

---

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

---

**Form 10-K**

---

**FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended December 31, 2004

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES AND EXCHANGE COMMISSION**

Commission File Number 0-23827

---

**PC CONNECTION, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**02-0513618**

(I.R.S. Employer Identification No.)

**Rt. 101A, 730 Milford Road  
Merrimack, New Hampshire**

(Address of principal executive offices)

**03054**

(Zip Code)

**(603) 683-2000**

Registrant's telephone number, including area code

---

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.01 par value

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

YES  NO

The aggregate market value of the voting and non-voting stock held by non-affiliates of the Registrant, based upon the closing price of the Registrant's Common Stock as reported on the NASDAQ National Market on June 30, 2004, was \$49,434,705. Although directors and executive officers of the registrant were assumed to be "affiliates" of the registrant for the purposes of this calculation, this classification is not to be interpreted as an admission of such status.

The number of outstanding shares of the Registrant's Common Stock on March 14, 2005 was 25,135,721.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the 2005 Annual Meeting of Shareholders for the fiscal year ended December 31, 2004, which is to be filed within 120 days of the end of the Company's fiscal year, are incorporated by reference into Part III of this Form 10-K. The incorporation by reference herein of portions of the Proxy Statement shall not be deemed to specifically incorporate by reference the information referred to in Item 402(a) (8) of Regulation S-K.

---

PC CONNECTION, INC. AND SUBSIDIARIES

FORM 10-K ANNUAL REPORT  
YEAR ENDED DECEMBER 31, 2004

TABLE OF CONTENTS

	<u>Page</u>
<b><u>PART I</u></b>	
ITEM 1. <a href="#">Business</a>	1
ITEM 2. <a href="#">Properties</a>	10
ITEM 3. <a href="#">Legal Proceedings</a>	10
ITEM 4. <a href="#">Submission of Matters to a Vote of Security Holders</a>	11
<b><u>PART II</u></b>	
ITEM 5. <a href="#">Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</a>	12
ITEM 6. <a href="#">Selected Financial and Operating Data</a>	13
ITEM 7. <a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	14
ITEM 7A. <a href="#">Quantitative and Qualitative Disclosure About Market Risk</a>	35
ITEM 8. <a href="#">Consolidated Financial Statements and Supplementary Data</a>	36
ITEM 9. <a href="#">Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</a>	36
ITEM 9A. <a href="#">Controls and Procedures</a>	36
ITEM 9B. <a href="#">Other Information</a>	37
<b><u>PART III</u></b>	
ITEM 10. <a href="#">Directors and Executive Officers of the Registrant</a>	38
ITEM 11. <a href="#">Executive Compensation</a>	38
ITEM 12. <a href="#">Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</a>	38
ITEM 13. <a href="#">Certain Relationships and Related Transactions</a>	38
ITEM 14. <a href="#">Principal Accountant Fees and Services</a>	38
<b><u>PART IV</u></b>	
ITEM 15. <a href="#">Exhibits and Financial Statement Schedules</a>	39
<a href="#">SIGNATURES</a>	44

**PART I**

**Item 1. Business**

*This section contains forward-looking statements based on management's current expectations, estimates, and projections about the industry in which we operate, management's beliefs, and certain assumptions made by management. All statements, trends, analyses, and other information contained in this report relative to trends in net sales, gross margin, and anticipated expense levels, as well as other statements, including words such as "anticipate," "believe," "plan," "estimate," "expect," "may," "project," "will," "would," and "intend" and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth under the caption "Factors That May Affect Future Results and Financial Condition" included in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations." Particular attention should be paid to the cautionary statements involving the industry's rapid technological change and exposure to inventory obsolescence, availability and allocations of goods, reliance on vendor support and relationships, competitive risks, pricing risks, and the overall level of economic activity and the level of business investment in information technology products. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events, or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission.*

**GENERAL**

We are a direct marketer of information technology products and solutions, including brand-name personal computers and related peripherals, software, accessories, and networking products through our three primary sales subsidiaries, PC Connection Sales Corporation, GovConnection, Inc., and MoreDirect, Inc. Our principal customers are small- and medium-sized businesses, known as SMBs (comprised of 20 to 500 employees), governmental agencies and educational organizations, and medium-to-large corporate accounts. We sell products through a combination of outbound telemarketing, field sales, targeted direct mail catalogs, our Internet Web sites, and advertisements on the Internet and in selected computer magazines. We offer a broad selection of approximately 100,000 products targeted for business use at competitive prices, including products from Acer, Apple Computer, Cisco Systems, Hewlett-Packard ("HP"), IBM, Microsoft, Sony, Symantec, and Toshiba. Our most frequently ordered products are carried in inventory and are typically shipped to customers the same day that the order is received.

We are subject to the informational requirements of the Exchange Act, and, accordingly, file reports, proxy statements, and other information with the Securities and Exchange Commission. Such reports, proxy statements, and other information can be read and copied at the public reference facilities maintained by the Securities and Exchange Commission at the Public Reference Room, 450 Fifth Street, NW, Washington, D.C. 20549. Information regarding the operation at the Public Reference Room may be obtained by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains a web site (<http://www.sec.gov>) that contains material regarding issuers that file electronically with the Securities and Exchange Commission. We maintain a Web site with the address [www.pcconnection.com](http://www.pcconnection.com). We are not including the information contained in our Web site as part of, or incorporating it by reference into, this annual report on Form 10-K. We make available free of charge through our Web site our annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file these materials with, or otherwise furnish them to, the Securities and Exchange Commission.

Since our founding in 1982, we have consistently served our customers' needs by providing innovative, reliable, and timely service and technical support, and by offering an extensive assortment of branded products,

## [Table of Contents](#)

through knowledgeable, well-trained sales and support teams. Our strategy's effectiveness is reflected in the recognition we have received, including being recently named to the Fortune 1000 and the VAR Business 500.

We believe that our consistent customer focus has also resulted in the development of strong brand name recognition and a broad and loyal customer base. At December 31, 2004, our mailing list consisted of approximately 3,350,000 customers, of which approximately 398,000 had purchased products from us within the last twelve months. Approximately 89% of our net sales in the year ended December 31, 2004 were made to customers who had previously purchased products from us. We believe we also have strong relationships with vendors, resulting in favorable product allocations and marketing assistance.

Our business-to-business marketing efforts are targeted to SMBs, government and educational organizations, and medium-to-large corporate accounts. As of December 31, 2004, we employed 591 account managers, including 137 new account managers with less than 12 months of outbound telemarketing experience with us. Account managers are responsible for managing corporate accounts and focus on outbound sales calls to prospective customers. We are continuing to focus on increasing the productivity of our account managers.

We publish several catalogs, including PC Connection<sup>®</sup>, focusing on PCs and compatible products, and MacConnection<sup>®</sup>, focusing on Apple personal computers and compatible products. We also issue, from time to time, specialty catalogs, including GovConnection catalogs directed to government and education organizations. With colorful illustrations, concise product descriptions, relevant technical information, along with toll-free telephone numbers for ordering, our catalogs are recognized as a leading source for personal computer hardware, software, and other related products. We distributed approximately 31 million catalogs during the year ended December 31, 2004.

We also market our products and services through our Web sites, [www.pcconnection.com](http://www.pcconnection.com), [www.govconnection.com](http://www.govconnection.com), [www.macconnection.com](http://www.macconnection.com), and [www.moredirect.com](http://www.moredirect.com). Our Web sites provide customers and prospective customers with product information and enable customers to place electronic orders for products. For the fiscal year 2004, Internet sales processed directly online were \$275.4 million, or 20.3% of net sales, compared to 16.2% in 2003. These sales during the fourth quarter of 2004 were \$74.8 million, or 22.0% of that quarter's net sales, compared to 16.5% for the fourth quarter of 2003.

The Internet supports three key business initiatives for us:

- **Customer choice** — We have built our business on the premise that our customers should be able to choose how they interact with us, be it by mail, telephone, fax, e-mail, or over the Internet.
- **Lowering transactions costs** — Our Web site tools, including robust product search features, Internet Business Accounts, and special interest pages, allow customers to quickly and easily find information about products of interest to them. If customers still have questions, they may call into our Telesales Representatives or Outbound Account Managers. Such phone calls are typically shorter and have higher close rates than calls from customers who have not first visited our Web sites.
- **Leveraging the time of experienced Account Managers** — Our investments in technology-based sales and service programs allow our Account Managers more time to build and maintain relationships with our customers and help them to solve their business problems.

## MARKET AND COMPETITION

We generate approximately 59% of our sales from the small- and medium-sized business market, 19% from governmental agencies and educational organizations, and 22% from medium-to-large corporate accounts (Fortune 1000). The overall U.S. Information Technology market that we serve is estimated at approximately \$200 billion. The largest segment of the market is served by local and regional "value added

## [Table of Contents](#)

resellers” (“VARs”), many of whom we believe are transitioning from the hardware and software business to IT services, which generally have higher margins.

We have transitioned from an end-user or desktop-centric computing supplier to a network or enterprise-wide computing supplier. We have also partnered with third-party technology and telecommunications service providers. We now offer access to the same services and technical expertise to our customers as local and regional VARs, but with more extensive product selection at lower prices.

Intense competition for customers has led manufacturers of PCs and related products to use all available channels, including direct marketers, to distribute products. Although certain manufacturers who have traditionally used resellers to distribute their products have established or attempted to establish their own direct marketing operations, including sales through the Internet, to our knowledge, only one has replaced its traditional indirect selling channels as the principal means of distribution. Accordingly, we believe that these manufacturers of PCs and related products will continue to provide us and other third-party direct marketers favorable product allocations and marketing support.

We believe new entrants to the direct marketing channel must overcome a number of obstacles, including:

- the substantial time and resources required to build a customer base of meaningful size, quality, and responsiveness for cost-effective circulation;
- the high costs of developing the information and operating infrastructure required by direct marketers;
- the advantages enjoyed by larger and more established competitors in terms of purchasing and operating efficiencies;
- the difficulty of building relationships with manufacturers to achieve favorable product allocations and attractive pricing terms; and
- the difficulty of identifying and recruiting management personnel with significant direct marketing experience in the industry.

## **BUSINESS STRATEGIES**

Our objective is to become the principal supplier of information technology products and solutions, including personal computers and related products and services, to our customers. The key elements of our business strategies include:

- ***Providing consistent award-winning customer service before, during, and after the sale.*** We believe that we have earned a reputation for providing superior customer service by consistently focusing on our customers’ needs. We deliver value to our customers through high quality service and technical support provided by our knowledgeable, well-trained personnel. We also have efficient delivery programs and offer our customers reasonable return policies.
- ***Offering a broad product selection at competitive prices.*** We offer our customers a wide assortment of information technology products and solutions, including personal computers and related products and networking products, at competitive prices. Our merchandising programs feature products that provide customers with aggressive price and performance and the convenience of one-stop shopping for their personal computer and related needs.
- ***Maintaining a strong brand name and customer awareness.*** Since our founding in 1982, we have built a strong brand name and customer awareness. We have been named to the Fortune 1000 and the VAR Business 500. Our mailing list includes approximately 3,350,000 names, of which approximately 398,000 have purchased products from us during the last 12 months.

## [Table of Contents](#)

- **Maintaining long-standing vendor relationships.** We have a history of strong relationships with vendors, and were among the first direct marketers qualified by manufacturers to market computer systems to end users. We provide our vendors with both information concerning customer preferences and an efficient channel for the advertising and distribution of their products.

### **GROWTH STRATEGIES**

Our growth strategies are to increase revenues derived from our penetration of our existing customers, broaden our product offerings, and expand our customer base. The key elements of our growth strategies include:

- **Targeting customer segments.** Through targeted mailings, we seek to expand the number of our active customers and generate additional sales from our existing customers. We have developed specialty catalogs, as well as standard catalogs with special cover pages, featuring product offerings designed to address the needs of specific customer populations, including new product inserts targeted to purchasers of graphics, server, and networking products.
- **Expanding product and service offerings.** We continually evaluate information technology products and services focused on business users, adding new products and services as they become available or in response to customer demand. We work closely with vendors to identify and source first-to-market product offerings at aggressive prices, and believe that the expansion of our corporate outbound marketing program will enhance our access to such product offerings. In addition to using our own inventories, we utilize our distribution and manufacturing suppliers to drop ship products directly to our customers. We drop shipped 38.3% of our net sales in 2004.
- **Expanding electronic commerce channel.** Our Web-based catalog provides detailed product descriptions, product search capabilities, and online order processing. This channel provides our customers with a convenient means of shopping with us, and it also allows us to leverage our account managers more effectively. The number of Internet Business Account users grew from 77,000 at December 31, 2003 to approximately 138,000 at December 31, 2004. We plan to further improve online sales capabilities, customer service and product information and customer support available on our Web site. We also plan to expand our online affinity sales programs with major customers and thereby solidify our long-term relationship with these customers.
- **Increasing outbound telemarketing productivity.** We believe that higher sales productivity is the key to leveraging our expense structure and driving future profitability improvements. We plan to expand and focus our training and evaluation programs, system enhancements, and sales tools more towards assisting our sales personnel in improving their productivity. As we increase our productivity, we plan to increase the number of our corporate account managers and assign them a greater number of our customers.
- **Pursuing strategic acquisitions and alliances.** We seek acquisitions and alliances that add new customers, strengthen our product offerings, add management talent, and produce operating results which are accretive to our core business earnings. In 2002, we acquired MoreDirect, a premier e-procurement supplier of IT products for medium-to-large corporate organizations nationwide.

### **SERVICE AND SUPPORT**

Since our founding in 1982, our primary objective has been to provide products that meet the demands and needs of customers and to supplement those products with up-to-date product information and excellent customer service and support. We believe that offering our customers superior value, through a combination of product knowledge, consistent and reliable service, and leading products at competitive prices, differentiates us from other direct marketers and provides the foundation for developing a broad and loyal customer base.

We invest in training programs for our service and support personnel, with an emphasis on putting customer needs and service first. We provide toll-free technical support from 9:00 a.m. through 5:30 p.m., Eastern time,

## [Table of Contents](#)

Monday through Friday. Product support technicians assist callers with questions concerning compatibility, installation, determination of defects, and more difficult questions relating to product use. The product support technicians authorize customers to return defective or incompatible products to either the manufacturer or to us for warranty service. In-house technicians perform both warranty and non-warranty repair on most major systems and hardware products.

Using our customized information system, we send our customer orders to our distribution center for processing immediately after a customer receives credit approval. Through our Everything Overnight® service, orders accepted up until 2:00 a.m. Eastern time, (until midnight on most custom-configured systems) are generally shipped for overnight delivery via DHL Worldwide. We also configure approximately 15% of the computer systems we ship from our distribution center. Configuration typically consists of the installation of memory, accessories, and/or software.

### MARKETING AND SALES

We sell our products through our direct marketing channels to SMBs, governmental agencies and educational organizations, and medium-to-large corporate accounts. We seek to be the primary supplier of information technology products and solutions, including personal computers and related products, to our existing customers and to expand our customer base. We use multiple marketing approaches to reach existing and prospective customers, including:

- outbound telemarketing and field sales;
- catalogs and inbound telesales;
- Web and print media advertising; and
- marketing programs targeted to specific customer populations.

All of our marketing approaches emphasize our broad product offerings, fast delivery, customer support, competitive pricing, and multiple payment options.

We believe that our ability to establish and maintain long-term customer relationships and to encourage repeat purchases is largely dependent on the strength of our telemarketing personnel and programs. Because our customers' primary contact with us is through our telemarketers, we are committed to maintaining a qualified, knowledgeable, and motivated sales staff with its principal focus on customer service.

The following table sets forth our percentage of net sales by sales channel:

Sales Channel	Years Ended December 31,		
	2004	2003	2002
Outbound Telemarketing and Field Sales	74%	77%	78%
Inbound Telesales	6	7	7
Online Internet	20	16	15
Total	100%	100%	100%

**Outbound Telemarketing and Field Sales.** We seek to build loyal relationships with our potential high-volume customers by assigning them to individual account managers. We believe that customers respond favorably to a one-on-one relationship with personalized, well-trained account managers. Once established, these one-on-one relationships are maintained and enhanced through frequent telecommunications and targeted catalogs and other marketing materials designed to meet each customer's specific computing needs. We pay most of our account managers a base annual salary plus incentive compensation. Incentive compensation is tied to gross profit dollars produced by the individual account manager. Account managers historically have

## Table of Contents

significantly increased productivity after approximately twelve months of training and experience. At December 31, 2004, we employed 591 sales representatives, including 137 with less than twelve months of outbound telemarketing experience with us.

**Inbound Telesales.** Our inbound sales representatives answer customer telephone calls generated by our catalog, magazine, and other advertising programs. These representatives also assist customers in making purchasing decisions, process product orders, and respond to customer inquiries on order status, product pricing, and availability. Using our proprietary information systems, sales representatives can quickly access customer records which detail purchase history and billing and shipping information, expediting the ordering process. In addition to receiving orders through our toll-free numbers, orders are also received via fax, mail, and electronic mail. Our two principal catalogs are PC Connection® for the PC market and MacConnection® for the Apple market. In 2004, we published twelve editions of the PC Connection catalog and eleven editions of the MacConnection catalog. We distribute catalogs to purchasers on our in-house mailing list as well as to other prospective customers. In addition, we mail specialty catalogs or customized versions of our catalogs to selected customers. We distribute specialty catalogs to educational and governmental customers and prospects on a periodic basis. We also distribute our monthly catalogs customized with special covers and inserts, offering a wider assortment of special offers on products in specific areas such as graphics, server/netcom, and mobile computing, or for specific customers, such as developers. These customized catalogs are distributed to targeted customers included in our customer database using past identification or purchase history, as well as to outside mailing lists.

**Online Internet. ([www.pcconnection.com](http://www.pcconnection.com), [www.govconnection.com](http://www.govconnection.com), [www.macconnection.com](http://www.macconnection.com), and [www.moredirect.com](http://www.moredirect.com))** We provide product descriptions and prices of all products online. Our PC Connection Web site also provides updated information for over 67,000 items and on-screen images for more than 46,000 items. We offer, and continuously update, selected product offerings and other special buys. We believe that our Web sites will be an increasingly important sales source and communication tool for improving customer service.

**Business Segments.** We conduct our business operations through three primary business segments: (1) consumer, small- and medium-sized business customers (“SMB”); (2) federal, state and local governments, and education institutions (“Public Sector”); and (3) large corporate (Fortune 1000) organizations (“Large Account”).

**SMB Segment.** While we continue to generate credit card sales to consumers, our principal target customers in this segment are small-to-medium-sized business customers with 20 to 500 employees. Our primary means of marketing to this segment incorporate all three sales channels—inbound telesales, particularly to our consumer group, outbound telemarketing, primarily to our business customers, and online Internet sales to both consumer and business customers.

**Public Sector Segment.** We use a combination of outbound telemarketing, including some on-site sales solicitation by field sales account managers, and online Internet sales through Internet Business Accounts, to reach these customers. Through our GovConnection subsidiary, we target each of the four distinct market sectors within this segment—federal government, higher educational institutions, school grades K through 12, and state and local governments.

**Large Account Segment.** Through our MoreDirect subsidiary’s custom designed Web-based system, we are able to offer our larger corporate customers an efficient and effective method of sourcing, evaluating, purchasing, and tracking a wide variety of IT products. MoreDirect’s account managers typically have ten to twenty years of experience and are located strategically across the United States. This allows them to work directly with customers, often on site. MoreDirect generally places all product orders with manufacturers and/or distribution companies for drop shipment directly to its customers.



## [Table of Contents](#)

The following table sets forth the relative distribution of our net sales by business segment:

Business Segment	Years Ended December 31,		
	2004	2003	2002
SMB	59%	57%	59%
Public Sector	19	24	25
Large Account	22	19	16
Total	100%	100%	100%

**Specialty Marketing.** Our specialty marketing activities include direct mail, other inbound and outbound telemarketing services, bulletin board services, “fax on demand” services, package inserts, fax broadcasts, and electronic mail. We also market call-answering and fulfillment services to certain of our product vendors.

**Customers.** We maintain an extensive database of customers and prospects currently aggregating approximately 3,350,000 names. During the year ended December 31, 2004, we received orders from approximately 398,000 customers. Approximately 89% of our net sales in the year ended December 31, 2004 were made to customers who had previously purchased products from us. Except for sales to the federal government, no single customer accounted for more than 2% of our consolidated revenue in 2004. The loss of any single customer will not have a material adverse effect on any of our product segments. In addition, we do not have individual orders in our backlog that are material to our business.

## PRODUCTS AND MERCHANDISING

We continuously focus on expanding the breadth of our product offerings. We currently offer our customers approximately 100,000 information technology products designed for business applications from more than 1,000 manufacturers, including hardware and peripherals, accessories, networking products, and software. We select the products that we sell based upon their technology and effectiveness, market demand, product features, quality, price, margins, and warranties. As part of our merchandising strategy, we also offer products related to PCs, such as digital cameras.

The following table sets forth our percentage of net sales (in dollars) of notebooks and personal digital assistants (“PDAs”), desktops and servers, storage devices, software, networking communications products, printers and printer supplies, video, imaging, and sound, memory and system enhancements, and accessories and other products during the years ended December 31, 2004, 2003, and 2002.

	PERCENTAGE OF NET SALES		
	Years Ended December 31,		
	2004	2003	2002
Notebooks and PDAs	21%	20%	17%
Desktops/Servers	14	15	15
Storage Devices	8	9	9
Software	12	11	14
Net/Com Products	7	8	8
Printers and Printer Supplies	11	11	12
Video, Imaging, and Sound	12	12	11
Memory and System Enhancements	5	5	5
Accessories/Other	10	9	9
Total	100%	100%	100%

We offer a 30-day right of return generally limited to defective merchandise. Returns of non-defective products are subject to restocking fees. Substantially all of the products marketed by us are warranted by the manufacturer. We generally accept returns directly from the customer and then either credit the customer’s account or ship the customer a similar product from our inventory.

## **PURCHASING AND VENDOR RELATIONS**

During the year ended December 31, 2004, we purchased approximately 41% of our products directly from manufacturers and the balance from distributors and aggregators. We ship the majority of our purchases directly to our distribution facility in Wilmington, Ohio. During the years ended December 31, 2004, 2003, and 2002, product purchases from Ingram Micro, Inc., our largest vendor, accounted for approximately 27%, 22%, and 28%, respectively, of our total product purchases. Purchases from Tech Data Corporation comprised 14%, 15%, and 14% of our total product purchases in the years ended December 31, 2004, 2003, and 2002, respectively. Effective May 3, 2002, HP completed its acquisition of Compaq Computer Corporation. Our combined purchases from HP and Compaq constituted 11%, 15%, and 15% of our total product purchases in 2004, 2003, and 2002, respectively. No other vendor accounted for more than 10% of our total product purchases in the years ended December 31, 2004, 2003, and 2002. We believe that alternative sources for products obtained from Ingram Micro, Tech Data, and HP are available to us.

Many product suppliers reimburse us for advertisements or other cooperative marketing programs in our catalogs or advertisements in personal computer magazines that feature a manufacturer's product. Reimbursements may be in the form of discounts, advertising allowances, and/or rebates. We also receive reimbursements from certain vendors based upon the volume of purchases or sales of the vendors' products by us.

Some of our vendors offer limited price protection in the form of rebates or credits against future purchases. We may also participate in end-of-life-cycle and other special purchases which may not be eligible for price protection.

We believe that we have excellent relationships with vendors. We generally pay vendors within stated terms and take advantage of all appropriate discounts. We believe that because of our volume purchases we are able to obtain product pricing and terms that are competitive with those available to other major direct marketers. Although brand names and individual product offerings are important to our business, we believe that competitive products are available in substantially all of the merchandise categories offered by us.

## **DISTRIBUTION**

At our approximately 205,000 square foot distribution and fulfillment complex in Wilmington, Ohio, we receive and ship inventory, configure computer systems, and process returned products. Orders are transmitted electronically from our Connecticut, Maryland, Massachusetts, and New Hampshire sales facilities to our Wilmington distribution center after credit approval, where packing documentation is printed automatically and order fulfillment takes place. Through our Everything Overnight® service, orders accepted up until 2:00 a.m. Eastern time, (until midnight on custom-configured systems) are generally shipped for overnight delivery via DHL Worldwide Express. We ship approximately 56% of our orders through DHL. Upon request, orders may also be shipped by other common carriers.

We also place product orders directly with manufacturers and/or distribution companies for drop shipment by those manufacturers and/or suppliers directly to customers. Our MoreDirect subsidiary generally places all product orders with manufacturers and/or distribution companies for drop shipment directly to customers. Order status with distributors is tracked online and in all circumstances, a confirmation of shipment from manufacturers and/or distribution companies is received prior to recording revenue. Products drop shipped by suppliers accounted for 38% of net sales in both 2004 and 2003. In future years, we expect that products drop shipped from suppliers will increase, both in dollars and as a percentage of net sales, as we seek to lower our overall inventory and distribution costs while maintaining excellent customer service.

## **MANAGEMENT INFORMATION SYSTEMS**

All of our subsidiaries, except for MoreDirect, use management information systems, principally comprised of applications software running on IBM AS/400 and RS6000 computers and Microsoft Windows 2000-based servers, which we have customized for our use. These systems permit centralized management of key functions, including order taking and processing, inventory and accounts receivable management, purchasing, sales, and distribution, and the preparation of daily operating control reports on key aspects of the business. We also operate advanced telecommunications equipment to support our sales and customer service operations. Key elements of the telecommunications systems are integrated with our computer systems to provide timely customer information to sales and service representatives, and to facilitate the preparation of operating and performance data.

