

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)

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

For the Quarterly Period Ended March 31, 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
(State of incorporation)

04-2441294
(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 No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

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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. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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

As of May 2, 2011, the registrant had 3,486,510 shares of common stock issued and outstanding.

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the Securities and Exchange Commission (SEC) on May 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 six-month periods ended March 31, 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 May 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 May 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 May 9, 2011.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | March 31, 2011 (Unaudited) | September 30, 2010 |
|--|----------------------------------|-----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$14,372 | \$15,531 |
| Accounts receivable, net of allowances of \$322 and \$288 | 12,610 | 12,190 |
| Inventories | 8,314 | 5,862 |
| Refundable income taxes | 228 | 721 |
| Deferred income taxes | 126 | 124 |
| Other current assets | 2,186 | 1,523 |
| Total current assets | 37,836 | 35,951 |
| Property, equipment and improvements, net | 920 | 873 |
| Other assets: | | |
| Intangibles, net | 631 | 687 |
| Deferred income taxes | 903 | 880 |
| Cash surrender value of life insurance | 2,867 | 2,689 |
| Other assets | 250 | 299 |
| Total other assets | 4,651 | 4,555 |
| Total assets | \$43,407 | \$41,379 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$10,577 | \$10,049 |
| Deferred revenue | 3,678 | 3,078 |
| Pension and retirement plans | 454 | 441 |
| Income taxes payable | 508 | 380 |
| Total current liabilities | 15,217 | 13,948 |
| Pension and retirement plans | 9,199 | 8,928 |
| Capital lease obligation | 24 | 24 |
| Total liabilities | 24,440 | 22,900 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Common stock, \$.01 par; authorized, 7,500 shares; issued and outstanding 3,485 and 3,520 shares, respectively | 35 | 35 |
| Additional paid-in capital | 11,052 | 11,280 |
| Retained earnings | 13,191 | 12,516 |
| Accumulated other comprehensive loss | (5,311) | (5,352) |

| | | |
|--|----------|----------|
| Total shareholders' equity | 18,967 | 18,479 |
| Total liabilities and shareholders' equity | \$43,407 | \$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 six months ended | |
|---|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| | March 31, 2011 (Restated) | March 31, 2010 (Restated) | March 31, 2011 (Restated) | March 31, 2010 (Restated) |
| Sales: | | | | |
| Product | \$12,767 | \$18,283 | \$28,058 | \$31,781 |
| Services | 4,862 | 4,568 | 10,198 | 8,878 |
| Total sales | 17,629 | 22,851 | 38,256 | 40,659 |
| Cost of sales: | | | | |
| Product | 9,961 | 13,986 | 23,376 | 26,028 |
| Services | 3,419 | 3,375 | 6,103 | 6,837 |
| Total cost of sales | 13,380 | 17,361 | 29,479 | 32,865 |
| Gross profit | 4,249 | 5,490 | 8,777 | 7,794 |
| Operating expenses: | | | | |
| Engineering and development | 508 | 430 | 1,018 | 902 |
| Selling, general and administrative | 3,310 | 3,411 | 6,685 | 6,468 |
| Total operating expenses | 3,818 | 3,841 | 7,703 | 7,370 |
| Operating income | 431 | 1,649 | 1,074 | 424 |
| Other income (expense): | | | | |
| Foreign exchange gain (loss) | 12 | (3) | 8 | (10) |
| Other income (expense), net | (13) | (13) | (30) | (26) |
| Total other income (expense), net | (1) | (16) | (22) | (36) |
| Income before income taxes | 430 | 1,633 | 1,052 | 388 |
| Income tax expense | 144 | 644 | 377 | 141 |
| Net income | \$286 | \$989 | \$675 | \$247 |
| Net income attributable to common shareholders | \$282 | \$979 | \$666 | \$245 |
| Net income per share – basic | \$0.08 | \$0.28 | \$0.19 | \$0.07 |
| Weighted average shares outstanding – basic | 3,437 | 3,552 | 3,455 | 3,544 |
| Net income per share – diluted | \$0.08 | \$0.27 | \$0.19 | \$0.07 |
| Weighted average shares outstanding – diluted | 3,471 | 3,581 | 3,491 | 3,573 |

See accompanying notes to unaudited consolidated financial statements.

CSP INC. AND SUBSIDIARIES
 UNAUDITED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
 For the Six Months Ended March 31, 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 | — | — | — | 675 | — | 675 | \$ 675 |
| Other comprehensive loss: | | | | | | | |
| Effect of foreign currency translation | — | — | — | — | 41 | 41 | 41 |
| Total comprehensive income | | | | | | | \$ 716 |
| Stock-based compensation | — | — | 46 | — | — | 46 | |
| Issuance of shares under employee stock purchase plan | 25 | — | 75 | — | — | 75 | |
| Restricted stock shares issued | 37 | 1 | 45 | — | — | 46 | |
| Purchase of common stock | (97) | (1) | (394) | — | — | (395) | |
| Balance as of March 31, 2011 | 3,485 | \$35 | \$11,052 | \$13,191 | \$ (5,311) | \$ 18,967 | |

See accompanying notes to unaudited consolidated financial statements.

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

| | For the six months ended | |
|--|--------------------------|-------------------|
| | March 31, 2011 | March 31, 2010 |
| Cash flows from operating activities: | | |
| Net income | \$ 675 | \$ 247 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 182 | 200 |
| Amortization of intangibles | 56 | 57 |
| Loss on disposal of fixed assets, net | 3 | 1 |
| Foreign exchange loss (gain) | (8) | 10 |
| Non-cash changes in accounts receivable | 34 | (21) |
| Stock-based compensation expense on stock options and restricted stock awards | 92 | 107 |
| Deferred income taxes | - | (60) |
| Increase in cash surrender value of life insurance | (41) | (41) |
| Changes in operating assets and liabilities: | | |
| Increase in accounts receivable | (202) | (7,718) |
| Increase in inventories | (2,442) | (705) |
| (Increase) decrease in refundable income taxes | 502 | (68) |
| (Increase) decrease in other current assets | (601) | 175 |
| Decrease in other assets | 52 | 5 |
| Increase in accounts payable and accrued expenses | 386 | 1,445 |
| Increase in deferred revenue | 509 | 358 |
| Increase in pension and retirement plans liability | 83 | 110 |
| Increase in income taxes payable | 127 | 145 |
| Decrease in other long term liabilities | - | (14) |
| Net cash used in operating activities | (593) | (5,767) |
| Cash flows from investing activities: | | |
| Life insurance premiums paid | (137) | (64) |
| Purchases of property, equipment and improvements | (211) | (172) |
| Net cash used in investing activities | (348) | (236) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of shares under employee stock purchase plan | 75 | 61 |
| Purchase of common stock | (395) | (40) |
| Net cash provided by (used in) financing activities | (320) | 21 |
| Effects of exchange rate on cash | 102 | (636) |
| Net decrease in cash and cash equivalents | (1,159) | (6,618) |
| Cash and cash equivalents, beginning of period | 15,531 | 18,904 |

