paid for income taxes	$404	$349
Cash paid for interest	$89	$105

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
THREE AND NINE MONTHS ENDED JUNE 30, 2010 AND 2009

Organization and Business

CSP Inc. and Subsidiaries ("CSPI" or the "Company") was founded in 1968 and is based in Billerica, Massachusetts. To meet the diverse requirements of its industrial, commercial and defense customers worldwide, CSPI and its subsidiaries develop and market IT integration solutions and high-performance cluster computer systems. The Company operates in two segments, its Systems segment and its Service and System Integration segment.

1. Basis of Presentation

The accompanying consolidated financial statements have been prepared by the Company, without audit, and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of the interim periods presented. All adjustments were of a normal recurring nature. Certain information and footnote disclosures normally included in the annual financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted. Accordingly, the Company believes that although the disclosures are adequate to make the information presented not misleading, the unaudited financial statements should be read in conjunction with the footnotes contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

2. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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 may differ from those estimates under different assumptions or conditions.

3. New Accounting Pronouncements

Subsequent Events

In January 2010, the FASB issued new accounting guidance entitled, "Subsequent Events." The new guidance, which is effective for the current reporting period, removes the requirement for an SEC filer to disclose a date that subsequent events have been evaluated as of, in both issued and revised financial statements. Accordingly, such date will no longer be disclosed in our financial statements.

Revenue Recognition

In October 2009, the FASB issued new accounting guidance entitled, "Multiple-Deliverable Revenue Arrangements—a Consensus of the FASB Emerging Issues Task Force." This new guidance amends existing revenue recognition accounting principles regarding multiple-deliverable revenue arrangements. The consensus provides accounting principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and how the consideration should be allocated. This guidance eliminates the requirement to establish verifiable, objective evidence of the fair value of undelivered products and services and also eliminates the residual method of allocating arrangement consideration. The new guidance provides for separate revenue recognition based upon management's estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. Under the previous guidance, if the fair value of all of the elements in the arrangement was not determinable, then revenue was deferred until all of the items were delivered or fair value was determined. This pronouncement is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted.

The Company has adopted this standard as of October 1, 2009. The disclosures included in this Note 3 are required pursuant to this new standard.

Description of multiple-deliverable arrangements

In most cases, our multiple-deliverable arrangements involve initial shipment of hardware and software products and subsequent delivery of services which add value to the products that have been shipped. In some instances, services are performed prior to product shipment, but more typically services are performed subsequent to shipment of the hardware products. The timing of the delivery and performance of deliverables may vary case-by-case. We evaluate whether we can determine vendor-specific objective evidence (“VSOE”) or third-party evidence to allocate revenue among the various elements in an arrangement. When VSOE or third-party evidence cannot be determined, we use estimated selling prices to allocate revenue to the various elements. Estimated selling prices are determined using the targeted gross margin for each element and calculating the gross revenue for each element that would have been required to achieve the targeted gross margin, and allocating revenue to each element based on those relative values. Typically, product revenue elements are recognized upon shipment, or when risk of loss passes to the customer, and services elements are recognized upon completion for fixed-price service arrangements and upon performance for time and materials service arrangements, or in accordance with applicable accounting standards that may apply. The period over which services are delivered typically ranges from approximately sixty to ninety days, or longer in some cases.

