CONVERSION SERVICES INTERNATIONAL INC
Form 10-Q
November 10, 2010

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

# FORM 10-Q

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

For the Quarterly Period Ended September 30, 2010

OR

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

For the Transition Period From _________ to_________

Commission File Number: 001-32623

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

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 20-0101495<br>(I.R.S. Employer Identification No.) |
| 100 Eagle Rock Avenue, East Hanover, New Jersey<br>(Address of principal executive offices) | 07936<br>(Zip Code) |

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

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

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

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

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

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 o No o

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

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

| Class | Outstanding at November 8, 2010 |
|---|---|
| Common Stock, $0.001 par value per share | 127,315,538 shares |

CONVERSION SERVICES INTERNATIONAL, INC.

FORM 10-Q

For the three and nine months ended September 30, 2010

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash | $ 12,460 | $ 96,957 |
| Accounts receivable, net | 2,205,334 | 3,912,021 |
| Accounts receivable from related parties, net | 254,284 | 236,233 |
| Prepaid expenses | 87,650 | 124,764 |
| TOTAL CURRENT ASSETS | 2,559,728 | 4,369,975 |
| | | |
| PROPERTY AND EQUIPMENT, at cost, net | 11,414 | 36,887 |
| | | |
| OTHER ASSETS | 92,556 | 110,494 |
| | | |
| Total Assets | $ 2,663,698 | $ 4,517,356 |
| | | |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| CURRENT LIABILITIES | | |
| Line of credit | $ 1,582,669 | $ 2,541,900 |
| Accounts payable and accrued expenses | 1,639,809 | 1,964,513 |
| Series A redeemable convertible preferred stock | 1,773,331 | - |
| Deferred revenue | 295,240 | 240,606 |
| Note payable | 97,452 | 92,236 |
| TOTAL CURRENT LIABILITIES | 5,388,501 | 4,839,255 |
| | | |
| Long-term debt | 500,000 | 500,000 |
| Total liabilities | 5,888,501 | 5,339,255 |
| | | |
| Series A convertible preferred stock, 19,000 shares issued and outstanding at December 31, 2009 | - | 1,488,332 |
| | | |
| COMMITMENTS AND CONTINGENCIES | | |
| | | |
| STOCKHOLDERS' DEFICIT | | |
| Common stock, $0.001 par value, 300,000,000 shares authorized; 127,307,586 and 122,295,838 issued and outstanding at September 30, 2010 and December 31, 2009, respectively | 127,308 | 122,296 |
| Series B convertible preferred stock, 20,000 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively | 1,352,883 | 1,352,883 |
| Additional paid in capital | 68,136,865 | 68,260,325 |
| | (423,869) | (423,869) |

| | | | | |
|---|---|---|---|---|
| Treasury stock, at cost, 1,145,382 shares in treasury as of September 30, 2010 and December 31, 2009, respectively | | | | |
| Accumulated deficit | | (72,417,990) | | (71,621,866) |
| Total Stockholders' Deficit | | (3,224,803) | | (2,310,231) |
| | | | | |
| Total Liabilities and Stockholders' Deficit | $ | 2,663,698 | $ | 4,517,356 |

See Notes to Condensed Consolidated Financial Statements

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CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30,
(Unaudited)