MoreDirect has developed a custom designed Internet-based system, Traxx, which is comprised of applications software running on Linux and Sun Solaris servers. This system is an integrated application of sales order processing, integrated supply chain visibility, and full EDI links with major manufacturers distribution partners for product information, availability, pricing, ordering, delivery, and tracking, including related accounting functions.

We believe that our customized information systems enable us to improve our productivity, ship customer orders on a same-day basis, respond quickly to changes in our industry, and provide high levels of customer service.

Our success is dependent in large part on the accuracy and proper use of our information systems, including our telephone systems, to manage our inventory and accounts receivable collections, to purchase, sell, and ship our products efficiently and on a timely basis, and to maintain cost-efficient operations. We expect to continually upgrade our information systems to more effectively manage our operations and customer database.

## **COMPETITION**

The direct marketing and sale of information technology products, including personal computers and related products, is highly competitive. PC Connection competes with other direct marketers of IT products, including CDW Computer Centers, Inc. and Insight Enterprises, Inc. We also compete with:

- certain product manufacturers that sell directly to customers, such as Dell Computer Corporation and Gateway, Inc., and more recently HP, IBM, and Apple;
- distributors that sell directly to certain customers;
- various cost-plus aggregators, franchisers, and national computer retailers; and
- companies with more extensive Web sites and commercial online networks.

Additional competition may arise if other new methods of distribution, such as broadband electronic software distribution, emerge in the future.

We compete not only for customers, but also for favorable product allocations and cooperative advertising support from product manufacturers. Several of our competitors are larger and have substantially greater financial resources than we have.

We believe that price, product selection and availability, and service and support are the most important competitive factors in our industry.

## **INTELLECTUAL PROPERTY RIGHTS**

Our trademarks include PC Connection<sup>®</sup>, GovConnection<sup>™</sup>, MacConnection<sup>®</sup>, and MoreDirect<sup>®</sup>, and their related logos; Everything Overnight<sup>®</sup>, The Connection<sup>®</sup>, Raccoon Character<sup>®</sup>, Service Connection<sup>®</sup>, Graphics Connection<sup>®</sup>, and Education Connection<sup>®</sup>, Your Brands, Your Way, Next Day<sup>®</sup>, and Epiq PC Systems<sup>®</sup>. We intend to use and protect these and our other marks, as we deem necessary. We believe our trademarks have significant value and are an important factor in the marketing of our products. We do not maintain a traditional research and development group, but we work closely with computer product manufacturers and other technology developers to stay abreast of the latest developments in computer technology, both with respect to the products we sell and use.

## **WORK FORCE**

As of December 31, 2004, we employed 1,390 persons, of whom 722 were engaged in sales related activities, 106 were engaged in providing customer service and support, 286 were engaged in purchasing, marketing, and distribution related activities, 80 were engaged in the operation and development of management information systems, and 196 were engaged in administrative and accounting functions. We consider our employee relations to be good. Our employees are not represented by a labor union, and we have never experienced a work stoppage since our inception.

### **Item 2. Properties**

In November 1997, we entered into a fifteen year lease for our corporate headquarters and telemarketing center located at 730 Milford Road, Merrimack, New Hampshire 03054-4631, with an affiliated entity, G&H Post, which is related to us through common ownership. The total lease is valued at approximately \$7.0 million, based upon an independent property appraisal obtained at the date of lease, and interest is calculated at an annual rate of 11%. The lease requires us to pay our proportionate share of real estate taxes and common area maintenance charges as additional rent and also to pay insurance premiums for the leased property. We have the option to renew the lease for two additional terms of five years each. The lease has been recorded as a capital lease in the financial statements.

We also lease 205,000 square feet in two facilities in Wilmington, Ohio, which houses our distribution and order fulfillment operations. The leases governing these two facilities expire in the fourth quarter of 2005 and the first quarter of 2007, respectively. We have the option to renew the former for an additional two-year term. We also operate telemarketing centers in Dover and Keene, New Hampshire, Marlborough, Massachusetts, Rockville, Maryland, Fairfield, Connecticut, and Boca Raton, Florida. We are relocating our Dover sales office to Portsmouth, New Hampshire during the second quarter of 2005. Leasehold improvements associated with these properties are amortized over the terms of the leases or their useful lives, whichever is shorter. We believe that existing distribution facilities in Wilmington, Ohio will be sufficient to support our anticipated needs through the next twelve months.

### **Item 3. Legal Proceedings**

On March 20, 2002, The Lemelson Medical, Education & Research Foundation, L.P. filed a complaint in U.S. District Court for the District of Arizona naming us as an additional defendant in the so-called "Federal Express" case. The Federal Express case involves approximately eighty-eight defendants and pertains to claims made by the foundation relating to its right to royalties for the use of bar code scanners that allegedly utilize technology covered by patents now owned by the foundation. The foundation had previously filed claims against manufacturers of bar code scanners in U.S. District Court for the District of Nevada alleging patent infringement. The manufacturers of bar code scanners prevailed on most points in litigation in the Nevada action relating to the validity of the patents at issue. However, Lemelson has appealed to the U.S. Court of Appeals for the Ninth Circuit. The defendants in the Arizona litigation have requested the U.S. District Court to stay the proceedings pending the outcome of the Nevada litigation, which the Court granted. Until the Nevada patent litigation is resolved, we will expend little, if any, legal fees in the Arizona case. If the bar code manufacturers are successful in the Nevada case, we expect the Arizona court to dismiss the action against us.

## [Table of Contents](#)

The foundation has not specified the amount of damages it seeks in its complaint, but such damages may be material. If the foundation ultimately prevails in the Arizona litigation, the damages assessed against us may be material and may have a material adverse effect on our financial condition. In addition, we may be required to modify the methods by which we track inventories and ship products that may have a material adverse effect on our results of operations. We intend to vigorously defend this claim and, to the extent we are found liable, we believe we have indemnification claims against certain manufacturers of bar code scanners.

While we may ultimately decide to seek indemnity from certain manufacturers of bar code scanners, we can provide no assurance that we would be successful in obtaining such indemnity. At a minimum, if the Nevada or Arizona litigation proceeds, we may incur material legal fees in the defense of the foundation's claims or in seeking indemnity from certain manufacturers of bar code scanners.

On October 7, 2003, Commissariat A L'Energie Atomique filed a complaint in the U.S. District Court for the District of Delaware, naming us as a defendant, along with several other computer-related resellers, in a patent infringement case. We are attempting under contract provision and the Uniform Commercial Code to be defended and indemnified by the manufacturers of the allegedly infringing products. In the event that the manufacturers do not agree to indemnify us, we may have to expend some defense costs and we may be liable for some amount of damages. No specific amount has been claimed as damages.

On September 10, 2004, NCR Corporation filed a complaint in the U.S. District Court for the Southern District of Ohio, alleging patent infringement against us. NCR alleges that our e-commerce web sites employ methods covered by certain patents held by NCR. We have filed a Motion to Dismiss for lack of personal jurisdiction, which has not yet been ruled upon. We also plan to enter non-binding mediation with NCR but are unable to determine the outcome of this matter.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

There were no matters submitted during the fourth quarter of 2004 to a vote of security holders.

#### **Executive Officers of PC Connection**

The executive officers of PC Connection and their ages as of March 14, 2005 are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Patricia Gallup	50	Chairman, President, and Chief Executive Officer
Robert F. Wilkins	43	Executive Vice President
Jack L. Ferguson	66	Treasurer and Interim Chief Financial Officer
Bradley G. Mousseau	53	Vice President of Human Resources

**Patricia Gallup** is a co-founder of PC Connection and has served as Chief Executive Officer and Chairman of the Board since September 2002. Ms. Gallup also assumed the role of President of PC Connection upon the resignation of its former president on March 21, 2003. Ms. Gallup served as Chairman from June 2001 to August 2002. Ms. Gallup has served as a member of our executive management team since its inception in 1982.

**Robert F. Wilkins** has served as Executive Vice President of PC Connection since January 2000. Mr. Wilkins served as Senior Vice President of Sales and Marketing from January 1999 to January 2000 and Senior Vice President of Merchandising and Product Management from January 1998 to January 1999. From December 1995 to January 1998, Mr. Wilkins served as Vice President of Merchandising and Product Management of PC Connection.

**Jack L. Ferguson** has served as Treasurer since November 1997 and as Interim Chief Financial Officer since October 2004. Mr. Ferguson served as a Director of Finance from December 1992 to November 1997. Prior to joining PC Connection, Mr. Ferguson was a partner with Deloitte & Touche LLP.

**Bradley G. Mousseau** has served as Vice President of Human Resources since January 2000. Prior to joining PC Connection, Mr. Mousseau served as Vice President of Global Workforce Strategies for Systems & Computer Technology Corporation (SCT) from April 1997 to January 2000.

**PART II****Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities***Market Information*

PC Connection's Common Stock commenced trading on March 3, 1998 on the Nasdaq National Market under the symbol "PCCC." As of March 14, 2005, there were 25,135,721 shares outstanding of our common stock held by approximately 114 stockholders of record.

The following table sets forth for the fiscal periods indicated the range of high and low sales prices for our common stock on the Nasdaq National Market.

<u>2004</u>	<u>High</u>	<u>Low</u>
Quarter Ended:		
December 31	\$10.00	\$6.66
September 30	7.74	6.21
June 30	8.64	6.52
March 31	10.90	6.45
<u>2003</u>		
Quarter Ended:		
December 31	\$11.90	\$6.50
September 30	13.47	6.54
June 30	10.82	4.94
March 31	8.33	4.69

We have never declared or paid cash dividends on our capital stock. We anticipate that we will retain all future earnings, if any, to fund the development and growth of our business, and we do not anticipate paying any cash dividends on our Common Stock in the foreseeable future. Our secured credit agreement contains restrictions that may limit our ability to pay dividends in the future.

*Share Repurchase Authorization*

We announced on March 28, 2001, that our Board of Directors authorized the spending of up to \$15.0 million to repurchase our common stock. Share purchases will be made in the open market from time to time depending on market conditions. We have repurchased an aggregate of 362,267 shares for \$2.3 million as of December 31, 2004, which are reflected as treasury stock on the consolidated balance sheet. We did not repurchase any shares of our common stock in the year ended December 31, 2004.

[Table of Contents](#)

**Item 6. Selected Financial and Operating Data**

The following selected financial and operating data should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other financial information included elsewhere in this Form 10-K.

	Years Ended December 31,				
	2004	2003	2002	2001	2000
(dollars in thousands, except per share and selected operating data)					
<b>Statement of Operations Data:</b>					
Net sales	\$ 1,353,834	\$ 1,312,891	\$ 1,191,497	\$ 1,186,217	\$ 1,440,227
Cost of sales	1,201,780	1,175,212	1,062,311	1,054,631	1,264,573
Gross profit	152,054	137,679	129,186	131,586	175,654
Selling, general, and administrative expenses	132,729	124,824	121,964	117,610	123,834
Special charges <sup>(1)</sup>	5,232	1,929	1,636	2,204	—
Income from operations	14,093	10,926	5,586	11,772	51,820
Interest expense	(1,385)	(1,305)	(1,152)	(1,179)	(2,086)
Other, net	152	117	513	1,307	589
Income before income taxes	12,860	9,738	4,947	11,900	50,323
Income tax provision	(4,556)	(3,850)	(1,700)	(4,521)	(19,126)
Net income	\$ 8,304	\$ 5,888	\$ 3,247	\$ 7,379	\$ 31,197
Basic net income per share	\$ .33	\$ .24	\$ .13	\$ .30	\$ 1.30
Diluted net income per share	\$ .33	\$ .23	\$ .13	\$ .30	\$ 1.22
<b>Selected Operating Data:</b>					
Active customers <sup>(2)</sup>	398,000	499,000	469,000	471,000	626,000
Catalogs distributed	31,125,000	31,525,000	28,765,000	41,683,000	45,028,000
Orders entered <sup>(3)</sup>	1,281,000	1,333,000	1,243,000	1,265,000	1,521,000
Average order size <sup>(3)</sup>	\$ 1,230	\$ 1,169	\$ 1,119	\$ 1,116	\$ 1,115

	December 31,				
	2004	2003	2002	2001	2000
(dollars in thousands)					
<b>Balance Sheet Data:</b>					
Working capital	\$ 103,637	\$ 96,883	\$ 91,289	\$ 120,442	\$ 111,048
Total assets	286,542	310,605	268,682	243,645	249,514
Short-term debt:					
Current maturities of capital lease obligations:					
To affiliate	373	334	200	171	153
To third party	391	—	—	—	—
Notes payable	4,810	5,614	—	1,000	1,000
Long-term debt:					
Capital lease obligations, less current maturities:					
To affiliate	5,715	6,088	6,421	6,621	6,792
To third party	841	—	—	—	—
Note payable	—	—	—	—	1,000
Total stockholders' equity	166,158	157,189	150,144	146,762	138,066

<sup>(1)</sup> Our 2004 special charges consist of \$860 for the cost of workforce reductions, \$101 for the remaining uninsured portion of a 2003 employee defalcation, \$3,559 related to our review of the 2003 General Services Administration ("GSA") contract cancellation and costs related to securing a new schedule, \$512 in professional fees related to a review of certain prior year rebate-related transactions, and \$200 related to a proposed litigation settlement. Our 2003 special charges consist of \$407 for the cost of workforce reductions, \$1,130 for an uninsured portion of an employee defalcation, and \$392 for an internal review of GovConnection's GSA contract cancellation. Our 2002 special charges consist of \$886 for the cost of workforce reductions and \$750 for costs relating to the Microsoft settlement. Our 2001 special charges consist of \$1,510 for the cost of workforce reductions and \$694 for costs relating to a proposed acquisition that was abandoned.

<sup>(2)</sup> Represents estimates of all customers included in our mailing list who have made a purchase within the last twelve month period.

<sup>(3)</sup> Does not reflect cancellations or returns.

## Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

*The following discussion and analysis of the Company’s financial condition and results of operations should be read in conjunction with the Company’s consolidated financial statements.*

*The following Management’s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements based on management’s current expectations, estimates, and projections about the Company’s industry, management’s beliefs, and certain assumptions made by management. All statements, trends, analyses, and other information contained in this report relative to trends in net sales, gross margin, and anticipated expense levels, as well as other statements, including words such as “anticipate,” “believe,” “plan,” “estimate,” “expect,” “may,” “project,” “will,” “would,” and “intend” and other similar expressions, constitute forward-looking statements. These forward-looking statements involve risks and uncertainties, and actual results may differ materially from those anticipated or expressed in such statements. Potential risks and uncertainties include, among others, those set forth under the caption “Factors That May Affect Future Results and Financial Condition” included within this section. Particular attention should be paid to the cautionary statements involving the industry’s rapid technological change and exposure to inventory obsolescence, availability and allocations of goods, reliance on vendor support and relationships, competitive risks, pricing risks, and the overall level of economic activity, and the level of business investment in information technology products. Except as required by law, the Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events, or otherwise. Readers, however, should carefully review the factors set forth in other reports or documents that the Company files from time to time with the Securities and Exchange Commission.*

### OVERVIEW

PC Connection is a national direct marketer of a wide range of information technology products and services—including computer systems, software and peripheral equipment, networking communications, and other products, and accessories that we purchase from manufacturers, distributors, and other suppliers. We also offer a growing range of repair, installation, and other services performed by third-party providers. We operate through three primary business segments: (a) consumers and small- to medium-sized businesses (“SMB”) through our PC Connection Sales subsidiary, (b) federal, state, and local government and educational institutions (“Public Sector”) through our GovConnection subsidiary, and (c) large corporate accounts (“Large Account”) through our MoreDirect subsidiary.

We generate sales through (i) outbound telemarketing and field sales contacts by account managers focused on the business, education, and government markets, (ii) our Web sites, and (iii) inbound calls from customers responding to our catalogs and other advertising media.

#### **Opportunities and Challenges**

With our sales representing less than 1% of the overall approximate \$200 billion United States Information Technology (“IT”) market, we believe we have an excellent opportunity to grow and gain a larger share of this market. We anticipate that most of this additional market share will come from smaller value-added resellers, or VARs, who have the largest share of the current IT market. We expect our expanding service offerings to compete effectively with these historical service providers.

Annual sales productivity per sales representative in 2004 was flat compared to 2003 as we focused our SMB and Public Sector sales efforts on improving gross margins. We implemented a number of sales and gross profit improvement initiatives in early 2004 in these two segments, including more stringent management of discounting, more extensive and focused sales training on costs and margins, and targeted improvements in sales pricing, sales incentives, and account management. With these initiatives, we saw our sales personnel generate more add-on sales, thereby further increasing sales per transaction as well as improving over-all gross margins.



## [Table of Contents](#)

As noted in our 2003 Annual Report on Form 10-K, the GSA cancelled its contract with GovConnection, following its review of that subsidiary's contract management system and procedures and the possibility of the sale of unqualified items and underpayment of required fees. We applied for a new contract, and in August 2004, the GSA awarded GovConnection authorization to sell to the federal government under a new GSA schedule. During the year ended December 31, 2004, we saw a significant year-over-year decline in our federal government sales, largely due to the loss of the GSA contract in November 2003. Accordingly, our revenues derived from sales to the federal government may continue to be negatively impacted as GovConnection seeks to regain sales under the new GSA contract. This matter is further discussed below in the section entitled "Factors That May Affect Future Results and Financial Condition."

The primary challenges we face in effectively managing our business are: (1) continuing our sales growth while stabilizing and ultimately improving our gross profit margins in all three business segments, (2) improving the productivity of our sales personnel, and (3) effectively managing and leveraging our selling, general, and administrative ("SG&A") expenses over a higher sales base. With only modest growth projected in the overall IT industry, any significant sales growth for us must come through increased market share. Competition is expected to be even more intense in the future, which could put more pressure on margins. We will seek to increase sales while maintaining or improving margins by continuing the initiatives described above.

### RESULTS OF OPERATIONS

The following table sets forth for the periods indicated information derived from our statements of income expressed as a percentage of net sales.

	Years Ended December 31,		
	2004	2003	2002
Net sales (in millions)	\$1,353.8	\$1,312.9	\$1,191.5
Net sales	100.0%	100.0%	100.0%
Gross profit	11.2	10.5	10.8
Selling, general, and administrative expenses	9.8	9.5	10.2
Special charges	0.4	0.2	0.1
Income from operations	1.0	0.8	0.5

The increase in gross profit as a percentage of sales resulted primarily from an increased focus on gross margins and product mix as described above. Additionally in the second half of 2004, we revised our estimates relating to vendor consideration as a result of Emerging Issues Task Force ("EITF") Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" ("EITF 02-16") and reclassified \$5.4 million of additional advertising reimbursements in excess of advertising costs incurred from SG&A expenses to cost of goods sold and inventory. Such excess advertising reimbursements had previously been recorded as an offset to SG&A expense, and that reclassification resulted in an increase, on a consolidated basis, of 0.4% in both gross margin and SG&A expenses as a percentage of net sales for 2004.

## [Table of Contents](#)

### **Sales Distribution**

The following table sets forth our percentage of net sales by business segment, sales channel, and product mix:

	Years Ended December 31,		
	2004	2003	2002
<b>Business Segment</b>			
SMB	59%	57%	59%
Public Sector	19	24	25
Large Account	22	19	16
Total	100%	100%	100%
<b>Sales Channel</b>			
Outbound Telemarketing and Field Sales	74%	77%	78%
Inbound Telesales	6	7	7
Online Internet	20	16	15
Total	100%	100%	100%
<b>Product Mix</b>			
Notebooks and PDAs	21%	20%	17%
Desktop/Servers	14	15	15
Storage Devices	8	9	9
Software	12	11	14
Net/Com Products	7	8	8
Printers and Printer Supplies	11	11	12
Video, Imaging, and Sound	12	12	11
Memory and System Enhancements	5	5	5
Accessories/Other	10	9	9
Total	100%	100%	100%

### **Gross Profit Margins**

The following table summarizes our overall gross profit margins, as a percentage of net sales, for the last three years:

	Years Ended December 31,		
	2004	2003	2002
<b>Segment</b>			
SMB	12.2%	11.2%	11.8%
Public Sector	9.4	8.2	8.6
Large Account	10.2	11.3	10.8
Total	11.2%	10.5%	10.8%

Our SMB segment implemented a number of gross margin improvement initiatives in early 2004, which contributed to an increased gross margin rate. Additionally, as discussed previously, revising our estimates relating to vendor consideration as a result of EITF 02-16 resulted in a 0.6% improvement in gross margin rate in the SMB segment. Despite an increase in competition in its education and government markets, our Public Sector segment was able to improve its gross margin rates by implementing many of the same initiatives as our SMB segment. Changes in MoreDirect's customer mix and reduced supplier rebates led to a decrease in our Large Account segment's margin rate for 2004.

## [Table of Contents](#)

Gross margin on sales to corporate accounts that purchase at volume discounts is generally lower than gross margins on consumer or smaller business sales. Gross margin on sales to public sector customers has historically been lower than that for commercial sales. However, the gross profit dollar contribution per public sector and large account order is generally higher as average order sizes are usually larger. We believe that sales to larger businesses and public sector customers will continue to represent a growing portion of our business mix in future periods. We also expect the increasing migration of customers to our web sites to continue to increase the percentage of online Internet sales, which generally have higher margins.

Gross margins also vary by product mix. Sales of notebooks and PDAs accounted for 21% of our overall sales in 2004, an increase from 20% in 2003. The increase in these two product lines served to decrease our overall gross margin rates. Sales of all computer systems (including desktops, servers, and notebooks) result in a relatively high dollar sales order and generally provide the largest gross profit dollar contribution per order of all our products. However they usually yield the lowest gross margin percentage.

### **Operating Expenses**

The following table breaks out our more significant operating expenses for the last three years (in millions of dollars):

	Years Ended December 31,		
	2004	2003	2002
Personnel costs	\$ 93.5	\$ 89.7	\$ 84.1
Facilities operations	9.3	9.4	10.1
Credit card fees	7.4	7.6	7.1
Depreciation and amortization	7.1	8.4	8.4
Bad debts	2.4	3.1	6.6
Other – net, including advertising	13.0	6.6	5.7
<b>Total</b>	<b>\$132.7</b>	<b>\$124.8</b>	<b>\$122.0</b>
<b>Percentage of net sales</b>	<b>9.8%</b>	<b>9.5%</b>	<b>10.2%</b>

Personnel costs continue to represent the majority of our operating expenses, with sales personnel representing the largest portion of these costs. Our other operating costs, except for credit card fees and bad debts, tend to be relatively fixed over changing sales levels. Our bad debt losses have decreased significantly from their high in 2002, due to more stringent credit management, lower customer bankruptcies, and an overall improvement in the economy.

Most product manufacturers provide us with co-op advertising support in exchange for product coverage in our catalogs as well as other advertising promotions. EITF 02-16, which addresses the income classification of vendor consideration, became effective for the periods beginning January 1, 2003. This pronouncement requires that such consideration be recorded as a reduction of cost of sales unless the consideration represents reimbursement for costs incurred for a specific advertising program funded by an individual vendor. For the years ended December 31, 2004, 2003, and 2002, we recorded advertising expense of \$22.5 million, \$22.8 million, and \$19.9 million, respectively. For the years ended December 31, 2004, 2003, and 2002, we received total vendor advertising funding of \$29.1 million, \$29.4 million, and \$28.3 million, respectively. We reclassified \$7.5 million, \$2.2 million, and \$2.8 million of these reimbursements to cost of sales and inventory. As discussed earlier, we revised our estimates used to determine excess vendor advertising in 2004, and accordingly, \$5.4 million of the 2004 reclassification referred to above relates to this revision in our estimates. Our net advertising expense was as a result higher in 2004. Although the level of vendor co-op advertising support available to us from certain manufacturers has declined, and may decline further in the future, the overall level of co-op advertising support has remained consistent with our levels of spending for catalog and other advertising programs. We believe that the overall levels of co-op advertising support available over the next twelve months will be consistent with our planned advertising programs.

