

EPLUS INC
Form 10-Q
November 07, 2007

**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 quarter ended December 31, 2006**

OR

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

For the transition period from ____ to ____ .

Commission file number: **0-28926**

ePlus inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

54-1817218
(I.R.S. Employer Identification No.)

13595 Dulles Technology Drive, Herndon, VA 20171-3413
(Address, including zip code, of principal executive offices)

Registrant's telephone number, including area code: **(703) 984-8400**

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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

Edgar Filing: EPLUS INC - Form 10-Q

The number of shares of common stock outstanding as of September 30, 2007, was 8,231,741.

TABLE OF CONTENTS

ePlus inc. AND SUBSIDIARIES

Part I. Financial Information:

Item 1.	<u>Financial Statements—Unaudited:</u>	3
	<u>Condensed Consolidated Balance Sheets as of March 31, 2006 and December 31, 2006</u>	3
	<u>Condensed Consolidated Statements of Operations, Three Months Ended December 31, 2005 (Restated) and 2006</u>	4
	<u>Condensed Consolidated Statements of Operations, Nine Months Ended December 31, 2005 (Restated) and 2006</u>	5
	<u>Condensed Consolidated Statements of Cash Flows, Nine Months Ended December 31, 2005 (Restated) and 2006</u>	6
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	8
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	40
Item 4.	<u>Controls and Procedures</u>	41
	<u>Part II. Other Information:</u>	43
Item 1.	<u>Legal Proceedings</u>	43
Item 1A.	<u>Risk Factors</u>	45
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
Item 3.	<u>Defaults Upon Senior Securities</u>	46
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	46
Item 5.	<u>Other Information</u>	46
Item 6.	<u>Exhibits</u>	46
	<u>Signatures</u>	47

Table of Contents

Explanatory Note

This Quarterly Report on Form 10-Q contains the restatement of our Condensed Consolidated Statements of Operations and Cash Flows for the three and nine months ended December 31, 2005 for the effects of errors in accounting for stock options and other items. See Note 2, "Restatement of Consolidated Financial Statements" to our Unaudited Condensed Consolidated Financial Statements contained elsewhere in this document. For further discussion of the effects of the restatement see the following sections of our Annual Report on Form 10-K for the year ended March 31, 2006: Explanatory Note; Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition; Item 9A. Controls and Procedures; and Note 2 to our Consolidated Financial Statements.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ePlus inc. AND SUBSIDIARIES**CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

	As of March 31, 2006	As of December 31, 2006
	(in thousands)	
ASSETS		
Cash and cash equivalents	\$ 20,697	\$ 20,946
Accounts receivable—net	103,060	150,868
Notes receivable	330	265
Inventories	2,292	11,360
Investment in leases and leased equipment—net	205,774	216,975
Property and equipment—net	5,629	5,427
Other assets	10,038	10,531
Goodwill	26,125	26,125
TOTAL ASSETS	\$ 373,945	\$ 442,497
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Accounts payable—equipment	\$ 7,733	\$ 6,226
Accounts payable—trade	19,235	22,692
Accounts payable—floor plan	46,689	53,815
Salaries and commissions payable	4,124	5,188
Accrued expenses and other liabilities	33,346	30,938
Income taxes payable	104	10,211
Recourse notes payable	6,000	10,000
Non-recourse notes payable	127,973	159,200
Deferred tax liability	165	165
Total Liabilities	245,369	298,435
COMMITMENTS AND CONTINGENCIES (Note 7)		
STOCKHOLDERS' EQUITY		
Preferred stock, \$.01 par value; 2,000,000 shares authorized; none issued or outstanding	-	-
Common stock, \$.01 par value; 25,000,000 shares authorized; 11,037,213 issued and 8,267,223 outstanding at March 31, 2006 and 11,210,731 issued and 8,231,741 outstanding at December 31, 2006	110	112
Additional paid-in capital	72,811	75,722
Treasury stock, at cost, 2,769,990 and 2,978,990 shares, respectively	(29,984)	(32,884)
Deferred compensation expense	(25)	-
Retained earnings	85,377	100,823
Accumulated other comprehensive income—foreign currency translation adjustment	287	289
Total Stockholders' Equity	128,576	144,062

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 373,945	\$ 442,497
--	------------	------------

See Notes to Unaudited Condensed Consolidated Financial Statements.

3

Table of Contents

ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended December 31,	
	2005	2006
	As Restated (1)	
	(dollar amounts in thousands, except per share data)	
REVENUES		
Sales of product and services	\$ 146,385	\$ 183,277
Sales of leased equipment	-	2,557
	146,385	185,834
Lease revenues	13,758	16,000
Fee and other income	2,931	3,544
Patent settlement income	-	17,500
	16,689	37,044
TOTAL REVENUES	163,074	222,878
COSTS AND EXPENSES		
Cost of sales, product and services	131,734	161,254
Cost of leased equipment	-	2,509
	131,734	163,763
Direct lease costs	4,742	5,574
Professional and other fees	2,464	7,245
Salaries and benefits	15,893	17,947
General and administrative expenses	4,469	4,050
Interest and financing costs	1,956	2,839
	29,524	37,655
TOTAL COSTS AND EXPENSES (2)	161,258	201,418
EARNINGS BEFORE PROVISION FOR INCOME TAXES	1,816	21,460
PROVISION FOR INCOME TAXES	740	9,056
NET EARNINGS	\$ 1,076	\$ 12,404
NET EARNINGS PER COMMON SHARE—BASIC	\$ 0.13	\$ 1.51
NET EARNINGS PER COMMON SHARE—DILUTED	\$ 0.12	\$ 1.47

WEIGHTED AVERAGE SHARES OUTSTANDING—BASIC	8,215,221	8,231,741
WEIGHTED AVERAGE SHARES OUTSTANDING—DILUTED	8,865,829	8,456,627

- (1) See Note 2, "Restatement of Consolidated Financial Statements".
- (2) Includes amounts to related parties of \$219 thousand and \$238 thousand for the three months ended December 31, 2005 and December 31, 2006, respectively.

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Nine Months Ended December 31,	
	2005	2006
	As Restated (1)	
	(dollar amounts in thousands, except per share data)	
REVENUES		
Sales of product and services	\$ 440,663	\$ 538,923
Sales of leased equipment	-	4,376
	440,663	543,299
Lease revenues	36,969	40,853
Fee and other income	9,488	9,484
Patent settlement income	-	17,500
	46,457	67,837
TOTAL REVENUES	487,120	611,136
COSTS AND EXPENSES		
Cost of sales, product and services	397,564	477,879
Cost of sales, leased equipment	-	4,284
	397,564	482,163
Direct lease costs	12,336	16,170
Professional and other fees	5,188	13,295
Salaries and benefits	45,969	52,912
General and administrative expenses	13,906	12,921
Interest and financing costs	5,210	7,492
	82,609	102,790
TOTAL COSTS AND EXPENSES (2)	480,173	584,953
EARNINGS BEFORE PROVISION FOR INCOME TAXES	6,947	26,183
PROVISION FOR INCOME TAXES	2,823	10,737
NET EARNINGS	\$ 4,124	\$ 15,446
NET EARNINGS PER COMMON SHARE—BASIC	\$ 0.49	\$ 1.88
NET EARNINGS PER COMMON SHARE—DILUTED	\$ 0.46	\$ 1.80
	8,411,268	8,222,700

WEIGHTED AVERAGE SHARES OUTSTANDING—BASIC		
WEIGHTED AVERAGE SHARES OUTSTANDING—DILUTED	8,998,659	8,577,999

(1) See Note 2, "Restatement of Consolidated Financial Statements."

(2) Includes amounts to related parties of \$658 thousand and \$710 thousand for the nine months ended December 31, 2005 and December 31, 2006, respectively.

See Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended December 31,	
	2005	2006
	As Restated (1)	
	(in thousands)	
Cash Flows From Operating Activities:		
Net earnings	\$ 4,124	\$ 15,446
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	12,673	16,153
Write-off of non-recourse debt	(22)	-
Reserves for credit losses	(280)	788
Provision for inventory losses	-	150
Impact of stock-based compensation	303	719
Excess tax benefit from exercise of stock options	-	(95)
Tax benefit of stock options exercised	50	308
Deferred taxes	(2,339)	-
Payments from lessees directly to lenders—operating leases	(4,650)	(8,244)
Loss on disposal of property and equipment	142	90
Gain on disposal of operating lease equipment	(932)	(600)
Excess increase in cash value of officers life insurance	-	(19)
Changes in:		
Accounts receivable—net	(26,354)	(48,784)
Notes receivable	(37)	65
Inventories	(1,555)	(9,219)
Investment in leases and leased equipment—net	(20,995)	(34,335)
Other assets	152	(279)
Accounts payable—equipment	(3,058)	(1,614)
Accounts payable—trade	12,074	3,709
Salaries and commissions payable, accrued expenses and other liabilities	(12,503)	8,763
Net cash used in operating activities	(43,207)	(56,998)
Cash Flows From Investing Activities:		
Proceeds from sale of operating lease equipment	1,647	1,270
Purchases of operating lease equipment	(22,578)	(19,711)
Proceeds from sale of property and equipment	2	2
Purchases of property and equipment	(1,927)	(2,145)
Premiums paid on officers life insurance	-	(219)
Net cash used in investing activities	(22,856)	(20,803)

Table of Contents**ePlus inc. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - continued**

(UNAUDITED)

(in thousands)

	Nine Months Ended December 31,	
	2005	2006
Cash Flows From Financing Activities:		
Borrowings:		
Non-recourse	\$ 68,682	\$ 87,029
Repayments:		
Non-recourse	(27,869)	(19,213)
Purchase of treasury stock	(5,732)	(2,900)
Proceeds from issuance of capital stock, net of expenses	187	1,911
Excess tax benefit from exercise of stock options	-	95
Net borrowings on floor-planning facility	8,532	7,126
Net borrowings on lines of credit	735	4,000
Net cash provided by financing activities	44,535	78,048
Effect of Exchange Rate Changes on Cash	92	2
Net (Decrease) Increase in Cash and Cash Equivalents	(21,436)	249
Cash and Cash Equivalents, Beginning of Period	38,852	20,697
Cash and Cash Equivalents, End of Period	\$ 17,416	\$ 20,946
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 2,094	\$ 1,981
Cash paid for income taxes	\$ 3,695	\$ 457
Schedule of Non-cash Investing and Financing Activities:		
Purchase of property and equipment included in accounts payable	\$ 24	\$ 67
Payments from lessees directly to lenders	\$ 21,218	\$ 36,589

(1) See Note 2, "Restatement of Consolidated Financial Statements".

See Notes To Unaudited Condensed Consolidated Financial Statements.

Table of Contents

ePlus inc. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements of ePlus inc. and subsidiaries and Notes thereto included herein are unaudited and have been prepared by us, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and reflect all adjustments that are, in the opinion of management, necessary for a fair statement of results for the interim periods. All adjustments made were of a normal recurring nature.

Certain information and note disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to SEC rules and regulations.

These interim financial statements should be read in conjunction with our Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K for the year ended March 31, 2006. Operating results for the interim periods are not necessarily indicative of results for an entire year.

PRINCIPLES OF CONSOLIDATION — The Condensed Consolidated Financial Statements include the accounts of ePlus inc. and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

REVENUE RECOGNITION — We adhere to guidelines and principles of sales recognition described in Staff Accounting Bulletin (“SAB”) No. 104, “*Revenue Recognition*,” issued by the staff of the SEC. Under SAB No. 104, sales are recognized when the title and risk of loss are passed to the customer, there is persuasive evidence of an arrangement for sale, delivery has occurred and/or services have been rendered, the sales price is fixed or determinable and collectibility is reasonably assured. Using these tests, the vast majority of our sales represent product sales recognized upon delivery.

From time to time, in the sales of product and services, we may enter into contracts that contain multiple elements. Sales of services currently represent less than 10% of our sales. For services that are performed in conjunction with product sales and are completed in our facilities prior to shipment of the product, sales for both the product and services are recognized upon shipment. Sales of services that are performed at customer locations are recorded as sales of product and services on the accompanying Condensed Consolidated Statements of Operations when the services are performed. If the service is performed at a customer location in conjunction with a product sale or other service sale, we recognize the sale in accordance with SAB No. 104 and Emerging Issues Task Force (“EITF”) 00-21, “*Accounting for Revenue Arrangements with Multiple Deliverables*.” Accordingly, in an arrangement with multiple deliverables, we recognize sales for delivered items only when all of the following criteria are satisfied:

- the delivered item(s) has value to the client on a stand-alone basis;
- there is objective and reliable evidence of the fair value of the undelivered item(s); and
- if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in our control.

We sell certain third-party service contracts and software assurance or subscription products for which we evaluate whether the subsequent sales of such services should be recorded as gross sales or net sales in accordance with the

sales recognition criteria outlined in SAB No. 104, EITF 99-19, “*Reporting Revenue Gross as a Principal versus Net as an Agent*” and Financial Accounting Standards Board (“FASB”) Technical Bulletin 90-1, “*Accounting for Separately Priced Extended Warranty and Product Contracts.*” We must determine whether we act as a principal in the transaction and assume the risks and rewards of ownership or if we are simply acting as an agent or broker. Under gross sales recognition, the entire selling price is recorded in sales of product and services and our costs to the third-party service provider or vendor is recorded in cost of sales, product and services on the accompanying Condensed Consolidated Statements of Operations. Under net sales recognition, the cost to the third-party service provider or vendor is recorded as a reduction to sales resulting in net sales equal to the gross profit on the transaction and there is no cost of sales.

In accordance with EITF 00-10, “*Accounting for Shipping and Handling Fees and Costs,*” we record freight billed to our customers as sales of product and services and the related freight costs as a cost of sales, product and services.

Table of Contents

We receive payments and credits from vendors, including consideration pursuant to volume sales incentive programs, volume purchase incentive programs and shared marketing expense programs. Vendor consideration received pursuant to volume sales incentive programs is recognized as a reduction to costs of sales, product and services in accordance with EITF Issue No. 02-16, “*Accounting for Consideration Received from a Vendor by a Customer (Including a Reseller of the Vendor’s Products)*.” Vendor consideration received pursuant to volume purchase incentive programs is allocated to inventories based on the applicable incentives from each vendor and is recorded in cost of sales, product and services, as the inventory is sold. Vendor consideration received pursuant to shared marketing expense programs is recorded as a reduction of the related selling and administrative expenses in the period the program takes place only if the consideration represents a reimbursement of specific, incremental, identifiable costs. Consideration that exceeds the specific, incremental, identifiable costs is classified as a reduction of cost of sales, product and services.

We are the lessor in a number of transactions and these transactions are accounted for in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 13, “*Accounting for Leases*.” Each lease is classified as either a direct financing lease, sales-type lease, or operating lease, as appropriate. Under the direct financing and sales-type lease methods, we record the net investment in leases, which consists of the sum of the minimum lease payments, initial direct costs (direct financing leases only), and unguaranteed residual value (gross investment) less the unearned income. The difference between the gross investment and the cost of the leased equipment for direct finance leases is recorded as unearned income at the inception of the lease. The unearned income is amortized over the life of the lease using the interest method. Under sales-type leases, the difference between the fair value and cost of the leased property plus initial direct costs (net margins) is recorded as revenue at the inception of the lease. For operating leases, rental amounts are accrued on a straight-line basis over the lease term and are recognized as lease revenue. SFAS No. 140, “*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*,” establishes criteria for determining whether a transfer of financial assets in exchange for cash or other consideration should be accounted for as a sale or as a pledge of collateral in a secured borrowing. Certain assignments of direct finance leases we make on a non-recourse basis meet the criteria for surrender of control set forth by SFAS No. 140 and have, therefore, been treated as sales for financial statement purposes.