Impact of Adoption of New Standard

Adoption of the new revenue recognition guidance for multiple-deliverable arrangements has had an impact on the pattern and timing of revenue recognition. In some cases, revenue that would have been deferred pursuant to the previously existing multiple-element revenue recognition guidance, has been recognized pursuant to the newly issued guidance. This is because in some cases we are not able to determine VSOE or third-party evidence of the service element in our arrangements. Under the new guidance, because the requirement to determine fair value of undelivered elements has been eliminated, and we may use estimated selling price to allocate revenue to elements in an arrangement, we are now more likely to be able to separate arrangements into separate units of accounting, and thereby recognize the delivered elements (typically product revenue) without having delivered the other elements in the arrangements (typically services). The impact of adopting this new accounting guidance on revenue for the three and nine months ended June 30, 2010 was that $3.0 million and $3.4 million, respectively, in additional revenue was recognized under the newly adopted guidance that wouldn't have been recognized had we not adopted the new standard. The impact of adopting this new accounting guidance on net income and EPS was an increase to net income of $224 thousand and $242 thousand for the three and nine months ended June 30, 2010, respectively and an increase of $0.06 and $0.07, respectively to both basic and fully diluted earnings per share for the three and nine months ended June 30, 2010.

Earnings Per Share

In June 2008, the FASB issued new accounting guidance entitled, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities." Under the new guidance, non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share ("EPS") pursuant to the two-class method. The two-class method determines EPS for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. The new guidance is effective for fiscal years beginning after December 15, 2008 (fiscal year ending September 30, 2010 for the Company). The new disclosures required pursuant to this new guidance are included in Note 4 – Earnings Per Share of Common Stock below.

4. Earnings Per Share of Common Stock

Basic net income per common share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted net income per common share reflects the maximum dilution that would have resulted from the assumed exercise and share repurchase related to dilutive stock options and is computed by dividing net income by the assumed weighted average number of common shares outstanding.

In accordance with new accounting guidance as described in Note 3 above, we are required to present EPS utilizing the two class method because we had outstanding, non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, which are considered participating securities.

Basic and diluted earnings (loss) per share computations for the Company's reported net income attributable to common stock holders are as follows:

	For the Three Months Ended		For the Nine Months Ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
	(Amounts in thousands, except per share data)			

Net income (loss)	$621	$(752)	$868	$(182)
Less: Net income attributable to nonvested common stock	7	-	8	-
Net income (loss) attributable to common stockholders	$614	$(752)	$860	$(182)
Weighted average number of shares outstanding – basic	3,548	3,531	3,545	3,628
Incremental shares from the assumed exercise of stock options	26	-	29	-
Weighted average number of shares outstanding – diluted	3,574	3,531	3,574	3,628
Net income (loss) per share – basic	$0.17	$(0.21)	$0.24	$(0.05)
Net income (loss) per share – diluted	$0.17	$(0.21)	$0.24	$(0.05)

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All anti-dilutive securities, including stock options, are excluded from the diluted income per share computation. For the three and nine months ended June 30, 2010, 234,000 and 246,000 options, respectively, were excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive. For the three and nine months ended June 30, 2009, approximately 333,000 and 337,000 options, respectively, were excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive.

For the three months ended June 30, 2010 and 2009, basic and fully diluted weighted average unvested share-based payment shares outstanding were 40 thousand and 23 thousand, respectively. For the three months ended June 30, 2010, basic and diluted earnings per share attributable to unvested shares were $0.17 per share. For the three months ended June 30, 2009, the loss per share attributable to unvested shares was $0.21 per share. For the nine months ended June 30, 2010 and 2009, basic and fully diluted weighted average unvested share-based payment shares outstanding were 33 thousand and 14 thousand, respectively. For the nine months ended June 30, 2010, basic and diluted earnings per share attributable to unvested shares were $0.24 per share. For the nine months ended June 30, 2009, the loss per share attributable to unvested shares was $0.05 per share.

5. Short Term Investments

At June 30, 2010 and September 30, 2009, investments consisted of the following:

	Amortized Cost	Gross Unrealized Gains	Fair Value
		(Amounts in thousands)	
June 30, 2010			
Corporate bonds:			
Bank of America Corporate Bond	$1,100	$—	$1,100
Total	$1,100	$—	$1,100
September 30, 2009			
Corporate bonds:	$—	$—	$—
	$—	$—	$—

	Short-term	Long-term	Total
June 30, 2010			
Available-for-sale	$1,100		