**YEAR-OVER-YEAR COMPARISONS**

*Year Ended December 31, 2004 Compared to Year Ended December 31, 2003*

Net sales increased 3.1% to \$1,353.8 million in 2004 from \$1,312.9 million in 2003. Our SMB and Large Account segments both increased, offsetting the decrease in our Public Sector's sales. Changes in net sales and gross profit by business segment are shown in the following table (dollars in millions):

	Years Ended December 31,				
	2004		2003		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
<b>Sales:</b>					
SMB	\$ 802.3	59.3%	\$ 744.4	56.7%	7.8%
Public Sector	253.0	18.7	320.6	24.4	(21.1)
Large Account	298.5	22.0	247.9	18.9	20.4
<b>Total</b>	<b>\$1,353.8</b>	<b>100.0%</b>	<b>\$1,312.9</b>	<b>100.0%</b>	<b>3.1%</b>
<b>Gross Profit:</b>					
SMB	\$ 98.0	12.2%	\$ 83.4	11.2%	17.5%
Public Sector	23.8	9.4	26.3	8.2	(9.5)
Large Account	30.3	10.2	28.0	11.3	8.2
<b>Total</b>	<b>\$ 152.1</b>	<b>11.2%</b>	<b>\$ 137.7</b>	<b>10.5%</b>	<b>10.5%</b>

- Net sales for our SMB segment increased due to the increase in the number of sales account managers employed in 2004 while maintaining sales productivity. Sales representatives for the SMB segment totaled 415 at December 31, 2004, up from 378 at December 31, 2003. Sales productivity was flat in 2004 compared to 2003 because we implemented company-wide gross margin improvement initiatives in early 2004. As discussed below, these initiatives inhibited our sales growth as we refrained from low-margin sales but resulted in improved over-all operating margins.
- Net sales for our Public Sector segment decreased due primarily to a 58.5% decrease in sales to the federal government. Our federal government sales decreased from the prior year due to the late 2003 cancellation of our GSA contract described previously. Although we were issued a new GSA contract in August 2004, it was too late into the federal buying season to recover this business. However, sales to state and local governmental and educational institutions ("SLED") increased 14.7% due to improvement in average sales productivity per account manager. Sales account managers for the Public Sector segment totaled 107 at December 31, 2004, up from 104 at December 31, 2003. The headcount mix between our federal and SLED account managers was unchanged from year to year due to our investment decision to maintain our federal account managers despite the nine month absence of our GSA contract.
- Net sales for our Large Account segment increased due to an improvement in average sales productivity per account manager. IT spending grew at a faster pace for our large Fortune 1000 customers than those of our other two business segments. Sales account managers for the Large Account segment totaled 69 at December 31, 2004, down from 85 at the end of 2003. This reduction in headcount resulted from a planned reduction in under-performing sales representatives.

Gross profit increased in our SMB and Large Account areas as shown by the above, whereas the gross margin percentage of net sales improved for our SMB and Public Sector segments.

- Gross profit for the SMB segment improved due to increases in both net sales and gross margin rate. We were able to improve gross margin rates by increasing add-on sales of accessories and other companion products to our system sales, as well increasing sales of third-party warranty, installation, and other services.

## [Table of Contents](#)

These initiatives were implemented in both our SMB and Public Sector segments in early 2004. Additionally, as discussed earlier, our revised estimates of advertising reimbursements in excess of costs incurred accounted for 60 basis points of our 1.0% increase in gross margin rate in the SMB segment.

- Despite an increase in gross margin rate, gross profit for the Public Sector segment decreased due to the decline in federal sales discussed above. Similar to our SMB segment, we were able to improve margin rates by increasing add-on sales of accessories and other companion products to our system sales, as well as increasing sales of third-party warranty, installation, and other services. As a result of losing its GSA contract in late 2003, the Public Sector increased its agency revenues from sales through third-party GSA schedules in 2004, which contributed to its improved gross margin rate. Revising our estimates used in EITF 02-16 led to an impact of less than 0.1% on this segment's gross margin rate.
- Gross profit for the Large Account segment increased due to the increase in sales explained earlier, despite a decrease in the gross margin rate. Changes in customer mix and continuing competitive pressures caused gross margin rates to decrease on a year-over-year basis.

*Selling, general, and administrative expenses* increased in both dollars and as a percentage of sales in 2004 from 2003.

We have concentrated our efforts on managing our overall operating costs. Personnel costs generally account for approximately two-thirds of our SG&A expenses, as shown earlier in the table of SG&A expenses. While we plan to continue our focus on controlling discretionary expenditures, we expect that our SG&A expense may vary depending on changes in sales volume, as well as the levels of continued investments in key growth initiatives such as hiring more experienced outbound sales account managers, improving marketing programs, and deploying next generation technology to support the sales organization.

SG&A expenses attributable to our operating segments are summarized below (dollars in millions):

	Year Ended December 31,				
	2004		2003		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
SMB	\$ 85.3	10.6%	\$ 82.3	11.1%	3.6%
Public Sector	31.9	12.6	28.5	8.9	11.9
Large Account	15.5	5.2	14.0	5.6	10.7
<b>Total</b>	<b>\$132.7</b>	<b>9.8%</b>	<b>\$124.8</b>	<b>9.5%</b>	<b>6.3%</b>

- SG&A expenses for the SMB segment increased slightly in 2004, while decreasing as a percentage of net sales from 2003. This segment has a relatively fixed cost structure, and the increase in its 2004 net sales resulted in a lower expense rate for this year. As discussed earlier, in 2004 we revised our estimates relating to vendor consideration as a result of EITF 02-16 and reclassified in our SMB segment \$5.4 million of advertising reimbursements in excess of advertising costs from SG&A expense to cost of goods sold and inventory. The resulting net increase in advertising expenses was the primary reason for our increased expense on a dollar basis but was partially offset by decreases in depreciation expense and bad debt expense.
- The Public Sector segment's SG&A expenses increased in 2004 but were significantly higher as a percentage of net sales from 2003. The significant decrease in our federal sales described above accounted for the increase in this segment's SG&A expense as a percentage of sales. We retained our experienced sales personnel in anticipation of our new GSA contract, which was awarded in August 2004.
- SG&A expenses for the Large Account segment increased on a dollar basis but decreased as a percentage of net sales. SG&A expenses for this segment represent the lowest of the three segments as a percentage of net sales, reflecting the nature and efficiency of this segment's variable cost field sales and drop-shipping operating model.

## [Table of Contents](#)

Special charges totaled \$5.2 million and \$1.9 million for the years ended December 31, 2004 and 2003, respectively. A roll forward of special charges for the two years ended December 31, 2004 is shown below (in thousands of dollars). There were no changes in estimates in any of the periods presented.

	<u>Workforce Reductions</u>	<u>Employee Defalcation</u>	<u>GSA Review</u>	<u>Other</u>	<u>Total</u>
Balance December 31, 2002	\$ 208	\$ —	\$ —	\$ —	\$ 208
Charges	407	1,130	392	—	1,929
Cash payments	(502)	(1,130)	(155)	—	(1,787)
Balance December 31, 2003	113	—	237	—	350
Charges	860	101	3,559	712	5,232
Cash payments	(724)	(101)	(3,072)	(497)	(4,394)
Balance December 31, 2004	\$ 249	\$ —	\$ 724	\$ 215	\$ 1,188

The charges for the employee defalcation represent the loss sustained by one of our commercial subsidiaries in excess of the amount covered by insurance. The charges for the GSA contract review represent costs of our review relating to the cancellation by the GSA in late 2003 of its contract with our subsidiary, GovConnection, and costs related to securing a new GSA schedule, which was awarded in August 2004. The other charges in 2004 include \$200 accrued as an estimated liability in a patent infringement case currently in litigation and \$512 in professional fees relating to our review of certain calendar year 2000 and 2003 transactions. We concluded our review of these transactions in October 2004.

Income from operations increased by \$3.2 million, or 29.4%, to \$14.1 million for the year ended December 31, 2004 from \$10.9 million compared to 2003. MoreDirect, our Large Account segment, accounted for \$14.6 million and \$12.9 million of our income from operations in 2004 and 2003, respectively. Excluding MoreDirect, we incurred a loss from operations of \$0.5 million for 2004 and \$2.0 million in 2003.

Income from operations as a percentage of net sales increased from 0.8% in 2003 to 1.0% in 2004. This increase was attributable to the changes in net sales, gross margin, and SG&A expenses as discussed above.

Interest expense was \$1.4 million in 2004 and \$1.3 million in 2003. Interest expense increased due to slightly higher average borrowings outstanding and slightly higher interest rates in 2004 as compared to 2003.

Our effective tax rate was 35.4% for 2004 and 39.5% for 2003. This year-over-year decrease was due to a decrease in our accrual for state tax contingencies in certain states in which we operate. We anticipate that our effective tax rate will be approximately 39% in 2005 due to anticipated changes in mix of state income taxes to which we are subject.

Net income increased by \$2.4 million, or 40.7%, to \$8.3 million in 2004 from \$5.9 million in 2003, principally as a result of the increase in income from operations.

### **Year Ended December 31, 2003 Compared to Year Ended December 31, 2002**

Net sales increased 10.2% to \$1,312.9 million in 2003 from \$1,191.5 million in 2002. The increase was due largely to the inclusion of MoreDirect for the full year in 2003 but only from its early April acquisition date in 2002. Had that acquisition taken place at the beginning of 2002, net sales would have increased in 2003 by only 5.4%.

## [Table of Contents](#)

Changes in net sales and gross profit by business segment are shown in the following table (dollars in millions):

	Years Ended December 31,				
	2003		2002		% Change
	Amount	% of Net Sales	Amount	% of Net Sales	
<b>Sales:</b>					
SMB	\$ 744.4	56.7%	\$ 703.5	59.0%	5.8%
Public Sector	320.6	24.4	293.9	24.7	9.1
Large Account	247.9	18.9	194.1	16.3	27.7
<b>Total</b>	<b>\$1,312.9</b>	<b>100.0%</b>	<b>\$1,191.5</b>	<b>100.0%</b>	<b>10.2%</b>
<b>Gross Profit:</b>					
SMB	\$ 83.4	11.2%	\$ 82.8	11.8%	0.7%
Public Sector	26.3	8.2	25.4	8.6	3.5
Large Account	28.0	11.3	21.0	10.8	33.3
<b>Total</b>	<b>\$ 137.7</b>	<b>10.5%</b>	<b>\$ 129.2</b>	<b>10.8%</b>	<b>6.6%</b>

- Net sales for our SMB segment increased due to the increase in the number of sales representatives in the year while also improving sales productivity. Sales representatives for the SMB segment totaled 378 at December 31, 2003, up from 341 at December 31, 2002.
- Net sales for our Public Sector segment increased due primarily to a 19.2% growth in sales to state and local government units and educational organizations. Sales to the federal government increased slightly from 2002, which included first quarter sales relating to the September 11, 2001 disaster. Sales account managers for the Public Sector segment totaled 104 at December 31, 2003, up from 99 at the end of 2002. The cancellation of the GSA contract described above did not have a significant impact on our 2003 sales, as most of the federal sales orders had been placed prior to the cancellation.
- Net sales for our Large Account segment increased due to the inclusion of this segment for only nine months in 2002. MoreDirect was acquired in early April of 2002, and accordingly, net sales for that company are included only from the date of its acquisition. Had the acquisition taken place at the beginning of 2002, net sales for this segment would have been substantially flat over the two years. Sales account managers for the Large Account segment totaled 85 at December 31, 2003, up from 72 at December 31, 2002.

*Gross profit* increased as shown by the above table, although the corresponding gross margin percentage of net sales decreased.

- Gross profit for the SMB segment was substantially flat, as the increase from higher sales was offset by the decline in the gross margin rate, reflecting continuing competitive pressures and the shift in product mix shown in previous tables. We expect to offset this decline in gross margin rates by increasing add-on sales of accessories and other companion products to our system sales, as well as continuing to increase the level of enterprise product sales and sales of third-party warranty, installation, and other services.
- Gross profit for the Public Sector segment increased due to the increase in sales discussed above, offset by a decline in the gross margin rate. The decline in margin was attributable to aggressive sales growth promotions to state and local government and educational customers.
- Gross profit for the Large Account segment increased due to the increase in sales explained earlier, plus an increase in the gross margin rate. This growth was attributable to changes in customer mix, plus higher rebates obtained from suppliers.

## [Table of Contents](#)

*Selling, general, and administrative expenses* increased in 2003 from 2002 but decreased as a percentage of sales. The dollar increase is attributable to the inclusion of MoreDirect for the full year in 2003, as explained above.

We have concentrated our efforts on managing our overall operating costs. Personnel costs generally account for approximately two-thirds of our SG&A expenses, as shown earlier in the table of SG&A expenses. While we plan to continue our focus on controlling discretionary expenditures, we expect that our SG&A expense may vary depending on changes in sales volume, as well as the levels of continued investments in key growth initiatives such as hiring more experienced outbound sales account managers, improving marketing programs, and deploying next generation Internet Web technology to support the sales organization.

SG&A expenses attributable to our operating segments are summarized below (dollars in millions):

	Year Ended December 31,				% Change
	2003		2002		
	Amount	% of Net Sales	Amount	% of Net Sales	
SMB	\$ 82.3	11.1%	\$ 82.4	11.7%	(0.1)%
Public Sector	28.5	8.9	28.9	9.8	(1.4)
Large Account	14.0	5.6	10.7	5.5	30.8
<b>Total</b>	<b>\$124.8</b>	<b>9.5%</b>	<b>\$122.0</b>	<b>10.2%</b>	<b>2.3%</b>

- SG&A expenses for the SMB segment remained flat in 2003 compared to 2002, while decreasing as a percentage of net sales. This segment has a relatively fixed cost structure, and the significant decrease in its 2002 net sales resulted in an unusually high expense rate for that year. We believe that the SMB segment's expense rate is higher than that for the other two segments, primarily due to lower sales productivity of its sales force and the additional costs associated with the level of its inventory procurement, stocking, and warehousing operations. The SMB segment can support a higher sales level in future periods.
- The Public Sector segment's SG&A expenses decreased slightly in 2003 while also decreasing as a percentage of net sales from 2002. This decrease is indicative of this segment's improvement in sales productivity by the generation of more sales per account manager and greater leveraging of its fixed costs.
- SG&A expenses for the Large Account segment increased in line with the full year reporting period in 2003 and the partial year period in 2002 discussed earlier. SG&A expenses for this segment represent the lowest of the three segments as a percentage of net sales, reflecting the nature and efficiency of this segment's variable cost field sales and drop-shipping operating model.

*Special charges* totaled \$1.9 million and \$1.6 million for 2003 and 2002, respectively. A roll forward of special charges for the two years ended December 31, 2003 is shown below (in thousands of dollars). There were no changes in estimates in any of the periods presented.

	Workforce Reductions	Litigation Settlement	Employee Defalcation	GSA Review	Total
Balance December 31, 2001	\$ 425	\$ —	\$ —	\$ —	\$ 425
Charges	886	750	—	—	1,636
Cash payments	(1,103)	(750)	—	—	(1,853)
Balance December 31, 2002	208	—	—	—	208
Charges	407	—	1,130	392	1,929
Cash payments	(502)	—	(1,130)	(155)	(1,787)
Balance December 31, 2003	\$ 113	\$ —	\$ —	\$ 237	\$ 350



## [Table of Contents](#)

The 2003 charges for the GSA contract review represent costs of our investigations relating to the GSA's cancellation in late 2003 of its contract with our subsidiary, GovConnection. The 2003 charges for employee defalcation represent the loss sustained by one of our commercial subsidiaries in excess of the amount covered by insurance. In 2002, we settled litigation commenced by Microsoft Corporation involving alleged trademark and copyright infringement. While denying these allegations, we recorded \$0.8 million in settlement costs and legal fees related to this matter. We have also recognized \$0.4 million and \$0.9 million in charges related to staff reductions in 2003 and 2002, respectively.

*Income from operations* increased by \$5.3 million, or 94.6%, to \$10.9 million for 2003 from \$5.6 million for 2002. MoreDirect, our Large Account segment, accounted for \$12.9 million and \$10.3 million of our income from operations in 2003 and 2002, respectively. Excluding MoreDirect, we incurred a loss from operations of \$2.0 million for 2003 and \$4.7 million in 2002.

Income from operations as a percentage of net sales increased from 0.5% in 2002 to 0.8% in 2003. This increase was attributable to the changes in net sales, gross margin, and SG&A expenses as discussed above.

*Interest expense* was \$1.3 million in 2003 and \$1.2 million in 2002. Interest expense increased due to slightly higher average borrowings outstanding offset by lower interest rates in 2003 as compared to 2002.

Our effective tax rate was 39.5% for 2003 and 34.4% for 2002. This year-over-year increase was due to our recognition in 2002 of a New Hampshire business enterprise tax credit. Such a tax credit was not recognized in 2003. The relative size of our tax provisions tends to magnify the beneficial impact of such credit on a percentage basis. We anticipate that our effective tax rate will be approximately 39% in 2004 due to the expected changes and mix of state income taxes.

*Net income* increased by \$2.7 million, or 84.4%, to \$5.9 million in 2003 from \$3.2 million in 2002, principally as a result of the increase in income from operations. MoreDirect's net income was \$7.8 million in 2003 and \$6.3 million in 2002. Excluding MoreDirect, our operations incurred a net loss of \$1.9 million in 2003 and \$3.1 million in 2002.

## **LIQUIDITY AND CAPITAL RESOURCES**

### ***Liquidity Overview***

Our primary sources of liquidity have historically been internally generated funds from operations and borrowings under our bank line of credit. We have used those funds to meet our capital requirements, which consist primarily of operational needs, capital expenditures for computer equipment and software used in our business, and more recently, earn-out payments required under our acquisition of MoreDirect.

We believe that funds generated from operations, together with available credit under our bank line of credit, will be sufficient to finance our working capital, capital expenditure, and other requirements for at least the next twelve calendar months. We expect our capital needs for 2005 to consist primarily of capital expenditures of \$3.0 to \$3.5 million, payments on capital and operating lease obligations of approximately \$4.6 million, and final payment of approximately \$6.9 million under our MoreDirect merger agreement. We expect to meet our cash requirements for 2005 through a combination of cash on hand, cash generated from operations and, if necessary, additional borrowings on our bank line of credit, as follows:

- *Cash on Hand.* At December 31, 2004 we had approximately \$6.8 million in unrestricted accounts.
- *Cash Generated from Operations.* We expect to generate cash flows from operations in excess of operating cash needs by generating earnings and balancing net changes in inventories and receivables with compensating changes in payables to generate a positive cash flow. Historically, we have consistently generated positive cash flows from operations.

## [Table of Contents](#)

- **Credit Facilities.** As of December 31, 2004, we had drawn \$4.8 million of our \$45.0 million bank line of credit. This line of credit can be increased, at our option, to \$65 million for approved acquisitions or other uses authorized by the bank. Borrowings are, however, limited by certain minimum collateral and earnings requirements, as described more fully below.

Our ability to continue funding our planned growth, both internally and externally, is dependent upon our ability to generate sufficient cash flow from operations or to obtain additional funds through equity or debt financing, or from other sources of financing, as may be required. While at this time we do not anticipate needing any additional sources of financing to fund our operations, if demand for information technology products declines, our cash flows from operations may be substantially affected. See also related risks listed below under "Factors That May Affect Future Results and Financial Condition."

### **Summary Sources and Uses of Cash**

The following table summarizes our sources and uses of cash over the last three years (in millions):

	Years Ended December 31,		
	2004	2003	2002
Net cash provided by operating activities	\$13.3	\$ 3.3	\$ 5.0
Net cash used for investing activities	(8.9)	(8.3)	(37.6)
Net cash (used for) provided by financing activities	(0.5)	6.2	(1.2)
Increase (decrease) in cash and cash equivalents	\$ 3.9	\$ 1.2	\$(33.8)

*Cash provided by operating activities* increased in 2004 but decreased in 2003. The primary reasons for the increase in 2004 were an increase in net earnings before depreciation and a decrease in receivables, partially offset by a decrease in payables. The decrease in 2003 resulted primarily from significant increases in receivables, inventory, and other current assets from prior levels, not fully offset by the increase in accounts payable.

At December 31, 2004, we had \$79.7 million in outstanding accounts payable. Such accounts are generally paid within 30 days of incurrence and will be financed by cash flows from operations or short-term borrowings under the line of credit. This amount includes \$8.2 million payable to two financial institutions under security agreements to facilitate the purchase of inventory. We believe we will be able to meet our obligations under our accounts payable with cash flows from operations and our existing line of credit.

*Cash used for investing activities* include our capital expenditures in the three years presented, primarily for computer equipment and capitalization of internally-developed software. Additionally, MoreDirect was acquired in April 2002, which accounted for \$32.6 million of the use of cash in 2002. We continued to use cash in both 2003 and 2004 to fund earn-out payments due to the former shareholder of MoreDirect. These payments totaled \$11.1 million and \$10.8 million in 2004 and 2003, respectively. The final payment in 2005 is expected to approximate \$6.9 million.

*Cash used for financing activities* in 2004 related to a decrease in our net borrowings by \$0.8 million under our bank line of credit, whereas there was an increase in our net borrowings of \$5.6 million in 2003. Further, our 2002 financing activities included a \$1.0 million repayment of a note payable and purchases of treasury stock aggregating \$0.8 million. There was no change in our net bank borrowings in 2002.

### **Debt Instruments, Contractual Agreements, and Related Covenants**

Below is a summary of certain provisions of our credit facilities and other contractual obligations. It is qualified in its entirety by the terms of the actual agreements, which are on file with the Securities and Exchange Commission. For more information about the restrictive covenants in our debt instruments and inventory

## [Table of Contents](#)

financing agreements, see “Factors Affecting Sources of Liquidity.” For more information about our obligations, commitments, and contingencies, see our consolidated financial statements and the accompanying notes included in this annual report.

**Bank Line of Credit.** Our bank line of credit provides us with a borrowing capacity of up to \$45 million, with an option to increase the facility up to \$65 million, based on sufficient levels of trade receivables to meet borrowing base requirements, and depending on meeting minimum EBITDA (earnings before interest, taxes, depreciation, and amortization) and equity requirements, described below under “Factors Affecting Sources of Liquidity.” Amounts outstanding under this facility were \$4.8 million at December 31, 2004; these amounts bear interest at the prime rate (5.25% at December 31, 2004). Substantially all of our assets are collateralized as security for this facility, and all of our subsidiaries are guarantors under the line of credit. Borrowing availability under the line was \$40.2 million at December 31, 2004. In 2005, we received a letter of commitment from the bank to increase the line to \$50 million and extend it for three years, on substantially the same terms, including the uplift feature. We are in the process of negotiating definitive documentation for this extended facility.

This facility operates under an automatic cash management program whereby disbursements in excess of available cash are added as borrowings at the time disbursement checks clear the bank, and available cash receipts are first applied against any outstanding borrowings and then invested in short-term qualified cash investments. Accordingly, borrowings under the line are classified as current.

**Inventory Trade Credit Arrangements.** We have security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. These agreements allow a collateralized first position in certain branded products inventory financed by these financial institutions. Although the agreements provide for financing up to an aggregate of \$45 million, any outstanding financing must be fully secured by available inventory. We do not pay any interest or discount fees on such inventory financing; such costs are borne by the suppliers as an incentive for us to purchase their products.

**Liquidity Table for Contractual Obligations.** The following table sets forth information with respect to our long-term obligations payable in cash as of December 31, 2004 (in thousands):

	Payments Due By Period				
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
<b>Contractual Obligations:</b>					
Capital lease obligations <sup>(1)</sup>	\$11,037	\$ 1,504	\$2,897	\$2,174	\$ 4,462
Operating lease obligations	6,875	3,124	2,588	1,040	123
Earn-out obligation for acquisition	6,921	6,921	—	—	—
<b>Total</b>	<b>\$24,833</b>	<b>\$ 11,549</b>	<b>\$5,485</b>	<b>\$3,214</b>	<b>\$ 4,585</b>

<sup>(1)</sup> Including interest, excluding taxes, insurance, and common area maintenance charges.

We do not have any other off-balance sheet arrangements that have or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

**Capital Leases.** We have a fifteen-year lease for our corporate headquarters with an affiliated company related through common ownership. We also have a three-year lease for certain computer equipment with an unrelated party. We are required to make lease payments aggregating from \$1.0 million to \$1.5 million per year. In addition to the rent payable under the facility lease, we are required to pay real estate taxes, insurance, and common area maintenance charges.

## [Table of Contents](#)

*Operating Leases.* We also lease facilities from our principal stockholders and facilities and equipment from third parties under non-cancelable operating leases. See the “Liquidity Table for Contractual Obligations” above for lease commitments under these leases.

*Earn-out Provisions of MoreDirect Merger Agreement.* We completed the acquisition of MoreDirect in April 2002. Under the terms of this agreement, we were required to make additional payments to the MoreDirect shareholder if certain earnings levels were achieved through December 31, 2004. An earn-out payment of \$6.9 million is due in 2005 based on MoreDirect’s 2004 earnings. Earn-out payments aggregating \$11.1 million and \$10.8 million were made in 2004 and 2003 based on MoreDirect’s 2003 and 2002 earnings, respectively.

### **Factors Affecting Sources of Liquidity**

*Internally Generated Funds.* The key factors affecting our internally generated funds are our ability to minimize costs and fully achieve our operating efficiencies, timely collection of our customer receivables, and management of our inventory levels.

*Bank Line of Credit.* Our credit facility contains certain financial ratios and operational covenants and other restrictions (including restrictions on additional debt, guarantees, dividends and other distributions, investments, and liens) with which the Company and all of its subsidiaries must comply. Any failure to comply with these covenants would not only prevent us from borrowing additional funds under this line of credit, but would also constitute a default. This credit facility contains two financial tests:

- The funded debt ratio (defined as the average outstanding advances under the line for the quarter, divided by the consolidated EBITDA for the four quarters) must not be more than 2.0 to 1.0. Our actual funded debt ratio at December 31, 2004 was 0.3 to 1.0.
- Minimum Consolidated Net Worth must be at least \$125.0 million, plus 50% of consolidated net income for each quarter since December 31, 2001 (loss quarters not counted). Such amount was calculated at December 31, 2004 as \$134.8 million, whereas our actual consolidated stockholders’ equity at this date was \$166.2 million.

The borrowing base under this facility is set at 80% of qualified commercial receivables, plus 50% of qualified government receivables, less \$20 million of the formula availability which must be held in reserves. As of December 31, 2004, \$40.2 million was available for additional borrowings.

