CSP INC /MA/
Form 10-Q/A
March 02, 2012

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

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

For the Quarterly Period Ended June 30, 2011.

¨ 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 x 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 ¨ (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 July 28, 2011, the registrant had 3,473,222 shares of common stock issued and outstanding.

INDEX

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, filed with the Securities and Exchange Commission (SEC) on August 9, 2011 is being filed to restate our consolidated financial statements and other financial information to give effect to adjustments resulting from the identification of sales that are maintenance and support services provided by third parties where the Company is not the primary obligor for the service, which requires presentation of the revenue reported by the Company net of the cost of the services as opposed to recognition as the gross sales value of the services. We have therefore reduced the product revenue and product cost of sales by the amount of the costs associated with these services. In addition, the Company identified certain other services provided pursuant to third party contracts for which the Company is the primary obligor and reported these services correctly at the gross sales value; however these services were reported as product revenue and should have been reported as service revenue. We have therefore, reclassified both the revenue and cost of sales for these services from product revenue and product cost of sales to service revenue and service cost of sales. The adjustments made to the restated financial statements referred to above did not affect gross profit, income before taxes, net income, cash flow, total assets, total liabilities, retained earnings or total shareholder equity as of or for the quarters and nine-month periods ended June 30, 2011 and 2010.

We have added a disclosure in Note 2 to our Consolidated Financial Statements that explains the restatement and the impact to our Consolidated Financial Statements that were originally filed. This Form 10-Q/A (Amendment No. 1) amends and restates Part I – Items 1, 2 and 4 of the August 9, 2011 filing, in each case to reflect only the adjustments described herein and the filing of restated financial statements as discussed above, and no other information in our August 9, 2011 filing is amended hereby. Except for the foregoing amended information, this Form 10-Q/A (Amendment No. 1) filing does not reflect events occurring after August 9, 2011.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	June 30, 2011 (Unaudited)	September 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$17,482	$15,531
Accounts receivable, net of allowances of $277 and $288	10,318	12,190
Inventories	5,586	5,862
Refundable income taxes	334	721
Deferred income taxes	126	124
Other current assets	2,054	1,523
Total current assets	35,900	35,951
Property, equipment and improvements, net	873	873
Other assets:		
Intangibles, net	602	687
Deferred income taxes	918	880
Cash surrender value of life insurance	2,888	2,689
Other assets	249	299
Total other assets	4,657	4,555
Total assets	$41,430	$41,379
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$8,978	$10,049
Deferred revenue	3,348	3,078
Pension and retirement plans	708	441
Income taxes payable	239	380
Total current liabilities	13,273	13,948
Pension and retirement plans	9,010	8,928
Capital lease obligation	25	24
Other long term liabilities	271	-
Total liabilities	22,579	22,900
Commitments and contingencies		
Shareholders' equity:		
Common stock, $.01 par; authorized, 7,500 shares; issued and outstanding 3,473 and 3,520 shares, respectively	35	35
Additional paid-in capital	11,035	11,280

Retained earnings	12,977	12,516
Accumulated other comprehensive loss	(5,196)	(5,352)
Total shareholders’ equity	18,851	18,479
Total liabilities and shareholders’ equity	$41,430	$41,379

See accompanying notes to unaudited consolidated financial statements.

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

	For the three months ended		For the nine months ended	
	June 30, 2011 (Restated)	June 30, 2010 (Restated)	June 30, 2011 (Restated)	June 30, 2010 (Restated)
Sales:				
Product	$14,726	$21,013	$42,784	$52,793
Services	4,063	5,998	14,261	14,877
Total sales	18,789	27,011	57,045	67,670
Cost of sales:				
Product	12,256	18,812	35,631	44,840
Services	2,912	3,303	9,016	10,140
Total cost of sales	15,168	22,115	44,647	54,980
Gross profit	3,621	4,896	12,398	12,690
Operating expenses:				
Engineering and development	442	498	1,460	1,401
Selling, general and administrative	3,450	3,740	10,135	10,207
Total operating expenses	3,892	4,238	11,595	11,608
Operating income (loss)	(271)	658	803	1,082
Other income (expense):				
Foreign exchange gain (loss)	(9)	(6)	-	(16)
Other income (expense), net	(24)	(4)	(55)	(30)
Net other income (expense)	(33)	(10)	(55)	(46)
Income (loss) before income taxes	(304)	648	748	1,036
Income tax expense (benefit)	(90)	27	287	168
Net income (loss)	$(214)	$621	$461	$868
Net income (loss) attributable to common shareholders	$(211)	$614	$455	$860
Net income (loss) per share – basic	$(0.06)	$0.17	$0.13	$0.24
Weighted average shares outstanding – basic	3,428	3,548	3,446	3,545
Net income (loss) per share – diluted	$(0.06)	$0.17	$0.13	$0.24
Weighted average shares outstanding – diluted	3,428	3,574	3,485	3,574

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, 2011
(Amounts in thousands)

	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated other comprehensive loss	Total Shareholders Equity	Comprehensive Income
Balance as of September 30, 2010	3,520	$ 35	$ 11,280	$ 12,516	$ (5,352)	$ 18,479	
Comprehensive income (loss):							
Net income	—	—	—	461	—	461	$ 461
Other comprehensive income:							
Effect of foreign currency translation	—	—	—	—	156	156	156
Total comprehensive income							$ 617
Stock-based compensation	—	—	54	—	—	54	
Issuance of shares under employee stock purchase plan	25	—	74	—	—	74	
Restricted stock shares issued	37	1	74	—	—	75	
Purchase of common stock	(109)	(1)	(447)	—	—	(448)	
Balance as of June 30, 2011	3,473	$ 35	$ 11,035	$ 12,977	$ (5,196)	$ 18,851	

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, 2011	June 30, 2010
Cash flows from operating activities:		
Net income	$461	$868
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	277	295
Amortization of intangibles	85	85
Loss on disposal of fixed assets, net	3	1
Foreign exchange loss (gain)		16
Non-cash changes in accounts receivable	(12)	8
Stock-based compensation expense on stock options and restricted stock awards	129	166
Deferred income taxes		(153)
Increase in cash surrender value of life insurance	(59)	(60)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	2,212	(4,819)
(Increase) decrease in inventories	295	(1,281)
(Increase) decrease in refundable income taxes	410	(46)
(Increase) decrease in other current assets	(449)	132
Decrease in other assets	54	10
Increase (decrease) in accounts payable and accrued expenses	(1,322)	4,959
Increase in deferred revenue	149	180
Increase in pension and retirement plans liability	58	159
Increase (decrease) in income taxes payable	(143)	252
Increase (decrease) in other long term liabilities	271	(309)
Net cash provided by operating activities	2,419	463
Cash flows from investing activities:		
Purchase of investments	-	(1,100)
Life insurance premiums paid	(140)	(121)
Purchases of property, equipment and improvements	(249)	(288)
Net cash used in investing activities	(389)	(1,509)
Cash flows from financing activities:		
Proceeds from issuance of shares under employee stock purchase plan	74	113
Purchase of common stock	(448)	(122)
Net cash used in financing activities	(374)	(9)
Effects of exchange rate on cash	295	(1,143)
Net increase (decrease) in cash and cash equivalents	1,951	(2,198)
Cash and cash equivalents, beginning of period	15,531	18,904
Cash and cash equivalents, end of period	$17,482	$16,706
Supplementary cash flow information:		
Cash paid for income taxes	$267	$404

Cash paid for interest	$85	$89

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, 2011 AND 2010

Organization and Business

CSP Inc. was founded in 1968 and is based in Billerica, Massachusetts. To meet the diverse requirements of its industrial, commercial and defense customers worldwide, CSP Inc. and its subsidiaries (collectively “CSPI” or the “Company”) 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, 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, 2010, and Form 8-K/A filed on January 11, 2012.