Sales of leased equipment represent revenue from the sales of equipment subject to a lease in which we are the lessor. If the rental stream on such lease has non-recourse debt associated with it, sales revenue is recorded at the amount of consideration received, net of the amount of debt assumed by the purchaser. If there is no non-recourse debt associated with the rental stream, sales revenue is recorded at the amount of gross consideration received, and costs of sales is recorded at the book value of the lease. Sales of equipment represents revenue generated through the sale of equipment sold primarily through our technology business unit.

Lease revenues consist of rentals due under operating leases and amortization of unearned income on direct financing and sales-type leases. Equipment under operating leases is recorded at cost and depreciated on a straight-line basis over the lease term to our estimate of residual value.

We assign all rights, title, and interests in a number of our leases to third-party financial institutions without recourse. These assignments are accounted for as sales since we have completed our obligations as of the assignment date, and we retain no ownership interest in the equipment under lease.

Revenue from hosting arrangements is recognized in accordance with EITF 00-3, “*Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity’s Hardware*.” Our hosting arrangements do not contain a contractual right to take possession of the software. Therefore, our hosting arrangements are not in the scope of SOP 97-2, “*Software Revenue Recognition*,” and require that the portion of the fee allocated to the hosting elements be recognized as the service is provided. Currently, the majority of our software revenue is generated through hosting agreements and is included in fee and other income on our Condensed

Consolidated Statements of Operations.

Revenue from sales of our software is recognized in accordance with SOP 97-2, as amended by SOP 98-4, “*Deferral of the Effective Date of a Provision of SOP 97-2,*” and SOP 98-9, “*Modification of SOP 97-2 With Respect to Certain Transactions.*” We recognize revenue when all the following criteria exist: (1) there is persuasive evidence that an arrangement exists; (2) delivery has occurred; (3) no significant obligations by us related to services essential to the functionality of the software remain with regard to implementation; (4) the sales price is determinable; and (5) and it is probable that collection will occur. Revenue from sales of our software is included in fee and other income on our Condensed Consolidated Statements of Operations.

Table of Contents

At the time of each sale transaction, we make an assessment of the collectibility of the amount due from the customer. Revenue is only recognized at that time if management deems that collection is probable. In making this assessment, we consider customer creditworthiness and assess whether fees are fixed or determinable and free of contingencies or significant uncertainties. If the fee is not fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. In assessing whether the fee is fixed or determinable, we consider the payment terms of the transaction and our collection experience in similar transactions without making concessions, among other factors. Our software license agreements generally do not include customer acceptance provisions. However, if an arrangement includes an acceptance provision, we record revenue only upon the earlier of (1) receipt of written acceptance from the customer or (2) expiration of the acceptance period.

Our software agreements often include implementation and consulting services that are sold separately under consulting engagement contracts or as part of the software license arrangement. When we determine that such services are not essential to the functionality of the licensed software and qualify as “service transactions” under SOP 97-2, we record revenue separately for the license and service elements of these agreements. Generally, we consider that a service is not essential to the functionality of the software based on various factors, including if the services may be provided by independent third parties experienced in providing such consulting and implementation in coordination with dedicated customer personnel. If an arrangement does not qualify for separate accounting of the license and service elements, then license revenue is recognized together with the consulting services using either the percentage-of-completion or completed-contract method of contract accounting. Contract accounting is also applied to any software agreements that include customer-specific acceptance criteria or where the license payment is tied to the performance of consulting services. Under the percentage-of-completion method, we may estimate the stage of completion of contracts with fixed or “not to exceed” fees based on hours or costs incurred to date as compared with estimated total project hours or costs at completion. If we do not have a sufficient basis to measure progress towards completion, revenue is recognized upon completion of the contract. When total cost estimates exceed revenues, we accrue for the estimated losses immediately. The use of the percentage-of-completion method of accounting requires significant judgment relative to estimating total contract costs, including assumptions relative to the length of time to complete the project, the nature and complexity of the work to be performed, and anticipated changes in salaries and other costs. When adjustments in estimated contract costs are determined, such revisions may have the effect of adjusting, in the current period, the earnings applicable to performance in prior periods.

We generally use the residual method to recognize revenues from agreements that include one or more elements to be delivered at a future date when evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements (e.g., maintenance, consulting and training services) based on vendor-specific objective evidence (“VSOE”) is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements (i.e., software license). If evidence of the fair value of one or more of the undelivered services does not exist, all revenues are deferred and recognized when delivery of all of those services has occurred or when fair values can be established. We determine VSOE of the fair value of services revenue based upon our recent pricing for those services when sold separately. VSOE of the fair value of maintenance services may also be determined based on a substantive maintenance renewal clause, if any, within a customer contract. Our current pricing practices are influenced primarily by product type, purchase volume, maintenance term and customer location. We review services revenue sold separately and maintenance renewal rates on a periodic basis and update our VSOE of fair value for such services to ensure that it reflects our recent pricing experience, when appropriate.

Maintenance services generally include rights to unspecified upgrades (when and if available), telephone and Internet-based support, updates and bug fixes. Maintenance revenue is recognized ratably over the term of the maintenance contract (usually one year) on a straight-line basis and is included in fee and other income on our Condensed Consolidated Statements of Operations.

When consulting qualifies for separate accounting, consulting revenues under time and materials billing arrangements are recognized as the services are performed. Consulting revenues under fixed-price contracts are generally recognized using the percentage-of-completion method. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved. Consulting revenues are classified as fee and other income on our Condensed Consolidated Statements of Operations.

Training services include on-site training, classroom training and computer-based training and assessment. Training revenue is recognized as the related training services are provided and is included in fee and other income on our Condensed Consolidated Statements of Operations.

Table of Contents

Amounts charged for our Procure+ service are recognized as services are rendered. Amounts charged for the Manage+ service are recognized on a straight-line basis over the contractual period for which the services are provided. In addition, other sources of revenue are derived from: (1) income from events that occur after the initial sale of a financial asset; (2) remarketing fees; (3) brokerage fees earned for the placement of financing transactions; (4) agent fees received from various manufacturers in the IT reseller business unit; (5) settlement fees related to disputes or litigation; and (6) interest and other miscellaneous income. These revenues are included in fee and other income on our Condensed Consolidated Statements of Operations. Patent settlement income related to SAP America, Inc. and its German parent, SAP AG, is included in patent settlement income on our Condensed Consolidated Statements of Operations -- see also Note 12 to our Condensed Consolidated Financial Statements.

RESIDUALS — Residual values, representing the estimated value of equipment at the termination of a lease, are recorded in our Condensed Consolidated Financial Statements at the inception of each sales-type or direct financing lease as amounts estimated by management based upon its experience and judgment. Unguaranteed residual values for sales-type and direct financing leases are recorded at their net present value and the unearned income is amortized over the life of the lease using the interest method. The residual values for operating leases are included in the leased equipment's net book value.

We evaluate residual values on an ongoing basis and record any downward adjustment, if required. No upward revision of residual values is made subsequent to lease inception.

RESERVES FOR CREDIT LOSSES — The reserve for credit losses (the “reserve”) is maintained at a level believed by management to be adequate to absorb losses inherent in our lease and accounts receivable portfolio. Management's determination of the adequacy of the reserve is based on an evaluation of historical credit loss experience, current economic conditions, volume, growth, the composition of the lease portfolio, and other relevant factors. The reserve is increased by provisions for potential credit losses charged against income. Accounts are either written off or written down when the loss is both probable and determinable, after giving consideration to the customer's financial condition, the value of the underlying collateral and funding status (i.e., discounted on a non-recourse or recourse basis).