| | For the three months ended 2010 | For the three months ended 2009 | For the nine months ended 2010 | For the nine months ended 2009 |
|---|---|---|---|---|
| REVENUE: | | | | |
| Services | $ 3,168,908 | $ 7,011,285 | $ 11,429,670 | $ 15,184,707 |
| Related party services | 411,941 | 531,142 | 1,348,076 | 1,567,211 |
| Reimbursable expenses | 119,587 | 410,470 | 464,834 | 855,427 |
| Other | 87,109 | 108,345 | 169,609 | 126,905 |
| | 3,787,545 | 8,061,242 | 13,412,189 | 17,734,250 |
| COST OF REVENUE: | | | | |
| Services | 2,212,762 | 4,214,161 | 8,143,168 | 10,692,230 |
| Related party services | 350,342 | 465,555 | 1,199,602 | 1,408,607 |
| Consultant expenses | 137,771 | 434,546 | 503,331 | 961,518 |
| | 2,700,875 | 5,114,262 | 9,846,101 | 13,062,355 |
| GROSS PROFIT | 1,086,670 | 2,946,980 | 3,566,088 | 4,671,895 |
| | | | | |
| OPERATING EXPENSES | | | | |
| Selling and marketing | 561,858 | 728,847 | 1,879,349 | 2,287,269 |
| General and administrative | 604,971 | 724,337 | 2,006,855 | 1,977,774 |
| Depreciation and amortization | 22,179 | 25,108 | 69,660 | 81,512 |
| | 1,189,008 | 1,478,292 | 3,955,864 | 4,346,555 |
| INCOME (LOSS) FROM OPERATIONS | (102,338) | 1,468,688 | (389,776) | 325,340 |
| | | | | |
| OTHER EXPENSE | | | | |
| Equity in losses from investments | - | - | - | (103,298) |
| Interest expense, net | (212,436) | (176,070) | (406,348) | (663,546) |
| | (212,436) | (176,070) | (406,348) | (766,844) |
| INCOME (LOSS) BEFORE INCOME TAXES | (314,774) | 1,292,618 | (796,124) | (441,504) |
| INCOME TAXES | - | - | - | - |
| | | | | |
| NET INCOME (LOSS) | (314,774) | 1,292,618 | (796,124) | (441,504) |
| Accretion of issuance costs associated with convertible preferred stock | - | (95,000) | (190,000) | (285,000) |
| Dividends on convertible preferred stock | (21,250) | (45,000) | (111,250) | (135,000) |
| NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS | $ (336,024) | $ 1,152,618 | $ (1,097,374) | $ (861,504) |
| | | | | |
| Earnings (loss) per share: | | | | |
| Basic | $ (0.00) | $ 0.01 | $ (0.01) | $ (0.01) |
| Diluted | $ (0.00) | $ 0.01 | $ (0.01) | $ (0.01) |
| | | | | |
| Shares used in calculation of earnings (loss) per share: | | | | |
| Basic | 125,601,045 | 119,895,174 | 124,188,635 | 119,813,903 |
| Diluted | 125,601,045 | 133,651,512 | 124,188,635 | 119,813,903 |

See Notes to Condensed Consolidated Financial Statements

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30,
(Unaudited)

| | 2010 | 2009 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | $ (796,124) | $ (441,504) |
| | | |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation of property and equipment and amortization of leasehold improvements | 25,473 | 37,325 |
| Amortization of debt discounts | - | 69,070 |
| Amortization of relative fair value of warrants issued | - | 115,189 |
| Amortization of deferred financing costs | 44,188 | 44,188 |
| Accretion of issuance costs associated with Series A convertible preferred stock | 95,000 | - |
| Dividends on Series A convertible preferred stock which are paid in common stock | 23,750 | - |
| Stock based compensation | 16,134 | 115,965 |
| Decrease in allowance for doubtful accounts | (74,048) | (97,909) |
| Losses from equity investments | - | 103,298 |
| Changes in operating assets and liabilities: | | |
| Decrease (increase) in accounts receivable | 1,759,040 | (1,118,865) |
| Decrease (increase) in accounts receivable from related parties | 3,644 | (118,527) |
| Decrease in prepaid expenses | 10,864 | 27,202 |
| (Decrease) increase in accounts payable and accrued expenses | (287,821) | 529,369 |
| Increase in deferred revenue | 54,634 | 113,058 |
| Net cash provided by (used in) operating activities | 874,734 | (622,141) |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | - | (10,670) |
| Net cash used in investing activities | - | (10,670) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net (repayments) borrowings under the line of credit | (959,231) | 726,044 |
| Principal payment on short-term notes payable | - | (400,000) |
| Net cash (used in) provided by financing activities | (959,231) | 326,044 |
| | | |
| NET DECREASE IN CASH | (84,497) | (306,767) |
| CASH, beginning of period | 96,957 | 338,240 |
| | | |
| CASH, end of period | $ 12,460 | $ 31,473 |