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| | | |
|--|-----------|-----------|
| Cash and cash equivalents, end of period | \$ 14,372 | \$ 12,286 |
| Supplementary cash flow information: | | |
| Cash paid for income taxes | \$ 251 | \$ 146 |
| 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 SIX MONTHS ENDED MARCH 31, 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 six-month periods ended March 31, 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 six-month periods ended March 31, 2011 or 2010.

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

| | Three months ended March 31, 2011 (unaudited) | | | Three months ended March 31, 2010 (unaudited) | | |
|--|--|------------------------|-----------|--|------------------------|-----------|
| | As reported | Restatement Adjustment | Restated | As reported | Restatement Adjustment | Restated |
| (Amounts in thousands except for per share data) | | | | | | |
| Sales: | | | | | | |
| Product | \$ 15,726 | \$ (2,959) | \$ 12,767 | \$ 20,551 | \$ (2,268) | \$ 18,283 |
| Services | 3,483 | 1,379 | 4,862 | 3,370 | 1,198 | 4,568 |

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| | | | | | | |
|---|--------|----------|--------|--------|----------|--------|
| Total sales | 19,209 | (1,580) | 17,629 | 23,921 | (1,070) | 22,851 |
| Cost of sales: | | | | | | |
| Product | 12,457 | (2,496) | 9,961 | 15,960 | (1,974) | 13,986 |
| Services | 2,503 | 916 | 3,419 | 2,471 | 904 | 3,375 |
| Total cost of sales | 14,960 | (1,580) | 13,380 | 18,431 | (1,070) | 17,361 |
| Gross profit | 4,249 | - | 4,249 | 5,490 | - | 5,490 |
| Operating expenses | | | | | | |
| Operating expenses | 3,818 | - | 3,818 | 3,841 | - | 3,841 |
| Operating income | 431 | - | 431 | 1,649 | - | 1,649 |
| Other income (expense), net | (1) | - | (1) | (16) | - | (16) |
| Income before income taxes | 430 | - | 430 | 1,633 | - | 1,633 |
| Income tax expense | 144 | - | 144 | 644 | - | 644 |
| Net income | \$286 | - | \$286 | \$989 | - | \$989 |
| Net income per share – basic | | | | | | |
| Net income per share – basic | \$0.08 | - | \$0.08 | \$0.28 | - | \$0.28 |
| Weighted average shares outstanding – basic | | | | | | |
| Weighted average shares outstanding – basic | 3,437 | - | 3,437 | 3,552 | - | 3,552 |
| Net income per share – diluted | | | | | | |
| Net income per share – diluted | \$0.08 | - | \$0.08 | \$0.27 | - | \$0.27 |
| Weighted average shares outstanding – diluted | | | | | | |
| Weighted average shares outstanding – diluted | 3,471 | - | 3,471 | 3,581 | - | 3,581 |

| | Six months ended March 31, 2011 (unaudited) | | | Six months ended March 31, 2010 (unaudited) | | |
|--|--|---------------------------|----------|--|---------------------------|----------|
| | As reported | Restatement Adjustment | Restated | As reported | Restatement Adjustment | Restated |
| (Amounts in thousands except for per share data) | | | | | | |
| Sales: | | | | | | |
| Product | \$33,150 | \$ (5,092) | \$28,058 | \$35,796 | \$ (4,015) | \$31,781 |
| Services | 8,169 | 2,029 | 10,198 | 6,786 | 2,092 | 8,878 |
| Total sales | 41,319 | (3,063) | 38,256 | 42,582 | (1,923) | 40,659 |
| Cost of sales: | | | | | | |
| Product | 27,750 | (4,374) | 23,376 | 29,576 | (3,548) | 26,028 |
| Services | 4,792 | 1,311 | 6,103 | 5,212 | 1,625 | 6,837 |
| Total cost of sales | 32,542 | (3,063) | 29,479 | 34,788 | (1,923) | 32,865 |
| Gross profit | 8,777 | - | 8,777 | 7,794 | - | 7,794 |
| Operating expenses | 7,703 | - | 7,703 | 7,370 | - | 7,370 |
| Operating income | 1,074 | - | 1,074 | 424 | - | 424 |
| Other income (expense), net | (22) | - | (22) | (36) | - | (36) |
| Income before income taxes | 1,052 | - | 1,052 | 388 | - | 388 |
| Income tax expense | 377 | - | 377 | 141 | - | 141 |
| Net income | \$675 | - | \$675 | \$247 | - | \$247 |
| Net income per share – basic | \$0.19 | - | \$0.19 | \$0.07 | - | \$0.07 |
| Weighted average shares outstanding – basic | 3,455 | - | 3,455 | 3,544 | - | 3,544 |
| Net income per share – diluted | \$0.19 | - | \$0.19 | \$0.07 | - | \$0.07 |
| Weighted average shares outstanding – diluted | 3,491 | - | 3,491 | 3,573 | - | 3,573 |