*Inventory Trade Credit Agreements.* These agreements contain similar financial ratios and operational covenants and restrictions as those contained in our bank line of credit described above. Such agreements also contain cross-default provisions whereby a default under the bank agreement would also constitute a default under these agreements. Financing under these agreements is limited to the purchase of specific branded products from authorized suppliers, and amounts outstanding must be fully collateralized by inventories of those products on hand.

*MoreDirect Merger Agreement.* The merger agreement with MoreDirect contemplated an earn-out period of three years following the closing whereby if MoreDirect maintained certain earnings levels, additional payments were to be made to MoreDirect’s shareholder. We accrued liabilities to MoreDirect’s shareholder for \$6.9 million, \$11.6 million, and \$10.8 million in earn-out consideration for the years ended December 31, 2004, 2003, and 2002, respectively, and have paid the amounts relating to 2003 and 2002. We expect to pay the earn-out consideration for 2004 in early 2005.

*Capital Markets.* Our ability to raise additional funds in the capital market depends upon, among other things, general economic conditions, the condition of the IT industry, our financial performance and stock price, and the state of the capital markets.

## **APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The SEC requires that all registrants disclose their most “critical accounting policies” in “Management’s Discussion of Financial Condition and Results of Operations.” A “critical accounting policy” has been defined as one that is both important to the portrayal of the registrant’s financial condition and results and requires management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Further, “critical accounting policies” are those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions.

We believe that our accounting policies described below fit the definition of “critical accounting policies.” We have reviewed our policies for the year ended December 31, 2004 and determined that they remain our most critical accounting policies.

### **Revenue Recognition**

Revenue on product sales is recognized at the point in time when persuasive evidence of an arrangement exists, the price is fixed and final, delivery has occurred, and there is a reasonable assurance of collection of the sales proceeds. We generally obtain oral or written purchase authorizations from our customers for a specified amount of product at a specified price. Because we either (i) have a general practice of covering customer losses while products are in transit despite title transferring to the customer at the point of shipment or (ii) have FOB – destination specifically set out in our arrangements with federal agencies, delivery is deemed to have occurred at the point in time when the product is received by the customer. We provide our customers with a limited thirty-day right of return generally limited to defective merchandise. Revenue is recognized at delivery and a reserve for sales returns is recorded. We have demonstrated the ability to make reasonable and reliable estimates of product returns in accordance with Statement of Financial Accounting Standards No. 48 (“SFAS No. 48”), “Revenue Recognition When Right of Return Exists,” based on significant historical experience. Should such returns no longer prove estimable, we believe that the impact on our financials would not necessarily be significant, since the return privilege expires 30 days after shipment.

Revenue for certain third party service contracts and software licenses that we sell are recorded on a net sales recognition basis because we do not assume the risks and rewards of ownership in these transactions. For such contracts and licenses, we evaluate whether the sales of such services should be recorded as gross sales or net sales as required under the guidelines described in Staff Accounting Bulletin No. 104, “Revenue Recognition” and EITF Issue No. 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent.” Under gross sales recognition, we are the primary obligor, and the entire selling process is recorded in sales with our cost to the third party service provider recorded as a cost of sales. Under net sales recognition, we are not the primary obligor, and the cost to the third party service provider is recorded as a reduction to sales, with no cost of goods sold, thus leaving the entire gross profit as the reported net sale for the transaction.

Similarly, we recognize revenue from agency sales transactions on a net sales basis. In agency sales transactions, we facilitate product sales by equipment manufacturers directly to our customers and receive agency fees for such transactions. We do not take title to the products in these transactions; title is passed directly from the supplier to our customer.

### **Accounts Receivable**

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and customers’ current credit worthiness. Our allowance is generally computed by (1) applying specific percentage reserves on accounts that are past due; and (2) specifically reserving for customers known to be in financial difficulty. Therefore, if the financial condition of certain of our customers were to deteriorate, or if we noted there was a lengthening of the timing of the settlement of receivables that was symptomatic of a general deterioration in the ability of our customers to pay, we would have to increase our allowance for doubtful

## [Table of Contents](#)

accounts. This would negatively impact our earnings. Our cash flows would be impacted to the extent that receivables could not be collected.

In addition to accounts receivable from customers, we record receivables from our vendors/suppliers for cooperative advertising, price protection, supplier reimbursements, rebates, and other similar arrangements. A portion of such receivables is estimated based on information available from our vendors at discrete points in time. While such estimates have historically approximated actual cash received, an unanticipated change in a promotional program could give rise to a reduction in the receivable. This could negatively impact our earnings and our cash flows.

Considerable judgment is used in assessing the ultimate realization of customer receivables and vendor/supplier receivables, including reviewing the financial stability of a customer, vendor information, and gauging current market conditions. If our evaluations are incorrect, we may incur future charges to our income statement.

### **Vendor Consideration**

We receive allowances from merchandise vendors for price protections, discounts, product rebates, and other programs. These allowances are treated as a reduction of the vendor's prices and are recorded as adjustments to cost of sales or inventory, as applicable. We also receive vendor co-op advertising funding for our catalogs and other programs. Vendors have the ability to place advertisements in the catalogs for which we receive advertising allowances. These vendor allowances, to the extent that they represent specific reimbursements of such specific, incremental, and identifiable costs, are offset against selling, general, and administrative expense on the consolidated statements of income. Advertising reimbursements that cannot be associated with a specific program funded by an individual vendor or that exceed the fair value of advertising expense associated with that program are reclassified to cost of sales in accordance with EITF 02-16. The level of allowances received from certain merchandise vendors has declined in past years and may do so again. Such a decline could have a material impact on gross margin and operating income.

### **Inventories – Merchandise**

Inventories (all finished goods) consisting of software packages, computer systems, and peripheral equipment are stated at cost (determined under the first-in, first-out method) or market, whichever is lower. Inventory quantities on hand are reviewed regularly, and provisions are made for obsolete, slow moving, and non-salable inventory, based primarily on management's forecast of customer demand for those products in inventory. The IT industry is characterized by rapid technological change and new product development that could result in increased obsolescence of inventory on hand. Increased obsolescence or decreased customer demand beyond management's expectations could require additional provisions. This could negatively impact our earnings. Our obsolescence charges have historically approximated \$6 million per annum. There have been no unusual charges precipitated by specific technological or forecast issues.

### **Contingencies**

From time to time we are subject to potential claims and assessments from third parties. We continually assess whether or not such claims have merit and warrant accrual under the "probable and estimable" criteria of Statement of Financial Accounting Standard No. 5, "Accounting for Contingencies." In 2003, we were subject to audit by the General Services Administration. While we have accrued an estimate of our anticipated liability in the financial statements, such estimate is subject to change based on incremental findings by the government auditors. Any such change in estimate will impact both our results of operations and our cash flows.

### **Value of Long-Lived Assets, Including Intangibles**

We carry a variety of long-lived assets on our balance sheet. These are all currently classified as held for use. These include property and equipment, identifiable intangibles, and goodwill. An impairment review is

## [Table of Contents](#)

undertaken on (1) an annual basis for assets such as goodwill and indefinite lived intangible assets; and (2) on an event-driven basis for all long-lived assets (including indefinite lived intangible assets and goodwill) when facts and circumstances suggest that cash flows emanating from such assets may be diminished. We may review the carrying value of all these assets based partly on our projections of anticipated cash flows – projections which are, in part, dependent upon anticipated market conditions, operational performance, and legal status. Any impairment charge that is recorded negatively impacts our earnings. Cash flows are generally not impacted.

Over the last several years, we have incurred no impairment charges. While we believe that our future estimates are reasonable, different assumptions regarding items such as future cash flows and the volatility inherent in markets which we serve could materially effect our valuations and result in impairment charges against the carrying value of those assets.

### **Employee Compensation and Benefits**

Our employee compensation model has several elements that we consider variable. These include our obligation to our employees for health care. We have selected a plan that results in our being self-insured up to certain stop-loss limits. Accordingly, we have to estimate the amount of health care claims outstanding at a given point in time. These estimates are based on historical experience and could be subject to change. Such change could negatively impact both our earnings and our cash flows.

We also have granted stock options to our employees. In general, such grants since 1998 have been made at the current fair value of our stock and accordingly, given that we account for option awards under APB Opinion 25, “Accounting for Stock Issued to Employees,” no compensation charge has been recorded. In previous years, most specifically those years prior to our initial public offering, there was a difference between the strike price of the option and the then current fair value of the stock. This difference resulted in a fixed and determinable compensation charge. We have not modified option grants in a manner that would cause either re-measurement of the awards or the commencement of variable accounting.

As described in the notes to the financial statements, pro-forma disclosure has been provided as if we applied the fair value methodology to option awards. The recognition of compensation for awards, as will be required upon the adoption of Statement of Financial Accounting Standard No. 123(R), “Share-Based Payment” (SFAS 123(R)) on July 1, 2005, will have an adverse effect on our earnings. As discussed below, we are currently evaluating the extent of the impact SFAS 123(R) will have on our consolidated statements of operations.

We have also engaged in workforce reduction actions in each of the last three years. These actions included formula driven termination benefits. These benefits were or are being paid relatively quickly and have not been subject to change. We do not foresee a circumstance where there could be significant variability in our workforce reduction estimates. However, if we did experience significant variability, such change could negatively impact our cash flows.

### **RECENTLY ISSUED FINANCIAL ACCOUNTING STANDARDS**

In January and December 2003, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 46 (FIN No. 46) and No. 46, revised (FIN No. 46(R)), respectively, “Consolidation of Variable Interest Entities.” These statements address accounting for entities commonly known as special-purpose or off-balance-sheet entities and require that the assets, liabilities, and results of the activity of variable interest entities be consolidated into the financial statements of the company that has the controlling financial interest. Certain provisions of FIN No. 46(R) related to interests in special purpose entities were effective for the period ended December 31, 2003. The adoption of FIN No. 46(R) did not have a material effect on our consolidated financial position or results of operations

## [Table of Contents](#)

In December 2004, the FASB issued SFAS 123(R). This Statement is a revision of SFAS 123 and supersedes APB 25 and its related implementation guidance. SFAS 123(R) requires a company to measure the grant date fair value of equity awards given to employees in exchange for services and recognize that cost over the period that such services are performed. SFAS 123(R) is effective for the first interim or annual reporting period that begins after June 15, 2005 and will be effective for our interim quarter ending September 30, 2005. We are evaluating the two methods of adoption allowed by SFAS 123(R): the modified-prospective transition method and the modified-retrospective transition method. Adoption of SFAS 123(R) may materially increase stock compensation expense and decrease net income. In addition, SFAS 123(R) requires that the excess tax benefits related to stock compensation be reported as a cash inflow from financing activities rather than as a reduction of taxes paid in cash from operations.

### **INFLATION**

We have historically offset any inflation in operating costs by a combination of increased productivity and price increases, where appropriate. We do not expect inflation to have a significant impact on our business in the foreseeable future.

### **FACTORS THAT MAY AFFECT FUTURE RESULTS AND FINANCIAL CONDITION**

Our future results and financial condition are dependent on our ability to continue to successfully market, sell, and distribute information technology products and services, including computers, hardware, and software. Inherent in this process are a number of factors that we must successfully manage in order to achieve a favorable financial condition and favorable operating results. Potential risks and uncertainties that could affect our future financial condition and operating results include, without limitation, the following factors:

#### **We have experienced variability in sales , and there is no assurance that we will be able to maintain profitable operations.**

Several factors have caused our sales and results of operations to fluctuate and we expect these fluctuations to continue on a quarterly basis. Causes of these fluctuations include:

- changes in the overall level of economic activity;
- changes in the level of business investment in information technology products;
- the condition of the personal computer industry in general;
- shifts in customer demand for hardware and software products;
- industry shipments of new products or upgrades;
- the timing of new merchandise and catalog offerings;
- fluctuations in response rates;
- fluctuations in postage, paper, shipping, and printing costs and in merchandise returns;
- adverse weather conditions that affect response, distribution, or shipping;
- shifts in the timing of holidays;



## [Table of Contents](#)

- changes in our product offerings;
- changes in consumer demand for information technology products; and
- changes in vendor distribution of products.

In addition, customer response rates for our catalogs and other marketing vehicles are subject to variations. The first and last quarters of the year generally have higher response rates while the two middle quarters typically have lower response rates.

We base our operating expenditures on sales forecasts. If our revenues do not meet anticipated levels in the future, we may not be able to reduce our staffing levels and operating expenses in a timely manner to avoid significant losses from operations.

### **Despite our August 2004 award of an authorization to sell to the federal government under a new General Services Administration schedule, our sales to that organization may not regain prior years' sales levels, which would negatively impact our business.**

In November 2003, we were advised that the GSA cancelled its contract with our subsidiary, GovConnection, following a review of its contract management system and procedures that may have resulted in the sale of unqualified items or underpayment of required fees. The matter has been referred to the Department of Justice for review, and we are cooperating in that review. While we were awarded authorization in August 2004 to resume selling to the federal government under a new GSA schedule, we saw a significant year-over-year decline in our 2004 federal government sales. Accordingly, our revenues may continue to be adversely impacted as we attempt to regain this business.

### **We are exposed to inventory obsolescence due to the rapid technological changes occurring in the personal computer industry.**

The market for personal computer products is characterized by rapid technological change and the frequent introduction of new products and product enhancements. Our success depends in large part on our ability to identify and market products that meet the needs of customers in that marketplace. In order to satisfy customer demand and to obtain favorable purchasing discounts, we have and may continue to carry increased inventory levels of certain products. By so doing, we are subject to the increased risk of inventory obsolescence. Also, in order to implement our business strategy, we intend to continue, among other things, to place larger than typical inventory stocking orders, and increase our participation in first-to-market purchase opportunities. We may also participate in end-of-life-cycle purchase opportunities and market products on a private-label basis, which would increase the risk of inventory obsolescence. In addition, we sometimes acquire special purchase products without return privileges. There can be no assurance that we will be able to avoid losses related to obsolete inventory. In addition, manufacturers are limiting return rights and are also taking steps to reduce their inventory exposure by supporting "build-to-order" programs authorizing distributors and resellers to assemble computer hardware under the manufacturers' brands. These trends reduce the costs to manufacturers and shift the burden of inventory risk to resellers like us which could negatively impact our business.

### **We acquire products for resale from a limited number of vendors; the loss of any one of these vendors could have a material adverse effect on our business.**

We acquire products for resale both directly from manufacturers and indirectly through distributors and other sources. The five vendors supplying the greatest amount of goods to us constituted 63%, 63%, and 67% of our total product purchases in the years ended December 31, 2004, 2003, and 2002, respectively. Among these five vendors, purchases from Ingram Micro, Inc. represented 27%, 22%, and 28% of our total product purchases

## [Table of Contents](#)

in the years ended December 31, 2004, 2003, and 2002, respectively. Purchases from Tech Data Corporation comprised 14%, 15%, and 14% of our total product purchases in the years ended December 31, 2004, 2003, and 2002, respectively. Effective May 3, 2002, Hewlett-Packard Company ("HP") completed its acquisition of Compaq Computer Corporation. Our combined purchases from HP and Compaq constituted 11%, 15%, and 15% of our total product purchases in the years ended December 31, 2004, 2003, and 2002, respectively. No other vendor supplied more than 10% of our total product purchases in the years ended December 31, 2004, 2003, and 2002. If we were unable to acquire products from Ingram, Tech Data, or HP, we could experience a short-term disruption in the availability of products and such disruption could have a material adverse effect on our results of operations and cash flows.

Substantially all of our contracts and arrangements with our vendors that supply significant quantities of products are terminable by such vendors or us without notice or upon short notice. Most of our product vendors provide us with trade credit, of which the net amount outstanding at December 31, 2004 was \$79.7 million. Termination, interruption, or contraction of relationships with our vendors, including a reduction in the level of trade credit provided to us, could have a material adverse effect on our financial position.

Some product manufacturers either do not permit us to sell the full line of their products or limit the number of product units available to direct marketers such as us. An element of our business strategy is to continue to increase our participation in first-to-market purchase opportunities. The availability of certain desired products, especially in the direct marketing channel, has been constrained in the past. We could experience a material adverse effect to our business if we are unable to source first-to-market purchase or similar opportunities, or if we face the reemergence of significant availability constraints.

### **We may experience a reduction in the incentive programs offered to us by our vendors.**

Some product manufacturers and distributors provide us with incentives such as supplier reimbursements, payment discounts, price protection, rebates, and other similar arrangements. The increasingly competitive computer hardware market has already resulted in the following:

- reduction or elimination of some of these incentive programs;
- more restrictive price protection and other terms; and
- reduced advertising allowances and incentives, in some cases.

Many product suppliers provide us with co-op advertising support and in exchange we feature their products in our catalogs. This support significantly defrays our catalog production expense. In the past, we have experienced a decrease in the level of co-op advertising support available to us from certain manufacturers. The level of co-op advertising support we receive from some manufacturers may further decline in the future. Such a decline could decrease our gross margin and increase our SG&A expenses as a percentage of sales and have a material adverse effect on our cash flows.

### **We face many competitive risks.**

The direct marketing industry and the computer products retail business, in particular, are highly competitive. We compete with consumer electronics and computer retail stores, including superstores. We also compete with other direct marketers of hardware and software and computer related products, including an increasing number of Internet retailers. Certain hardware and software vendors, such as HP, IBM, and Apple, who provide products to us, are also selling their products directly to end users through their own catalogs and over the Internet. We compete not only for customers, but also for co-op advertising support from personal computer product manufacturers. Some of our competitors have larger catalog circulations and customer bases and greater financial, marketing, and other resources than we do. In addition, some of our competitors offer a wider range of products and services than we do and may be able to respond more quickly to new or changing

## [Table of Contents](#)

opportunities, technologies, and customer requirements. Many current and potential competitors also have greater name recognition, engage in more extensive promotional activities, and adopt more aggressive pricing policies than us. We expect competition to increase as retailers and direct marketers who have not traditionally sold computers and related products enter the industry.

In addition, product resellers and direct marketers are combining operations or acquiring or merging with other resellers and direct marketers to increase efficiency. Moreover, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to enhance their products and services. Accordingly, it is possible that new competitors or alliances among competitors may emerge and acquire significant market share.

We cannot assure you that we can continue to compete effectively against our current or future competitors. If we encounter new competition or fail to compete effectively against our competitors, our business may be harmed.

### **We face and will continue to face significant price competition.**

Generally, pricing is very aggressive in the personal computer industry and we expect pricing pressures to continue. An increase in price competition could result in a reduction of our profit margins. There can be no assurance that we will be able to offset the effects of price reductions with an increase in the number of customers, higher sales, cost reductions, or otherwise. Also, our sales of personal computer hardware products are generally producing lower profit margins than those associated with software products. Such pricing pressures could result in an erosion of our market share, reduced sales, and reduced operating margins, any of which could have a material adverse effect on our business.

### **The methods of distributing personal computers and related products are changing and such changes may negatively impact us and our business.**

The manner in which personal computers and related products are distributed and sold is changing, and new methods of distribution and sale, such as online shopping services, have emerged. Hardware and software manufacturers have sold, and may intensify their efforts to sell, their products directly to end users. From time to time, certain manufacturers have instituted programs for the direct sales of large order quantities of hardware and software to certain major corporate accounts. These types of programs may continue to be developed and used by various manufacturers. Some of our vendors, including Apple, HP, and IBM, currently sell some of their products directly to end users and have stated their intentions to increase the level of such direct sales. In addition, manufacturers may attempt to increase the volume of software products distributed electronically to end users. An increase in the volume of products sold through or used by consumers of any of these competitive programs or distributed electronically to end users could have a material adverse effect on our results of operations.

### **We could experience system failures which would interfere with our ability to process orders.**

We depend on the accuracy and proper use of our management information systems including our telephone system. Many of our key functions depend on the quality and effective utilization of the information generated by our management information systems, including:

- our ability to manage inventory and accounts receivable collection;
- our ability to purchase, sell, and ship products efficiently and on a timely basis; and
- our ability to maintain operations.

## [Table of Contents](#)

Our management information systems require continual upgrades to most effectively manage our operations and customer database. Although we maintain some redundant systems, with full data backup, a substantial interruption in management information systems or in telephone communication systems, including those resulting from natural disasters as well as power loss, telecommunications failure, and similar events, would substantially hinder our ability to process customer orders and thus could have a material adverse effect on our business.

### **We rely on the continued development of electronic commerce and Internet infrastructure development.**

We have had an increasing amount of sales made over the Internet in part because of the growing use and acceptance of the Internet by end users. No one can be certain that acceptance and use of the Internet will continue to develop or that a sufficiently broad base of consumers will adopt and continue to use the Internet and other online services as a medium of commerce. Sales of computer products over the Internet do not currently represent a significant portion of overall computer product sales. Growth of our Internet sales is dependent on potential customers using the Internet in addition to traditional means of commerce to purchase products. We cannot accurately predict the rate at which they will do so.

Our success in growing our Internet business will depend in large part upon the development of an infrastructure for providing Internet access and services. If the number of Internet users or their use of Internet resources continues to grow rapidly, such growth may overwhelm the existing Internet infrastructure. Our ability to increase the speed with which we provide services to customers and to increase the scope of such services ultimately is limited by and reliant upon the speed and reliability of the networks operated by third parties and these networks may not continue to be developed.

### **We depend heavily on third-party shippers to deliver our products to customers.**

We ship approximately 56% of our products to customers by DHL Worldwide Express (“DHL”), with the remainder being shipped by United Parcel Service, Inc. and other overnight delivery and surface services. A strike or other interruption in service by these shippers could adversely affect our ability to market or deliver products to customers on a timely basis.

### **We may experience potential increases in shipping, paper, and postage costs, which may adversely affect our business if we are not able to pass such increases on to our customers.**

Shipping costs are a significant expense in the operation of our business. Increases in postal or shipping rates and paper costs could significantly impact the cost of producing and mailing our catalogs and shipping customer orders. Postage prices and shipping rates increase periodically and we have no control over future increases. We have a long-term contract with DHL whereby DHL ships products to our customers. We believe that we have negotiated favorable shipping rates with DHL. We generally invoice customers for shipping and handling charges. There can be no assurance that we will be able to pass on to our customers the full cost, including any future increases in the cost, of commercial delivery services such as DHL.

We also incur substantial paper and postage costs related to our marketing activities, including producing and mailing our catalogs. Paper prices historically have been cyclical and we have experienced substantial increases in the past. Significant increases in postal or shipping rates and paper costs could adversely impact our business, financial condition, and results of operations, particularly if we cannot pass on such increases to our customers or offset such increases by reducing other costs.

### **Privacy concerns with respect to list development and maintenance may materially adversely affect our business.**

We mail catalogs and send electronic messages to names in our proprietary customer database and to potential customers whose names we obtain from rented or exchanged mailing lists. World-wide public concern

## [Table of Contents](#)

regarding personal privacy has subjected the rental and use of customer mailing lists and other customer information to increased scrutiny. Any domestic or foreign legislation enacted limiting or prohibiting these practices could negatively affect our business.

### **We face many uncertainties relating to the collection of state sales or use tax.**

We presently collect sales and use taxes on sales of products to residents in many states. Taxable sales to customers were approximately 29% of our net sales during the year ended December 31, 2004. Various states have sought to impose on direct marketers the burden of collecting state sales and use taxes on the sales of products shipped to their residents. In 1992, the United States Supreme Court affirmed its position that it is unconstitutional for a state to impose sales or use tax collection obligations on an out-of-state mail-order company whose only contacts with the state are limited to the distribution of catalogs and other advertising materials through the mail and the subsequent delivery of purchased goods by United States mail or by interstate common carrier. However, legislation that would expand the ability of states to impose sales and use tax collection obligations on direct marketers has been introduced in Congress on many occasions. Moreover, due to our presence on various forms of electronic media and other operational factors, our contacts with many states may exceed the limited contacts involved in the Supreme Court case. We cannot predict the level of contacts that is sufficient to permit a state to impose on us a sales or use tax collection obligation. Two of our competitors have elected to collect sales and use taxes in all states. If the Supreme Court changes its position or if legislation is passed to overturn the Supreme Court's decision, or, if a court were to determine that our contacts with a state exceed the constitutionality permitted contacts, the imposition of a sales or use tax collection obligation on us in states to which we ship products would result in additional administrative expenses to us, could result in tax liability for past sales as well as price increases to our customers, and could reduce demand for our product.

### **We are dependent on key personnel.**

Our future performance will depend to a significant extent upon the efforts and abilities of our senior executives. The competition for qualified management personnel in the computer products industry is very intense, and the loss of service of one or more of these persons could have an adverse effect on our business. Our success and plans for future growth will also depend on our ability to hire, train, and retain skilled personnel in all areas of our business, including sales account managers and technical support personnel. There can be no assurance that we will be able to attract, train, and retain sufficient qualified personnel to achieve our business objectives.

### **We are controlled by two principal stockholders.**

Patricia Gallup and David Hall, our two principal stockholders, beneficially own or control, in the aggregate, approximately 68% of the outstanding shares of our common stock. Because of their beneficial stock ownership, these stockholders can continue to elect the members of the Board of Directors and decide all matters requiring stockholder approval at a meeting or by a written consent in lieu of a meeting. Similarly, such stockholders can control decisions to adopt, amend, or repeal our charter and our bylaws, or take other actions requiring the vote or consent of our stockholders and prevent a takeover of us by one or more third parties, or sell or otherwise transfer their stock to a third party, which could deprive our stockholders of a control premium that might otherwise be realized by them in connection with an acquisition of us. Such control may result in decisions that are not in the best interest of our public stockholders. In connection with our initial public offering, the principal stockholders placed substantially all shares of common stock beneficially owned by them into a voting trust, pursuant to which they are required to agree as to the manner of voting such shares in order for the shares to be voted. Such provisions could discourage bids for our common stock at a premium as well as have a negative impact on the market price of our common stock.