See Notes to Condensed Consolidated Financial Statements

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CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30,
(Unaudited)

| | 2010 | 2009 |
|---|---|---|
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid for interest | $ 273,165 | $ 469,362 |
| Accretion of Series A preferred stock liability | 285,000 | 285,000 |
| Common stock issued in payment of dividends on preferred stock | 151,667 | 111,250 |
| Common stock issued in payment of 2009 compensation | 15,000 | - |

See Notes to Condensed Consolidated Financial Statements

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

Note 1 - Accounting Policies

Organization and Business

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

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

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by the Company and are unaudited. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for any future period or for the full fiscal year. In the opinion of management, all adjustments (consisting of normal recurring adjustments unless otherwise indicated) necessary to present fairly the financial position, results of operations and cash flows at September 30, 2010, and for all periods presented, have been made. Footnote disclosure has been condensed or omitted as permitted by Securities and Exchange Commission rules over interim financial statements.

These condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009 and other reports filed with the Securities and Exchange Commission.

Principles of Consolidation

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

Revenue recognition

Revenues are principally derived from consulting and professional services and are recognized as earned when the services are rendered, evidence of an arrangement exists, the fee is fixed or determinable and collection is probable. For projects charged on a time and materials basis, revenue is recognized based on the number of hours worked by consultants at an agreed-upon rate per hour. For large services projects where costs to complete the contract could reasonably be estimated, the Company undertakes projects on a fixed-fee basis and recognizes revenues on the percentage of completion method of accounting based on the evaluation of actual costs incurred to date compared to total estimated costs. Revenues recognized in excess of billings are recorded as costs in excess of billings. Billings in excess of revenues recognized are recorded as deferred revenues until revenue recognition criteria are met.

Reimbursements, including those relating to travel and other out-of-pocket expenses, are included in revenues, and an equivalent amount of reimbursable expenses are included in cost of services.

Fair value of financial instruments

The Company utilizes the fair value standards defined by generally accepted accounting principles which provide guidance for measuring fair value and requires certain disclosures. A fair value hierarchy is used which is categorized into three levels based on the inputs to the valuation techniques used to measure fair value. Certain valuation techniques are used, such as the market approach (comparable market prices), the income approach (present value of future income or cash flows) and the cost approach (cost to replace the service capacity of an asset or replacement cost).

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

Concentrations of credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk are cash and accounts receivable arising from its normal business activities. The Company routinely assesses the financial strength of its customers, based upon factors surrounding their credit risk, establishes an allowance for doubtful accounts, and as a consequence believes that its accounts receivable credit risk exposure beyond such allowances is limited. At September 30, 2010, receivables related to Bank of America, PNC Bank, Thomson Reuters and LEC, a related party, comprised approximately 26.8%, 16.7%, 10.5% and 10.0% of the Company’s accounts receivable balance, respectively.

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

Income taxes

The Company accounts for income taxes under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, the Company generally considers all expected future events other than enactments of changes in the tax laws or rates.

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

Prior to recording its income tax liability, the Company makes a determination as to whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. If the more-likely-than-not threshold is met, the tax position is measured to determine the amount to recognize in the financial statements. At September 30, 2010, the Company has no unrecognized tax benefits. As of September 30, 2010, the Company had no accrued interest or penalties related to uncertain tax positions.

Use of estimates

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

Note 2 - Liquidity Issues and Going Concern

The Company has incurred a $796,124 net loss for the nine months ended September 30, 2010 and, while the Company reported a profit of $31,956 for the fiscal year ended December 31, 2009, it incurred significant losses for the years ended December 31, 2004 through 2008. Although the Company had positive cash flow from operating activities during the year ended December 31, 2009 and the nine months ended September 30, 2010, it incurred negative cash flows from operating activities for the years ended December 31, 2004 through 2008, and had an accumulated deficit of $72.4 million at September 30, 2010. Additionally, the Company's revolving line of credit matures on March 31, 2011 and the Company's Series A preferred stock is redeemable on February 1, 2011. The Company has relied upon cash from its financing activities to fund its ongoing operations as it has not been able to generate sufficient cash from its operating activities in the past, and there is no assurance that it will be able to do so in the future. Due to this history of losses and operating cash consumption the Company cannot predict how long it will continue to incur further losses or whether it will become profitable again, or if the Company's business will improve. These factors raise substantial doubt as to its ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As of September 30, 2010, the Company had a cash balance of approximately $12,460, compared to $96,957 at December 31, 2009, and a working capital deficiency of $2.8 million.