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 Six Months Ended | |
|--|---|-------------------|--------------------------|-------------------|
| | March 31, 2011 | March 31, 2010 | March 31, 2011 | March 31, 2010 |
| | (Amounts in thousands, except per share data) | | | |
| Net income | \$286 | \$989 | \$ 675 | \$ 247 |
| Less: Net income attributable to nonvested common stock | 4 | 10 | 9 | 2 |
| Net income attributable to common stockholders | 282 | 979 | 666 | 245 |
| Weighted average total shares outstanding – basic | 3,492 | 3,591 | 3,504 | 3,577 |
| Less: weighted average non-vested shares outstanding | 55 | 39 | 49 | 33 |
| Weighted average number of common shares outstanding – basic | 3,437 | 3,552 | 3,455 | 3,544 |
| Potential common shares from non-vested stock awards and the assumed exercise of stock options | 34 | 29 | 36 | 29 |
| Weighted average common shares outstanding – diluted | 3,471 | 3,581 | 3,491 | 3,573 |
| Net income per share – basic | \$0.08 | \$0.28 | \$ 0.19 | \$ 0.07 |
| Net income per share – diluted | \$0.08 | \$0.27 | \$ 0.19 | \$ 0.07 |

All anti-dilutive securities, including stock options, are excluded from the diluted income per share computation. For the three and six months ended March 31, 2011, 208,000 and 211,000 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:

| | March 31, 2011 | September 30, 2010 |
|-----------------|------------------------|-----------------------|
| | (Amounts in thousands) | |
| Raw materials | \$1,162 | \$1,029 |
| Work-in-process | 808 | 439 |
| Finished goods | 6,344 | 4,394 |
| Total | \$8,314 | \$5,862 |

Finished goods includes inventory that has been shipped, but for which all revenue recognition criteria has not been met of approximately \$3.6 million and \$2.4 million as of March 31, 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 March 31, 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 Six Months Ended | |
|--|----------------------------|-------------------|--------------------------|-------------------|
| | March 31, 2011 | March 31, 2010 | March 31, 2011 | March 31, 2010 |
| | (Amounts in thousands) | | | |
| Net income | \$286 | \$989 | \$675 | \$247 |
| Effect of foreign currency translation | 102 | (297) | 41 | (356) |
| Minimum pension liability | — | — | — | — |
| Comprehensive income (loss) | \$388 | \$692 | \$716 | \$(109) |

The components of Accumulated Other Comprehensive Loss are as follows:

| | March 31, 2011 | September 30, 2010 |
|---|-------------------|-----------------------|
| (Amounts in thousands) | | |
| Cumulative effect of foreign currency translation | \$ (2,092) | \$ (2,133) |
| Additional minimum pension liability | (3,219) | (3,219) |
| Accumulated Other Comprehensive Loss | \$ (5,311) | \$ (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 six months ended March 31, 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 March 31 | | | | | |
|--------------------------------|-------------------------------------|--------------|--------|---------|--------------|--------|
| | Foreign | 2011 U.S. | Total | Foreign | 2010 U.S. | Total |
| (Amounts in thousands) | | | | | | |
| Pension: | | | | | | |
| Service cost | \$ 18 | \$ 2 | \$ 20 | \$ 15 | \$ 2 | \$ 17 |
| Interest cost | 172 | 25 | 197 | 168 | 30 | 198 |
| Expected return on plan assets | (126) | — | (126) | (111) | — | (111) |
| Amortization of: | | | | | | |
| Prior service gain | — | — | — | — | — | — |
| Amortization of net gain | 17 | 8 | 25 | 11 | 7 | 18 |
| Net periodic benefit cost | \$ 81 | \$ 35 | \$ 116 | \$ 83 | \$ 39 | \$ 122 |
| 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 Six Months Ended March 31

2011

2010

| | Foreign | U.S. | Total | Foreign | U.S. | Total |
|--|---------|------|-------|---------|------|-------|
|--|---------|------|-------|---------|------|-------|

(Amounts in thousands)

Pension:

| | | | | | | |
|--------------------------------|--------|------|--------|--------|------|--------|
| Service cost | \$36 | \$4 | \$40 | \$31 | \$4 | \$35 |
| Interest cost | 342 | 50 | 392 | 345 | 58 | 403 |
| Expected return on plan assets | (251) | — | (251) | (227) | — | (227) |
| Amortization of: | | | | | | |
| Prior service gain | — | — | — | — | — | — |
| Amortization of net gain | 34 | 16 | 50 | 22 | 15 | 37 |
| Net periodic benefit cost | \$161 | \$70 | \$231 | \$171 | \$77 | \$248 |
| Post Retirement: | | | | | | |
| Service cost | \$— | \$10 | \$10 | \$— | \$9 | \$9 |
| Interest cost | — | 34 | 34 | — | 34 | 34 |
| Amortization of net gain | — | 24 | 24 | — | 33 | 33 |
| Net periodic benefit cost | \$— | \$68 | \$68 | \$— | \$76 | \$76 |

8. Segment Information

The following table presents certain operating segment information.