### **Item 7A. Quantitative and Qualitative Disclosure About Market Risk**

We invest cash balances in excess of operating requirements in short-term securities, generally with maturities of 90 days or less. In addition, our unsecured credit agreement provides for borrowings which bear

## [Table of Contents](#)

interest at variable rates based on the prime rate. We had \$4.8 million in borrowings outstanding pursuant to the credit agreement as of December 31, 2004. We believe the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows should not be material. Our credit agreement exposes earnings to changes in short-term interest rates since interest rates on the underlying obligations are variable. However, as noted above, \$4.8 million in borrowings were outstanding on the credit agreement at December 31, 2004, and the average outstanding borrowings during the year were not material. Accordingly, the change in earnings resulting from a hypothetical 10% increase or decrease in interest rates is not material.

### **Item 8. Consolidated Financial Statements and Supplementary Data**

The information required by this Item is included in this Report beginning at page F-1.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

### **Item 9A. Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Interim Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2004. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on this evaluation, our Chief Executive Officer and Interim Chief Financial Officer concluded that, as of December 31, 2004, our disclosure controls and procedures were in the reasonable assurance level.

Except as stated below, no change in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended December 31, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Upon the request of the Chief Executive Officer and Chairman of our Board of Directors, the Audit Committee of our Board conducted a review of certain transactions that occurred in 2000 and 2003. This review was completed in October 2004. Although the Audit Committee determined that no adjustments to our financial statements were required, it concluded that there were instances in which existing internal controls relating to the authorization, review, and processing of such transactions were overridden, and document retention policies with respect to certain vendor rebates were not followed or were deficient. Accordingly, we implemented certain corrective actions in the fourth quarter of 2004. These included enhancing management review procedures over significant sales and rebate transactions, and modifying our document retention policies relating to rebate-related vendor reporting as necessary. We have evaluated and realigned certain senior management responsibilities and authority.

## [Table of Contents](#)

Concurrent with the completion of our documentation and testing of our internal controls over financial reporting, and as a matter of course, we will arrange for additional Sarbanes-Oxley training for our management personnel. In addition, we have implemented an on-line business-ethics training program for substantially all employees of our organization.

### **Item 9B. Other Information**

On February 14, 2005, our subsidiary MoreDirect, Inc. entered into a five-year lease with Boca Technology Center, LLC for office property located in Boca Raton, Florida. The lease commences April 1, 2005 and requires monthly payments of \$8,091 in year one of the lease. Subsequent years' rents are subject to a 4% annual increase. MoreDirect occupied this facility in March 2005 and is expected to terminate its previous Boca Raton lease, as required, on April 30, 2005.

On February 28, 2005, our subsidiary Merrimack Services Corporation, entered into a two-year amendment to its lease with EWE Warehouse Investments V, LTD. for property located in Wilmington, Ohio. The lease, one of two that we have for our Wilmington distribution center, was effective March 1, 2005 and requires a monthly payment of \$45,739.

On March 5, 2005, our subsidiary Merrimack Services Corporation entered into a five-year lease with 222 International, LP for office property located in Portsmouth, New Hampshire. The lease commences May 1, 2005 and requires a monthly payment of \$16,205.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

The information included under the headings, “Executive Officers of PC Connection” in Item 4 of Part I hereof and “Information Concerning Directors, Nominees, and Executive Officers,” “Section 16(a) Beneficial Ownership Reporting Compliance” and “Code of Business Conduct” in our definitive Proxy Statement for our 2005 Annual Meeting of Stockholders to be held on June 9, 2005 (the “Proxy Statement”) is incorporated herein by reference. We anticipate filing the Proxy Statement within 120 days after December 31, 2004. With the exception of the foregoing information and other information specifically incorporated by reference into this Form 10-K, the Proxy Statement is not being filed as a part hereof.

**Item 11. Executive Compensation**

The information included under the heading “Executive Compensation” in the Proxy Statement is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

The information included under the heading “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” in the Proxy Statement is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions**

The information included under the heading “Certain Transactions and Relationships” in the Proxy Statement is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information included under the heading “Principal Accountant Fees and Services” in the Proxy Statement is incorporated herein by reference.



**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) List of Documents Filed as Part of This Report:

(1) Consolidated Financial Statements

The consolidated financial statements listed below are included in this document.

<u>Consolidated Financial Statements</u>	<u>Page References</u>
Report of Management	F-2
Report of Independent Registered Public Accounting Firm	F-3
Consolidated Balance Sheets	F-4
Consolidated Statements of Income	F-5
Consolidated Statement of Changes in Stockholders' Equity	F-6
Consolidated Statements of Cash Flows	F-7
Notes to Consolidated Financial Statements	F-8

(2) Consolidated Financial Statement Schedule:

The following Consolidated Financial Statement Schedule, as set forth below, is filed with this report:

<u>Schedule</u>	<u>Page Reference</u>
Schedule II—Valuation and Qualifying Accounts	S-1

All other schedules have been omitted because they are either not applicable or the relevant information has already been disclosed in the financial statements.

(3) Supplementary Data

Not applicable.

## [Table of Contents](#)

### (b) Exhibits

The exhibits listed below are filed herewith or are incorporated herein by reference to other filings.

#### EXHIBIT INDEX

##### Exhibits

3.2(1)	Amended and Restated Certificate of Incorporation of Registrant.
3.4(1)	Bylaws of Registrant.
4.1(1)	Form of specimen certificate for shares of Common Stock, \$0.01 par value per share, of the Registrant.
9.1(1)	Form of 1998 PC Connection Voting Trust Agreement among the Registrant, Patricia Gallup individually and as a trustee, and David Hall individually and as trustee.
10.1(1)	1993 Incentive and Non-Statutory Stock Option Plan, as amended.
10.2(1)	1997 Stock Incentive Plan.
10.3(1)	Lease between the Registrant and Gallup & Hall partnership, dated June 1, 1987, as amended, for property located in Marlow, New Hampshire.
10.4(1)	Employment Agreement between the Registrant and Robert F. Wilkins, dated December 23, 1995.
10.5(1)	Lease between the Registrant and Gallup & Hall partnership, dated May 1, 1997, for property located at 442 Marlboro Street, Keene, New Hampshire.
10.6(1)	Agreement between the Registrant and Ingram Micro, Inc., dated October 30, 1997, as amended.
10.7(1)	Amended and Restated Lease between the Registrant and G&H Post, LLC, dated December 29, 1997 for property located at Route 101A, Merrimack, New Hampshire.
10.8(1)	Employment Agreement, dated as of January 1, 1998, between the Registrant and Patricia Gallup.
10.9(1)	Form of Registration Rights Agreement among the Registrant, Patricia Gallup, David Hall, and the 1998 PC Connection Voting Trust.
10.10(2)	Employment Agreement between the Registrant and Mark A. Gavin, dated February 5, 1998.
10.11(3)	Agreement for Wholesale Financing, dated as of March 25, 1998, between the Registrant and Deutsche Financial Services Corporation.
10.12(3)	Amendment to Agreement for Wholesale Financing, dated as of March 25, 1998, between the Registrant and Deutsche Financial Services Corporation.
10.13(1)	Lease between the Registrant and Gallup & Hall partnership, dated July 22, 1998, for property located at 450 Marlboro Street, Keene, New Hampshire.
10.14(4)	Amendment, dated January 1, 1999, to the Lease Agreement between the Registrant and Gallup & Hall Partnership, dated June 1, 1987, as amended for property located in Marlow, New Hampshire.
10.15(2)	Amendment No. 1 to Amended and Restated Lease between the Registrant and G&H Post, LLC, dated December 29, 1998, for property located at Route 101A, Merrimack, New Hampshire.
10.16(4)	Lease between PC Connection, Inc. and The Hillsborough Group, dated January 5, 2000, for property located at 706 Route 101A, Merrimack, New Hampshire.
10.17(3)	Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between the Registrant and Deutsche Financial Services Corporation.
10.18(3)	Guaranty, dated as of February 25, 2000, entered into by PC Connection, Inc. in connection with the Amendment to Agreement for Wholesale Financing, dated as of February 25, 2000, between the Registrant and Deutsche Financial Services Corporation.
10.19(3)	Amended and Restated Credit Agreement, dated February 25, 2000, between PC Connection, Inc., the Lenders Party hereto and Citizens Bank of Massachusetts.
10.20(4)	Amendment to Employment Agreement between the Registrant and Robert F. Wilkins dated December 23, 1995.
10.21(4)	Lease between PC Connection Sales and Dover Mills L.P., dated May 1, 2000, for property located at 100 Main Street, Dover, New Hampshire.

## Table of Contents

### Exhibits

- 10.22(4) Amendment, dated June 26, 2000 to the Lease Agreement between Merrimack Services Corporation and EWE Warehouse Investments V, LTD., dated July 31, 1998 for property located at 2840 Old State Route 73, Wilmington, Ohio.
- 10.23(4) Lease between ComTeq Federal, Inc. and Rockville Office/Industrial Associates dated December 14, 1993, for property located at 7503 Standish Place, Rockville, Maryland.
- 10.24(4) Amendment, dated November 1, 1996 to the Lease Agreement between ComTeq Federal, Inc. and Rockville Office/Industrial Associates for property located in Rockville, Maryland.
- 10.25(4) Amendment, dated March 31, 1998 to the Lease Agreement between ComTeq Federal, Inc. and Rockville Office/Industrial Associates, dated November 1, 1996, as amended for property located in Rockville, Maryland.
- 10.26(4) Amendment, dated August 31, 2000 to the Lease Agreement between ComTeq Federal, Inc. and Rockville Industrial Associates, dated March 31, 1998, as amended for property located in Rockville, Maryland.
- 10.27(4) Lease between Merrimack Services Corporation and Schleicher & Schuell, Inc., dated November 16, 2000, for property located at 10 Optical Avenue, Keene, New Hampshire.
- 10.28(5) Amendment, dated December 27, 2000, to the Amended and Restated Credit Agreement, dated February 25, 2000, between PC Connection, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
- 10.29(5) Amendment, dated May 4, 2001 to the Amended and Restated Credit Agreement, dated December 27, 2000, between PC Connection, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
- 10.30(6) Amendment, dated August 22, 2001 to the Amended and Restated Credit Agreement, dated May 4, 2001, between PC Connection, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
- 10.31(6) Agreement and Plan of Merger, dated March 25, 2002, by and among PC Connection, Inc., Boca Acquisition Corp., MoreDirect, Inc. and the stockholders of MoreDirect, Inc. set forth on Schedule 1 thereto.
- 10.32(7) Amendment No. 1 to the Agreement and Plan of Merger, dated April 5, 2002, by and among PC Connection, Inc., Boca Acquisition Corp., MoreDirect, Inc., Russell Madris, the sole stockholder of MoreDirect, Inc. and Michael Diamant, James Garrity, and Scott Madris.
- 10.33(8) Amended and Restated Credit and Security Agreement, dated May 31, 2002, among Citizens Bank of Massachusetts, as lender and agent, other financial institutions party thereto from time to time, as lenders, PC Connection, Inc., as borrower, Comteq Federal of New Hampshire, Inc., GovConnection, Inc., Merrimack Services Corporation, PC Connection Sales Corporation, PC Connection Sales of Massachusetts, Inc., and MoreDirect, Inc., each as guarantors.
- 10.34(9) Amendment, dated June 1, 2002, to the Lease Agreement between Merrimack Services Corporation and Gallup & Hall, dated May 1, 1997, for property located at 442 Marlboro Street, located in Keene, New Hampshire.
- 10.35(9) Amendment, dated July 31, 2002 to the Lease Agreement between Merrimack Services and EWE Warehouse Investments V, LTD, dated June 26, 2000 for property located at Old State Route 73, Wilmington, Ohio.
- 10.36(9) Lease between Merrimack Services Corporation and Audio Accessories, Inc., dated November 1, 2002 for property located at Mill Street, Marlow, New Hampshire.
- 10.37(9) Lease between MoreDirect.com, Inc. and Bryam Hill Realty Corporation, dated April 1, 2000, for property located at 7300 N. Federal Highway, Boca Raton, FL.
- 10.38(9) Lease between MoreDirect.com, Inc. and Bryam Hill Realty Corporation, dated February 2001, for property located at 7300 N. Federal Highway, Boca Raton, FL.
- 10.39(9) Assignment of lease dated August 27, 2002, between MoreDirect, Inc. and Robert Leone Trust, for property located at 7300 N. Federal Highway, Boca Raton, FL.

## Table of Contents

### Exhibits

10.40(9)	Amendment, dated November 20, 2002, to the Lease Agreement between GovConnection (formerly known as ComTeq Federal, Inc.) and Rockville Office/Industrial Associates, dated March 31, 1998, as amended for property located in Rockville, Maryland.
10.41(10)	Lease between GovConnection, Inc. and Fairhaven Investors Limited Partnership, dated April 30, 2003, for property located at 2150 Post Road, Fairfield, Connecticut.
10.42(11)(+)	National Account Agreement between Airborne Express, Inc. and Merrimack Services Corporation d/b/a PC Connection Services, dated June 2, 2003.
10.43(12)	Amendment to Agreement for Wholesale Financing and Guaranty, dated as of December 18, 2001, by and among the Registrant, PC Connection Sales Corporation, Merrimack Services Corporation, and Deutsche Financial Services Corporation.
10.44(12)	First Amendment, dated June 14, 2002 to the Amended and Restated Credit and Security Agreement, dated May 31, 2002, between PC Connection, Inc., Comteq Federal of New Hampshire, Inc., GovConnection, Inc., PC Connection Sales Corporation, MoreDirect, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
10.45(12)	Second Amendment, dated July 29, 2002 to the Amended and Restated Credit and Security Agreement, dated May 31, 2002, between PC Connection, Inc., Comteq Federal of New Hampshire, Inc., GovConnection, Inc., PC Connection Sales Corporation, MoreDirect, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
10.46(12)	Agreement for Inventory Financing, dated as of October 31, 2002, by and among the Registrant, Merrimack Services Corporation, GovConnection, Inc., MoreDirect, Inc., and IBM Credit Corporation.
10.47(12)	Guaranty, dated as of November 14, 2002, entered into by Registrant in connection with the Agreement for Inventory Financing, dated as of October 31, 2002, by and among the Registrant, Merrimack Services Corporation, GovConnection, Inc., MoreDirect, Inc., and IBM Credit Corporation.
10.48(12)	Guaranty, dated as of November 14, 2002, entered into by PC Connection Sales Corporation in connection with the Agreement for Inventory Financing, dated as of October 31, 2002, by and among the Registrant, Merrimack Services Corporation, GovConnection, Inc., MoreDirect, Inc., and IBM Credit Corporation.
10.49(12)	Amendment, dated April 23, 2003 to the Lease Agreement between Merrimack Services and EWE Warehouse Investments V, LTD, as amended June 19, 2001, for property located at Old State Route 73, Wilmington, Ohio.
10.50(12)	Third Amendment, dated October 1, 2003 to the Amended and Restated Credit and Security Agreement, dated May 31, 2002, between PC Connection, Inc., Comteq Federal of New Hampshire, Inc., GovConnection, Inc., PC Connection Sales Corporation, MoreDirect, Inc., the Lender's Party hereto and Citizens Bank of Massachusetts.
10.51(12)	Acknowledgement, Waiver and Amendment to Agreement for Inventory Financing, dated as of November 25, 2003, by and among the Registrant, Merrimack Services Corporation, GovConnection, Inc., MoreDirect, Inc. and IBM Credit LLC.
10.52(13)	Amendment, dated September 7, 2004 to the Lease Agreement between Merrimack Services Corporation and The Hillsborough Group, dated January 5, 2000, for property located at 706 Route 101A, Merrimack, New Hampshire.
10.53(13)	Amendment, dated September 24, 2004 to the Lease Agreement between Merrimack Services Corporation and Bronx II, LLC, dated October 27, 1988, as amended for property located in Marlborough, MA.
10.54(13)	Separation Agreement by and between the Company and Mark A. Gavin, dated October 20, 2004.
10.55	Lease between MoreDirect, Inc. and Boca Technology Center, LLC, dated February 14, 2005, for property located in Boca Raton, Florida.
10.56	Fifth Amendment, dated February 28, 2005, to the Lease Agreement between Merrimack Services Corporation and EWE Warehouse Investments V, LTD., for property located at 2780-2880 Old State Route 73, Wilmington, Ohio.

## Table of Contents

### Exhibits

10.57	Sublease between Merrimack Services Corporation and 222 International, LP, dated March 4, 2005, for property located in Portsmouth, New Hampshire.
10.58	Summary of Compensation for Executive Officers.
10.59	Summary of Compensation for Non-Employee Directors.
14.1(12)	Code of Business Conduct.
21.1	Subsidiaries of Registrant.
23.1	Consent of Deloitte & Touche LLP.
31.1	Certification of the Company's Chairman and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Company's Treasurer and Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Company's Chairman and Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Company's Treasurer and Interim Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- 
- (1) Incorporated by reference from the exhibits filed with the Company's registration statement (333-41171) on Form S-1 filed under the Securities Act of 1933.
  - (2) Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 31, 1999.
  - (3) Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K/A Amendment No. 1, File Number 0-23827, filed on April 4, 2000.
  - (4) Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 30, 2001.
  - (5) Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed on August 14, 2001.
  - (6) Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on April 1, 2002.
  - (7) Incorporated by reference from exhibits filed with the Company's current report on Form 8-K, dated April 5, 2002.
  - (8) Incorporated by reference from exhibits filed with the Company's current Report on Form 8-K, dated June 5, 2002.
  - (9) Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 31, 2003.
  - (10) Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed on August 13, 2003.
  - (11) Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File number 0-23827, filed November 20, 2003.
  - (12) Incorporated by reference from exhibits filed with the Company's annual report on Form 10-K, File Number 0-23827, filed on March 30, 2004.
  - (13) Incorporated by reference from exhibits filed with the Company's quarterly report on Form 10-Q, File Number 0-23827, filed November 15, 2004.
  - (+) Confidential treatment requested for this agreement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 31, 2005

PC CONNECTION, INC.

By: \_\_\_\_\_ /s/ PATRICIA GALLUP

**Patricia Gallup,  
Chairman and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
/s/ BRUCE BARONE _____ <b>Bruce Barone</b>	Director	March 31, 2005
<b>Joseph Baute</b> _____ /s/ PETER BAXTER	Director	March 31, 2005
<b>Peter Baxter</b> _____ /s/ DAVID BEFFA-NEGRINI	Director	March 31, 2005
<b>David Beffa-Negrini</b> _____ /s/ JACK FERGUSON	Treasurer and Interim Chief Financial Officer (Principal Financial and Accounting Officer)	March 31, 2005
<b>Jack Ferguson</b> _____ /s/ PATRICIA GALLUP	Chairman and Chief Executive Officer	March 31, 2005
<b>Patricia Gallup</b> _____ /s/ DAVID HALL	Director	March 31, 2005
<b>David Hall</b> _____		

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<b>Page</b>
<a href="#">Report of Management</a>	F-2
<a href="#">Report of Independent Registered Public Accounting Firm</a>	F-3
<a href="#">Consolidated Balance Sheets as of December 31, 2004 and 2003</a>	F-4
<a href="#">Consolidated Statements of Income for the years ended December 31, 2004, 2003, and 2002</a>	F-5
<a href="#">Consolidated Statement of Changes in Stockholders' Equity for the years ended December 31, 2004, 2003, and 2002</a>	F-6
<a href="#">Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003, and 2002</a>	F-7
<a href="#">Notes to Consolidated Financial Statements</a>	F-8

## REPORT OF MANAGEMENT

Responsibility for the integrity and objectivity of the financial information presented in this Annual Report on Form 10-K rests with PC Connection, Inc. and its subsidiaries (“the Company”) management. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, applying certain estimates and judgments as required.

The Company maintains an effective internal control structure. It consists, in part, of an organization with clearly defined lines of responsibility and delegation of authority, comprehensive systems and control procedures. We believe that, after the implementation of the control changes described in Item 9A, “Controls and Procedures” of our Annual Report on Form 10-K, this structure provides reasonable assurance that transactions are executed in accordance with management authorization and accounting principles generally accepted in the United States of America.

To assure the effective administration of internal control, we carefully select and train our employees, develop and disseminate written policies and procedures, provide appropriate communication channels, and foster an environment conducive to the effective functioning of controls. We believe that it is essential for the Company to conduct its business affairs in accordance with the highest ethical standards.

Deloitte & Touche LLP, an independent registered public accounting firm, are retained to audit the Company’s consolidated financial statements. Its accompanying report is based on an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Audit Committee of the Board of Directors is composed solely of outside directors and is responsible for recommending to the Board of Directors the independent accounting firm to be retained for the coming year. The Audit Committee meets periodically and privately with the independent auditors, as well as with Company management, to review accounting, auditing, internal control structure, and financial reporting matters.

Patricia Gallup  
President and  
Chief Executive Officer

Jack L. Ferguson  
Treasurer and  
Interim Chief Financial Officer



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors of  
PC Connection, Inc.  
Merrimack, New Hampshire

We have audited the accompanying consolidated balance sheets of PC Connection, Inc. and subsidiaries (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of PC Connection, Inc. and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Deloitte & Touche LLP  
March 21, 2005

## PC CONNECTION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(amounts in thousands, except per share data)

	December 31,	
	2004	2003
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 6,829	\$ 2,977
Restricted cash	—	5,000
Accounts receivable, net	120,752	144,337
Inventories – merchandise	78,390	80,140
Deferred income taxes	3,039	3,051
Income taxes receivable	1,325	2,190
Prepaid expenses and other current assets	3,644	3,649
Total current assets	213,979	241,344
Property and equipment, net	17,647	20,396
Goodwill, net	51,687	45,264
Other intangibles, net	3,040	3,393
Other assets	189	208
<b>Total Assets</b>	<b>\$286,542</b>	<b>\$310,605</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Current maturities of capital lease obligations:		
To affiliate	\$ 373	\$ 334
To third party	391	—
Note payable – bank	4,810	5,614
Accounts payable	79,709	112,538
Accrued expenses and other liabilities	18,138	14,382
Acquisition earn-out obligation	6,921	11,593
Total current liabilities	110,342	144,461
Capital lease obligations, less current maturities:		
To affiliate	5,715	6,088
To third party	841	—
Deferred income taxes	3,486	2,867
<b>Total Liabilities</b>	<b>120,384</b>	<b>153,416</b>
Commitments and Contingencies (Note 13)		
Stockholders' Equity:		
Preferred Stock, \$.01 par value, 10,000 shares authorized, none issued	—	—
Common Stock, \$.01 par value, 100,000 shares authorized, 25,462 and 25,342 issued, 25,100 and 24,980 outstanding at December 31, 2004 and December 31, 2003, respectively	255	253
Additional paid-in capital	77,091	76,428
Retained earnings	91,098	82,794
Treasury stock at cost	(2,286)	(2,286)
<b>Total Stockholders' Equity</b>	<b>166,158</b>	<b>157,189</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$286,542</b>	<b>\$310,605</b>

See notes to consolidated financial statements.

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
*(amounts in thousands, except per share data)*

	Years Ended December 31,		
	2004	2003	2002
Net sales	<b>\$ 1,353,834</b>	\$ 1,312,891	\$ 1,191,497
Cost of sales	<b>1,201,780</b>	1,175,212	1,062,311
Gross profit	<b>152,054</b>	137,679	129,186
Selling, general, and administrative expenses	<b>132,729</b>	124,824	121,964
Special charges	<b>5,232</b>	1,929	1,636
Income from operations	<b>14,093</b>	10,926	5,586
Interest expense	<b>(1,385)</b>	(1,305)	(1,152)
Other, net	<b>152</b>	117	513
Income before taxes	<b>12,860</b>	9,738	4,947
Income taxes	<b>(4,556)</b>	(3,850)	(1,700)
Net income	<b>\$ 8,304</b>	\$ 5,888	\$ 3,247
Earnings per common share:			
Basic	<b>\$ .33</b>	\$ .24	\$ .13
Diluted	<b>\$ .33</b>	\$ .23	\$ .13
Shares used in computation of earnings per common share:			
Basic	<b>25,028</b>	24,713	24,555
Diluted	<b>25,269</b>	25,114	24,860

See notes to consolidated financial statements.