The liquidity issues that have resulted from the Company's history of losses have been addressed in the past through the sale of Company common stock, preferred stock and by entering into various debt instruments.

The Company executed a three-year revolving line of credit agreement in March 2008 with Access Capital, Inc. ("Access Capital" or "Access"), which matures on March 31, 2011. As of June 30, 2008, the Company was in default of the Loan and Security Agreement and remains in default as of September 30, 2010. As a result of the default, Access had increased the interest rate payable on borrowings under the line of credit to 18% per annum, has notified the Company's clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital. Effective January 1, 2010, although the Company remains in default with respect to the Access Capital Loan and Security Agreement, Access Capital agreed to reduce the interest rate on borrowings under the line of credit from 18%, to 12% per annum. Refer to footnote 4 of the Notes to Condensed Consolidated Financial Statements for further discussion on the Line of Credit.

In February 2006, the Company issued Series A Preferred Stock, in the amount of $1,900,000, which is redeemable for cash or common stock at the Company's option on February 1, 2011. The Company does not currently have the funds, or available shares of common stock, to repay this debt upon maturity. While the Company continues to have available shares reserved if the holder elects to convert the preferred shares to common stock, as a result of a recent reduction in the Company's stock price, the Company no longer has enough shares available to enable it to redeem the preferred stock by issuing shares of its common stock. Therefore, the Series A convertible preferred stock has been reclassified to current liabilities during the three months ended September 30, 2010.

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

Note 3 - New Accounting Standards

In October 2009, the FASB issued ASU No. 2009-13, Multiple-Deliverable Revenue Arrangements (“ASU 2009-13”). ASU 2009-13, amends existing revenue recognition accounting pronouncements that are currently within the scope of Codification Subtopic 605-25 (previously included within EITF 00-21, Revenue Arrangements with Multiple Deliverables (“EITF 00-21”). The consensus to ASU 2009-13 provides accounting principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated, and the consideration allocated. This guidance eliminates the requirement to establish the fair value of undelivered products and services and instead provides for separate revenue recognition based upon management’s estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item. EITF 00-21 previously required that the fair value of the undelivered item be the price of the item either sold in a separate transaction between unrelated third parties or the price charged for each item when the item is sold separately by the vendor. Under EITF 00-21, if the fair value of all of the elements in the arrangement was not determinable, then revenue was deferred until all of the items were delivered or fair value was determined. This new approach is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and allows for retroactive application. The Company is currently evaluating the potential impact of this standard on its financial position and results of operations.

In April 2010, the FASB issued ASU No. 2010-17, Milestone Method of Revenue Recognition (“ASU 2010-17”). ASU 2010-17, updates guidance on the criteria that should be met for determining whether the milestone method of revenue recognition is appropriate with the scope of Codification Subtopic 605 (previously included within EITF 00-21, Revenue Arrangements with Multiple Deliverables (“EITF 00-21”). The consensus to ASU 2010-17 provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition in which arrangements include payment provisions whereby a portion or all of the consideration is contingent upon milestone events such as successful completion of phases or a specific result. This new approach is effective prospectively for milestones achieved in fiscal years beginning on or after June 15, 2010 and allows for retroactive application. The Company is currently evaluating the potential impact of this standard on its financial position and results of operations as there are not currently any milestones that will be achieved.