| Three Months Ended March 31, | Systems Segment | Service and System Integration Segment | | | | Consolidated Total |
|-----------------------------------|--------------------|--|-------------------|----------|----------|-----------------------|
| | | Germany | United Kingdom | U.S. | Total | |
| (Amounts in thousands) | | | | | | |
| 2011 | | | | | | |
| Sales: | | | | | | |
| Product | \$1,931 | \$2,785 | \$61 | \$7,990 | \$10,836 | \$ 12,767 |
| Service | 368 | 3,401 | 364 | 729 | 4,494 | 4,862 |
| Total sales | 2,299 | 6,186 | 425 | 8,719 | 15,330 | 17,629 |
| Profit from operations | 72 | 39 | 15 | 305 | 359 | 431 |
| Assets | 13,335 | 13,150 | 3,847 | 13,075 | 30,072 | 43,407 |
| Capital expenditures | 77 | 11 | 1 | 11 | 23 | 100 |
| Depreciation and amortization | 21 | 45 | 7 | 45 | 97 | 118 |
| 2010 | | | | | | |
| Sales: | | | | | | |
| Product | \$4,136 | \$2,407 | \$25 | \$11,715 | \$14,147 | \$ 18,283 |
| Service | 432 | 3,056 | 460 | 620 | 4,136 | 4,568 |
| Total sales | 4,568 | 5,463 | 485 | 12,335 | 18,283 | 22,851 |
| Profit from operations | 1,431 | 47 | 18 | 153 | 218 | 1,649 |
| Assets | 13,926 | 10,340 | 4,001 | 13,475 | 27,816 | 41,742 |
| Capital expenditures | 5 | 103 | 4 | 10 | 117 | 122 |
| Depreciation and amortization | 30 | 44 | 6 | 50 | 100 | 130 |
| Six Months Ended March 31, | | | | | | |
| (Amounts in thousands) | | | | | | |
| 2011 | | | | | | |
| Sales: | | | | | | |
| Product | \$2,240 | \$6,251 | \$72 | \$19,495 | \$25,818 | \$ 28,058 |
| Service | 1,884 | 6,022 | 696 | 1,596 | 8,314 | 10,198 |
| Total sales | 4,124 | 12,273 | 768 | 21,091 | 34,132 | 38,256 |
| Profit (loss) from operations | 186 | 151 | (15) | 752 | 888 | 1,074 |
| Assets | 13,335 | 13,150 | 3,847 | 13,075 | 30,072 | 43,407 |
| Capital expenditures | 133 | 47 | 3 | 28 | 78 | 211 |
| Depreciation and amortization | 41 | 92 | 14 | 91 | 197 | 238 |
| 2010 | | | | | | |
| Sales: | | | | | | |
| Product | \$4,529 | \$5,762 | \$51 | \$21,439 | \$27,252 | \$ 31,781 |

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| | | | | | | |
|-------------------------------|--------|--------|-------|--------|--------|--------|
| Service | 493 | 6,314 | 845 | 1,226 | 8,385 | 8,878 |
| Total sales | 5,022 | 12,076 | 896 | 22,665 | 35,637 | 40,659 |
| Profit from operations | 136 | 48 | 14 | 226 | 288 | 424 |
| Assets | 13,926 | 10,340 | 4,001 | 13,475 | 27,816 | 41,742 |
| Capital expenditures | 15 | 135 | 9 | 13 | 157 | 172 |
| Depreciation and amortization | 64 | 79 | 12 | 102 | 193 | 257 |

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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 six month periods ended March 31, 2011 and 2010.

| | For the Three Months Ended | | | For the Six Months Ended | | | | |
|----------|------------------------------|------------------|-------------------|--------------------------|-------------------|------------------|-------------------|------------------|
| | March 31, 2011 | % of Revenues | March 31, 2010 | % of Revenues | March 31, 2011 | % of Revenues | March 31, 2010 | % of Revenues |
| | Amount | | Amount | | Amount | | Amount | |
| | (Dollar amounts in millions) | | | | | | | |
| Vodafone | \$3.2 | 18 % | \$2.3 | 10 % | \$4.8 | 13 % | \$4.9 | 12 % |
| Verio | \$1.8 | 10 % | \$5.8 | 25 % | \$4.3 | 11 % | \$7.8 | 19 % |
| Raytheon | \$0.1 | % | \$3.7 | 16 % | \$0.1 | % | \$3.8 | 9 % |

9. Fair Value Measures

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

| | Fair Value Measurements Using | | | Total Balance | Gain or (loss) |
|-------------------------------------|---|--|--|------------------|----------------------|
| | Active Markets for Identical Instruments (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | | |
| | As of March 31, 2011 (Amounts in thousands) | | | | |
| Assets: | | | | | |
| Money Market funds | \$3,488 | \$— | \$ — | \$3,488 | \$— |
| Total assets measured at fair value | \$3,488 | \$— | \$ — | \$3,488 | \$— |

| | 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 March 31, 2011. The Company had no assets or liabilities measured at fair value on a non recurring basis as of March 31, 2011.

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 97 thousand shares of its outstanding common stock during the six months ended March 31, 2011. As of March 31, 2011, approximately 298 thousand shares remain authorized for repurchase under the Company’s stock repurchase program.

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 six months ended March 31, 2011 Results of Operations

Highlights include:

Revenue decreased by approximately \$2.4 million, or 6%, to \$38.3 million for the six months ended March 31, 2011 versus \$40.7 million for the six months ended March 31, 2010.

For the six months ended March 31, 2011, operating income was approximately \$1.1 million versus operating income of approximately \$0.4 million for the six months ended March 31, 2010.

For the six months ended March 31, 2011, net income was approximately \$0.7 million versus net income of approximately \$0.2 million for the six months ended March 31, 2010.

The following table details our results of operations in dollars and as a percentage of sales for the six months ended March 31, 2011 and 2010:

| March 31, 2011 | % of sales | March 31, 2010 | % of sales |
|-------------------|---------------|-------------------|---------------|
|-------------------|---------------|-------------------|---------------|

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(Dollar amounts in thousands)

| | | | | | | |
|-------------------------------------|----------|-----|---|----------|-----|---|
| Sales | \$38,256 | 100 | % | \$40,659 | 100 | % |
| Costs and expenses: | | | | | | |
| Cost of sales | 29,479 | 77 | % | 32,865 | 81 | % |
| Engineering and development | 1,018 | 3 | % | 902 | 2 | % |
| Selling, general and administrative | 6,685 | 17 | % | 6,468 | 16 | % |
| Total costs and expenses | 37,182 | 97 | % | 40,235 | 99 | % |
| Operating income | 1,074 | 3 | % | 424 | 1 | % |
| Other expense | (22) | — | % | (36) | — | % |
| Income before income taxes | 1,052 | 3 | % | 388 | 1 | % |
| Income tax expense | 377 | 1 | % | 141 | — | % |
| Net income | \$675 | 2 | % | \$247 | 1 | % |