2. Restatement

The Company has restated its Consolidated Statements of Operations for the three-month and nine-month periods ended June 30, 2011 and 2010 to reflect adjustments and reclassifications of revenue and cost of sales, in connection with the identification of sales that are maintenance and support services provided by third parties where the Company is not the primary obligor of the service, which requires presentation of the revenue reported by the Company net of the cost of the services as opposed to recognition of the gross sales value of the services. In addition, the Company identified certain other services provided pursuant to third party contracts for which the Company is the primary obligor and reported these services correctly at the gross sales value; however these services were reported as product revenue and should have been included as service revenue. We have therefore, reclassified both the revenue and cost of sales for these services from product revenue and product cost of sales to service revenue and service cost of sales.

The adjustments made to the restated financial statements referred to above did not affect gross profit, income before taxes, net income, cash flow, total assets, total liabilities, retained earnings or total shareholder equity as of or for the quarters and nine-month periods ended June 30, 2011 and 2010.

The tables below show the impact to the statements of operations for the restated periods.

	Three months ended June 30, 2011 (unaudited)			Three months June 30, 2010 (unaudited)		
	As reported	Restatement Adjustment	Restated	As reported	Restatement Adjustment	Restated
	(Amounts in thousands except for per share data)					
Sales:						
Product	$16,416	$ (1,690)	$14,726	$23,753	$ (2,740)	$21,013
Services	3,265	798	4,063	4,815	1,183	5,998
Total sales	19,681	(892)	18,789	28,568	(1,557)	27,011

Cost of sales:						
Product	13,690	(1,434)	12,256	21,153	(2,341)	18,812
Services	2,370	542	2,912	2,519	784	3,303
Total cost of sales	16,060	(892)	15,168	23,672	(1,557)	22,115
Gross profit	3,621	-	3,621	4,896	-	4,896
Operatingexpenses	3,892	-	3,892	4,238	-	4,238
Operating income	(271)	-	(271)	658	-	658
Other income (expense), net	(33)	-	(33)	(10)	-	(10)
Income before income taxes	(304)	-	(304)	648	-	648
Income tax expense	(90)	-	(90)	27	-	27
Net income	$(214)	-	$(214)	$621	-	$621
Net income per share – basic	$(0.06)	-	$(0.06)	$0.17	-	$0.17
Weighted average shares outstanding – basic	3,428	-	3,428	3,548	-	3,548
Net income per share – diluted	$(0.06)	-	$(0.06)	$0.17	-	$0.17
Weighted average shares outstanding – diluted	3,428	-	3,428	3,574	-	3,574

	Nine months ended June 30, 2011 (unaudited)			Nine months ended June 30, 2010 (unaudited)		
	As reported	Restatement Adjustment	Restated	As reported	Restatement Adjustment	Restated
	(Amounts in thousands except for per share data)					
Sales:						
Product	$ 49,566	$ (6,782)	$ 42,784	$ 59,549	$ (6,756)	$ 52,793
Services	11,434	2,827	14,261	11,601	3,276	14,877
Total sales	61,000	(3,955)	57,045	71,150	(3,480)	67,670
Cost of sales:						
Product	41,440	(5,809)	35,631	50,729	(5,889)	44,840
Services	7,162	1,854	9,016	7,731	2,409	10,140
Total cost of sales	48,602	(3,955)	44,647	58,460	(3,480)	54,980
Gross profit	12,398	-	12,398	12,690	-	12,690
Operatingexpenses	11,595	-	11,595	11,608	-	11,608
Operating income	803	-	803	1,082	-	1,082
Other income (expense), net	(55)	-	(55)	(46)	-	(46)
Income before income taxes	748	-	748	1,036	-	1,036
Income tax expense	287	-	287	168	-	168
Net income	$ 461	-	$ 461	$ 868	-	$ 868
Net income per share – basic	$ 0.13	-	$ 0.13	$ 0.24	-	$ 0.24
Weighted average shares outstanding – basic	3,446	-	3,446	3,545	-	3,545
Net income per share – diluted	$ 0.13	-	$ 0.13	$ 0.24	-	$ 0.24
Weighted average shares outstanding – diluted	3,485	-	3,485	3,574	-	3,574

3. 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.

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.

We are required to present earnings per share, or 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 per share computations for the Company's reported net income attributable to common stockholders are as follows:

	For the Three Months Ended		For the Nine Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
	(Amounts in thousands, except per share data)			
Net income (loss)	$ (214)	$ 621	$ 461	$ 868
Less: Net income (loss) attributable to nonvested common stock	(3)	7	6	8
Net income (loss) attributable to common stockholders	(211)	614	455	860
Weighted average total shares outstanding – basic	3,484	3,588	3,497	3,578
Less: weighted average non-vested shares outstanding	(56)	(40)	(51)	(33)
Weighted average number of common shares outstanding – basic	3,428	3,548	3,446	3,545
Potential common shares from non-vested stock awards and the assumed exercise of stock options		26	39	29
Weighted average common shares outstanding – diluted	3,428	3,574	3,485	3,574
Net income (loss) per share – basic	$ (0.06)	$ 0.17	$ 0.13	$ 0.24
Net income (loss) per share – diluted	$ (0.06)	$ 0.17	$ 0.13	$ 0.24

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, 2011, 247,000 and 205,000 options, respectively, were excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive.

5. Inventories

Inventories consist of the following:

	June 30, 2011	September 30, 2010
	(Amounts in thousands)	
Raw materials	$ 966	$ 1,029
Work-in-process	948	439
Finished goods	3,672	4,394
Total	$ 5,586	$ 5,862

Finished goods includes inventory that has been shipped, but for which all revenue recognition criteria has not been met of approximately $1.7 million and $2.4 million as of June 30, 2011 and September 30, 2010, respectively.

Total inventory balances in the table above are shown net of reserves for obsolescence of approximately $4.2 million and $4.1 million as of June 30, 2011 and September 30, 2010, respectively.