CASH AND CASH EQUIVALENTS — Cash and cash equivalents include funds in operating accounts as well as money market funds.

INVENTORIES — Inventories are stated at the lower of cost (weighted average basis) or market.

PROPERTY AND EQUIPMENT — Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from three to ten years.

CAPITALIZATION OF COSTS OF SOFTWARE FOR INTERNAL USE — We have capitalized certain costs for the development of internal use software under the guidelines of SOP 98-1, “*Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.*” Approximately \$178 thousand and \$685 thousand of internal use software were capitalized for the nine months ended December 31, 2006 and 2005, respectively, which is included in the accompanying Condensed Consolidated Balance Sheets as a component of property and equipment.

CAPITALIZATION OF COSTS OF SOFTWARE TO BE MADE AVAILABLE TO CUSTOMERS — In accordance with SFAS No. 86, “*Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed,*” software development costs are expensed as incurred until technological feasibility has been established. At such time such costs are capitalized until the product is made available for release to customers. For the nine months ended December 31, 2006 and 2005, costs of \$59 thousand and \$91 thousand, respectively, were capitalized for software to be made available to customers.

INTANGIBLE ASSETS — In June 2001, the FASB issued SFAS No. 141, “*Business Combinations.*” SFAS No. 141 requires that the purchase method of accounting be used for all business combinations transacted after June 30, 2001. SFAS No. 141 also specifies criteria that intangible assets acquired in a business combination must be recognized and reported separately from goodwill. In May 2004, we acquired certain assets and liabilities of Manchester Technologies, Inc. The excess of the cost over the fair value of net tangible assets acquired was assigned to identifiable intangible assets and goodwill utilizing the purchase method of accounting. The final determination of the purchase price allocation was based on the fair values of the assets and liabilities assumed, including acquired intangible assets. This determination was made by management through various means, including obtaining a third-party valuation of identifiable intangible assets acquired and an evaluation of the fair value of other assets and liabilities acquired.

Effective January 1, 2002, we adopted SFAS No. 142, “*Goodwill and Other Intangible Assets,*” which eliminates amortization of goodwill and intangible assets that have indefinite useful lives and requires annual tests of impairment of those assets. SFAS No. 142 also provides specific guidance about how to determine and measure goodwill and intangible asset impairments, and requires additional disclosures of information about goodwill and other intangible assets.

Table of Contents

Further, SFAS No. 142 requires us to perform an impairment test at least on an annual basis at any time during the fiscal year, provided the test is performed at the same time every year. We perform the impairment test as of September 30th of each year and follow the two-step process prescribed in SFAS No. 142 to test our goodwill for impairment under the goodwill impairment test. The first step is to screen for potential impairment, while the second step measures the amount of the impairment, if any.

IMPAIRMENT OF LONG-LIVED ASSETS — We review long-lived assets, including property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and the carrying value of the asset.

FAIR VALUE OF FINANCIAL INSTRUMENTS — The carrying value of our financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and other accrued expenses, approximates fair value due to their short maturities. The carrying amount of our non-recourse and recourse notes payable approximates its fair value. We determined the fair value of notes payable by applying the average portfolio debt rate and applying such rate to future cash flows of the respective financial instruments. The estimated fair value of our recourse and non-recourse notes payable at March 31, 2006 and December 31, 2006 was \$134,412,611 and \$168,737,035, compared to a carrying amount of \$133,973,456 and \$169,199,885, respectively.

TREASURY STOCK — We account for treasury stock under the cost method and include treasury stock as a component of stockholders' equity.

INCOME TAXES — Deferred income taxes are accounted for in accordance with SFAS No. 109, "*Accounting for Income Taxes*." Under this method, deferred income tax assets and liabilities are determined based on the temporary differences between the financial statement reporting and tax bases of assets and liabilities, using tax rates currently in effect. Future tax benefits, such as net operating loss carryforwards, are recognized to the extent that realization of these benefits is considered to be more likely than not.

ESTIMATES — The preparation of financial statements in conformity with U.S. GAAP 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 could differ from those estimates.

COMPREHENSIVE INCOME — Comprehensive income consists of net income and foreign currency translation adjustments. For the nine months ended December 31, 2006 and 2005, accumulated other comprehensive income increased \$1.7 thousand and \$92.1 thousand, respectively, resulting in total comprehensive income of \$15.4 million and \$4.2 million, respectively.

EARNINGS PER SHARE — Earnings per share ("EPS") have been calculated in accordance with SFAS No. 128, "*Earnings per Share*." In accordance with SFAS No. 128, basic EPS amounts were calculated based on weighted average shares outstanding of 8,411,268 for the nine months ended December 31, 2005 and 8,222,700 for the nine months ended December 31, 2006. Diluted EPS amounts were calculated based on weighted average shares outstanding and potentially dilutive common stock equivalents of 8,998,659 for the nine months ended December 31, 2005, and 8,577,999 for the nine months ended December 31, 2006. Additional shares included in the diluted EPS calculations are attributable to incremental shares issuable upon the assumed exercise of stock options and other common stock equivalents. Both basic and diluted EPS and weighted average shares outstanding for the three and nine months ended December 31, 2005 have been restated for changes in measurement dates resulting from the Audit Committee Investigation (as defined below in Note 2, "Restatement of Consolidated Financial Statements").

STOCK-BASED COMPENSATION — In December 2004, the FASB issued SFAS No. 123 (revised 2004), “*Share-Based Payment*,” or SFAS No. 123R. SFAS No. 123R replaces SFAS No. 123, “*Accounting for Stock-Based Compensation*,” and supersedes APB 25, “*Accounting for Stock Issued to Employees*,” and subsequently issued stock option related guidance. This statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments. Entities are required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide services in exchange for the award (usually the vesting period). The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models. If an equity award is modified after the grant date, incremental compensation expense will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification.

Table of Contents

On April 1, 2006, we adopted SFAS No. 123R and elected the modified-prospective transition method. Under the modified-prospective method, we must recognize compensation expense for all awards subsequent to adopting the standard and for the unvested portion of previously granted awards outstanding upon adoption. We have recognized compensation expense equal to the fair values for the unvested portion of share-based awards at April 1, 2006 over the remaining period of service, as well as compensation expense for those share-based awards granted or modified on or after April 1, 2006 over the vesting period based on the grant-date fair values using the straight-line method. For those awards granted prior to the date of adoption, compensation expense is recognized on an accelerated basis based on the grant-date fair value amount as calculated for pro forma purposes under SFAS No. 123.

RECENT ACCOUNTING PRONOUNCEMENTS —In May 2005, the FASB issued SFAS No. 154, “*Accounting Changes and Error Corrections — A Replacement of APB Opinion No. 20 and FASB Statement No. 3.*” SFAS No. 154 requires retrospective application, or the latest practical date, as the preferred method to report a change in accounting principle or correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. While the adoption of SFAS No. 154 did not have a material impact on our Condensed Consolidated Financial Statements, the restatement disclosures included herein comply with the provisions of the standard.

In June 2006, the FASB issued FASB Interpretation No. 48, “*Accounting for Uncertainty in Income Taxes — An Interpretation of FASB Statement No. 109*” (“FIN 48”). The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company’s financial statements in accordance with SFAS No. 109, “*Accounting for Income Taxes.*” Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation is effective for us on April 1, 2007. We are currently evaluating the impact that FIN 48 will have on our financial condition and results of operations.