Sales

The following table details our sales by operating segment for the six months ended March 31, 2011 and 2010:

| | Systems | Service and System Integration | Total | % of Total | |
|--|---------|--------------------------------------|----------|---------------|---|
| (Dollar amounts in thousands) | | | | | |
| For the six months ended March 31, 2011: | | | | | |
| Product | \$2,240 | \$25,818 | \$28,058 | 73 | % |
| Services | 1,884 | 8,314 | 10,198 | 27 | % |
| Total | \$4,124 | \$34,132 | \$38,256 | 100 | % |
| % of Total | 11 | % 89 | % 100 | % | |

| | Systems | Service and System Integration | Total | % of Total | |
|--|---------|--------------------------------------|----------|---------------|---|
| For the six months ended March 31, 2010: | | | | | |
| Product | \$4,529 | \$27,252 | \$31,781 | 78 | % |
| Services | 493 | 8,385 | 8,878 | 22 | % |
| Total | \$5,022 | \$35,637 | \$40,659 | 100 | % |
| % of Total | 12 | % 88 | % 100 | % | |

| | Systems | Service and System Integration | Total | % increase (decrease) | |
|---------------------|-----------|--------------------------------------|-----------|-----------------------------|---|
| Increase (Decrease) | | | | | |
| Product | \$(2,289) | \$(1,434) | \$(3,723) | (12) | % |
| Services | 1,391 | (71) | 1,320 | 15 | % |
| Total | \$(898) | \$(1,505) | \$(2,403) | (6) | % |
| % decrease | (18)% | (4)% | (6)% | | |

As shown above, total revenues decreased by approximately \$2.4 million, or 6%, for the six months ended March 31, 2011 compared to the same period of fiscal year 2010. Revenues in the Systems segment decreased for the current year six month period versus the prior year six month period by approximately \$0.9 million, while revenues in the Service and System Integration segment decreased by approximately \$1.5 million, resulting in the overall decrease of approximately \$2.4 million.

Product revenues decreased by approximately \$3.7 million, or 12%, for the six months ended March 31, 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 \$2.3 million over the prior year six months, and a decrease in product revenues in the Service and System Integration segment of approximately \$1.4 million versus the prior year six months.

The decrease in product revenues in the Systems segment of \$2.3 million was due to having shipped a large order in the six month period ended March 31, 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 six month period ended March 31, 2011. Offsetting this decrease, we realized an increase of approximately \$1.1 million in product sales in the current year six month period versus the

prior year six month period, to an existing customer that supplies equipment to the Japanese defense market, and an increase in product sales to another customer that supplies a US defense program, of \$0.2 million.

The decrease in the Service and System Integration segment product sales of approximately \$1.4 million was due primarily to a decrease in product sales in the U.S. division of the segment of approximately \$1.9 million, offset by an increase in this segment's German division of approximately \$0.5 million.

In the US division, product sales to our two largest customers decreased by a total of approximately \$5.5 million, consisting of a decrease in sales to our largest customer of \$3.5 million and a decrease in product sales to our second largest customer of approximately \$2.0 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. These decreases were partially offset by an increase in product sales to a large number of smaller customers, with smaller deal sizes than the sales to those larger customers. In Germany, sales volume was up \$0.8 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 telecommunications customers. Offsetting these increases in sales was the unfavorable impact of currency fluctuation of approximately \$0.3 million affecting a stronger US dollar versus the Euro for the six months ended March 31, 2011 versus 2010.

As shown in the table above, service revenues increased by approximately \$1.3 million for the six months ended March 31, 2011 compared to the comparable six months of fiscal 2010. This increase in service revenue was substantially all within the Systems segment, reflecting an increase in royalty revenue from a large US defense program supplier which was approximately \$1.6 million for the six months ended March 31, 2011, versus approximately \$0.2 million for the six months ended March 31, 2010.

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

| | For the Six Months Ended | | | | | | \$ Increase (Decrease) | % Increase (Decrease) |
|----------|-------------------------------|-------|-------------------|-------|-------------|--------|---------------------------|--------------------------|
| | March 31, 2011 | % | March 31, 2010 | % | | | | |
| | (Dollar amounts in thousands) | | | | | | | |
| Americas | \$ 22,901 | 60 % | \$ 26,390 | 65 % | \$ (3,489) | (13 %) | | |
| Europe | 13,219 | 34 % | 13,308 | 33 % | (89) | (1 %) | | |
| Asia | 2,136 | 6 % | 961 | 2 % | 1,175 | 122 % | | |
| Totals | \$ 38,256 | 100 % | \$ 40,659 | 100 % | \$ (2,403) | (6 %) | | |

The decrease in Americas revenue for the six months ended March 31, 2011 versus the six months ended March 31, 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 \$2.1 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 \$1.4 million of the decrease.

The decrease in sales in Europe was primarily the result of the higher sales from the German division of the Service and System Integration segment which accounted for approximately \$0.2 million in increased sales to Europe, offset by decreases in sales to European customers of approximately \$0.2 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 six months ended March 31, 2011 and 2010:

| | Systems | Service and System Integration | Total | % of Total | |
|---|---------|--------------------------------------|-----------|---------------|----|
| (Dollar amounts in thousands) | | | | | |
| For the six months ended March 31, 2011: | | | | | |
| Product | \$995 | \$22,381 | \$23,376 | 79 | % |
| Services | 137 | 5,966 | 6,103 | 21 | % |
| Total | \$1,132 | \$28,347 | \$29,479 | 100 | % |
| % of Total | 4 | % 96 | % 100 | % | |
| % of Sales | 27 | % 83 | % 77 | % | |
| Gross Margins: | | | | | |
| Product | 56 | % 13 | % 17 | % | |
| Services | 93 | % 28 | % 40 | % | |
| Total | 73 | % 17 | % 23 | % | |
| For the six months ended March 31, 2010: | | | | | |
| Product | \$1,928 | \$24,100 | \$26,028 | 79 | % |
| Services | 150 | 6,687 | 6,837 | 21 | % |
| Total | \$2,078 | \$30,787 | \$32,865 | 100 | % |
| % of Total | 6 | % 94 | % 100 | % | |
| % of Sales | 41 | % 86 | % 81 | % | |
| Gross Margins: | | | | | |
| Product | 57 | % 12 | % 18 | % | |
| Services | 70 | % 20 | % 23 | % | |
| Total | 59 | % 14 | % 19 | % | |
| Decrease | | | | | |
| Product | \$(933) | \$(1,719) | \$(2,652) | (10) |)% |
| Services | (13) | (721) | (734) | (11) |)% |
| Total | \$(946) | \$(2,440) | \$(3,386) | (10) |)% |
| % Decrease | (46) |)% (8 |)% (10 |)% | |
| % of Sales | (14) |)% (3 |)% (4 |)% | |
| Gross Margins: | | | | | |
| Product | (1) |)% 1 |)% (1 |)% | |
| Services | 23 | % 8 | % 17 | % | |
| Total | 14 | % 3 | % 4 | % | |