6. Accumulated Other Comprehensive Loss

The components of comprehensive income (loss) are as follows:

	For the Three Months Ended		For the Nine Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
	(Amounts in thousands)			
Net income (loss)	$(214)	$621	$461	$868
Effect of foreign currency translation	115	(297)	156	(653)
Comprehensive income (loss)	$(99)	$324	$617	$215

The components of Accumulated Other Comprehensive Loss are as follows:

	June 30, 2011	September 30, 2010
	(Amounts in thousands)	
Cumulative effect of foreign currency translation	$ (1,977)	$ (2,133)
Additional minimum pension liability	(3,219)	(3,219)
Accumulated Other Comprehensive Loss	$ (5,196)	$ (5,352)

7. Pension and Retirement Plans

The Company has defined benefit and defined contribution plans in the United Kingdom, Germany and the U.S. In the United Kingdom and Germany, the Company provides defined benefit pension plans and defined contribution plans for the majority of its employees. In the U.S., the Company provides benefits through supplemental retirement plans to certain current and former employees. The domestic supplemental retirement plans have life insurance policies which are not plan assets but were purchased by the Company as a vehicle to fund the costs of the plan. Domestically, the Company also provides for officer death benefits through post-retirement plans to certain officers. All of the Company's defined benefit plans are closed to newly hired employees and have been for fiscal years 2009, 2010 and for the nine months ended June 30, 2011.

The Company funds its pension plans in amounts sufficient to meet the requirements set forth in applicable employee benefits laws and local tax laws. Liabilities for amounts in excess of these funding levels are accrued and reported in the consolidated balance sheets.

Our pension plan in the United Kingdom is the only plan with plan assets. The plan assets consist of an investment in a commingled fund which in turn comprises a diversified mix of assets including corporate equity securities, government securities and corporate debt securities.

The components of net periodic benefit costs related to the U.S. and international plans are as follows:

	For the Three Months Ended June 30					
	2011			2010		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(Amounts in thousands)					
Pension:						
Service cost	$ 18	$ 3	$ 21	$ 14	$ 2	$ 16
Interest cost	176	25	201	159	29	188
Expected return on plan assets	(128)	—	(128)	(106)	—	(106)
Amortization of:						
Prior service gain	—	—	—	—	—	—
Amortization of net gain	18	7	25	10	8	18
Net periodic benefit cost	$ 84	$ 35	$ 119	$ 77	$ 39	$ 116
Post Retirement:						
Service cost	$ —	$ 5	$ 5	$ —	$ 5	$ 5
Interest cost	—	17	17	—	17	17
Amortization of net gain	—	12	12	—	16	16
Net periodic benefit cost	$ —	$ 34	$ 34	$ —	$ 38	$ 38

	For the Nine Months Ended June 30					
	2011			2010		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(Amounts in thousands)					
Pension:						
Service cost	$ 54	$ 8	$ 62	$ 44	$ 7	$ 51
Interest cost	518	74	592	504	87	591
Expected return on plan assets	(379)	—	(379)	(333)	—	(333)
Amortization of:						
Prior service gain	—	—	—	—	—	—
Amortization of net gain	52	23	75	33	22	55
Net periodic benefit cost	$ 245	$ 105	$ 350	$ 248	$ 116	$ 364
Post Retirement:						
Service cost	$ —	$ 15	$ 15	$ —	$ 14	$ 14
Interest cost	—	51	51	—	52	52
Amortization of net gain	—	35	35	—	48	48
Net periodic benefit cost	$ —	$ 101	$ 101	$ —	$ 114	$ 114

8. Segment Information

The following table presents certain operating segment information.

Three Months Ended June 30,	Systems Segment	Service and System Integration Segment: Germany	United Kingdom	U.S.	Total	Consolidated Total
	(Amounts in thousands)					
2011						
Sales:						
Product	$ 1,323	$ 3,230	$ 68	$ 10,105	$ 13,403	$ 14,726
Service	152	2,787	347	777	3,911	4,063
Total sales	1,475	6,017	415	10,882	17,314	18,789
Profit (loss) from operations	(810)	63	15	461	539	(271)
Assets	12,508	13,699	3,890	11,333	28,922	41,430
Capital expenditures	10	12	9	7	28	38
Depreciation and amortization	24	46	7	46	99	123
2010						
Sales:						
Product	$ 313	$ 1,522	$ -	$ 19,178	$ 20,700	$ 21,013
Service	1,741	2,747	356	1,154	4,257	5,998
Total sales	2,054	4,269	356	20,332	24,957	27,011
Profit (loss) from operations	55	(159)	(35)	797	603	658
Assets	14,111	9,114	3,704	17,626	30,444	44,555
Capital expenditures	10	58	15	33	106	116
Depreciation and amortization	27	37	7	52	96	123

Nine Months Ended June 30,	Systems Segment	Service and System Integration Segment: Germany	United Kingdom	U.S.	Total	Consolidated Total
	(Amounts in thousands)					
2011						
Sales:						
Product	$ 3,563	$ 9,481	$ 140	$ 29,600	$ 39,221	$ 42,784
Service	2,036	8,809	1,043	2,373	12,225	14,261
Total sales	5,599	18,290	1,183	31,973	51,446	57,045
Profit (loss) from operations	(624)	213	-	1,214	1,427	803
Assets	12,508	13,699	3,890	11,333	28,922	41,430
Capital expenditures	142	59	12	36	107	249
Depreciation and amortization	66	138	21	137	296	362
2010						
Sales:						
Product	$ 4,842	$ 7,284	$ 49	$ 40,618	$ 47,951	$ 52,793

Service	2,234	9,062	1,201	2,380	12,643	14,877
Total sales	7,076	16,346	1,250	42,998	60,594	67,670
Profit from operations	191	(111)	(21)	1,023	891	1,082
Assets	14,111	9,114	3,704	17,626	30,444	44,555
Capital expenditures	25	193	24	46	263	288
Depreciation and amortization	90	116	20	154	290	380

Profit (loss) from operations is sales less cost of sales, engineering and development, selling, general and administrative expenses but is not affected by either non-operating charges/income or by income taxes. Non-operating charges/income consists principally of investment income and interest expense. All intercompany transactions have been eliminated.

The following table lists customers from which the Company derived revenues in excess of 10% of total revenues for the three and nine month periods ended June 30, 2011 and 2010.

	For the Three Months Ended				For the Nine Months Ended			
	June 30, 2011		June 30, 2010		June 30, 2011		June 30, 2010	
	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues	Amount	% of Revenues
	(Dollar amounts in millions)							
Vodafone	$1.5	8 %	$1.0	4 %	$6.3	11 %	$5.9	9 %
Verio	$4.5	24 %	$9.7	36 %	$8.8	15 %	$17.5	26 %
Atos	$2.2	12 %	$0.5	2 %	$4.5	8 %	$2.3	3 %

9. Fair Value Measures

Assets and Liabilities measured at fair value on a recurring basis are as follows:

	Fair Value Measurements Using				
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance	Gain or (loss)
	As of June 30, 2011 (Amounts in thousands)				
Assets:					
Money Market funds	$ 3,491	$ —	$ —	$ 3,491	$ —
Total assets measured at fair value	$ 3,491	$ —	$ —	$ 3,491	$ —
	As of September 30, 2010 (Amounts in thousands)				
Assets:					
Money Market funds	$ 3,482	$ —	$ —	$ 3,482	$ —
Total assets measured at fair value	$ 3,482	$ —	$ —	$ 3,482	$ —

These assets are included in cash and cash equivalents in the accompanying consolidated balance sheets. All other monetary assets and liabilities are short-term in nature and approximate their fair value.