During September 2006, the SEC released SAB No. 108, “*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.*” SAB No. 108 requires a registrant to quantify all misstatements that could be material to financial statement users under both the “rollover” and “iron curtain” approaches. If either approach results in quantifying a misstatement that is material, the registrant must adjust its financial statements. SAB No. 108 is applicable for our fiscal year 2007. We are currently evaluating the impact that SAB No. 108 will have on our financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 157, “*Fair Value Measurements.*” SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 is effective for our fiscal year 2009. We are currently evaluating the impact that SFAS No. 157 will have on our financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115.*” SFAS No. 159 gives companies an opportunity to use fair value measurements in financial reporting and permits entities to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that SFAS No. 159 will have on our financial condition and results of operations.

2. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

As a result of the errors discussed below, we have restated our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2005 and our Condensed Consolidated Statement of Cash Flows for the nine months ended December 31, 2005, including related disclosures.

Table of Contents

Restatement for Historical Stock Option Grants

Restated Accounting for Historical Stock Option Grants

In response to a letter received by our Chief Executive Officer (“CEO”), the Audit Committee, with the assistance of outside legal counsel and forensic accountants, commenced an investigation (“Audit Committee Investigation” or “Investigation”) into our historical practices related to stock options, including a review of option grant measurement dates. Prior to April 1, 2006, we accounted for all of our employee and director-based compensation awards under APB 25 and provided the required disclosures in accordance with SFAS No. 123.

In connection with the Audit Committee Investigation, we performed a review of stock option grants recorded for financial reporting purposes. Based on the individual facts and circumstances, we concluded that the exercise price for a number of option grants from our initial public offering (“IPO”) in 1996 through August 10, 2006 were below the fair market value of our common stock on the revised measurement date of the grant. This resulted from certain option grant dates having been established prior to the completion of all the final granting actions necessary for those grants. In some cases, the exercise price and date of the grant was determined with hindsight to provide a more favorable exercise price for such grants at quarterly or monthly low stock prices. The grants in question included grants made to newly hired employees, annual director grants, grants made to employees in connection with an acquisition, and discretionary grants made to officers, non-employee and employee directors, and rank and file employees. Applying the revised measurement dates to the impacted stock option grants resulted in a stock-based compensation charge if the fair market value of our common stock as of the revised measurement date exceeded the exercise price of the option grant, in accordance with APB 25.

Based on the facts and circumstances, we concluded that we (1) used incorrect measurement dates for the accounting of certain stock options, (2) had not properly accounted for certain modifications of stock options, and (3) had incorrectly accounted for certain stock options that required the application of the variable accounting method.

We determined revised measurement dates for those option grants with incorrect measurement dates and recorded stock-based compensation expense to the extent that the fair market value of our stock on the revised measurement date exceeded the exercise price of the stock option, in accordance with APB 25 and related FASB interpretations. Additionally, we restated both basic and diluted weighted average shares outstanding for changes in measurement dates resulting from the Investigation which also resulted in a change in the assumptions utilized in the Black-Scholes option pricing model for the nine months ended December 31, 2005. The combination of recording stock-based compensation expense and restating our weighted average shares outstanding has resulted in restated basic and diluted EPS.

We also determined that we should have recorded stock-based compensation expense associated with the modification of certain stock option grants which resulted in the application of variable accounting under FASB Interpretation No. 44, “*Accounting for Certain Transactions Involving Stock Compensation*” (“FIN 44”). The modified grants included certain grants made to newly hired employees, annual director grants, grants made to employees in connection with an acquisition, and discretionary grants made to officers, employee directors, and rank and file employees. For these grants, documentation exists that supports the completion of all the final granting actions necessary for an original grant and measurement date. However, certain of the terms of the awards were subsequently modified.

Income and Payroll Tax Related Matters

In certain instances where a revised measurement date was applied to those stock options classified as incentive stock options (“ISO”), in accordance with United States tax rules it had the effect of disqualifying the ISO tax treatment of those stock options, causing those stock options to be recharacterized as non-qualified options. For purposes of

assessing the tax impact of the accounting change, we concluded that the grant date for tax purposes is the same as the measurement date for financial reporting purposes. The recharacterization of the ISOs to non-qualified status resulted in a failure to withhold certain employee payroll taxes and consequently we have recorded an adjustment to salaries and benefits, along with an adjustment to interest and financing costs for penalties and interest, based on the period of exercise. In subsequent periods in which the liabilities were legally extinguished due to statutes of limitations, the payroll taxes, interest and penalties were reversed, and recognized as a reduction in the related functional expense category in our Condensed Consolidated Statements of Operations.

Table of Contents

Summary of the Restatement — Other Items

In addition to the stock option errors described above, we have also restated our Condensed Consolidated Statement of Cash Flows for the nine months ended December 31, 2005 for the following reasons:

We use floor planning agreements for dealer financing of products purchased from distributors and resold to end-users. Historically, we classified the cash flows from our floor plan financing agreements in operating activities in our Condensed Consolidated Statements of Cash Flows. We previously treated the floor plan facility as an outsourced accounts payable function, and, therefore, considered the payments made by our floor plan facility as cash paid to suppliers under Financial Accounting Standards No. 95, “*Statement of Cash Flows*.”

We have now determined that when an unaffiliated finance company remits payments to our suppliers on our behalf, we should show this transaction as a financing cash inflow and an operating cash outflow. In addition, when we repay the financing company, we should present this transaction as a financing cash outflow. As a result, we have restated the accompanying Condensed Consolidated Statement of Cash Flows for the nine months ended December 31, 2005 to correct this error.

Also, payments made by our lessees directly to third-party, non-recourse lenders were previously reported on our Condensed Consolidated Statements of Cash Flows as repayments of non-recourse debt in the financing section and a decrease in our investment in leases and leased equipment—net in the operating section. As these payments were not received or disbursed by us, management determined that these amounts should not be shown as cash used in financing activities and cash provided by operating activities on our Condensed Consolidated Statements of Cash Flows. Rather, these payments are now disclosed as a non-cash financing activity on our Condensed Consolidated Statements of Cash Flows.

Reclassifications

We have also reclassified certain items for our December 31, 2005 Condensed Consolidated Statement of Cash Flows to conform to our presentation on our December 31, 2006 Condensed Consolidated Statement of Cash Flows. These reclassifications include: (1) certain liabilities that had been included in accounts payable—trade have been reclassified to accrued expenses and other liabilities; and (2) certain personal property taxes have been reclassified to eliminate from investment in leases and leased equipment—net and accounts payable—equipment.

Impact of the Restatement

The following tables present the effects of the restatement and reclassifications on our previously issued Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2005 and the Condensed Consolidated Statement of Cash Flows for the nine months ended December 31, 2005 (in thousands, except per share data):

**UNAUDITED CONDENSED
CONSOLIDATED STATEMENTS OF OPERATIONS**

Three Months Ended December 31, 2005	As Previously Reported	Adjustments Stock-Based Compensation and Tax Impact	As Restated
Revenue			
Sales of product and services	\$ 146,385	-	\$ 146,385
Lease revenues	13,758	-	13,758
Fee and other income	2,931	-	2,931
Total Revenue	163,074	-	163,074
Cost and Expense			
Cost of sales, product and services	131,734	-	131,734
Direct lease costs	4,742	-	4,742
Professional and other fees	2,464	-	2,464
Salaries and benefits	15,678	215	15,893
General and administrative expenses	4,469	-	4,469
Interest and financing costs	1,950	6	1,956
Total Costs and Expenses	161,037	221	161,258
Earnings Before Provision for Income Taxes	2,037	(221)	1,816
Provision for Income Taxes	825	(85)	740
Net Earnings	\$ 1,212	\$ (136)	\$ 1,076
Net Earnings Per Share:			
Basic	\$ 0.15	\$ (0.02)	\$ 0.13
Diluted	\$ 0.14	\$ (0.02)	\$ 0.12
Shares Used in Computing Net Earnings Per Share:			
Basic	8,215,221	-	8,215,221
Diluted	8,890,948	(25,119)	8,865,829