Total cost of sales decreased by approximately \$3.4 million when comparing the six months ended March 31, 2011 versus the six months ended March 31, 2010. This decrease in cost of sales of 10% overall, compares with a decrease

in sales of 6%. The primary reason that cost of sales decreased by a proportionally higher amount than the decrease in sales was due in large part to the fact that royalty revenue in the Systems segment increased by approximately \$1.4 million. There is zero cost of sales on royalty revenue. In addition, the sales mix in the Service and System Integration segment resulted in a greater decrease in cost of sales versus the decrease in sales, as shown in the tables above and described in more detail below.

Cost of sales in the Systems segment decreased by approximately \$0.9 million, or 46%, when comparing the current year six month period versus the prior year six month period, while sales in the Systems segment also decreased by approximately \$0.9 million, or 18%. This proportionately larger decrease in cost of sales versus sales in the Systems segment was due to the fact that royalty revenue increased by \$1.4 million. Royalty revenue carries no cost of sales.

Cost of sales in the Service and System Integration segment decreased by approximately \$2.4 million, which is an 8% decrease when comparing the current year six months versus the prior year six months. While this trend is consistent with the decrease in sales over the prior year, the rate of decrease of 8% is greater than the rate of decrease in sales, which was 4%. 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 six months ended March 31, 2011 versus the prior year six month period, which resulted in lower cost as a percent of revenue.

The overall gross profit margin for the six months ended March 31, 2011 was 23% compared to 19% for the six months ended March 31, 2010. The gross margin in the Systems segment improved to 73% from 59% which was driven by the royalty revenue which is referred to above. The gross margin in the Service and System Integration segment increased from 14% for the six months ended March 31, 2010 to 17% for the six months ended March 31, 2011. This increase in gross profit margin for the Service and System Integration segment was 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 six months ended March 31, 2011 and 2010:

| | March 31, 2011 | For the Six Months Ended | | March 31, 2010 | For the Six Months Ended | | \$ Increase | % | |
|-----------------------------------|-------------------|--------------------------|----------|-------------------|--------------------------|----------|---------------|-----------|----------|
| | | % of Total | | | % of Total | | | Increase | Increase |
| (Dollar amounts in thousands) | | | | | | | | | |
| By Operating Segment: | | | | | | | | | |
| Systems | \$ 1,018 | 100 | % | \$ 902 | 100 | % | \$ 116 | 13 | % |
| Service and System Integration | — | — | % | — | — | % | — | — | % |
| Total | \$ 1,018 | 100 | % | \$ 902 | 100 | % | \$ 116 | 13 | % |

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 six months ended March 31, 2011 and 2010:

| | March 31, 2011 | For the Six Months Ended | | March 31, 2010 | For the Six Months Ended | | \$ Increase (Decrease) | % Increase (Decrease) | |
|-----------------------------------|-------------------|--------------------------|----------|-------------------|--------------------------|----------|---------------------------|--------------------------|------------|
| | | % of Total | | | % of Total | | | (Decrease) | (Decrease) |
| (Dollar amounts in thousands) | | | | | | | | | |
| By Operating Segment: | | | | | | | | | |
| Systems | \$1,788 | 27 | % | \$1,904 | 29 | % | \$ (116) | (6) | %) |
| Service and System Integration | 4,897 | 73 | % | 4,564 | 71 | % | 333 | 7 | % |
| Total | \$6,685 | 100 | % | \$6,468 | 100 | % | \$ 217 | 3 | % |

The decrease in selling, general and administrative (“SG&A”) expenses in the Systems segment displayed above was primarily due to lower commission expense resulting from lower sales in the segment. In the Service and System Integration segment, SG&A expenses increased due to sales department headcount increases and increased expenses associated with company marketing events and trade show attendance and participation.

Other Income/Expenses

The following table details our other income/expenses for the six months ended March 31, 2011 and 2010:

| | For the Six Months Ended | | Increase (Decrease) |
|------------------------------|--------------------------|-------------------|------------------------|
| | March 31, 2011 | March 31, 2010 | |
| | (Amounts in thousands) | | |
| Interest expense | \$ (43) | \$ (45) | \$ 2 |
| Interest income | 16 | 18 | (2) |
| Foreign exchange gain (loss) | 8 | (10) | 18 |
| Other income (expense), net | (3) | 1 | (4) |
| Total other expense, net | \$ (22) | \$ (36) | \$ 14 |

Other income (expense), net, for the six month periods ended March 31, 2011 and 2010 was not significant nor was the change from the prior year six month period to that of the current year.

Overview of the three months ended March 31, 2011 Results of Operations

Highlights include:

Revenue decreased by approximately \$5.2 million, or 23%, to \$17.6 million for the three months ended March 31, 2011 versus \$22.9 million for the three months ended March 31, 2010.

For the three months ended March 31, 2011, operating income was approximately \$0.4 million versus operating income of approximately \$1.6 million for the three months ended March 31, 2010, for a decrease of approximately \$1.2 million, or 74%.

For the three months ended March 31, 2011, net income was approximately \$0.3 million versus a net income of approximately \$1.0 million for the three months ended March 31, 2010, for a decrease of approximately \$0.7 million, or 71%.