The Company had no liabilities measured at fair value as of June 30, 2011 or September 30, 2010. The Company had no assets or liabilities measured at fair value on a non recurring basis as of June 30, 2011 or September 30, 2010.

10. Common Stock Repurchase

On February 3, 2009, the Board of Directors (the “Board”) authorized the Company to purchase up to 350 thousand additional shares of the Company’s outstanding common stock at market price. As of September 30, 2010, there remained approximately 145 thousand shares pursuant to this authorization. On February 8, 2011, the Board authorized the Company to purchase up to 250 thousand additional shares of the Company’s outstanding common stock at market price. Pursuant to this and the prior authorization by the Board, the Company repurchased approximately 109 thousand shares of its outstanding common stock during the nine months ended June 30, 2011. As of June 30, 2011, approximately 286 thousand shares remain authorized for repurchase under the Company’s stock repurchase program.

11. Income Taxes

We follow the applicable accounting provisions which clarify the accounting for uncertainty in income tax positions. These provisions require us to recognize in the consolidated financial statements only those tax positions determined to be more-likely-than-not of being sustained upon examination, based on the technical merits of the positions as of the reporting date. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the position are recognized. The more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit.

As of June 30, 2011, the total amount of uncertain tax liabilities was $271 thousand, all of which would affect our effective tax rate if recognized. We recognize interest and potential penalties accrued related to unrecognized tax benefits in our provision for income taxes.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

	Three months ended June 30, 2011	Three months ended June 30, 2010
	(Amounts in thousands)	
Beginning balance	$—	$326
Increases in tax positions in the current year	271	—
Settlements	—	—
Lapse in statute of limitations	—	(302)
Accrued penalties and interest	—	8
Balance, end of period	$271	$32

	Nine months ended June 30, 2011	Nine months ended June 30, 2010
	(Amounts in thousands)	
Balance, beginning of year	$—	$326
Increases in tax positions in the current year	271	—
Settlements	—	—
Lapse in statute of limitations	—	(302)
Accrued penalties and interest	—	8
Balance, end of period	$271	$32

We file income tax returns in the U.S. federal jurisdictions and various state and foreign jurisdictions. The Internal Revenue Service has completed an examination of fiscal year 2007, which did not result in any tax adjustment relating to our uncertain tax positions. The Company has reviewed the tax positions taken on returns filed domestically and in its foreign jurisdictions for all open years, generally fiscal 2006 through 2010, and believes that tax adjustments in any audited year will not be material, except for the uncertain tax position described above.

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

Forward-Looking Statements

The discussion below contains certain forward-looking statements related to, among others, but not limited to, statements concerning future revenues and future business plans. Actual results may vary from those contained in such forward-looking statements.

Markets for our products and services are characterized by rapidly changing technology, new product introductions and short product life cycles. These changes can adversely affect our business and operating results. Our success will depend on our ability to enhance our existing products and services and to develop and introduce, on a timely and cost effective basis, new products that keep pace with technological developments and address increasing customer requirements. The inability to meet these demands could adversely affect our business and operating results.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate our estimates, including those related to uncollectible receivables, inventory valuation, income taxes, deferred compensation and retirement plans, estimated selling prices used for revenue recognition and contingencies. We base our estimates on historical performance 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. A description of our critical accounting policies is contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 in the “Critical Accounting Policies” section of Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

Overview of the nine months ended June 30, 2011 Results of Operations

Highlights include:

- Revenue decreased by approximately $10.6 million, or 16%, to $57.0 million for the nine months ended June 30, 2011 versus $67.6 million for the nine months ended June 30, 2010.

- For the nine months ended June 30, 2011, operating income was approximately $0.8 million versus operating income of approximately $1.1 million for the nine months ended June 30, 2010.

- For the nine months ended June 30, 2011, net income was approximately $0.5 million versus net income of approximately $0.9 million for the nine months ended June 30, 2010.

The following table details our results of operations in dollars and as a percentage of sales for the nine months ended June 30, 2011 and 2010:

	June 30, 2011	% of sales	June 30, 2010	% of sales
	(Dollar amounts in thousands)			
Sales	$ 57,045	100 %	$ 67,670	100 %
Costs and expenses:				
Cost of sales	44,647	78 %	54,980	81 %
Engineering and development	1,460	3 %	1,401	2 %
Selling, general and administrative	10,135	18 %	10,207	15 %
Total costs and expenses	56,242	99 %	66,588	98 %
Operating income	803	1 %	1,082	2 %
Other expense	(55)	— %	(46)	— %
Income before income taxes	748	1 %	1,036	2 %
Income tax expense	287	— %	168	1 %
Net income	$ 461	1 %	$ 868	1 %

Sales

The following table details our sales by operating segment for the nine months ended June 30, 2011 and 2010:

	Systems	Service and System Integration	Total	% of Total
	(Dollar amounts in thousands)			
For the nine months ended June 30, 2011:				
Product	$ 3,563	$ 39,221	$ 42,784	75 %
Services	2,036	12,225	14,261	25 %
Total	$ 5,599	$ 51,446	$ 57,045	100 %
% of Total	10 %	90 %	100 %	

	Systems	Service and System Integration	Total	% of Total
For the nine months ended June 30, 2010:				
Product	$ 4,842	$ 47,951	$ 52,793	78 %
Services	2,234	12,643	14,877	22 %
Total	$ 7,076	$ 60,594	$ 67,670	100 %
% of Total	10 %	90 %	100 %	

	Systems	Service and System Integration	Total	% decrease
Increase (Decrease)				
Product	$ (1,279)	$ (8,730)	$ (10,009)	(19)%
Services	(198)	(418)	(616)	(4)%
Total	$ (1,477)	$ (9,148)	$ (10,625)	(16)%
% decrease	(21)%	(15)%	(16)%	

As shown above, total revenues decreased by approximately $10.6 million, or 16%, for the nine months ended June 30, 2011 compared to the same period of fiscal year 2010. Revenues in the Systems segment decreased for the current year nine month period versus the prior year nine month period by approximately $1.5 million, while revenues in the Service and System Integration segment decreased by approximately $9.1 million, resulting in the overall decrease of approximately $10.6 million.

Product revenues decreased by approximately $10.0 million, or 19%, for the nine months ended June 30, 2011 compared to the comparable period of fiscal 2010. This change in product revenues was made up of a decrease in product revenues in the Systems segment of approximately $1.3 million over the prior year nine months, and a decrease in product revenues in the Service and System Integration segment of approximately $8.7 million versus the prior year nine months.

The decrease in product revenues in the Systems segment of $1.3 million was due to having shipped a large order in the nine month period ended June 30, 2010, for approximately $3.6 million, consisting of two major systems, which was a follow on order for a major US defense program, that we began supplying to one of our customers in fiscal 2007. No sales of this nature were made in the nine month period ended June 30, 2011. Offsetting this decrease, we realized an increase of approximately $1.3 million in product sales in the current year nine month period versus the prior year nine month period, to an existing customer that supplies equipment to the Japanese defense market, and increases in product sales to two other customers that supply US defense programs, of $1.1 million.