Table of Contents**UNAUDITED CONDENSED
CONSOLIDATED STATEMENTS OF OPERATIONS**

	As Previously Reported	Adjustments Stock-Based Compensation and Tax Impact	As Restated
Nine Months Ended December 31, 2005			
Revenue			
Sales of product and services	\$ 440,663	\$ -	\$ 440,663
Lease revenues	36,969	-	36,969
Fee and other income	9,488	-	9,488
Total Revenue	487,120	-	487,120
Cost and Expense			
Cost of sales, product and services	397,564	-	397,564
Direct lease costs	12,336	-	12,336
Professional and other fees	5,188	-	5,188
Salaries and benefits	45,482	487	45,969
General and administrative expenses	13,906	-	13,906
Interest and financing costs	5,203	7	5,210
Total Costs and Expenses	479,679	494	480,173
Earnings Before Provision for Income Taxes	7,441	(494)	6,947
Provision for Income Taxes	3,014	(191)	2,823
Net Earnings	\$ 4,227	\$ (303)	\$ 4,124
Net Earnings Per Share:			
Basic	\$ 0.53	\$ (0.04)	\$ 0.49
Diluted	\$ 0.49	\$ (0.03)	\$ 0.46
Shares Used in Computing Net Earnings Per Share:			
Basic	8,411,268	-	8,411,268
Diluted	8,992,035	6,624	8,998,659

Table of Contents**Unaudited Condensed
Consolidated Statement
of Cash Flows****Nine Months Ended
December 31, 2005**

Adjustments

	As Previously Reported	Stock-Based Compensation	Floor Plan	Lessee Payments to Lenders	Other	As Restated
Cash Flows From Operating Activities:						
Net earnings	\$ 4,427	\$ (303)	\$ -	\$ -	\$ -	\$ 4,124
Adjustments to reconcile net earnings to net cash used in operating activities:						
Depreciation and amortization	12,673	-	-	-	-	12,673
Write-off of non-recourse debt	(22)	-	-	-	-	(22)
Reserve for credit losses	(280)	-	-	-	-	(280)
Impact of stock-based compensation	-	303	-	-	-	303
Tax benefit of stock options exercised	50	-	-	-	-	50
Deferred taxes	(2,339)	-	-	-	-	(2,339)
Payments from lessees directly to lenders	(5,645)	-	-	995	-	(4,650)
Loss on disposal of property and equipment	142	-	-	-	-	142
Gain on disposal of operating lease equipment	(932)	-	-	-	-	(932)
Changes in:						
Accounts receivable	(26,354)	-	-	-	-	(26,354)
Notes receivable	(37)	-	-	-	-	(37)
Inventories	(1,555)	-	-	-	-	(1,555)
Investment in leases and leased equipment—net	(4,525)	-	-	(16,569)	99	(20,995)
Other assets	152	-	-	-	-	152
Accounts payable—equipment	(2,959)	-	-	-	(99)	(3,058)
Accounts payable—trade	18,247	-	(8,532)	-	2,359	12,074
Salaries and commissions payable, accrued expenses and other liabilities	(10,144)	-	-	-	(2,359)	(12,503)
Net cash used in operating activities	(19,101)	-	(8,532)	(15,574)	-	(43,207)

**Cash Flows From
Investing Activities:**

Edgar Filing: EPLUS INC - Form 10-Q

Proceeds from sale of operating equipment	1,647	-	-	-	-	1,647
Purchases of operating lease equipment	(22,578)	-	-	-	-	(22,578)
Proceeds from sale of property and equipment	2	-	-	-	-	2
Purchases of property and equipment	(1,927)	-	-	-	-	(1,927)
Net cash used in investing activities	(22,856)	-	-	-	-	(22,856)

Cash Flows From Financing Activities:

Borrowings:						
Nonrecourse	68,682	-	-	-	-	68,682
Repayments:						
Nonrecourse	(43,443)	-	-	15,574	-	(27,869)
Purchase of treasury stock	(5,732)	-	-	-	-	(5,732)
Proceeds from issuance of capital stock, net of expenses	187	-	-	-	-	187
Net borrowings on floor-planning facility	-	-	8,532	-	-	8,532
Net borrowings on lines of credit	735	-	-	-	-	735
Net cash provided by financing activities	20,429	-	8,532	15,574	-	44,535

Effect of Exchange Rate Changes on Cash

	92	-	-	-	-	92
--	----	---	---	---	---	----

Net Decrease in Cash and Cash Equivalents

	(21,436)	-	-	-	-	(21,436)
--	----------	---	---	---	---	----------

Cash and Cash Equivalents, Beginning of Period

	38,852	-	-	-	-	38,852
--	--------	---	---	---	---	--------

Cash and Cash Equivalents, End of Period

	\$ 17,416	\$ -	\$ -	\$ -	\$ -	\$ 17,416
--	-----------	------	------	------	------	-----------

Table of Contents**3. INVESTMENT IN LEASES AND LEASED EQUIPMENT—NET**

Investment in leases and leased equipment—net consists of the following (in thousands):

	March 31, 2006	As of December 31, 2006
Investment in direct financing and sales-type leases-net	\$ 155,910	\$ 161,209
Investment in operating lease equipment-net	49,864	55,766
	\$ 205,774	\$ 216,975

INVESTMENT IN DIRECT FINANCING AND SALES-TYPE LEASES—NET

Our investment in direct financing and sales-type leases—net consists of the following (in thousands):

	March 31, 2006	As of December 31, 2006
Minimum lease payments	\$ 149,200	\$ 158,368
Estimated unguaranteed residual value (1)	23,804	22,973
Initial direct costs, net of amortization (2)	1,763	1,684
Less: Unearned lease income	(15,944)	(19,240)
Reserve for credit losses	(2,913)	(2,576)
Investment in direct finance and sales-type leases-net	\$ 155,910	\$ 161,209

(1) Includes estimated unguaranteed residual values of \$1,451 and \$1,213 as of March 31, 2006 and December 31, 2006, respectively, for direct financing SFAS 140 leases.

(2) Initial direct costs are shown net of amortization of \$1,786 and \$1,385 as of March 31, 2006 and December 31, 2006, respectively.

Our net investment in direct financing and sales-type leases is collateral for non-recourse and recourse equipment notes, if any.

INVESTMENT IN OPERATING LEASE EQUIPMENT—NET

Investment in operating lease equipment—net primarily represents leases that do not qualify as direct financing leases or are leases that are short-term renewals on a month-to-month basis. The components of the net investment in operating lease equipment are as follows (in thousands):

	March 31, 2006	As of December 31, 2006
Cost of equipment under operating leases	\$ 71,786	\$ 87,738
Less: Accumulated depreciation and amortization	(21,922)	(31,972)
Investment in operating lease equipment-net	\$ 49,864	\$ 55,766

Table of Contents**4. RESERVES FOR CREDIT LOSSES**

As of March 31 and December 31, 2006, our activity in our reserves for credit losses is as follows (in thousands):

	Accounts Receivable	Lease-Related Assets	Total
Balance April 1, 2005	\$ 1,959	\$ 3,056	\$ 5,015
Bad debts expense	1,033	-	1,033
Recoveries	(308)	-	(308)
Write-offs and other	(624)	(143)	(767)
Balance March 31, 2006	\$ 2,060	\$ 2,913	\$ 4,973
Bad debts expense	1,417	(100)	1,317
Recoveries	(522)	-	(522)
Write-offs and other	(148)	(237)	(385)
Balance December 31, 2006	\$ 2,807	\$ 2,576	\$ 5,383

5. RECOURSE AND NON-RECOURSE NOTES PAYABLE

Recourse and non-recourse obligations consist of the following (in thousands):