## PC CONNECTION, INC. AND SUBSIDIARIES

**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**  
*(amounts in thousands)*

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Shares		Total
	Shares	Amount			Shares	Amount	
<b>Balance, January 1, 2002</b>	<b>24,748</b>	<b>\$ 247</b>	<b>\$ 74,393</b>	<b>\$ 73,659</b>	<b>(205)</b>	<b>\$ (1,537)</b>	<b>\$ 146,762</b>
Exercise of stock options, including income tax benefits	108	1	371	—	—	—	372
Issuance of stock under employee stock purchase plan	141	2	510	—	—	—	512
Net income and comprehensive income	—	—	—	3,247	—	—	3,247
Repurchase of common stock for Treasury	—	—	—	—	(157)	(749)	(749)
<b>Balance, December 31, 2002</b>	<b>24,997</b>	<b>250</b>	<b>75,274</b>	<b>76,906</b>	<b>(362)</b>	<b>(2,286)</b>	<b>150,144</b>
Exercise of stock options, including income tax benefits	257	2	728	—	—	—	730
Issuance of stock under employee stock purchase plan	88	1	426	—	—	—	427
Net income and comprehensive income	—	—	—	5,888	—	—	5,888
<b>Balance, December 31, 2003</b>	<b>25,342</b>	<b>253</b>	<b>76,428</b>	<b>82,794</b>	<b>(362)</b>	<b>(2,286)</b>	<b>157,189</b>
Exercise of stock options, including income tax benefits	47	1	259	—	—	—	260
Issuance of stock under employee stock purchase plan	73	1	404	—	—	—	405
Net income and comprehensive income	—	—	—	8,304	—	—	8,304
<b>Balance, December 31 2004</b>	<b>25,462</b>	<b>\$ 255</b>	<b>\$ 77,091</b>	<b>\$ 91,098</b>	<b>(362)</b>	<b>\$ (2,286)</b>	<b>\$ 166,158</b>

See notes to consolidated financial statements.

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(amounts in thousands)*

	Years Ended December 31,		
	2004	2003	2002
<b>Cash Flows from Operating Activities:</b>			
Net income	\$ 8,304	\$ 5,888	\$ 3,247
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	7,127	8,363	8,145
Deferred income taxes	632	(888)	1,475
Provision for doubtful accounts	4,280	2,953	7,238
Loss on disposal of fixed assets	8	41	1
Changes in assets and liabilities:			
Accounts receivable	19,305	(11,976)	(6,478)
Inventories	1,750	(27,661)	5,295
Prepaid expenses and other current assets	870	(1,267)	83
Other non-current assets	19	126	(48)
Accounts payable	(32,829)	27,045	(12,808)
Income tax benefits from exercise of stock options	97	349	117
Accrued expenses and other liabilities	3,755	328	(1,279)
Net cash provided by operating activities	<u>13,318</u>	<u>3,301</u>	<u>4,988</u>
<b>Cash Flows from Investing Activities:</b>			
Purchases of property and equipment	(2,804)	(2,517)	(5,075)
Proceeds from sale of property and equipment	3	2	17
Payments for acquisition, net of cash acquired	(11,095)	(10,829)	(22,585)
Cash escrow distributed (funded) for acquisition	5,000	5,000	(10,000)
Net cash used for investing activities	<u>(8,896)</u>	<u>(8,344)</u>	<u>(37,643)</u>
<b>Cash Flows from Financing Activities:</b>			
Proceeds from short-term borrowings	369,285	238,259	69,836
Repayment of short-term borrowings	(370,089)	(232,645)	(69,836)
Repayment of notes payable	—	—	(1,000)
Repayment of capital lease obligation to affiliate	(334)	(199)	(171)
Exercise of stock options	163	381	255
Issuance of stock under employee stock purchase plan	405	427	512
Purchase of treasury shares	—	—	(749)
Net cash (used for) provided by financing activities	<u>(570)</u>	<u>6,223</u>	<u>(1,153)</u>
Increase (decrease) in cash and cash equivalents	3,852	1,180	(33,808)
Cash and cash equivalents, beginning of year	2,977	1,797	35,605
Cash and cash equivalents, end of year	<u>\$ 6,829</u>	<u>\$ 2,977</u>	<u>\$ 1,797</u>
<b>Supplemental Cash Flow Information:</b>			
Interest paid	\$ 1,155	\$ 899	\$ 901
Income taxes paid	2,819	6,065	1,734
Acquisition earn-out obligation, net of adjustments	6,423	11,560	10,800
Purchase of assets through capital lease obligation	1,232	—	—

See notes to consolidated financial statements.

**PC CONNECTION, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
*(amounts in thousands, except per share data)*

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

PC Connection, Inc. and subsidiaries is a direct marketer of information technology products and solutions, including brand-name personal computers and related peripherals, software, accessories, and networking products through our three primary sales subsidiaries, PC Connection Sales Corporation, GovConnection, Inc., and MoreDirect, Inc. Our primary customers are small- and medium-sized businesses, governmental agencies and educational organizations, and medium-to-large corporate accounts. The following is a summary of significant accounting policies.

***Principles of Consolidation***

The Consolidated Financial Statements include the accounts of PC Connection, Inc. and subsidiaries. Intercompany transactions and balances are eliminated in consolidation.

***Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the amounts reported in the accompanying consolidated financial statements. Actual results could differ from those estimates.

***Revenue Recognition***

Revenue on product sales is recognized at the point in time when persuasive evidence of an arrangement exists, the price is fixed and final, delivery has occurred, and there is a reasonable assurance of collection of the sales proceeds. We generally obtain oral or written purchase authorizations from our customers for a specified amount of product at a specified price. Because we either (i) have a general practice of covering customer losses while products are in-transit despite title transferring at the point of shipment or (ii) have FOB—destination specifically set out in our arrangements with federal agencies, delivery is deemed to have occurred at the point in time when the product is received by the customer.

We provide our customers with a limited thirty-day right of return generally limited to defective merchandise. Revenue is recognized at delivery and a reserve for sales returns is recorded. We have demonstrated the ability to make reasonable and reliable estimates of product returns in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 48, “Revenue Recognition When Right of Return Exists,” based on significant historical experience. Should such returns no longer prove estimable, we believe that the impact on our financials would not necessarily be significant since the return privilege expires 30 days after shipment.

All amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenues earned for the goods provided and have been classified as “net sales.” Costs related to such shipping and handling billings are classified as “cost of sales.”

Revenue for certain third party service contracts and software licenses that we sell are recorded on a net sales recognition basis because we do not assume the risks and rewards of ownership in these transactions. For such contracts and licenses, we evaluate whether the sales of such services should be recorded as gross sales or net sales as required under the guidelines described in Staff Accounting Bulletin No. 104, “Revenue Recognition” and Emerging Issues Task Force (“EITF”) Issue No. 99-19, “Reporting Revenue Gross as a Principal versus Net as an Agent.” Under gross sales recognition, we are the primary obligor, and the entire

## [Table of Contents](#)

selling process is recorded in sales with our cost to the third party service provider recorded as a cost of sales. Under net sales recognition, we are not the primary obligor, and the cost to the third party service provider is recorded as a reduction to sales, with no cost of goods sold, thus leaving the entire gross profit as the reported net sale for the transaction.

Similarly, we recognize revenue from agency sales transactions on a net sales basis. In agency sales transactions, we facilitate product sales by equipment manufacturers directly to our customers and receive agency fees for such transactions. We do not take title to the products in these transactions; title is passed directly from the supplier to our customer.

### ***Cash and Cash Equivalents***

We consider all highly liquid short-term investments with original maturities of 90 days or less to be cash equivalents. The carrying value of our cash equivalents approximates fair value.

### ***Restricted Cash***

In connection with the acquisition of MoreDirect, Inc. in 2002 (see Note 3 – Acquisitions), we established a \$10,000 cash escrow to fund a portion of the contingent consideration. In the first quarter of 2003, we used \$5,000 of these escrowed funds to satisfy a portion of the 2002 earn-out obligation payable by us. We used the remaining \$5,000 to satisfy a portion of our 2003 obligation paid in 2004.

### ***Accounts Receivable***

We perform ongoing credit evaluations of our customers and adjust credit limits based on payment history and customer credit-worthiness. We maintain an allowance for estimated doubtful accounts based on our historical experience and the customer credit issues identified. We monitor collections regularly and adjust the allowance for doubtful accounts as necessary to recognize any changes in credit exposure.

### ***Inventories—Merchandise***

Inventories (all finished goods) consisting of software packages, computer systems, and peripheral equipment, are stated at cost (determined under the first-in, first-out method) or market, whichever is lower. Inventory quantities on hand are reviewed regularly, and allowances are maintained for obsolete, slow moving, and nonsalable inventory.

### ***Vendor Allowances***

We receive allowances from merchandise vendors for price protections, discounts, product rebates, and other programs. These allowances are treated as a reduction of the vendor's prices and are recorded as adjustments to cost of sales or inventory, as applicable.

### ***Advertising Costs and Reimbursements***

Costs of producing and distributing catalogs are deferred and charged to expense over the period that each catalog remains the most current selling vehicle (generally one to two months) which approximate the period of probable benefits. Other advertising costs are expensed as incurred. Vendors have the ability to place advertisements in the catalogs for which we receive advertising allowances. These vendor allowances, to the extent that they represent specific reimbursements of such specific, incremental, and identifiable costs, are offset against selling, general, and administrative expense on the consolidated statements of income. Advertising reimbursements that cannot be associated with a specific program funded by an individual vendor or that exceed the fair value of advertising expense associated with that program are reclassified to cost of sales in accordance

## [Table of Contents](#)

with EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" ("EITF 02-16").

Advertising costs charged to expense were \$22,494, \$22,764, and \$19,871 for the respective years ended December 31, 2004, 2003, and 2002. Total advertising reimbursements received from vendors were \$29,119, \$29,430, and \$28,347 for the respective years ended December 31, 2004, 2003, and 2002. We reclassified \$7,498, \$2,247, and \$2,819 of these reimbursements to cost of sales or inventory in the respective years ended December 31, 2004, 2003, and 2002.

### ***Property and Equipment***

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization is provided for both financial and income tax reporting purposes over the estimated useful lives of the assets ranging from three to seven years. Computer software, including licenses and internally developed software is capitalized and amortized over lives ranging from three to five years, except that certain capitalized internally developed software is expensed for income tax reporting purposes. Depreciation is and has been provided using accelerated methods for property acquired prior to 1996 and on the straight-line method for property acquired thereafter. Leasehold improvements and facilities under capital leases are amortized over the terms of the related leases or their useful lives, whichever is shorter, whereas for income tax reporting purposes, they are amortized over the applicable tax lives. We periodically evaluate the carrying value of property and equipment based upon current and anticipated undiscounted cash flows, and recognize an impairment when it is probable that such estimated future cash flows will be less than the asset carrying value. We did not recognize any impairments in 2004, 2003, or 2002.

### ***Goodwill and Other Intangible Assets***

Our intangible assets consist of: (1) goodwill, which commencing in 2002, is not being amortized; (2) indefinite lived intangibles, which consist of certain trademarks that are not subject to amortization; and (3) amortizing intangibles, which consist of customer lists, which are being amortized over their useful lives. All intangible assets are subject to impairment tests on a periodic basis.

Note 2 describes the impact of accounting for the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," and the annual impairment methodology that we will employ on January 1<sup>st</sup> of each year in calculating the recoverability of goodwill. This same impairment test will be performed at other times during the course of a year should an event occur which suggests that the recoverability of goodwill should be challenged. Non-amortizing intangibles are also subject to annual impairment tests.

Amortizing intangibles are currently evaluated for impairment using the methodology set forth in SFAS No. 144. Recoverability of these assets is assessed only when events have occurred that may give rise to an impairment. When a potential impairment has been identified, forecasted undiscounted net cash flows of the operations to which the asset relates are compared to the current carrying value of the long-lived assets present in that operation. If such cash flows are less than such carrying amounts, long-lived assets including such intangibles, are written down to their respective fair values.

### ***Income Taxes***

Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on anticipated tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized.



## [Table of Contents](#)

Accruals for tax contingencies are recorded when certain positions taken in filed tax returns, although supported, are probable of being successfully challenged, resulting in additional tax liabilities. Accruals are not recorded for tax contingencies not likely to be successfully challenged. Such accruals are adjusted as necessary in light of changing facts and circumstances.

### **Concentrations**

Concentrations of credit risk with respect to trade account receivables are limited due to the large number of customers comprising our customer base. Ongoing credit evaluations of customers' financial condition are performed by management on a regular basis.

During the years ended December 31, 2004, 2003, and 2002, product purchases from Ingram Micro, Inc., our largest vendor, accounted for approximately 27%, 22%, and 28%, respectively, of our total product purchases. Purchases from Tech Data Corporation comprised 14%, 15%, and 14% of our total product purchases in the years ended December 31, 2004, 2003, and 2002, respectively. Effective May 3, 2002, Hewlett-Packard Company ("HP") completed its acquisition of Compaq Computer Corporation. Our combined purchases from HP and Compaq constituted 11%, 15%, and 15% of our total product purchases in 2004, 2003, and 2002, respectively. No other vendor supplied more than 10% of our total product purchases in the years ended December 31, 2004, 2003, and 2002.

No single customer other than the federal government accounted for more than 2% of total net sales in 2004. Net sales to the federal government in 2004, 2003, and 2002 were \$64,900, \$156,600, and \$156,400, or 4.8%, 11.9%, and 13.1% of total net sales, respectively.

### **Earnings Per Share**

Basic earnings per common share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding adjusted for the incremental shares attributed to options outstanding to purchase common stock, if dilutive.

The following table sets forth the computation of basic and diluted earnings per share:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Numerator:</b>			
Net income	<b>\$ 8,304</b>	\$ 5,888	\$ 3,247
<b>Denominator:</b>			
Denominator for basic earnings per share	<b>25,028</b>	24,713	24,555
<b>Effect of dilutive securities:</b>			
Employee stock options	<b>241</b>	401	305
<b>Denominator for diluted earnings per share</b>	<b>25,269</b>	25,114	24,860
<b>Earnings per share:</b>			
Basic	<b>\$ .33</b>	\$ .24	\$ .13
Diluted	<b>\$ .33</b>	\$ .23	\$ .13

The following unexercised stock options were excluded from the computation of diluted earnings per share for years ended December 31, 2004, 2003, and 2002 because the exercise prices of the options were generally greater than the average market price of the common shares during the respective periods:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Anti-dilutive stock options	<b>1,426</b>	1,516	2,447

### Stock-Based Compensation

Compensation expense associated with awards of stock or options to employees and directors is measured using the intrinsic value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." The intrinsic value method requires that compensation expense, if any, be measured by the difference between the fair value of our common stock and the strike price of the option as of a measurement date. This measurement date is generally when both the number of shares and the strike price of the options are determined. Information concerning the impact of the utilization of the fair market value model prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," is shown below:

We did not record any compensation expense under the intrinsic value method in 2004, 2003, or 2002. Had we recorded compensation expense using the fair value method under SFAS No. 123, pro forma net income and diluted net income per share for the years ended December 31 would have been as follows:

	2004	2003	2002
Net income, as reported	<b>\$8,304</b>	\$5,888	\$3,247
Compensation expense, net of taxes, under SFAS No. 123	<b>1,110</b>	1,877	1,982
Net income, under SFAS No. 123	<b>7,194</b>	4,011	1,265
Basic net income per share, as reported	<b>.33</b>	.24	.13
Basic net income per share, under SFAS No. 123	<b>.29</b>	.16	.05
Diluted net income per share, as reported	<b>.33</b>	.23	.13
Diluted net income per share, under SFAS No. 123	<b>.28</b>	.16	.05

We measured the fair value of options on their grant date using the Black/Scholes option-pricing model. The key weighted-average assumptions we used to apply this pricing model were as follows:

	2004	2003	2002
Risk-free interest rates	<b>3.08%</b>	3.20%	2.80%
Volatility	<b>94.5%</b>	68.6%	125.5%
Expected life of option grants	<b>4 years</b>	4 years	4 years
Dividend yield	<b>0%</b>	0%	0%

### Share Repurchase Authorization

We announced on March 28, 2001, that our Board of Directors authorized the spending of up to \$15,000 to repurchase our common stock. Share purchases will be made in the open market from time to time depending on market conditions. We have repurchased an aggregate of 362,267 shares for \$2,286 as of December 31, 2004, which are reflected as treasury stock on the consolidated balance sheet.

### Recently Issued Financial Accounting Standards

In January and December 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46 (FIN No. 46) and No. 46, revised (FIN No. 46(R)), respectively, "Consolidation of Variable Interest Entities." These statements address accounting for entities commonly known as special-purpose or off-balance-sheet entities and require that the assets, liabilities, and results of the activity of variable interest entities be consolidated into the financial statements of the company that has the controlling financial interest. Certain provisions of FIN No. 46(R) related to interests in special purpose entities were effective for the period ended December 31, 2003. The adoption of FIN No. 46(R) did not have a material effect on our consolidated financial position or results of operations.

## [Table of Contents](#)

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment" (SFAS 123(R)). This Statement is a revision of SFAS 123 and supersedes APB 25 and its related implementation guidance. SFAS 123(R) requires a company to measure the grant date fair value of equity awards given to employees in exchange for services and recognize that cost over the period that such services are performed. SFAS 123(R) is effective for the first interim or annual reporting period that begins after June 15, 2005 and will be effective for our interim quarter ending September 30, 2005. We are evaluating the two methods of adoption allowed by SFAS 123(R): the modified-prospective transition method and the modified-retrospective transition method. Adoption of SFAS 123(R) may materially increase stock compensation expense and decrease net income. In addition, SFAS 123(R) requires that the excess tax benefits related to stock compensation be reported as a cash inflow from financing activities rather than as a reduction of taxes paid in cash from operations.

### **Reclassifications**

Certain amounts in the 2003 and 2002 financial statements have been reclassified to conform to the 2004 presentation.

## **2. GOODWILL AND OTHER INTANGIBLE ASSETS**

We apply the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 required, among other things, the discontinuance of the amortization of goodwill and certain other identified intangibles. SFAS No. 142 also includes provisions for the assessment of the value and useful lives of existing recognized intangibles (including goodwill), reclassification of certain intangibles both in and out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill and other intangibles. We perform the assessment annually on January 1<sup>st</sup>. We completed the impairment review required by SFAS No. 142 on January 1, 2004 and 2005, and determined that our goodwill and intangible assets were not impaired.

Intangible assets not subject to amortization are as follows:

	December 31,	
	2004	2003
Goodwill	\$ 51,687	\$ 45,264
Trademarks	1,190	1,190

A rollforward of goodwill is as follows:

Balance, January 1, 2002	\$ 8,807
MoreDirect acquisition April 5, 2002	14,097
MoreDirect contingent consideration	10,800
Balance, December 31, 2002	33,704
Adjustment to MoreDirect acquisition	(62)
Adjustment to 2002 contingent consideration	29
MoreDirect contingent consideration	11,593
Balance, December 31, 2003	45,264
Adjustment to 2003 contingent consideration	(498)
MoreDirect contingent consideration	6,921
Balance, December 31, 2004	\$51,687

Intangible assets subject to amortization, consisting of customer lists, were \$1,850 and \$2,203 at December 31, 2004 and 2003, respectively (net of accumulated amortization of \$970 and \$617, respectively). For the years ended December 31, 2004, 2003, and 2002, we recorded amortization expense of \$353, \$353, and \$264, respectively.

## [Table of Contents](#)

The estimated amortization expense relating to customer lists for each of the five succeeding years and thereafter is as follows:

<u>For the Year Ended December 31,</u>	
2005	353
2006	353
2007	353
2008	353
2009	353
2010 and thereafter	85

### 3. ACQUISITIONS

On April 5, 2002, we completed the acquisition of MoreDirect. Under the terms of the agreement, all outstanding stock options of MoreDirect were cashed out for approximately \$4,100, which was funded by us, and we paid the sole shareholder of MoreDirect approximately \$18,000 in cash at closing. MoreDirect also distributed approximately \$7,900 to its sole shareholder from available cash balances for previously taxed but undistributed S Corporation earnings. Acquisition costs of \$600 have been included in the purchase price. In addition we paid additional cash to the MoreDirect shareholder based upon MoreDirect achieving targeted levels of annual earnings before income taxes through December 31, 2004. For the years ended December 31, 2004, 2003, and 2002, we accrued earn-out consideration owed to MoreDirect's shareholder of \$6,921, \$11,593, and \$10,829, respectively. We also escrowed \$10,000 in cash at closing to fund a portion of these contingent payments, of which \$5,000 was used to satisfy a portion of the 2002 liability paid by us in 2003, and the balance was used to satisfy a portion of the 2003 liability paid by us in 2004.

The transaction was accounted for by the purchase method, and accordingly, MoreDirect's results of operations are included in our consolidated financial statements only for periods after April 5, 2002.

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of the acquisition. The fair values of certain intangible assets were determined by management through a third party valuation.

<u>At April 5, 2002</u>	
Current assets	\$29,675
Property, plant and equipment and other assets	1,587
Intangible assets	4,010
Goodwill	14,097
	<hr/>
Total acquired	49,369
Less current liabilities	26,669
	<hr/>
Net assets acquired	22,700
Less cash acquired	115
	<hr/>
Purchase price for acquisition, net of cash acquired	\$22,585

Of the \$4,010 of acquired intangible assets, \$1,190 was assigned to registered trademarks that are not subject to amortization. The remaining \$2,820 of acquired intangible assets represents customer relationships (8 year weighted-average useful life).

Additional goodwill of \$6,423 (net of a \$498 adjustment), \$11,560 (net of a \$33 adjustment), and \$10,800 was added in 2004, 2003, and 2002, respectively, relating to the payment of contingent consideration. The goodwill was assigned to the Large Account segment. All of this goodwill is expected to be deductible for income tax purposes as a result of this acquisition.

## [Table of Contents](#)

### 4. ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

	December 31,	
	2004	2003
Trade	\$ 119,797	\$ 138,653
Co-op advertising	2,837	4,331
Vendor returns, rebates, and other	3,579	6,800
Due from employees	165	202
<b>Total</b>	<b>126,378</b>	<b>149,986</b>
Less allowances for:		
Sales returns	1,493	1,520
Doubtful accounts	4,133	4,129
<b>Accounts receivable, net</b>	<b>\$ 120,752</b>	<b>\$ 144,337</b>

### 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 31,	
	2004	2003
Facilities and equipment under capital lease	\$ 8,447	\$ 7,215
Leasehold improvements	5,968	5,912
Furniture and equipment	25,415	27,114
Computer software, including licenses and internally-developed software	29,051	28,055
Automobiles	169	157
<b>Total</b>	<b>69,050</b>	<b>68,453</b>
Less accumulated depreciation and amortization	51,403	48,057
<b>Property and equipment, net</b>	<b>\$ 17,647</b>	<b>\$ 20,396</b>

We recorded depreciation and amortization expense, including capital lease amortization, of \$6,774, \$8,074, and \$8,094 for the years ended December 31, 2004, 2003, and 2002, respectively.

### 6. SPECIAL CHARGES

In 2004, we recorded a charge of \$3,559 related to our review of the General Services Administration (“GSA”) contract cancellation and costs related to securing a new schedule. We also recorded in 2004 a charge of \$860 related to staff reductions, a charge of \$512 for professional fees incurred relating to a review of certain calendar year 2000 and 2003 transactions, a charge of \$101 related to the remaining uninsured portion of a 2003 employee defalcation, and a charge of \$200 related to a proposed litigation settlement involving alleged patent infringement.

In 2003, we recorded a charge of \$407 related to staff reductions, a charge of \$392 related to the GSA contract cancellation, and a charge of \$1,130 related to the uninsured portion of an employee defalcation.

On March 15, 2002, we announced that we had settled litigation commenced by Microsoft Corporation involving alleged trademark and copyright infringement. While denying the allegations, we recorded a \$750 charge in settlement costs and legal fees related to this matter. We recorded a charge of \$886 related to staff reductions in 2002.

## Table of Contents

A rollforward of special charges for the three years in the period ended December 31, 2004 is shown below. There were no changes in estimates in the interim periods.

	Workforce Reduction	Litigation Matters	GSA Review	Employee Defalcation	Other	Total
Balance January 1, 2002	\$ 425	\$ —	\$ —	\$ —	\$ —	\$ 425
Charges	886	750	—	—	—	1,636
Cash Payments	(1,103)	(750)	—	—	—	(1,853)
Balance December 31, 2002	208	—	—	—	—	208
Charges	407	—	392	1,130	—	1,929
Cash Payments	(502)	—	(155)	(1,130)	—	(1,787)
Balance December 31, 2003	113	—	237	—	—	350
Charges	860	200	3,559	101	512	5,232
Cash payments	(724)	—	(3,072)	(101)	(497)	(4,394)
Liabilities at December 31, 2004	\$ 249	\$ 200	\$ 724	\$ —	\$ 15	\$ 1,188

Liabilities at December 31, 2004, 2003, and 2002 are included in accrued expenses and other liabilities on the balance sheet.

## 7. BANK BORROWINGS

We have a \$45,000 credit facility secured by substantially all of our business assets. This facility was amended as of October 1, 2003 to give us the option of increasing the borrowing by up to \$20,000. Amounts outstanding under this facility bear interest at the prime rate (5.25% at December 31, 2004). The credit facility includes various customary financial and operating covenants, including minimum net worth and maximum funded debt ratio requirements, and restrictions on the payment of dividends, and default acceleration provisions, none of which we believe significantly restricts our operations. The maximum allowable funded debt ratio under the agreement is 2.0 to 1.0; our actual funded debt ratio at December 31, 2004 was only 0.3 to 1.0. Funded debt ratio is the ratio of average outstanding advances under the facility to EBITDA (Earnings Before Interest Expense, Taxes, Depreciation and Amortization). Borrowing availability under the agreement was \$40,190 at December 31, 2004.

Borrowings of \$4,810 and \$5,614 were outstanding under this credit facility at December 31, 2004 and 2003, respectively. The credit facility matures on December 31, 2005, at which time amounts outstanding become due. We received a commitment from the bank dated March 1, 2005 to extend the facility for an additional three years to March 31, 2008 and to raise the facility to \$50,000 and retain the \$20,000 option to increase further, on substantially the same terms as the existing facility. We are in the process of negotiating definitive documentation for the new agreement.