The decrease in the Service and System Integration segment product sales of approximately $9.1 million was due to a decrease in product sales in the U.S. division of the segment of approximately $11.0 million, offset by an increase in this segment's German division of approximately $2.2 million.

In the US division, product sales to our two largest customers decreased by a total of approximately $11.5 million, consisting of a decrease in sales to our largest customer of approximately $8.6 million and a decrease in product sales to our second largest customer of approximately $2.9 million. These customers are both IT managed service providers, which did not require the level of expansion of capacity as in prior years due to lost customers and a general leveling off of the size of their infrastructure. In Germany, product sales volume was up $2.1 million in constant dollars versus the prior year. This constant dollar increase in sales was due primarily to an increase in sales to one of our largest systems integration customers. The remainder of the increases in sales was due to the favorable impact of currency fluctuation of approximately $0.1 million affecting a weaker US dollar versus the Euro for the nine months ended June 30, 2011 versus 2010.

As shown in the table above, service revenues decreased by approximately $0.6 million for the nine months ended June 30, 2011 compared to the comparable nine months of fiscal 2010. The Systems segment service revenue decrease reflects a decrease in royalty revenue from a large US defense program supplier. The decrease in service revenue in the Service and System Integration segment occurred in our European region and was due to overall weaker demand for our services in those markets.

Our sales by geographic area, based on the location to which the products were shipped or services rendered, are as follows:

	For the Nine Months Ended					
	June 30, 2011	%	June 30, 2010	%	$ Increase (Decrease)	% Increase (Decrease)
	(Dollar amounts in thousands)					
Americas	$ 34,976	61 %	$ 48,537	71 %	$ (13,561)	(28)%
Europe	19,656	35 %	18,113	27 %	1,543	9 %
Asia	2,413	4 %	1,020	2 %	1,393	137 %
Totals	$ 57,045	100 %	$ 67,670	100 %	$ (10,625)	(16)%

The decrease in Americas revenue for the nine months ended June 30, 2011 versus the nine months ended June 30, 2010 was primarily the result of the changes in revenues described above in the Systems segment relating to product and services sales to US defense programs, which accounted for approximately $2.9 million of the decrease and the decreases in sales to customers in the Americas from the U.S. division of our Service and System Integration segment, which accounted for the remaining $10.7 million of the decrease.

The increase in sales in Europe was primarily the result of the higher sales described above from the German division of the Service and System Integration segment which accounted for approximately $1.9 million in increased sales to Europe, offset by decreases in sales to European customers of approximately $0.3 million and $0.1 million from the US and UK divisions of the Service and System Integration segment, respectively. The increase in Asia sales was the result of the increase in sales described above to our existing customer which supplies a large Japanese defense program.

Cost of Sales and Gross Margins

The following table details our cost of sales by operating segment for the nine months ended June 30, 2011 and 2010:

	Systems	Service and System Integration	Total	% of Total
	(Dollar amounts in thousands)			
For the nine months ended June 30, 2011:				
Product	$ 1,614	$ 34,017	$ 35,631	80 %
Services	239	8,777	9,016	20 %
Total	$ 1,853	$ 42,794	$ 44,647	100 %
% of Total	4 %	96 %	100 %	
% of Sales	33 %	83 %	78 %	
Gross Margins:				
Product	55 %	13 %	17 %	
Services	88 %	28 %	37 %	
Total	67 %	17 %	22 %	

	Systems	Service and System Integration	Total	% of Total
For the nine months ended June 30, 2010:				
Product	$ 2,216	$ 42,624	$ 44,840	82 %
Services	267	9,873	10,140	18 %
Total	$ 2,483	$ 52,497	$ 54,980	100 %
% of Total	5 %	95 %	100 %	
% of Sales	35 %	87 %	81 %	
Gross Margins:				
Product	54 %	11 %	15 %	
Services	88 %	22 %	32 %	
Total	65 %	13 %	19 %	
Decrease				
Product	$ (602)	$ (8,607)	$ (9,209)	(21)%
Services	(28)	(1,096)	(1,124)	(11)%
Total	$ (630)	$ (9,703)	$ (10,333)	(19)%
% Decrease	(25)%	(18)%	(19)%	
% of Sales	(2)%	(4)%	(3)%	
Gross Margins:				
Product	1 %	2 %	2 %	
Services	- %	6 %	5 %	
Total	2 %	4 %	3 %	

Total cost of sales decreased by approximately $10.3 million when comparing the nine months ended June 30, 2011 versus the nine months ended June 30, 2010. This decrease in cost of sales of 19% overall, compares with a decrease in sales of 16%.

Cost of sales in the Systems segment decreased by approximately $0.6 million, or 25%, when comparing the current year nine month period versus the prior year nine month period, while sales in the Systems segment decreased by approximately $1.5 million, or 21%.   This proportionately larger decrease in cost of sales versus sales in the Systems segment was because overall sales were lower in the current year nine month period versus the prior year three month period, and although royalty revenue was approximately $1.9 million in the prior year period versus $1.6 million in the current year period, royalty revenue made up a greater proportion of total revenue in the current year nine-month period, resulting in the increased gross profit margin reflected above.

Cost of sales in the Service and System Integration segment decreased by approximately $9.7 million, which is an 18% decrease when comparing the current year nine months versus the prior year nine months. While this trend is relatively consistent with the decrease in sales over the prior year, the rate of decrease of 18% is greater than the rate of decrease in sales, which was 15%. The reason for this is two-fold. First, on the product sales side we experienced smaller deal size with better margins (i.e., higher relative prices per unit). In the prior year, a higher percentage of our sales were to higher-volume-lower-margin customers, particularly in the US division. Secondly, we had better utilization of service resources in the nine months ended June 30, 2011 versus the prior year nine-month period, which resulted in lower cost as a percent of revenue.

The overall gross profit margin for the nine months ended June 30, 2011 was 22% compared to 19% for the nine months ended June 30, 2010. The gross margin in the Systems segment improved to 67% from 65% as described above. The gross margin in the Service and System Integration segment increased from 13% for the nine months ended June 30, 2010 to 17% for the nine months ended June 30, 2011. This increase in gross profit margin for the Service and System Integration segment was also due to the reasons described in the preceding paragraph.

Engineering and Development Expenses

The following table details our engineering and development expenses by operating segment for the nine months ended June 30, 2011 and 2010:

	For the Nine Months Ended					
	June 30, 2011	% of Total	June 30, 2010	% of Total	$ Increase	% Increase
	(Dollar amounts in thousands)					
By Operating Segment:						
Systems	$ 1,460	100 %	$ 1,401	100 %	$ 59	4 %
Service and System Integration	—	— %	—	— %	—	— %
Total	$ 1,460	100 %	$ 1,401	100 %	$ 59	4 %

The increase in engineering and development expenses displayed above was due to higher engineering consulting expenditures in connection with the development of the next generation of MultiComputer products in the Systems segment.