The following table details our results of operations in dollars and as a percentage of sales for the three months ended March 31, 2011 and 2010:

| | March 31, 2011 | % of sales | March 31, 2010 | % of sales |
|-------------------------------------|-------------------------------|---------------|-------------------|---------------|
| | (Dollar amounts in thousands) | | | |
| Sales | \$17,629 | 100 | % \$22,851 | 100 % |
| Costs and expenses: | | | | |
| Cost of sales | 13,380 | 76 | % 17,361 | 76 % |
| Engineering and development | 508 | 3 | % 430 | 2 % |
| Selling, general and administrative | 3,310 | 19 | % 3,411 | 15 % |
| Total costs and expenses | 17,198 | 98 | % 21,202 | 93 % |
| Operating income | 431 | 2 | % 1,649 | 7 % |
| Other expense | (1) | — | % (16) | — % |
| Income before income taxes | 430 | 2 | % 1,633 | 7 % |

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| | | | | | | |
|--------------------|-------|---|---|-------|---|---|
| Income tax expense | 144 | 1 | % | 644 | 3 | % |
| Net income | \$286 | 1 | % | \$989 | 4 | % |

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Sales

The following table details our sales by operating segment for the three months ended March 31, 2011 and 2010:

| | Systems | Service and System Integration | Total | % of Total | |
|--|---------|--------------------------------------|----------|---------------|---|
| (Dollar amounts in thousands) | | | | | |
| For the three months ended March 31, 2011: | | | | | |
| Product | \$1,931 | \$10,836 | \$12,767 | 72 | % |
| Services | 368 | 4,494 | 4,862 | 28 | % |
| Total | \$2,299 | \$15,330 | \$17,629 | 100 | % |
| % of Total | 13 | % 87 | % 100 | % | |

| | Systems | Service and System Integration | Total | % of Total | |
|--|---------|--------------------------------------|----------|---------------|---|
| For the three months ended March 31, 2010: | | | | | |
| Product | \$4,136 | \$14,147 | \$18,283 | 80 | % |
| Services | 432 | 4,136 | 4,568 | 20 | % |
| Total | \$4,568 | \$18,283 | \$22,851 | 100 | % |
| % of Total | 20 | % 80 | % 100 | % | |

| | Systems | Service and System Integration | Total | % increase (decrease) | |
|---------------------|------------|--------------------------------------|------------|-----------------------------|---|
| Increase (Decrease) | | | | | |
| Product | \$(2,205) | \$(3,311) | \$(5,516) | (30) | % |
| Services | (64) | 358 | 294 | 6 | % |
| Total | \$(2,269) | \$(2,953) | \$(5,222) | (23) | % |
| % decrease | (50)% | (16)% | (23)% | | |

As shown above, total revenues decreased by approximately \$5.2 million, or 23%, for the three months ended March 31, 2011 compared to the three months ended March 31, 2010. Revenue in the Systems segment decreased for the current year three month period versus the prior year three month period by approximately \$2.3 million, while revenues in the Service and System Integration segment decreased by approximately \$3.0 million, resulting in the overall decrease of approximately \$5.2 million.

Product revenues decreased by approximately \$5.5 million, or 30% for the three months ended March 31, 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 Systems segment of approximately \$2.2 million and a decrease in product revenues in the Service and System Integration segment of approximately \$3.3 million for the three month period ended March 31, 2011 versus the three month period ended March 31, 2010.

The decrease in product revenues in the Systems segment of \$2.2 million was due to having shipped a large order in the three month period ended March 31, 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 our customer in fiscal 2007. No sales of this nature were made in the three month period ended March 31, 2011. Offsetting this decrease, we realized an increase of approximately \$1.3 million in product sales in the current year three month period versus the prior year

three month period, to an existing customer that supplies the Japanese defense market.

The decrease in the Service and System Integration segment product sales of approximately \$3.3 million was due primarily to a decrease in product sales in the U.S. division of the segment of \$3.6 million, offset by an increase in this segment's German division of approximately \$0.4 million.

In the US division, product sales to the two largest customers of the division, decreased by a total of approximately \$5.2 million, which was primarily the result of a decrease in sales to our largest customer of \$4.0 million and a decrease in sales to our second largest customer of approximately \$1.2 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. These decreases in sales to the division's two largest customers were offset by a net increases to all other customers of \$1.6 million. In Germany, the \$0.4 million increase was due primarily to increased sales to one of our largest telecommunications customers.

As shown in the table above, service revenues increased by approximately \$0.3 million, or 6%. The decrease shown above in service revenue in the Systems segment was due to services provided in the prior year in connection with the two large system sales referred to above, which did not recur in the three month period ended March 31, 2011. In the Service and System Integration segment, the \$0.3 million increase was from modest increases in service revenue in both the US and German divisions, of approximately \$0.1 million in each of those two divisions.

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 | | | | \$ Increase (Decrease) | % Increase (Decrease) |
|----------|-------------------------------|-------|-------------------|-------|---------------------------|--------------------------|
| | March 31, 2011 | % | March 31, 2010 | % | | |
| | (Dollar amounts in thousands) | | | | | |
| Americas | \$ 8,848 | 50 % | \$ 16,058 | 70 % | \$ (7,210) | (45)% |
| Europe | 6,784 | 39 % | 6,225 | 27 % | 559 | 9 % |
| Asia | 1,997 | 12 % | 568 | 3 % | 1,429 | 252 % |
| Totals | \$ 17,629 | 100 % | \$ 22,851 | 100 % | \$ (5,222) | (23)% |

The decrease in Americas revenue for the three months ended March 31, 2011 versus the three months ended March 31, 2010 was primarily the result of the decreases described above in the Systems segment regarding our prior year shipment into a large US defense program and the decreases in sales from the US division of our 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 described above 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 March 31, 2011 and 2010:

| | Systems | Service and System Integration | Total | % of Total | |
|--|---------|--------------------------------------|--------------|---------------|----|
| (Dollar amounts in thousands) | | | | | |
| For the three months ended March 31, 2011: | | | | | |
| Product | \$750 | \$9,211 | \$9,961 | 74 | % |
| Services | 63 | 3,356 | 3,419 | 26 | % |
| Total | \$813 | \$12,567 | \$13,380 | 100 | % |
| % of Total | 6 | % 95 | % 100 | % | |
| % of Sales | 35 | % 82 | % 76 | % | |
| Gross Margins: | | | | | |
| Product | 61 | % 15 | % 22 | % | |
| Services | 83 | % 25 | % 30 | % | |
| Total | 65 | % 18 | % 24 | % | |
| | Systems | Service and System Integration | Total | % of Total | |
| For the three months ended March 31, 2010: | | | | | |
| Product | \$1,584 | \$12,402 | \$13,986 | 80 | % |
| Services | 102 | 3,273 | 3,375 | 20 | % |
| Total | \$1,686 | \$15,675 | \$17,361 | 100 | % |
| % of Total | 10 | % 90 | % 100 | % | |
| % of Sales | 37 | % 86 | % 76 | % | |
| Gross Margins: | | | | | |
| Product | 62 | % 12 | % 24 | % | |
| Services | 76 | % 21 | % 26 | % | |
| Total | 63 | % 14 | % 24 | % | |
| Increase (decrease) | | | | | |
| Product | \$(834) | %) \$(3,191) | %) \$(4,025) | (29) |)% |
| Services | (39) | %) 83 | %) 44 | 1 | % |
| Total | \$(873) | %) \$(3,108) | %) \$(3,981) | (23) |)% |
| % Decrease | (52) |)% (20) |)% (23) |)% | |
| % of Sales | (2) |)% (3) |)% 1 | % | |
| Gross Margins: | | | | | |
| Product | (1) |)% 3 |)% (2) |)% | |
| Services | 7 | % 4 | % 4 | % | |
| Total | 2 | % 4 | % | % | |

Total cost of sales decreased by approximately \$4.0 million when comparing the three months ended March 31, 2011 versus the three months ended March 31, 2010. This decrease in cost of sales of 23% overall, is consistent with the decrease in sales of 23% overall, as described previously.

In analyzing the gross profit margins by segment, the service gross margin in the Systems segment for the three months ended March 31, 2011 versus the prior year three month period increased to 83% from 76%. This was due to the fact that a greater proportion of the service sales in this segment were from higher margin services such as repairs and maintenance versus the prior year, which contained more labor intensive professional services.

In the Service and System Integration segment, the improvement in the gross profit margin from 14% to 18% 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 March 31 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 March 31, 2011 and 2010:

| | March 31, 2011 | For the Three Months Ended | | March 31, 2010 | For the Three Months Ended | | \$ Increase | For the Three Months Ended | | |
|-----------------------------------|-------------------|----------------------------|----------|-------------------|----------------------------|----------|--------------|----------------------------|----------|--|
| | | % of Total | | | % of Total | | | % Increase | | |
| (Dollar amounts in thousands) | | | | | | | | | | |
| By Operating Segment: | | | | | | | | | | |
| Systems | \$ 508 | 100 | % | \$ 430 | 100 | % | \$ 78 | 18 | % | |
| Service and System Integration | — | — | % | — | — | % | — | — | % | |
| Total | \$ 508 | 100 | % | \$ 430 | 100 | % | \$ 78 | 18 | % | |

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 three months ended March 31, 2011 and 2010:

| | March 31, 2011 | For the Three Months Ended | | March 31, 2010 | For the Three Months Ended | | \$ Increase (Decrease) | For the Three Months Ended | | |
|-----------------------------------|-------------------|----------------------------|----------|-------------------|----------------------------|----------|---------------------------|----------------------------|----------|--|
| | | % of Total | | | % of Total | | | % Increase (Decrease) | | |
| (Dollar amounts in thousands) | | | | | | | | | | |
| By Operating Segment: | | | | | | | | | | |
| Systems | \$ 906 | 27 | % | \$ 1,020 | 30 | % | \$ (114) | (11) | % | |
| Service and System Integration | 2,404 | 73 | % | 2,391 | 70 | % | 13 | 1 | % | |
| Total | \$ 3,310 | 100 | % | \$ 3,411 | 100 | % | \$ (101) | (3) | % | |

The decrease in selling, general and administrative (“SG&A”) expenses displayed above was primarily due to lower commission expense in the Systems segment associated with the lower sales for the three month period ended March 31, 2011 versus the three month period ended March 31, 2010.

Other Income/Expenses

The following table details our other income/expenses for the three months ended March 31, 2011 and 2010:

| | For the Three Months Ended | | Increase (Decrease) |
|------------------------------|----------------------------|-------------------|------------------------|
| | March 31, 2011 | March 31, 2010 | |
| (Amounts in thousands) | | | |
| Interest expense | \$(21) | \$(22) | \$ 1 |
| Interest income | 9 | 7 | 2 |
| Foreign exchange gain (loss) | 12 | (3) | 15 |

| | | | | | |
|-----------------------------|------|---|-------|----|------|
| Other income (expense), net | (1 |) | 2 | (3 |) |
| Total other expense, net | \$(1 |) | \$(16 |) | \$15 |

Other income (expense), net, for the three month periods ended March 31, 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 provision of approximately \$0.1 million for the quarter ended March 31, 2011 reflecting an effective income tax rate of 33% compared to an income tax provision of approximately \$0.6 million for the quarter ended March 31, 2010, which reflected an effective income tax rate of 39%. For the six months ended March 31, 2011, the Company recorded an income tax provision of approximately \$0.4 million reflecting an effective income tax rate of 36% compared to an income tax provision of approximately \$0.1 million for the six months ended March 31, 2010, which also reflected an effective income tax rate of 36%.

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 decreased by approximately \$1.1 million to \$14.4 million as of March 31, 2011 from \$15.5 million as of September 30, 2010. At March 31, 2011, cash equivalents consisted of money market funds which totaled \$3.5 million.

Significant sources of cash for the six months ended March 31, 2011 were net income of approximately \$0.7 million, an increase in accounts payable and accrued expenses of approximately \$0.4 million and an increase in deferred revenue of approximately \$0.5 million. The significant uses of cash during the period were an increase in inventory of approximately \$2.4 million, and the repurchase of CSPI common stock of \$0.4 million.

As of March 31, 2011 and September 30, 2010, cash held by our foreign subsidiaries located in Germany and the United Kingdom totaled approximately \$6.3 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 March 31, 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 March 31, 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 six months ended March 31, 2011:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Issuer Purchases of Equity Securities | |
|---------------------|-------------------------------------|---------------------------------|---|--|
| | | | 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 | |
| Total | 96,597 | \$ 4.09 | 96,597 | 297,959 |

(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

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

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