Certain information with respect to short-term borrowings were as follows:

Year ended December 31,	Weighted Average Interest Rate	Maximum Amount Outstanding	Average Amount Outstanding
2004	4.3%	\$ 22,441	\$ 9,447
2003	4.1	27,623	5,452
2002	4.1	10,408	1,038

## 8. TRADE CREDIT ARRANGEMENTS

At December 31, 2004 and 2003, we had security agreements with two financial institutions to facilitate the purchase of inventory from various suppliers under certain terms and conditions. The agreements allow a collateralized position in inventory financed by the financial institutions up to an aggregated amount of \$45,000. The cost of such financing under these agreements is borne by the suppliers by discounting their invoices to the financial institutions as an incentive for us to purchase their products. We do not pay any interest or discount fees on such inventory financing. At December 31, 2004 and 2003, accounts payable included \$8,215 and \$6,397, respectively, owed to these financial institutions.

## 9. CAPITAL LEASE

In November 1997, we entered into a fifteen-year lease for our corporate headquarters with an affiliated company related to us through common ownership. We occupied the facility upon completion of construction in late November 1998, and the lease payments commenced in December 1998.

Annual lease payments under the terms of the lease, as amended, are approximately \$911 for the first five years of the lease, increasing to \$1,025 for years six through ten and \$1,139 for years eleven through fifteen. The lease requires us to pay our proportionate share of real estate taxes and common area maintenance charges as additional rent and also to pay insurance premiums for the leased property. We have the option to renew the lease for two additional terms of five years each. The lease has been recorded as a capital lease.

In December 2004, we entered into a sale-leaseback transaction with a three-year lease for certain computer equipment. The cost of the leased equipment included in furniture and equipment was approximately \$1,232. Annual lease payments under the terms of the lease are approximately \$442 for each of the three years. At the termination of the lease we have the option of either continuing the lease at the current rate, returning the equipment, or purchasing the equipment at fair market value.

The net book value of capital lease assets was \$5,521 and \$4,770 as of December 31, 2004 and 2003, respectively.

Future aggregate minimum annual lease payments under these leases at December 31, 2004 are as follows:

<u>Year Ending December 31</u>	<u>Payments</u>
2005	\$ 1,504
2006	1,467
2007	1,430
2008	1,035
2009	1,139
2010 and thereafter	4,462
<b>Total minimum payments (excluding taxes, maintenance, and insurance)</b>	<b>11,037</b>
Less amount representing interest	3,717
<b>Present value of minimum lease payments</b>	<b>7,320</b>
Less current maturities (excluding interest)	764
<b>Long-term portion</b>	<b>\$ 6,556</b>

## 10. STOCKHOLDERS' EQUITY

### *Preferred Stock*

Our Amended and Restated Certificate of Incorporation (the "Restated Certificate") authorized the issuance of up to 10,000,000 shares of preferred stock, \$.01 par value per share (the "Preferred Stock"). Under the terms

## [Table of Contents](#)

of the Restated Certificate, the Board is authorized, subject to any limitations prescribed by law, without stockholder approval, to issue by a unanimous vote such shares of Preferred Stock in one or more series. Each such series of Preferred Stock shall have such rights, preferences, privileges, and restrictions, including voting rights, dividend rights, redemption privileges, and liquidation preferences, as shall be determined by the Board. There were no preferred shares outstanding at 2004 and 2003.

### *Incentive and Non-Statutory Stock Option Plans*

In December 1993, the Board adopted and the stockholders approved the 1993 Incentive and Non-Statutory Stock Option Plan (the "1993 Plan"). Under the terms of the 1993 Plan, we are authorized to make awards of restricted stock and to grant incentive and non-statutory options to our employees, consultants, and advisors to purchase shares of our stock. A total of 1,686 shares of our Common Stock was authorized for issuance upon exercise of options granted or awards made under the 1993 Plan. Options vest over varying periods up to four years and have contractual lives up to ten years.

In November 1997, the Board adopted and the stockholders approved the 1997 Stock Incentive Plan (the "1997 Plan"), which became effective on the closing of our initial public offering in 1998. The 1997 Plan provides for the grant of incentive stock options, non-statutory stock options, stock appreciation rights, performance shares, and awards of restricted stock and unrestricted stock. A total of 3,600 shares have been reserved for issuance under this Plan.

Information regarding the 1993 and 1997 Plans is as follows:

	<u>Option Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Fair Value</u>
Outstanding January 1, 2002	2,894	13.40	
Granted	485	6.63	5.36
Exercised	(108)	5.52	
Forfeited	(721)	14.42	
Outstanding December 31, 2002	2,550	12.29	
Granted	1,070	6.74	3.63
Exercised	(257)	8.59	
Forfeited	(636)	13.56	
Outstanding, December 31, 2003	2,727	10.78	
Granted	260	7.85	4.55
Exercised	(46)	9.06	
Forfeited	(594)	9.59	
Outstanding, December 31, 2004	2,347	10.90	



[Table of Contents](#)

The following table summarizes the status of outstanding stock options as of December 31, 2004:

Exercise Price Range	Options Outstanding			Options Exercisable	
	No. of Shares	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	No. of Shares	Weighted Average Exercise Price
\$0.51	17	0.50	\$ 0.51	17	\$ 0.51
\$3.81—\$6.95	590	7.29	5.19	279	4.96
\$7.10—\$9.98	762	6.91	7.91	197	8.89
\$10.01—\$14.35	679	5.06	11.19	550	11.42
\$15.25—\$34.83	208	5.16	19.97	208	19.98
\$51.81—\$52.75	91	5.56	51.98	91	51.98
<b>\$ 0.51—\$52.75</b>	<b>2,347</b>	<b>6.22</b>	<b>\$ 10.90</b>	<b>1,342</b>	<b>\$ 13.65</b>

Total exercisable options and their weighted average exercise price at December 31, 2003 and 2002 were 1,204 shares at \$13.92 and 1,267 shares at \$11.62, respectively.

**1997 Employee Stock Purchase Plan**

In November 1997, the Board adopted and the stockholders approved the 1997 Employee Stock Purchase Plan (the “Purchase Plan”), which became effective on February 1, 1999. The Purchase Plan authorizes the issuance of Common Stock to participating employees. Under the terms of the Purchase Plan, the purchase price is an amount equal to 85% of the fair market value per share of the Common Stock on either the first day or the last day of the offering period, whichever is lower. An aggregate of 638 shares of Common Stock has been reserved for issuance under the Purchase Plan, of which 581 shares were purchased.

**11. INCOME TAXES**

The 2004, 2003, and 2002 provision for income taxes consisted of the following:

	Years Ended December 31,		
	2004	2003	2002
<b>Paid or currently payable:</b>			
Federal	\$3,985	\$4,108	\$ (142)
State	(60)	630	367
<b>Total current</b>	<b>3,925</b>	<b>4,738</b>	<b>225</b>
<b>Deferred:</b>			
Federal	600	(697)	1,567
State	31	(191)	(92)
<b>Net deferred</b>	<b>631</b>	<b>(888)</b>	<b>1,475</b>
<b>Net provision</b>	<b>\$4,556</b>	<b>\$3,850</b>	<b>\$1,700</b>

## Table of Contents

The components of the deferred taxes at December 31, 2004 and 2003 are as follows:

	2004	2003
<b>Current:</b>		
Provisions for doubtful accounts	\$ 1,571	\$ 1,374
Inventory costs capitalized for tax purposes	274	317
Inventory and sales returns reserves	556	699
Deductible expenses, primarily employee-benefit related	126	4
Other	512	657
Net deferred tax asset—current	<b>\$ 3,039</b>	<b>3,051</b>
<b>Non-Current:</b>		
Compensation under non-statutory stock option agreements	\$ 37	53
State tax credit carryforwards	1,465	1,015
Excess of book value over the tax basis of goodwill and other intangibles	(2,528)	(1,389)
Excess of book value over the tax basis of property and equipment	(1,595)	(2,131)
Subtotal	(2,621)	(2,452)
Valuation allowance	(865)	(415)
Net deferred tax liability—non-current	<b>(3,486)</b>	<b>(2,867)</b>
Net deferred tax (liability) asset	<b>\$ (447)</b>	<b>\$ 184</b>

The state tax credit carryforwards are available to offset future state income taxes in years with sufficient state income levels to create creditable tax and within the applicable carryforward period for these credits. Total carryforwards aggregated \$1,465 and \$1,015 at December 31, 2004 and 2003, respectively, against which we have provided valuation allowances of \$865 and \$415, respectively, representing the portion of carryforward credits that we believe is not likely to be realized due to these restrictions. These credits are subject to a five-year carryforward period, with \$150 expiring beginning in 2006 and \$450, \$415, and \$450 expiring respectively on an annual basis through 2009.

The reconciliation of our 2004, 2003, and 2002 income tax provision to the statutory federal tax rate is as follows:

	2004	2003	2002
Statutory tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.5	4.5	4.8
Prior year tax matters	(3.5)	—	—
State tax credits carried forward, net of federal tax	—	—	(5.9)
Nondeductible expenses	0.4	0.1	0.2
Other—net	—	(0.1)	0.2
Effective income tax rate	<b>35.4%</b>	<b>39.5%</b>	<b>34.3%</b>

We have established accruals for certain state and federal tax contingencies when, despite our belief that our tax return positions are fully supported, we believe that certain positions are probable of being successfully challenged. These accruals relate primarily to various state tax jurisdictional issues concerning the nature and extent of our operations and activities in those states.

The tax contingency accruals are adjusted in light of changing facts and circumstances. Total tax contingency reserves were \$1,197 at December 31, 2004.

## 12. EMPLOYEE BENEFIT PLAN

We have a contributory profit-sharing and employee savings plan covering all qualified employees. No contributions to the profit-sharing element of the plan were made by us in 2004, 2003, or 2002. We made matching contributions to the employee savings element of the plan of \$653, \$602, and \$614 in 2004, 2003, and 2002, respectively.

## 13. COMMITMENTS AND CONTINGENCIES

### *Operating Leases*

We lease certain office facilities from our principal stockholders under 20-year noncancelable operating leases. The lease agreement for one facility requires us to pay all real estate taxes and insurance premiums related thereto. We also lease several other buildings from our principal stockholders on a month-to-month basis.

In addition, we lease office, distribution facilities, and equipment from unrelated parties with remaining terms of one to six years.

Future aggregate minimum annual lease payments under these leases at December 31, 2004 are as follows:

<u>Year Ending December 31</u>	<u>Related Parties</u>	<u>Others</u>	<u>Total</u>
2005	\$ 147	\$2,254	\$2,401
2006	147	1,310	1,457
2007	144	728	872
2008	82	651	733
2009	—	307	307
2010 and thereafter	—	123	123

Total rent expense aggregated \$4,905, \$4,952, and \$5,732 for the years ended December 31, 2004, 2003, and 2002, respectively, under the terms of the leases described above. Such amounts included \$147, \$147, and \$173 in 2004, 2003, and 2002, respectively, paid to related parties.

### *Contingencies*

We are subject to various legal proceedings and claims which have arisen during the ordinary course of business. These claims include certain patent infringement litigation alleging damages of \$800. We have accrued \$200 and expect to enter non-binding mediation to settle this litigation. In the opinion of management, the outcome of such matters is not expected to have a material effect on our financial position, results of operations, and cash flows.

We are also subject to audit by various government agencies relating to sales under certain government contracts. An audit was conducted on our GSA contract for the period May 1, 1997 to March 31, 2002, and in November 2003, the GSA's contract with our subsidiary, GovConnection, was cancelled. Management has concluded that such cancellation was precipitated by an audit of contractual compliance, although we have not received an audit report or received a claim from the GSA concerning amounts that might be owed pursuant to this audit. A new GSA contract was awarded in August 2004.

Based on our own internal review of contractual compliance, we have noted that several internal control deficiencies have existed at GovConnection surrounding its compliance with the GSA contract. Actions have been taken to address these deficiencies. We believe that we have provided adequate reserves to cover any claims as they relate to payment of fees required under the contract or any penalties assessed. We have reserved \$0.8 million for such fees or any penalties assessed. However, we will continue to evaluate such reserves in light of additional information that comes to our attention.

We have been informally advised that audit matters related to GovConnection have been referred to the Department of Justice for its review. Such a referral exposes us to possible civil damages for non-compliance

with the GSA contract. Such damages can be substantial. No reserves have been provided for such a claim because of the preliminary nature of this matter. We will continue to evaluate our reserves—as they relate both to the GSA audit and the Department of Justice investigation—in light of additional information that comes to our attention. The ultimate outcome of these matters cannot be determined. Future events may result in conclusions that could have a material impact, either positively or negatively, on our results of operations or financial condition. We have no indication of intentional wrongdoing by GovConnection regarding the GSA contract. In order to assist in this evaluation, we have engaged outside counsel and an independent accounting firm to undertake a review of our systems, policies, and procedures relative to its federal, state, and local government contracts.

#### 14. OTHER RELATED PARTY TRANSACTIONS

As described in Notes 9 and 13, we have leased certain facilities from related parties. Other related-party transactions include the transactions summarized below. Related parties consist primarily of affiliated companies related to us through common ownership.

	Years Ended December 31		
	2004	2003	2002
Revenue:			
Sales of various products	\$ 0	\$ 1	\$ 3
Sales of services to affiliated companies	74	64	132
Costs:			
Purchase of services from affiliated companies	0	0	1

#### 15. SEGMENT AND RELATED DISCLOSURES

SFAS No. 131, “Disclosures About Segments of an Enterprise and Related Information,” requires that public companies report profits and losses and certain other information on their “reportable operating segments” in their annual and interim financial statements. The internal organization used by our Chief Operating Decision Maker (CODM) to assess performance and allocate resources determines the basis for our reportable operating segments. Our CODM is our Chief Executive Officer.

Our operations are organized under three reportable operating segments — the “SMB” segment, which serves small- and medium-sized businesses, as well as consumers, the “Public Sector” segment, which serves federal, state and local government organizations, and educational institutions, and the “Large Account” segment, acquired in April 2002, which serves medium-to-large corporations.

[Table of Contents](#)

Segment information applicable to our reportable operating segments for the years ended December 31, 2004, 2003, and 2002 is shown below:

**Year Ended December 31, 2004**

	SMB Segment	Public Sector Segment	Large Acct. Segment	Eliminations	Consolidated
Sales to external customers	\$ 802,303	\$ 253,073	\$ 298,458	\$ —	\$ 1,353,834
Transfers between segments	224,114	—	—	(224,114)	—
<b>Net sales</b>	<b>\$ 1,026,417</b>	<b>\$ 253,073</b>	<b>\$ 298,458</b>	<b>\$ (224,114)</b>	<b>\$ 1,353,834</b>
Operating income (loss) before allocations	\$ 58,103	\$ 2,746	\$ 16,217	\$ (62,973)	\$ 14,093
Allocations	46,856	14,502	1,615	(62,973)	—
Operating income (loss)	11,247	(11,756)	14,602	—	14,093
Interest and other — net	(987)	(285)	39	—	(1,233)
<b>Income (loss) before taxes</b>	<b>\$ 10,260</b>	<b>\$ (12,041)</b>	<b>\$ 14,641</b>	<b>\$ —</b>	<b>\$ 12,860</b>
<b>Selected Operating Expenses:</b>					
Depreciation and amortization	\$ 6,306	\$ 115	\$ 706	\$ —	\$ 7,127
Special charges	1,389	3,618	225	—	5,232
<b>Balance Sheet Data:</b>					
Total assets	\$ 197,914	\$ 54,116	\$ 93,178	\$ (58,666)	\$ 286,542
Goodwill, net	1,173	7,634	42,880	—	51,687

**Year Ended December 31, 2003**

	SMB Segment	Public Sector Segment	Large Acct. Segment	Eliminations	Consolidated
Sales to external customers	\$ 744,396	\$ 320,622	\$ 247,873	\$ —	\$ 1,312,891
Transfers between segments	245,466	—	—	(245,466)	—
<b>Net sales</b>	<b>\$ 989,862</b>	<b>\$ 320,622</b>	<b>\$ 247,873</b>	<b>\$ (245,466)</b>	<b>\$ 1,312,891</b>
Operating income (loss) before allocations	\$ 49,151	\$ 9,840	\$ 14,270	\$ (62,335)	\$ 10,926
Allocations	48,511	12,427	1,397	(62,335)	—
Operating income (loss)	640	(2,587)	12,873	—	10,926
Interest and other — net	(1,002)	(202)	16	—	(1,188)
<b>Income (loss) before taxes</b>	<b>\$ (362)</b>	<b>\$ (2,789)</b>	<b>\$ 12,889</b>	<b>\$ —</b>	<b>\$ 9,738</b>
<b>Selected Operating Expenses:</b>					
Depreciation and amortization	\$ 7,658	\$ 86	\$ 682	\$ —	\$ 8,426
Special charges	421	392	1,116	—	1,929
<b>Balance Sheet Data:</b>					
Total assets	\$ 202,778	\$ 93,241	\$ 96,237	\$ (81,651)	\$ 310,605
Goodwill, net	1,173	7,634	36,457	—	45,264

Year Ended December 31, 2002

	<u>SMB Segment</u>	<u>Public Sector Segment</u>	<u>Large Acct. Segment</u>	<u>Eliminations</u>	<u>Consolidated</u>
Sales to external customers	\$ 703,505	\$ 293,938	\$ 194,054	\$ —	\$ 1,191,497
Transfers between segments	203,199	—	—	(203,199)	—
<b>Net sales</b>	<b>\$ 906,704</b>	<b>\$ 293,938</b>	<b>\$ 194,054</b>	<b>\$ (203,199)</b>	<b>\$ 1,191,497</b>
Operating income (loss) before allocations	\$ 42,360	\$ 8,867	\$ 10,816	\$ (56,457)	\$ 5,586
Allocations	43,445	12,486	526	(56,457)	—
<b>Operating income (loss)</b>	<b>(1,085)</b>	<b>(3,619)</b>	<b>10,290</b>	<b>\$ —</b>	<b>5,586</b>
Interest and other — net	(696)	24	33	—	(639)
<b>Income (loss) before taxes</b>	<b>\$ (1,781)</b>	<b>\$ (3,595)</b>	<b>\$ 10,323</b>	<b>\$ —</b>	<b>\$ 4,947</b>
<b><u>Selected Operating Expenses:</u></b>					
Depreciation and amortization	\$ 7,779	\$ 77	\$ 502	\$ —	\$ 8,358
Special charges	1,511	125	—	—	1,636
<b><u>Balance Sheet Data:</u></b>					
Total assets	\$ 187,161	\$ 83,389	\$ 76,144	\$ (78,012)	\$ 268,682
Goodwill, net	1,173	7,634	24,897	—	33,704

General and administrative expenses were charged to the reportable operating segments, based on their estimated usage of the underlying functions. Interest and other expense was charged to the segments, based on the actual costs incurred by each segment, net of interest and other income generated. The amount shown above representing total assets eliminated consists of inter-segment receivables, resulting primarily from inter-segment sales and transfers reported above and from inter-segment service charges.

Senior management also monitors revenue by sales channel (Outbound Telemarketing and Field Sales, Inbound Telesales, and Online Internet) and product mix (Notebooks and PDAs, Desktops and Servers, Storage Devices, Software, Net/Com Products, Printers and Printer Supplies, Video, Imaging, and Sound, Memory and System Enhancements, and Accessories/Other).

[Table of Contents](#)

Net sales by segment, sales channel, and product mix are presented below:

	Years Ended December 31,		
	2004	2003	2002
<b>Segment (excludes transfers between segments)</b>			
SMB	\$ 802,303	\$ 744,396	\$ 703,505
Public Sector	253,073	320,622	293,938
Large Account	298,458	247,873	194,054
Total	<b>\$ 1,353,834</b>	<b>\$ 1,312,891</b>	<b>\$ 1,191,497</b>
<b>Sales Channel</b>			
Outbound Telemarketing and Field Sales	\$ 992,955	\$ 1,007,758	\$ 922,694
Inbound Telesales	85,481	93,056	87,085
Online Internet	275,398	212,077	181,718
Total	<b>\$ 1,353,834</b>	<b>\$ 1,312,891</b>	<b>\$ 1,191,497</b>
<b>Product Mix</b>			
Notebooks and PDAs	\$ 276,208	\$ 261,540	\$ 202,065
Desktop/Servers	192,563	193,560	173,833
Storage Devices	110,442	116,785	112,056
Software	162,575	144,843	162,640
Net/Com Products	98,522	103,995	98,243
Printers and Printer Supplies	149,211	149,302	141,317
Video, Imaging, and Sound	164,933	154,268	131,192
Memory and System Enhancements	71,480	75,109	65,708
Accessories/Other	127,900	113,489	104,443
Total	<b>\$ 1,353,834</b>	<b>\$ 1,312,891</b>	<b>\$ 1,191,497</b>

Substantially, all of our net sales in 2004, 2003, and 2002 were made to customers located in the United States. Shipments to customers located in foreign countries aggregated less than 2% in 2004, 2003, and 2002. All of our assets at December 31, 2004 and 2003 were located in the United States. Our primary target customers are small- to medium-sized businesses comprised of 20 to 500 employees, federal, state, and local governmental agencies, educational institutions, and medium-to-large corporate accounts. No single customer other than the federal government accounted for more than 2% of total net sales in 2004. Net sales to the federal government in 2004, 2003, and 2002 were \$64,900, \$156,600, and \$156,400, or 4.8%, 11.9%, and 13.1% of total net sales, respectively.

## 16. SELECTED UNAUDITED QUARTERLY FINANCIAL RESULTS

The following table sets forth certain unaudited quarterly data of the Company for each of the quarters since January 2003. This information has been prepared on the same basis as the annual financial statements and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the selected quarterly information when read in conjunction with the annual financial statements and the notes thereto included elsewhere in this document. The quarterly operating results are not necessarily indicative of future results of operations. See “Factors That May Affect Future Results and Financial Condition—Historical Net Losses; Variability of Quarterly Results.”

	Quarters Ended			
	March 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004
Net sales	\$327,635	\$335,335	\$351,265	\$339,599
Cost of sales	293,710	299,173	311,859	297,038
Gross profit	33,925	36,162	39,406	42,561
Selling, general, and administrative expenses	30,690	31,483	32,765	37,791
Special charges	1,030	753	1,800	1,649
Income from operations	2,205	3,926	4,841	3,121
Interest expense	(384)	(341)	(334)	(326)
Other, net	47	54	35	16
Income before income taxes	1,868	3,639	4,542	2,811
Income tax provision	(710)	(1,383)	(1,725)	(738)
Net income	\$ 1,158	\$ 2,256	\$ 2,817	\$ 2,073
Weighted average common shares outstanding:				
Basic	24,998	25,008	25,047	25,057
Diluted	25,356	25,225	25,215	25,271
Earnings per common share:				
Basic	\$ .05	\$ .09	\$ .11	\$ .08
Diluted	\$ .05	\$ .09	\$ .11	\$ .08

	Quarters Ended			
	March 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003
Net sales	\$283,527	\$321,568	\$349,420	\$358,376
Cost of sales	251,052	288,611	313,494	322,055
Gross profit	32,475	32,957	35,926	36,321
Selling, general, and administrative expenses	29,639	30,018	32,059	33,108
Special charges	—	397	—	1,532
Income from operations	2,836	2,542	3,867	1,681
Interest expense	(303)	(276)	(270)	(456)
Other, net	44	54	27	(8)
Income before income taxes	2,577	2,320	3,624	1,217
Income tax provision	(1,002)	(917)	(1,444)	(487)
Net income	\$ 1,575	\$ 1,403	\$ 2,180	\$ 730
Weighted average common shares outstanding:				
Basic	24,651	24,665	24,741	24,792
Diluted	24,920	25,013	25,322	25,308
Earnings per common share:				
Basic	\$ .06	\$ .06	\$ .09	\$ .03
Diluted	\$ .06	\$ .06	\$ .09	\$ .03



**PC CONNECTION, INC. AND SUBSIDIARIES**  
**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**  
*(amounts in thousands)*

<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Deductions- Write-Offs</u>	<u>Other</u>	<u>Balance at End of Period</u>
<b>Allowance for Sales Returns</b>					
Year Ended December 31, 2002	\$ 1,745	\$ 34,722	\$ (35,459)	459 <sup>(2)</sup>	1,467
Year Ended December 31, 2003	1,467	34,174	(34,121)	—	1,520
Year Ended December 31, 2004	1,520	32,892	(32,919)	—	1,493
<b>Allowance for Doubtful Accounts</b>					
Year Ended December 31, 2002	7,432	7,238 <sup>(1)</sup>	(10,525)	997 <sup>(2)</sup>	5,142
Year Ended December 31, 2003	5,142	2,953 <sup>(1)</sup>	(3,966)	—	4,129
Year Ended December 31, 2004	4,129	4,279 <sup>(1)</sup>	(4,275)	—	4,133
<b>Inventory Valuation Reserve</b>					
Year Ended December 31, 2002	1,200	4,877	(4,827)	20 <sup>(2)</sup>	1,270
Year Ended December 31, 2003	1,270	5,889	(5,699)	—	1,460
Year Ended December 31, 2004	1,460	5,636	(5,861)	—	1,235

<sup>(1)</sup> Additions to the provision for doubtful accounts include charges to advertising and cost of sales aggregating \$1,878, \$(104), and \$665 for the years ended December 31, 2004, 2003, and 2002 respectively. Such allowances relate to receivables under cooperative arrangements with vendors.