Selling, General and Administrative

The following table details our selling, general and administrative expense by operating segment for the nine months ended June 30, 2011 and 2010:

	For the Nine Months Ended					
	June 30, 2011	% of Total	June 30, 2010	% of Total	$ Decrease	% Decrease
	(Dollar amounts in thousands)					
By Operating Segment:						
Systems	$ 2,910	29 %	$ 2,976	29 %	$ (66)	(2)%
Service and System Integration	7,225	71 %	7,231	71 %	(6)	- %
Total	$ 10,135	100 %	$ 10,207	100 %	$ (72)	(1)%

The decrease in selling, general and administrative (“SG&A”) expenses in the Systems segment displayed above was primarily due to lower commission and bonus expense of approximately $0.1 million resulting from lower gross profit and net earnings in the segment. In addition, audit fees were lower in the current year nine-month period by approximately $0.1 million because the prior year included charges for additional work, which was not required in the current year nine-month period. Offsetting these decreases, legal expense increased by approximately $0.1 million in connection with a government investigation of a third party. The Company received a subpoena to produce documents in connection with this matter.

20

Other Income/Expenses

The following table details our other income/expenses for the nine months ended June 30, 2011 and 2010:

	For the Nine Months Ended June 30, 2011	June 30, 2010	Increase (Decrease)
	(Amounts in thousands)		
Interest expense	$(64)	$(68)	$4
Interest income	27	38	(11)
Foreign exchange loss	-	(16)	16
Other expense, net	(18)	-	(18)
Total other expense, net	$(55)	$(46)	$(9)

Other income (expense), net, for the nine month periods ended June 30, 2011 and 2010 was not significant nor was the change from the prior year nine month period to that of the current year.

Overview of the three months ended June 30, 2011 Results of Operations

Highlights include:

- Revenue decreased by approximately $8.2 million, or 30%, to $18.8 million for the three months ended June 30, 2011 versus $27.0 million for the three months ended June 30, 2010.

- For the three months ended June 30, 2011, we had an operating loss of approximately $0.3 million versus operating income of approximately $0.7 million for the three months ended June 30, 2010, for a decrease of approximately $1.0 million, or 141% in our operating result.

- For the three months ended June 30, 2011, we had a net loss of approximately $0.2 million versus net income of approximately $0.6 million for the three months ended June 30, 2010, for a decrease of approximately $0.8 million, or 134%.

The following table details our results of operations in dollars and as a percentage of sales for the three months ended June 30, 2011 and 2010:

	June 30, 2011	% of sales	June 30, 2010	% of sales
	(Dollar amounts in thousands)			
Sales	$ 18,789	100 %	$ 27,011	100 %
Costs and expenses:				
Cost of sales	15,168	81 %	22,115	82 %
Engineering and development	442	2 %	498	2 %
Selling, general and administrative	3,450	18 %	3,740	14 %
Total costs and expenses	19,060	101 %	26,353	98 %
Operating income	(271)	(1)%	658	2 %
Other expense	(33)	— %	(10)	— %
Income (loss) before income taxes	(304)	(2)%	648	2 %
Income tax expense (benefit)	(90)	1 %	27	— %
Net income (loss)	$ (214)	(1)%	$ 621	2 %

21

Sales

The following table details our sales by operating segment for the three months ended June 30, 2011 and 2010:

	Systems	Service and System Integration	Total	% of Total
	(Dollar amounts in thousands)			
For the three months ended June 30, 2011:				
Product	$ 1,323	$ 13,403	$ 14,726	78 %
Services	152	3,911	4,063	22 %
Total	$ 1,475	$ 17,314	$ 18,789	100 %
% of Total	8 %	92 %	100 %	

	Systems	Service and System Integration	Total	% of Total
For the three months ended June 30, 2010:				
Product	$ 313	$ 20,700	$ 21,013	78 %
Services	1,741	4,257	5,998	22 %
Total	$ 2,054	$ 24,957	$ 27,011	100 %
% of Total	8 %	92 %	100 %	

	Systems	Service and System Integration	Total	% decrease
Increase (Decrease)				
Product	$ 1,010	$ (7,297)	$ (6,287)	(30)%
Services	(1,589)	(346)	(1,935)	(32)%
Total	$ (579)	$ (7,643)	$ (8,222)	(30)%
% decrease	(28)%	(31)%	(30)%	

As shown above, total revenues decreased by approximately $8.2 million, or 30%, for the three months ended June 30, 2011 compared to the three months ended June 30, 2010. Revenue in the Systems segment decreased for the current year three month period versus the prior year three month period by approximately $0.6 million, while revenues in the Service and System Integration segment decreased by approximately $7.6 million, resulting in the overall decrease of approximately $8.2 million.

Product revenues decreased by approximately $6.3 million, or 30% for the three months ended June 30, 2011 compared to the comparable period of the prior fiscal year. This change in product revenues was made up of a decrease in product revenues in the Service and System Integration segment of approximately $7.3 million and an offsetting increase in product revenues in the Systems segment of approximately $1.0 million for the three month period ended June 30, 2011 versus the three month period ended June 30, 2010.

The increase in product revenues in the Systems segment of approximately $1.0 million was from the sale of parts, components and spares into existing programs for both US and Japanese defense department customers.

The decrease in the Service and System Integration segment product sales of approximately $7.3 million was due primarily to a decrease in product sales in the U.S. division of the segment of $9.0 million, offset by an increase in this segment's German division of approximately $1.7 million.

In the US division, product sales to the two largest customers of the division, decreased by a total of approximately $6.0 million. The decrease in sales to our largest customer was $5.2 million and a decrease in sales to our second largest customer was approximately $0.7 million. These customers are both IT managed service providers, which did not require the level of expansion of capacity as in prior years, due to lost customers and a general leveling off of the size of their infrastructure. In addition, sales to a large hotel for the build out of its unified communications network of $1.6 million, in the quarter ended June 30, 2010, did not recur in 2011. We also had a decrease in sales to a large law firm customer of approximately $0.5 million. Decreases in sales to other customers made up for the remaining $1.3 million difference.

In Germany, the $1.7 million increase was due to the favorable foreign currency exchange fluctuation from the weaker US dollar versus the Euro in the three months ended June 30, 2011 versus June 30, 2010, which accounted for $0.4 million of the increase. The remaining $1.3 million increase in sales was due primarily to higher sales volume to our large systems integrator customer, which Modcomp Germany supplies as a subcontractor.

As shown in the table above, service revenues decreased by approximately $1.9 million, or 32%. The decrease of $1.6 million in the Systems segment was entirely the result of royalty revenues from a large US defense contractor which we received in the three months ended June 30, 2010. We realized a similar amount of royalty revenue during the first half of fiscal 2011, however we did not realize any royalty revenue in the three month period ended June 30, 2011. The decrease in service revenue in the Service and System Integration segment occurred substantially in the US division of the segment, and was due to a large desktop support engagement at one of our large banking customers in the FY2010 three month period which did not recur in the FY2011 three month period.