Note 4 - Line of credit

The Company executed a revolving line of credit agreement in March 2008 with Access Capital. This line of credit provides for borrowing up to a maximum of $3,500,000, based upon collateral availability, a 90% advance rate against eligible accounts receivable, has a three year term, an interest rate of prime (which was 3.25% as of September 30, 2010) plus 2.75% prior to a default, but 18% upon default and matures on March 31, 2011. The Company must comply with a minimum working capital covenant which requires the Company to maintain minimum monthly working capital of $400,000. The Company was not in compliance with this covenant as of June 30, 2008 and remains in default as of September 30, 2010 and, as such, the amounts outstanding under the revolving line of credit are callable. Additionally, during the third year of the three year term the Company must maintain a minimum average monthly loan balance of $2,500,000. The Company must also pay an annual facility fee equal to 1% of the maximum available under the facility and a $1,750 per month collateral management fee. Further debt incurred by the Company may need to be subordinated to Access Capital, Inc. Although the Company remained in default of the Access Capital Loan and Security Agreement, effective January 2010, Access Capital agreed to reduce the interest rate to be charged on revolving line of credit borrowings from 18% to 12% per annum.

The Company was in default of the Loan and Security Agreement as of September 30, 2010 since its working capital was below the minimum required working capital of $400,000. In the event of a default under the Loan and Security Agreement, Access Capital’s remedies include, but are not limited to, the following:

- Access may perform or observe such covenant on behalf and in the name, place and stead of the Company and may take actions which they deem necessary to cure or correct such failure, including, but not limited to, payment of taxes, satisfaction of liens, performance of obligations owed to debtors, procurement of insurance, execution of assignments, security agreements and financing statements and the endorsement of instruments;

- upon the occurrence of, and for so long as any event of default exists, the interest rate is increased to one and one-half percent (1.5%) per month;

- Access may notify the Company’s account debtors of their security interest in the accounts, collect them directly and charge the collection costs and expenses to the Company’s account;

- At Access Capital's election, following the occurrence of an event of default, they may terminate the Loan and Security Agreement. In the event of early termination after the occurrence of default, the Company would be liable for various early payment fees, penalties and interest;

- Access shall have the right to demand repayment in full of all obligations, whether or not otherwise due, including required prepayment fees, interest, and penalties.

As a result of this default, to date, Access has increased the interest rate payable on borrowings under the line of credit to 12% per annum beginning in January 2010, has notified the Company's clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital.

As of September 30, 2010, approximately $1.6 million was outstanding under the line of credit and the Company had approximately $454,000 available under the line of credit.

Note 5 - Stock Based Compensation

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

To the extent that CSI derives a tax benefit from options exercised by employees, such benefit will be credited to additional paid-in capital when realized on the Company's income tax return. There were no tax benefits realized by the Company during the nine months ended September 30, 2010 or during the years ended December 31, 2009 or 2008.

The following summarizes the stock option transactions under the 2003 Plan during 2010:

| | Shares | Weighted average exercise price |
|---|---|---|
| Options outstanding at December 31, 2009 | 4,771,999 | $ 0.76 |
| Options granted | - | - |
| Options exercised | - | - |
| Options canceled | (549,000) | 0.55 |
| Options outstanding at September 30, 2010 | 4,222,999 | $ 0.79 |

The following table summarizes information concerning outstanding and exercisable Company common stock options at September 30, 2010:

| Range of exercise prices | Options outstanding | Weighted average exercise price | Weighted average remaining contractual life | Options exercisable | Weighted average exercise price |
|---|---|---|---|---|---|
| $0.25-$0.30 | 1,695,000 | $ 0.257 | 5.6 | 1,695,000 | $ 0.257 |
| $0.46-$0.60 | 1,005,000 | 0.461 | 5.3 | 1,005,000 | 0.461 |
| $0.83 | 910,000 | 0.830 | 4.9 | 910,000 | 0.830 |
| $2.475-$3.45 | 612,999 | 2.746 | 3.4 | 612,999 | 2.746 |
| | 4,222,999 | | | 4,222,999 | |

The Company recorded approximately zero and $16,000 and $4,000 and $116,000 of expense related to stock options which vested during the three and nine months ended September 30, 2010 and 2009, respectively.