	March 31, 2006	As of December 31, 2006
GE Commercial Distribution Finance Corporation – Recourse accounts receivable component of our credit facility bearing interest at prime less 0.5% (7.75% at December 31, 2006) with a maximum balance of \$30,000,000. Either party may terminate with 90 days' advance notice.	\$ -	\$ -
National City Bank – Recourse credit facility of \$35,000,000 expiring on July 21, 2009. At our option, the carrying interest rate is either LIBOR rate plus 175–250 basis points, or the Alternate Base Rate of the higher of prime, or federal funds rate plus 50 basis points, plus 0.25 basis points of margin. The interest rate at December 31, 2006 was 6.875%.	6,000	10,000
Total recourse obligations	\$ 6,000	\$ 10,000
Non-recourse equipment notes secured by related investments in leases with interest rates ranging from 3.05% to 9.05% for year ended March 31, 2006 and 3.05% to 9.25% for the nine months ended December 31, 2006.	\$ 127,973	\$ 159,200

There are two components of the GE Commercial Distribution Finance Corporation (“GECDF”) credit facility: (1) a floor plan component and (2) an accounts receivable component. As of December 31, 2006 and as a result of the June 29, 2006 amendment, the facility agreement had an aggregate limit of the two components of \$85.0 million, and the accounts receivable component had a sub-limit of \$30 million other than during the overline period from June 26,

2006 through September 21, 2006 in which the aggregate limit of the two components was \$100.0 million. Effective June 20, 2007, the facility with GECDF was again amended to temporarily increase the total credit facility limit to \$100.0 million during the period from June 19, 2007 through August 15, 2007. On August 2, 2007, the period was extended from August 15, 2007 to September 30, 2007 and then extended again on October 1, 2007 through October 31, 2007. Other than during the temporary increase periods described above, the total credit facility limit is \$85.0 million. Effective October 29, 2007, the aggregate limit of the facility was increased to \$125.0 million with an accounts receivable sub-limit of \$30.0 million, and the temporary overline period was eliminated. Availability under the GECDF facility may be limited by the asset value of equipment we purchase and may be further limited by certain covenants and terms and conditions of the facility. We were in compliance with these covenants as of December 31, 2006.

The facility provided by GECDF requires a guaranty of up to \$10.5 million by *ePlus* inc. The guaranty requires *ePlus* inc. to deliver its annual audited financial statements by a certain date. We have not delivered the annual audited financial statements for the year ended March 31, 2007; however, GECDF has extended the delivery date to provide the financial statements through November 30, 2007. The loss of the GECDF credit facility could have a material adverse effect on our future results as we currently rely on this facility and its components for daily working capital and liquidity for our technology sales business and as an operational function of our accounts payable process.

Table of Contents

Borrowings under our \$35 million line of credit from National City Bank are subject to and in compliance with certain covenants regarding minimum consolidated tangible net worth, maximum recourse debt to net worth ratio, cash flow coverage, and minimum interest expense coverage ratio. We were in compliance with or had received amendments extending these covenants as of December 31, 2006. The borrowings are secured by our assets such as leases, receivables, inventory, and equipment. Borrowings are limited to our collateral base, consisting of equipment, lease receivables and other current assets, up to a maximum of \$35 million. In addition, the credit agreement restricts, and under some circumstances prohibits, the payment of dividends.

The National City Bank facility requires the delivery of our Audited and Unaudited Financial Statements, and pro forma financial projections, by certain dates. We have not delivered the following documents as required by Section 5.1 of the facility: (a) annual Audited Financial Statements for the year ended March 31, 2007; (b) "Projections" for our fiscal year ending March 31, 2008; and (c) quarterly Unaudited Financial Statements for the quarters ended December 31, 2006 and June 30, 2007. We entered into the following amendments which have extended the delivery date requirements for these documents: a First Amendment dated July 11, 2006, a Second Amendment dated July 28, 2006, a third Amendment dated August 30, 2006, a Fourth Amendment dated September 27, 2006, a Fifth Amendment dated November 15, 2006, a Sixth Amendment dated January 11, 2007, a Seventh Amendment dated March 12, 2007, an Eighth Amendment dated June 27, 2007 and a Ninth Amendment dated August 22, 2007. As a result of the amendments, the agents agreed, *inter alia*, to extend the delivery date of the documents above through November 30, 2007.

We believe we will receive additional extensions from our lenders, if needed, regarding our requirement to provide financial statements as described above through the date of delivery of the documents. However, we cannot guarantee that we will receive any such additional extensions.

6. RELATED PARTIES

We lease 50,322 square feet for use as our principal headquarters from Norton Building 1, LLC. The annual rent is \$19.50 per square foot for the first year, with a rent escalation of three percent per year for each year thereafter. Phillip G. Norton is the Manager of Norton Building 1, LLC and is Chairman of the Board, President, and CEO of ePlus inc. The lease is at or below market taking into consideration the rental charges and the ability to terminate the lease. During the three and nine months ended December 31, 2006, we paid rent in the amount of \$238 thousand and \$710 thousand, respectively. During the three and nine months ended December 31, 2005, we paid rent in the amount of \$219 thousand and \$658 thousand, respectively.

During the nine months ended December 31, 2005, we reimbursed the landlord for certain construction costs in the amount of \$280 thousand, which are being amortized over the lease term. There was no such reimbursement during the nine months ended December 31, 2006. The capitalized reimbursement is included in property and equipment—net on the Condensed Consolidated Balance Sheets.

7. COMMITMENTS AND CONTINGENCIES

Pending Litigation

We have been involved in several matters described below, arising from four separate installment sales to a customer named Cyberco Holdings, Inc. ("Cyberco"), which was perpetrating a fraud related to installment sales that were assigned to various lenders and were non-recourse to us.

In the first lawsuit, which was filed May 10, 2005, an underlying lender, Banc of America Leasing and Capital, LLC ("BoA") sought repayment from us of approximately \$3,062,792 plus interest and attorneys' fees. The case went to trial,

and a final judgment in favor of BoA was entered on February 6, 2007. We have recorded \$4,081,697, representing \$3,025,000 verdict, \$871,232 in attorneys' fees and \$185,465 in interest and other costs in the fiscal year ended March 31, 2006. We have recorded an additional \$36,429 in interest in the quarter ended December 31, 2006 and \$108,891 for the nine months ended December 31, 2006.

Table of Contents

The second lawsuit was filed on November 3, 2006 by BoA against ePlus inc., seeking to enforce a guaranty in which ePlus inc. guaranteed ePlus Group, inc.'s obligations to BoA relating to the Cyberco transaction. ePlus Group has already paid to BoA the judgment in the suit against ePlus Group referenced above. The suit against ePlus seeks attorneys' fees BoA incurred in ePlus' appeal of BoA's suit against ePlus Group referenced above, expenses that may be incurred in a bankruptcy adversary proceeding relating to Cyberco, attorneys' fees incurred by BoA in defending a pending suit by ePlus Group against BoA, and any other costs or fees relating to any of the described matters. The trial is scheduled to begin in March 2008. ePlus is vigorously defending the suit. We cannot predict the outcome of this suit. We believe a loss is not probable, and we have not accrued for this matter.

In the bankruptcy adversary proceeding, which was filed on December 7, 2006, Cyberco's bankruptcy trustee is seeking approximately \$775,000 as alleged preferential transfers. Discovery has commenced. We cannot predict the outcome of this litigation. We dispute that we are liable, believe we have strong defenses to the claims and intend to vigorously defend against them. We believe a loss is not probable, and we have not accrued for this matter.