Our sales by geographic area, based on the location to which the products were shipped or services rendered, are as follows:

	For the three Months Ended					
	June 30, 2011	%	June 30, 2010	%	$ Increase (Decrease)	% Increase (Decrease)
	(Dollar amounts in thousands)					
Americas	$ 12,075	64 %	$ 22,148	82 %	$ (10,073)	(45)%
Europe	6,437	34 %	4,805	18 %	1,632	34 %
Asia	277	2 %	58	- %	219	378 %
Totals	$ 18,789	100 %	$ 27,011	100 %	$ (8,222)	(30)%

The decrease in Americas revenue for the three months ended June 30, 2011 versus the three months ended June 30, 2010 was primarily the result of the decreases described above in the Systems segment and the US division of the Service and System Integration segment.

The increase in sales in Europe was primarily the result of the higher sales described above from the German division of the Service and System Integration segment. The increase in Asia sales was the result of the increase in sales to our existing customer that supplies a large Japanese defense program.

Cost of Sales and Gross Margins

The following table details our cost of sales by operating segment for the three months ended June 30, 2011 and 2010:

	Systems		Service and System Integration		Total		% of Total	
	(Dollar amounts in thousands)							
For the three months ended June 30, 2011:								
Product	$ 619		$ 11,636		$ 12,255		81	%
Services	102		2,811		2,913		19	%
Total	$ 721		$ 14,447		$ 15,168		100	%
% of Total	5	%	95	%	100	%		
% of Sales	49	%	83	%	81	%		
Gross Margins:								
Product	53	%	13	%	17	%		
Services	33	%	28	%	28	%		
Total	51	%	17	%	19	%		

	Systems		Service and System Integration		Total		% of Total	
For the three months ended June 30, 2010:								
Product	$ 288		$ 18,524		$ 18,812		85	%
Services	117		3,186		3,303		15	%
Total	$ 405		$ 21,710		$ 22,115		100	%
% of Total	2	%	98	%	100	%		
% of Sales	20	%	87	%	82	%		
Gross Margins:								
Product	8	%	11	%	10	%		
Services	93	%	25	%	45	%		
Total	80	%	13	%	18	%		
Increase (decrease)								
Product	$ 331		$ (6,888	)	$ (6,557	)	(35	)%
Services	(15	)	(375	)	(390	)	(12	)%
Total	$ 316		$ (7,263	)	$ (6,947	)	(31	)%
% Increase (decrease)	78	%	(33	)%	(31	)%		
% of Sales	29	%	(4	)%	(1	)%		
Gross Margins:								
Product	45	%	2	%	7	%		
Services	(60	)%	3	%	(17	)%		
Total	(29	)%	4	%	1	%		

Total cost of sales decreased by approximately $6.9 million when comparing the three months ended June 30, 2011 versus the three months ended June 30, 2010. This decrease in cost of sales of 31% overall, is consistent with the decrease in sales of 30% overall, as described previously. The resulting higher profit margin of 19% for the three months ended June 30, 2011 versus 18% for 2010, was due to several factors.

In analyzing the gross profit margins by segment, the service gross margin in the Systems segment for the three months ended June 30, 2011 versus the prior year three month period decreased significantly to 33% from 93%. This was due to the fact that a large portion (92%) of the Systems segment service revenue in the three months ended June 30, 2010, was royalty revenue which carries a 100% gross margin, whereas the current year quarter Systems segment service revenue was from services such as repairs and maintenance which are more labor intensive professional services. The gross margin for product revenue in the Systems segment increased by 45 percentage points, which was due to the very low volume of product sales for the quarter ended June 30, 2010, with approximately the same level of fixed expenses in cost of sales which resulted in the low margin in the prior year quarter.

In the Service and System Integration segment, the improvement in the gross profit margin from 13% to 17% was due to a better mix of sales of higher margin networking products, higher value services being delivered and smaller deal size in the current year three month period ended June 30 versus the prior year.

Engineering and Development Expenses

The following table details our engineering and development expenses by operating segment for the three months ended June 30, 2011 and 2010:

	For the Three Months Ended					
	June 30, 2011	% of Total	June 30, 2010	% of Total	$ Decrease	% Decrease
	(Dollar amounts in thousands)					
By Operating Segment:						
Systems	$ 442	100 %	$ 498	100 %	$ (56)	(11)%
Service and System Integration	—	— %	—	— %	—	— %
Total	$ 442	100 %	$ 498	100 %	$ (56)	(11)%

The decrease in engineering and development expenses displayed above was due to lower engineering consulting expenditures in connection with the development of the next generation of MultiComputer products in the Systems segment.

Selling, General and Administrative

The following table details our selling, general and administrative ("SG&A") expense by operating segment for the three months ended June 30, 2011 and 2010:

	For the Three Months Ended					
	June 30, 2011	% of Total	June 30, 2010	% of Total	$ Increase (Decrease)	% Increase (Decrease)
	(Dollar amounts in thousands)					
By Operating Segment:						
Systems	$ 1,122	33 %	$ 1,073	29 %	$ 49	5 %
Service and System Integration	2,328	67 %	2,667	71 %	(339)	(13)%
Total	$ 3,450	100 %	$ 3,740	100 %	$ (290)	(8)%

The increase in SG&A expense in the Systems segment was primarily the result of an increase in legal expenses of approximately $0.1 million in connection with a government investigation of a third party. The Company received a subpoena to produce documents in connection with this matter.

The decrease in SG&A expenses in the Service and System Integration segment was primarily in the US division of the segment and was due to a decrease in commission expense of approximately $0.2 million because of lower gross profit, and a decrease in sales salaries and wages of approximately $0.1 million from lower headcount.

Other Income/Expenses

The following table details our other income/expenses for the three months ended June 30, 2011 and 2010:

	For the Three Months Ended		
	June 30, 2011	June 30, 2010	Increase (Decrease)
	(Amounts in thousands)		
Interest expense	$(21)	$(22)	$1
Interest income	11	20	(9)
Foreign exchange gain (loss)	(9)	(6)	(3)
Other income (expense), net	(14)	(2)	(12)
Total other expense, net	$(33)	$(10)	$(23)

Other income (expense), net, for the three month periods ended June 30, 2011 and 2010 was not significant nor was the change from the prior year three month period to that of the current year.

Income Taxes

Income Tax Provision

The Company recorded an income tax benefit of approximately $0.1 million for the quarter ended June 30, 2011 reflecting an effective income tax rate of 30% compared to an income tax provision of approximately $0.03 million for the quarter ended June 30, 2010, which reflected an effective income tax rate of 4%. For the nine months ended June 30, 2011, the Company recorded an income tax provision of approximately $0.3 million reflecting an effective income tax rate of 38% compared to an income tax provision of approximately $0.2 million for the nine months ended June 30, 2010, which reflected an effective income tax rate of 16%. The effective tax rates for the three and nine months ended June 30, 2010, were impacted favorably by the de-recognition of a liability of approximately $302 thousand for an unrecognized tax benefit, which the company had recorded pursuant to accounting principles regarding uncertain tax positions. This de-recognition was the result of the lapsing of the statute of limitations and the completion of an audit by the Internal Revenue Service, which did not result in any adjustment related to the uncertain tax position. The Company recorded an additional liability for an uncertain tax position related to research and development credits which did not meet the more-likely-than-not threshold for recognition of approximately $0.3 million during the three months ended June 30, 2011.

In assessing the realizability of deferred tax assets, we considered our taxable future earnings and the expected timing of the reversal of temporary differences. Accordingly, we have recorded a valuation allowance which reduces the gross deferred tax asset to an amount that we believe will more likely than not be realized. Our inability to project future profitability beyond fiscal year 2011 in the U.S. and cumulative losses incurred in recent years in the United Kingdom represent sufficient negative evidence to record a valuation allowance against certain deferred tax assets. We maintained a substantial valuation allowance against our United Kingdom deferred tax assets as we have experienced cumulative losses and do not have any indication that the operation will be profitable in the future to an extent that will allow us to utilize much of our net operating loss carryforwards. To the extent that actual experience deviates from our assumptions, our projections would be affected and hence our assessment of realizability of our deferred tax assets may change.

Liquidity and Capital Resources

Our primary source of liquidity is our cash and cash equivalents, which increased by approximately $2.0 million to $17.5 million as of June 30, 2011 from $15.5 million as of September 30, 2010. At June 30, 2011, cash equivalents consisted of money market funds which totaled $3.5 million.

Significant sources of cash for the nine months ended June 30, 2011 were net income of approximately $0.5 million, a decrease in accounts receivable of approximately $2.2 million, decrease in refundable income taxes of approximately $0.4 million, decrease in inventories of approximately $0.3 million, depreciation and amortization of approximately $0.4 million and the effects foreign currency translation of approximately $0.3 million. The significant uses of cash during the period were the repurchase of CSPI common stock of approximately $0.4 million, decrease in accounts payable and accrued expenses of approximately $1.3 million, increase in other assets of approximately $0.4 million and the purchase of property, plant and equipment for approximately $0.2 million.

As of June 30, 2011 and September 30, 2010, cash held by our foreign subsidiaries located in Germany and the United Kingdom totaled approximately $8.6 million and $6.0 million, respectively. This cash is included in our total cash and cash equivalents reported above. We consider this cash to be permanently reinvested into these foreign locations because repatriating it would result in unfavorable tax consequences. Consequently, it is not available for activities that would require it to be repatriated to the U.S.

If cash generated from operations is insufficient to satisfy working capital requirements, we may need to access funds through bank loans or other means. There is no assurance that we will be able to raise any such capital on terms acceptable to us, on a timely basis or at all. If we are unable to secure additional financing, we may not be able to complete development or enhancement of products, take advantage of future opportunities, respond to competition or continue to effectively operate our business.

Based on our current plans and business conditions, management believes that the Company's available cash and cash equivalents, the cash generated from operations and availability on our lines of credit will be sufficient to provide for the Company's working capital and capital expenditure requirements for the foreseeable future.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2011. Our chief executive officer, our chief financial officer, and other members of our senior management team supervised and participated in this evaluation. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company’s management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2011, the Company’s chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Controls over Financial Reporting

As we have previously reported, management assessed the effectiveness of the Company’s internal control over financial reporting as of September 30, 2011, and identified material weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected in a timely basis.

The material weaknesses were in connection with our determination that we did not sufficiently assess and apply certain aspects of ASC 605-45-45 Principal Agent Considerations, to the particular facts and circumstances of many of our revenue arrangements. We therefore determined that this failure to accurately assess an accounting principle amounted to a material weakness in our controls over financial reporting. As a result, we had concluded that the Company’s internal control over financial reporting was not effective as of September 30, 2011 and 2010.

During the quarter ended December 31, 2011, in response to the identification of the material weakness referred to above, management assessed various alternatives to modify our existing internal control processes and systems to remediate this material weakness. Currently, we have devised a method whereby we are able to utilize data-mining techniques to identify the applicable transactions, and then apply the appropriate accounting treatment to them. We have incorporated this process into our existing internal control structure to insure that we apply the appropriate accounting for these transactions beginning with the quarter ended December 31, 2011.

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Share Repurchase Plans. The following table provides information with respect to shares of our common stock that we repurchased during the nine months ended June 30, 2011:

	Issuer Purchases of Equity Securities			
Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans
October 1-31, 2010	7,940	$4.53	7,940	
November 1-30, 2010	9,500	$4.52	9,500	
December 1-31, 2010	28,221	$3.98	28,221	
January 1-31, 2011	44,393	$3.98	44,393	
February 1-28, 2011	3,543	$4.01	3,543	
March 1-31, 2011	3,000	$4.20	3,000	
April 1-30, 2011	—	$—	—	
May 1-31, 2011	4,145	$4.47	4,145	
June 1-30, 2011	8,692	$4.36	8,692	
Total	109,434	$4.12	109,434	285,122

(1) All shares were purchased under publicly announced plans. For additional information about these publicly announced plans, please refer to Note 12 of our audited financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2010. On February 8, 2011, the Board of Directors authorized the Company to purchase up to 250 thousand additional shares of the Company's outstanding common stock at market price.

Item 6. Exhibits

Number	Description
3.1	Articles of Organization and amendments thereto (incorporated by reference to Exhibit 3.1 to our Form 10-K for the year ended September 30, 2007)
3.2	By-Laws, as amended (incorporated by reference to Exhibit 3.2 to our Form 10-K for the year ended September 30, 2007)
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	Interactive Data Files regarding (a) our Consolidated Balance Sheets as of June 30, 2011 and September 30, 2010, (b) our Consolidated Statements of Operations for the Three and Nine Months Ended June 30, 2011 and 2010, (c) our Consolidated Statement of Shareholders' Equity for the Nine Months Ended June 30, 2011, (d) our Consolidated Statements of Cash Flows for the Nine Months Ended June 30, 2011 and 2010 and (e) the Notes to such Consolidated Financial Statements.

*Filed Herewith

SIGNATURES

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

	CSP INC.	
Date: March 1, 2012	By:	/s/Alexander R. Lupinetti Alexander R. Lupinetti Chief Executive Officer, President and Chairman
Date: March 1, 2012	By:	/s/Gary W. Levine Gary W. Levine Chief Financial Officer

30

Exhibit Index

Number	Description
3.1	Articles of Organization and amendments thereto (incorporated by reference to Exhibit 3.1 to our Form 10-K for the year ended September 30, 2007)
3.2	By-Laws, as amended (incorporated by reference to Exhibit 3.2 to our Form 10-K for the year ended September 30, 2007)
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	Interactive Data Files regarding (a) our Consolidated Balance Sheets as of June 30, 2011 and September 30, 2010, (b) our Consolidated Statements of Operations for the Three and Nine Months Ended June 30, 2011 and 2010, (c) our Consolidated Statement of Shareholders' Equity for the Nine Months Ended June 30, 2011, (d) our Consolidated Statements of Cash Flows for the Nine Months Ended June 30, 2011 and 2010 and (e) the Notes to such Consolidated Financial Statements.

*Filed Herewith

31