On December 11, 2006, ePlus inc. and SAP America, Inc. and its German parent, SAP AG (collectively, "SAP") entered into a Patent License and Settlement Agreement (the "Agreement") to settle a patent lawsuit between the companies which was filed on April 20, 2005. Under the terms of the Agreement, we licensed to SAP our existing patents as well as patents developed and/or acquired by us within the next five years in exchange for a one-time cash payment of \$17,500,000, which was paid on January 16, 2007. No royalties or additional payments of any kind are required to keep this Agreement in full force. We are not engaged in licensing patents in the normal course of our business and do not perform research and development activities to obtain patentable processes or products; however, we may patent our existing business processes or products. We do not anticipate incurring any additional costs arising as a result of this Agreement and there are no further actions that are required to be taken by us. In addition, SAP has agreed not to pursue legal action against us for patent infringement as to any of our current lines of business on any of SAP's patents for a period of five years. The Agreement also provided for general release, indemnification for its violation, and dismissed the litigation with prejudice. We accrued for the Agreement in the quarter ended December 31, 2006 in patent settlement income on the accompanying Condensed Consolidated Statements of Operations.

On January 18, 2007 a stockholder derivative action related to stock option practices was filed in the United States District Court for the District of Columbia. The amended complaint names ePlus inc. as nominal defendant, and personally names eight individual defendants who are directors and/or executive officers of ePlus. The amended complaint alleges violations of federal securities law, and various state law claims such as breach of fiduciary duty, waste of corporate assets and unjust enrichment. We have filed a Motion to Dismiss the plaintiff's amended complaint. The amended complaint seeks monetary damages from individual defendants and that we take certain corrective actions relating to option grants and corporate governance, and attorneys' fees. We cannot predict the outcome of this suit. No amount has been accrued for this matter.

We are also engaged in other ordinary and routine litigation incidental to our business. While we cannot predict the outcome of these various legal proceedings, management believes that a loss is not probable and no amount has been accrued for these matters.

Regulatory and Other Legal Matters

As discussed in more detail in Note 2, "Restatement of Consolidated Financial Statements," in June 2006, the Audit Committee commenced an investigation of our stock option grants since our initial public offering in 1996. In August 2006, the Audit Committee voluntarily contacted and advised the staff of SEC of its investigation and the Audit Committee's preliminary conclusion that a restatement will be required. The SEC opened an informal inquiry and we have and will continue to cooperate with the staff. No amount has been accrued for this matter.

We are currently engaged in a dispute with the government of the District of Columbia (“DC”) regarding personal property taxes on property we financed for our customers. DC is seeking approximately \$508,000 plus interest and penalties, relating to property we financed for our customers. We believe the tax is owed by our customers, and are seeking resolution in DC’s Office of Administrative Hearings. We cannot predict the outcome of this matter. While management does not believe this matter will have a material effect on its financial condition and results of operations, resolution of this dispute is ongoing.

8. EARNINGS PER SHARE

Basic and diluted income per share amounts are determined in accordance with the provisions of SFAS No. 128, *Earnings Per Share*. Basic income per share is computed using the weighted average number of shares of common stock outstanding for the period. Diluted income per share is computed using the weighted average number of shares of common stock, adjusted for the dilutive effect of potential common stock. Potential common stock, computed using the treasury stock method or the if-converted method, includes options.

Table of Contents

The following table provides a reconciliation of the numerators and denominators used to calculate basic and diluted net income per common share as disclosed in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2005 and 2006 (in thousands, except per share data).

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005 As Restated (1)	2006	2005 As Restated (1)	2006
Net income available to common shareholders-- basic and diluted	\$ 1,076	\$ 12,404	\$ 4,124	\$ 15,446
Weighted average common shares outstanding—basic	8,215	8,232	8,411	8,223
In-the-money options exercisable under stock compensation plans	651	225	588	355
Weighted average common shares outstanding—diluted	8,866	8,457	8,999	8,578
Income per common share:				
Basic	\$ 0.13	\$ 1.51	\$ 0.49	\$ 1.88
Diluted	\$ 0.12	\$ 1.47	\$ 0.46	\$ 1.80

(1) See Note 2, “Restatement of Consolidated Financial Statements.”

Unexercised employee stock options to purchase 890,907 and 844,707 shares of our common stock were not included in the computations of diluted EPS for the three and nine months ended December 31, 2006, respectively, because the options’ exercise prices were greater than the average market price of our common stock during the applicable periods.

9. STOCK REPURCHASE

On November 17, 2004, a purchase program was authorized by our Board. This program authorized the repurchase of up to 3,000,000 shares of our outstanding common stock over a period of time ending no later than November 17, 2005 and was limited to a cumulative purchase amount of \$7,500,000. On March 2, 2005, our Board approved an increase, from \$7,500,000 to \$12,500,000, for the maximum total cost of shares that could be purchased, which expired November 17, 2005. On November 18, 2005, the Board authorized a new stock repurchase program of up to 3,000,000 shares with a cumulative purchase limit of \$12,500,000.

During the nine months ended December 31, 2006, we repurchased 209,000 shares of our outstanding common stock for \$2.9 million, whereas during the nine months ended December 31, 2005, we repurchased 447,056 shares for \$5.7 million. Since the inception of our initial repurchase program on September 20, 2001, and as of December 31, 2006, we had repurchased 2,978,990 shares of our outstanding common stock at an average cost of \$11.04 per share for a total of \$32.9 million. When the stock repurchase program expired on November 17, 2006, a maximum purchase amount of \$7,856,187 and up to 763,107 shares were available. As of December 31, 2006, there was no approved stock repurchase plan.

10. STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "*Share-Based Payment*," or SFAS No. 123R. SFAS No. 123R replaces SFAS No. 123 "*Accounting for Stock-Based Compensation*," and supersedes APB 25, "*Accounting for Stock Issued to Employees*," and subsequently issued stock option related guidance. This statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Entities are required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification.

Table of Contents

On April 1, 2006, we adopted SFAS No. 123R using the modified prospective transition method. We have recognized compensation cost equal to the fair values for the unvested portion of share-based awards at April 1, 2006 over the remaining period of service, as well as compensation cost for those share-based awards granted or modified on or after April 1, 2006 over the vesting period based on the grant-date fair values using the straight-line method. The fair values were estimated using the Black-Scholes option pricing model. For those awards granted prior to the date of adoption, compensation expense is recognized on an accelerated basis based on the grant-date fair value amount as calculated for pro forma purposes under SFAS No. 123.

Stock Option Plans

We issued only incentive and non-qualified stock option awards, and, except as noted below, each grant was issued under one of the following five plans; (1) the 1996 Stock Incentive Plan (the “1996 SIP”), (2) Amendment and Restatement of the 1996 Stock Incentive Plan (“the Amended SIP”) (collectively the “1996 Plans”), (3) the 1998 Long-Term Incentive Plan (the “1998 LTIP”), (4) Amendment and Restatement of the 1998 Long-Term Incentive Plan (2001) (the “Amended LTIP (2001)”) or (5) Amendment and Restatement of the 1998 Long-Term Incentive Plan (2003) (the “Amended LTIP (2003)”). A summary of the plans are detailed below. All the stock option plans require the use of the previous trading day’s closing price when the grant date falls on a date the stock was not traded.

In addition, at the IPO, there were 245,000 options issued that were not part of any plan, but issued under various employment agreements.

1996 Stock Incentive Plan

The allowable number of outstanding shares under this plan was 155,000. On September 1, 1996, the Board adopted this plan, and it was effective on November 8, 1996 when the SEC declared our Registration Statement on Form S-1 effective in connection with our IPO on November 20, 1996. The 1996 SIP is comprised of an Incentive Stock Option Plan, a Nonqualified Stock Option Plan, and an Outside Director Stock Option Plan. Each of the components of the 1996 Plans provided that options would only be granted after execution of an Option Agreement. Except for the number of options awarded to directors, the salient provisions of the 1996 SIP are identical to the Amended SIP, which is more fully described below.

With regard to director options, the 1996 Outside Director Stock Option Plan provided for 10,000 options to be granted to each non-employee director upon completion of the IPO, and 5,000 options to be granted to each non-employee director on the anniversary of each full year of his or her services as a director of ePlus. As with the other components of the 1996 Plans, the director options would be granted only