<sup>(2)</sup> Acquisition of MoreDirect subsidiary on April 5, 2002.

**T-REX CORPORATE CENTER@BOCA  
LEASE AGREEMENT - STANDARD PROVISIONS**

**THIS LEASE AGREEMENT** ("Lease") is dated as of the 14<sup>th</sup> day of February, 2005, by and between **Boca Technology Center, LLC**, a Florida limited liability company ("Landlord"), and **MoreDirect, Inc.** ("Tenant").

**ARTICLE 1  
INCORPORATION OF BASIC LEASE INFORMATION RIDER**

1. The Basic Lease Information Rider ("Rider") attached hereto, and all of the defined terms contained therein, are incorporated herein by reference and made a part hereof. In the event of any conflict between the terms of the Rider and the terms of the Standard Provisions to Lease, the terms of the Rider shall control.

**ARTICLE 2  
PREMISES**

2.1 (a) Landlord hereby leases to Tenant, and Tenant hereby leases from Landlord, the Premises, for the term and upon the conditions and covenants set forth herein. The Premises are outlined on **Exhibit B-1**, which is attached hereto for locational purposes only and by this reference made a part hereof.

(b) In addition to the occupancy of the Premises, Tenant and its officers, employees, agents, customers and invitees also shall have the right to the non-exclusive use of public parking areas (as distinguished from parking areas or portions thereof that are specifically licensed to tenants of the building from time-to-time during the Term hereof), walkways, landscaped areas, driveways and sidewalks within the Building that are designated by Landlord from time to time as areas for the common use of all tenants (the "**Common Areas**"). Landlord agrees to make the Common Areas continuously available to Tenant for the non-exclusive use by Tenant, other tenants and the their respective officers, employees, agents, customers and invitees during the Lease Term and any extension thereof, except when portions of the Common Areas temporarily may be unavailable for use by reason of repair work then being underway thereon and as a result of the temporary use of such Common Areas by Landlord and other tenants and their respective contractors while they are engaged in the construction and/or renovation of other areas of the Building. Landlord shall have the right from time to time temporarily to close the Common Areas to prevent the acquisition of public rights thereon. Landlord shall, as part of Operating Charges, operate and maintain the Common Areas during the Lease Term and any extensions thereof in good order and repair in accordance with the standards of comparable Buildings in the area in which the Premises are located.

**ARTICLE 3  
TERM**

3.1 The Lease Term shall be as set forth on the Rider and shall continue for the period set forth thereon. The Lease Term shall also include any renewal or extension of the term of this Lease as described in the Rider.

3.2 The Rent Commencement Date shall be the date set forth in the Rider.

3.3 "Lease Year" shall mean a period of twelve (12) consecutive months, the first such Lease Year to commence on the Lease Commencement Date; provided, however, that if the Lease Commencement Date is not the first day of a month, then the first Lease Year shall commence on the Lease Commencement Date and shall continue for the balance of the month in which the Lease Commencement Date occurs and for a period of twelve (12) consecutive months thereafter. Each succeeding Lease Year shall be a period of twelve (12) consecutive months commencing immediately upon the expiration of the prior Lease Year.

**ARTICLE 4**  
**BASE RENT**

4.1 Commencing on the Rent Commencement Date and during each Lease Year of the Lease Term, Tenant shall pay the Base Rent specified in the Rider attached hereto and made a part hereof. The Base Rent shall be due and payable in equal monthly installments, without notice, demand, setoff or deduction, in advance on the first day of each month during each Lease Year.

4.2 All sums payable by Tenant under this Lease shall be paid to Landlord in legal tender of the United States by wire transfer (in accordance with wire transfer instructions contained on **Schedule 4.2** attached hereto and made a part hereof, as same may be amended from time-to-time in accordance with the notice provisions of this Lease) or by check drawn on a U.S. bank (subject to collection), at the address to which notices to Landlord are to be given or to such other party or such other address as Landlord may designate in writing. Landlord's acceptance of rent after it shall have become due and payable shall not excuse a delay upon any subsequent occasion or constitute a waiver of any of Landlord's rights. Until further notice, it is agreed that Tenant shall pay all sums due under this Lease by wire transfer (with Tenant to pay the cost of wire transfer) to Landlord's "lock-box account." With respect to such wire transfers, Tenant shall bear the full risk of receipt of funds by 2:00 pm on the date due at Landlord's depository bank. In the event that Landlord's lender imposes special collection and bank account procedures on Landlord as a condition of Landlord's financing, Tenant agrees to cooperate fully with Landlord in assisting Landlord in complying with such requirements and such modified terms shall be deemed to be made a part hereof.

**ARTICLE 5**  
**OPERATING CHARGES AND REAL ESTATE TAXES**

5.1 (a) Tenant shall also pay as additional rent ("Additional Rent"): (i) Tenant's Proportionate Share of the Operating Charges (as defined in Section 5.1(b)) incurred during each calendar year falling entirely or partly within the Lease Term and (ii) Tenant's Proportionate Share of the amount of Real Estate Taxes (as defined in Section 5.1(c)) incurred during each calendar year falling entirely or partly within the Lease Term. Tenant's Proportionate Share has been set forth on the Rider. In the event the number of square feet comprising the Premises increases or decreases, respectively, pursuant to any provision of this Lease or of the Rider, or in the event the number of square feet of rentable area in the Building increases or decreases, Tenant's Proportionate Share shall increase or decrease accordingly. Total Rentable Space for the Building may change from time to time. Therefore, if and when such change occurs, Tenant's Proportionate Share will be appropriately adjusted and Landlord will provide Tenant with a written statement describing the adjustment.

(b) Operating Charges shall mean all costs and expenses incurred by the Landlord in the operation of the Building, including without limitation, those items set forth on **Schedule 5.1(b)** attached hereto and made a part hereof.

(c) Real Estate Taxes shall mean (1) all real estate taxes, and/or public space rentals (including general and special assessments, if any), which are imposed upon Landlord or assessed against the Building and/or the land upon which the Building is located (the "Land"), (2) any other present or future taxes or governmental charges that are imposed upon Landlord or assessed against the Building and/or the Land which are in the nature of or in substitution for real estate taxes, including any tax levied on or measured by the rents payable by tenants of the Building, and (3) expenses (including reasonable attorneys', consultants' and appraisers' fees) incurred in reviewing, protesting or seeking a reduction of Real Estate Taxes.

Real Estate Taxes will not include capital stock, succession, transfer, franchise, gift, estate or inheritance taxes imposed on Landlord.

5.2 (a) Tenant shall make estimated monthly payments to Landlord on account of the Operating Charges and Real Estate Taxes expected to be incurred during each calendar year. From time to time, Landlord will submit a statement to Tenant setting forth Landlord's reasonable estimate of such charges and the amount of Tenant's Proportionate Share thereof. Tenant shall pay to Landlord on the first day of each month following receipt of such statement, until Tenant's receipt of the succeeding annual statement, an amount equal to one-twelfth (1/12) of such share (estimated on an annual basis).

(b) Within one hundred twenty (120) days following the end of each calendar year, Landlord shall submit a statement showing (1) Tenant's Proportionate Share of the actual amount of Operating Charges and Real Estate Taxes actually incurred during the preceding calendar year, and (2) the aggregate amount of Tenant's estimated payments during such year. If such statement indicates that the aggregate amount of such estimated payments exceeds Tenant's actual liability, then Tenant shall deduct the net overpayment from its next monthly payment(s) of estimated Operating Charges and Real Estate Taxes. If such statement indicates that Tenant's actual liability exceeds the aggregate amount of such estimated payments, then Tenant shall pay the amount of such excess within thirty (30) days of Tenant's receipt of such notice of excess due. Such statement of Operating Charges and Real Estate Taxes shall become binding and conclusive if not contested by Tenant within sixty (60) days after it is rendered.

Notwithstanding anything to the contrary in the Lease, within sixty (60) days of Tenant's receipt of Landlord's statement, in the event any dispute arises between Landlord and Tenant as to Operating Charges and/or Real Estate Taxes, Tenant shall have the right, upon reasonable notice, to inspect and photocopy, if desired, Landlord's records concerning the Operating Charges and/or Real Estate Taxes of the Building. If, after such inspection, Tenant continues to dispute Operating Charges and/or Real Estate Taxes, Tenant shall be entitled, within such sixty (60) day period, to retain an independent accountant or accountancy firm that has a specialty in auditing operating expenses to conduct an audit. The accountant or accountancy firm shall not be compensated on a contingency basis. The results of any such audit shall be completed not later than one hundred twenty days (120) days after Tenant's receipt of Landlord's statement. If as to any specific issue it is determined that Tenant has been overcharged, then Tenant shall receive a credit against the next month's required payment of Operating Charges in the amount of such overcharge. If the audit reveals that Tenant was undercharged, then, within thirty (30) days after the results of such audit are made available to Tenant, Tenant shall reimburse Landlord for the amount of such undercharge. Tenant shall pay the cost of any audits requested by Tenant, unless any audit reveals that Landlord's determination of the Operating Charges and/or Real Estate Taxes was in error by more than five percent (5%), in which case Landlord shall pay the cost of such audit. Landlord shall be required to maintain records of the Operating Charges and Real Estate Taxes for the three-year period following each Operating Charges statement. To the extent either party owes any amount to the other, and such obligation arises at the end of the Term, such amount shall be paid in its entirety within thirty (30) days following the completion of the audit process.

(c) If the Lease Term commences or expires on a day other than the first day or the last day of a calendar year, respectively, then Tenant's liability for Tenant's Proportionate Share of Operating Charges and Real Estate Taxes incurred during such calendar year shall be equitably apportioned on a pro-rata basis.

5.3. If during all or part of any Lease Year or portion of a Lease Year of the Term, Landlord does not furnish any particular item of work or service which would constitute an item of "Operating Charges" to ninety-five percent (95%) of the Buildings because less than all of the Building is occupied, then an adjustment shall be made in computing Operating Charges for such Lease Year (or partial Lease Year) so that Operating Charges shall be increased for such Lease Year (or partial Lease Year) to the amount that reasonably would have been incurred had Landlord provided such item of work or service to ninety-five percent (95%) of the aggregate leaseable area of the Building for the entire Lease Year (or partial Lease Year). **For example**, if there are two groups of tenants in the Building, one of which groups occupies forty percent (40%) of the aggregate leaseable area of the Building for an entire Lease Year (the "40% Group"), and the other of which occupies sixty percent (60%) of the aggregate leaseable area of

the Building for the same entire Lease Year (the "60% Group"), and during the second Lease Year the 40% Group vacates the Building following the expiration of three (3) months of said second Lease Year, and following said 40% Group's vacating of the Building, Landlord continues to provide heat to the entire leaseable area of the Building but only provides water service to the leaseable area occupied by the 60% Group, then Operating Charges would include such expenses for heat and water service determined as follows:

Heat 100% of the heating costs of the Building, because Landlord continued to provide heat to the entire Building even after the 40% Group vacated its space. In other words, no adjustment is necessary.

Water Service

- a. For the first three (3) months of the second Lease Year, include the actual cost of water service, because during the 3 month period Landlord provided such service for the entire Building and the cost was thus the actual cost incurred for the entire Building. In other words, no adjustment is necessary.
- b. For the remaining nine (9) months of the second Lease Year, include an amount which is equal to the product of (i) the actual costs of water service during said 9 month period multiplied by (ii) a fraction, the numerator of which is 95 and the denominator of which is the 60% Group's proportionate share, because the objective is to include the cost of water service that would have been provided had the Building been fully occupied. For example, if the actual amount for water service during said nine (9) month period when only the 60% Group occupied the Building was \$30,000, the amount which would be includable as the water service element of Operating Charges for said 9 month period would be \$47500, i.e. \$30,000 multiplied by 95 divided by 60.

**ARTICLE 6**  
**USE OF PREMISES**

6.1 (a) Tenant may use, occupy and operate the Premises in accordance with the use clause set forth in the Rider. Tenant agrees at all times during the Lease Term and any extensions thereof to comply with all applicable laws affecting the use of the Premises.

(b) Tenant acknowledges and agrees that the precise location of equipment of the Premises in the Building, to the Building or between and among floors, both at the commencement of Tenant's occupancy and as same may be modified, expanded or adjusted from time-to-time after initial occupancy, shall be in conformity with plans and specifications which have been approved in writing in advance by the Landlord, in Landlord's sole discretion, and shall otherwise be in accordance with Building operating regulations. With respect to the location of equipment within the Premises, Landlord shall have the right to review and approve such initial placement and any relocation thereof, with such approval not to be unreasonably withheld or delayed.

(c) Tenant shall not use the Premises for any unlawful purpose or in any manner that will constitute waste, nuisance or unreasonable annoyance to Landlord or any other tenant of the Building, or in any manner that will increase the number of parking spaces required for the Building at full occupancy or otherwise as required by law. Tenant shall not generate, use, store, or dispose of any materials posing a health or environmental hazard in or about the Building, nor use or occupy the Premises in any manner which may result in an increase in Landlord's insurance premiums payable in respect of the Building. Tenant shall comply with and conform to all present and future laws, ordinances, regulations and orders of all applicable governmental or quasi-governmental authorities having jurisdiction over the Premises, including those concerning the use, occupancy and condition of the Premises and all machinery, equipment and furnishings therein. The party installing the initial leasehold improvements described in **Exhibit D** hereto shall obtain the initial certificate of occupancy for the Premises. Any amended or substitute certificate of occupancy necessitated by Tenant's particular use of the Premises or any Alterations made by Tenant in the Premises shall be obtained by Tenant at Tenant's sole expense. (The

foregoing sentence shall not be construed as to constitute the consent of the Landlord for any Alterations of the Premises.) Use of the Premises is subject to all covenants, conditions and restrictions of record.

6.2 Tenant shall pay, within thirty (30) days of notice thereof, but in any event before delinquency, any business, rent or other taxes or fees that are now or hereafter levied, assessed or imposed upon Tenant's use or occupancy of the Premises, the conduct of Tenant's business in the Premises or Tenant's equipment, fixtures, furnishings, inventory or personal property. If any such tax or fee is enacted or altered so that such tax or fee is levied against Landlord or so that Landlord is responsible for collection or payment thereof, then Tenant shall pay to Landlord as Additional Rent the amount of such tax or fee within thirty (30) days of its having been assessed, but in no event in a fashion as to constitute a delinquency in the payment of such taxes, fees or assessments. Tenant shall also promptly pay any sales tax and/or other local tax now or hereafter in existence that is imposed. Any sales tax on rent shall be paid by Tenant to Landlord simultaneously with the monthly payment of Base Rent. Any such tax obligation shall be deemed Additional Rent.

6.3 (a) Tenant shall not cause or permit any Hazardous Materials to be generated, used, released, stored or disposed of in or about the Building. At the expiration or earlier termination of this Lease, Tenant shall surrender the Premises to Landlord free of Hazardous Materials and in compliance with all Environmental Laws except to the extent any Hazardous Materials or violation of Environmental Laws was caused by the conduct or actions of Landlord or its agents or employees. "Hazardous Materials" means (a) asbestos and any asbestos containing material and any substance that is then defined or listed in, or otherwise classified pursuant to, any Environmental Law or any other applicable Law as a "hazardous substance," "hazardous material," "hazardous waste," "infectious waste," "toxic substance," "toxic pollutant" or any other formulation intended to define, list, or classify substances by reason of deleterious properties such as ignitability, corrosivity, reactivity, carcinogenicity, toxicity, reproductive toxicity, or Toxicity Characteristic Leaching Procedure (TCLP) toxicity, (b) any petroleum and drilling fluids, produced waters, and other wastes associated with the exploration, development or production of crude oil, natural gas, or geothermal resources, and (c) any petroleum product, polychlorinated biphenyls, urea formaldehyde, radon gas, radioactive material (including any source, special nuclear, or by-product material), medical waste, chlorofluorocarbon, lead or lead-based product, and any other substance whose presence could be detrimental to the Building or the Land or hazardous to health or the environment. "Environmental Law" means any present and future Law and any amendments (whether common law, statute, rule, order, regulation or otherwise), permits and other requirements or guidelines of governmental authorities applicable to the Building or the Land and relating to the environment and environmental conditions or to any Hazardous Material (including, without limitation, CERCLA, 42 U.S.C. § 9601 *et seq.*, the Resource Conservation and Recovery Act of 1976, 42 U.S.C. § 6901 *et seq.*, the Hazardous Materials Transportation Act, 49 U.S.C. § 1801 *et seq.*, the Federal Water Pollution Control Act, 33 U.S.C. § 1251 *et seq.*, the Clean Air Act, 33 U.S.C. § 7401 *et seq.*, the Toxic Substances Control Act, 15 U.S.C. § 2601 *et seq.*, the Safe Drinking Water Act, 42 U.S.C. § 300f *et seq.*, the Emergency Planning and Community Right-To-Know Act, 42 U.S.C. § 1101 *et seq.*, the Occupational Safety and Health Act, 29 U.S.C. § 651 *et seq.*, and any so-called "Super Fund" or "Super Lien" law, any Law requiring the filing of reports and notices relating to hazardous substances, environmental laws administered by the Environmental Protection Agency, and any similar state and local Laws, all amendments thereto and all regulations, orders, decisions, and decrees now or hereafter promulgated thereunder concerning the environment, industrial hygiene or public health or safety). Tenant, however, may use and dispose of traditional office supply materials, commonly used in the ordinary course of business, so long as such use and disposal is not in contravention of Federal or Florida State law.

(b) Notwithstanding any termination of this Lease, Tenant shall indemnify and hold Landlord, its employees and agents, and, if applicable, Landlord's prime landlord under any ground lease to which Landlord is a party, and Landlord's lender(s), harmless from and against any damage, injury, loss, liability, charge, demand or claim based on or arising out of the presence or removal of, or failure to remove, Hazardous Materials generated, used, released, stored or disposed of by Tenant or any Invitee in or about the Building, whether before or after Lease Commencement Date. In addition, Tenant shall give Landlord immediate verbal and follow-up written notice of any actual or threatened Environmental Default, which Environmental Default Tenant shall cure at the sole expense of the Tenant in accordance with all Environmental Laws and to the satisfaction of Landlord and only after Tenant has obtained Landlord's prior written consent. An "Environmental Default" means any of the following by Tenant or any Invitee: a violation of an Environmental Law; a release, spill or discharge of a Hazardous Material on or from the Premises, the Land or the Building; an environmental condition requiring responsive action; or an emergency environmental condition. Upon any Environmental Default, in addition to all other rights available to Landlord under this Lease, at law or in equity, Landlord shall have the right, but not the obligation, to immediately enter the Premises, to supervise and approve any actions taken by Tenant to address the Environmental Default, and, if Tenant fails to immediately address same to Landlord's satisfaction, to perform, at Tenant's sole cost and expense, any lawful action necessary to address same. This provision will survive the termination or expiration of this Lease, and any renewals, extensions or expansions thereof.

**ARTICLE 7**  
**ASSIGNMENT AND SUBLETTING**

7.1 Except as provided below, Tenant will not sell, assign, transfer, mortgage or otherwise encumber this Lease or sublet, rent or permit occupancy or use of the Premises or any part thereof by others, without obtaining the prior written consent of Landlord, nor shall any assignment or transfer of this Lease or the right of occupancy hereunder be effectuated by operation of law or otherwise without the prior written consent of Landlord, which shall not be unreasonably withheld. Any such assignment, subletting or occupancy without the prior written consent of Landlord shall constitute an Event of Default, or, at the election of the Landlord, shall be void. Tenant shall pay all reasonable expenses (including attorney's fees) incurred by Landlord in connection with Tenant's request for Landlord to give its consent to any assignment, subletting or occupancy.

7.2 Any transfer, by operation of law or otherwise, of Tenant's interest in this Lease (in whole or in part), or of a fifty percent (50%) or greater interest in Tenant (whether stock, partnership interest or otherwise), or any mortgaging or encumbering of any interest in Tenant, shall be deemed an assignment of this Lease within the meaning of this Article 7. The issuance of shares of stock to other than the existing shareholders is deemed to be a transfer of that stock for the purposes of this Article 7. If there has been a previous transfer of less than a fifty percent (50%) interest in Tenant, then any other transfer of an interest in Tenant which, when added to the total percentage interest previously transferred, totals a transfer of greater than a fifty percent (50%) interest in Tenant shall be deemed an assignment of Tenant's interest in this Lease within the meaning of this Article 7. Tenant shall be obligated to notify Landlord when a transfer of fifty percent (50%) or greater interest in Tenant is proposed. The provisions of this Section 7.2 shall not apply to the sale of shares by persons other than those deemed "insiders" within the meaning of the Securities Exchange Act of 1934, as amended, where such sale is effected through any recognized exchange or through the "over-the-counter market."

7.3 If Landlord shall decline to give its consent to any proposed assignment or sublease, or if Landlord shall exercise any of its rights under this Article 7, Tenant shall indemnify, defend and hold harmless Landlord against and from any and all loss, liability, damages, costs and expenses (including reasonable attorneys' fees) resulting in connection with any claim relating to the proposed assignment or sublease that may be made against Landlord by the proposed assignee or sublessee or by any brokers or other persons, including, without limitation, claims for a commission or similar compensation in connection with the proposed assignment or sublease.

7.4 In the event that (i) Landlord fails to exercise any of its options under this Article 7 and (ii) Tenant fails to execute and deliver the assignment or sublease to which Landlord consented within forty-five (45) days after the giving of such consent then, Tenant shall again comply with all of the provisions and conditions of this Article 7 before assigning its interest in this Lease or subletting any portion of the Premises.

7.5 The consent by Landlord to an assignment or to a subletting shall not relieve Tenant from obtaining the express consent in writing of Landlord to any further assignment or subletting. If Tenant's interest in this Lease is assigned, or if the Premises or any part thereof is sublet or occupied by anyone other than Tenant, Landlord may collect rent from the assignee, subtenant or occupant and apply the net amount collected to the Rent payable hereunder, but no such assignment, subletting, occupancy or collection shall be deemed a waiver of the provisions of this Article 7 or of any default hereunder or the acceptance of the assignee, subtenant or occupant as Tenant, or a release of Tenant from the further observance or performance by Tenant of all covenants, conditions, terms and provisions on the part of Tenant to be performed or observed.

7.6 Notwithstanding anything to the contrary in this section, Tenant, without Landlord's consent may (a) assign this Lease to any party into which Tenant is merged, consolidated or reorganized, or to which all or substantially all of Tenant's assets are transferred or sold, provided: (i) Landlord shall receive a copy of the executed transfer document promptly after execution, (ii) Tenant or its successors by merger shall remain liable under this Lease, (iii) the transferee shall expressly assume Tenant's obligations under this Lease and the successor entity is, after the transfer or assignment, at least as creditworthy as Tenant; and (b) upon prior written notice to Landlord, sublease the Premises to Tenant's affiliates. For purposes of this Lease, an affiliate of Tenant is a corporation, partnership, limited liability company, or other entity that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, the Tenant. The term "control" (including the terms "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct, or cause the direction of, the management and policies of Tenant, whether through the ownership of voting securities, by contract, or otherwise. Tenant shall give Landlord written notice (containing the information described above) of any such sublease to Tenant's affiliates.

7.7 In the event of an attempted subletting or assignment to an unaffiliated third party, Tenant shall submit a request for consent thereto to Landlord. If Landlord elects to deny the request for consent to assignment, Landlord shall have the right to recapture the Premises, or that portion of the Premises sought to be subleased, by providing Tenant written notice of intent to recapture, within thirty (30) days of Landlord's receipt of a request by Tenant for consent to assignment to an unaffiliated third party of this permitted assignment. If Landlord consents to such an assignment or sublease, Tenant agrees that Landlord and Tenant shall equally share in any amount of rent received in excess of the then-effective Base Rent, after deduction of Landlord's expenses in connection with the assignment or sublease.

## **ARTICLE 8**

### **MAINTENANCE AND REPAIRS**

8.1 Tenant shall keep and maintain the Premises, and all fixtures and equipment located therein, in clean, safe and sanitary condition, shall take good care thereof and make all repairs thereto, and shall suffer no waste or injury thereto. At the expiration or earlier termination of the Lease Term, Tenant shall surrender the Premises, and in the same order and condition in which they were on the Lease Commencement Date, ordinary wear and tear and unavoidable damage by the elements excepted. Except as otherwise provided in Article 18, all injury, breakage and damage to the Premises and to any other part of the Building or the Land caused by any act or omission of Tenant or of any invitee, agent, employee, subtenant, assignee, contractor, client, family member, licensee, customer or guest of Tenant (collectively, "Invitees"), including any act or omission in connection with the installation and/or removal of any of Tenant's furniture, fixtures and equipment, shall be repaired by and at Tenant's expense, except that Landlord shall have the right at Landlord's option to make any such repair and to charge Tenant for all costs and expenses incurred in connection therewith.



8.2 Landlord shall keep and maintain in good order and repair the base-building structure and systems, including the roof, exterior walls, elevators, electrical, plumbing and common area HVAC systems (which excludes such elevator, electrical, plumbing and HVAC systems to the extent same are located within or exclusively service the Tenant's Premises or the premises of other tenants only, in which event same shall be governed by Section 8.1 above), and the ground floor lobby and other common areas and facilities of the Building.

**ARTICLE 9**  
**INITIAL TENANT IMPROVEMENTS AND ALTERATIONS**

9.1 The original improvement of the Premises shall be accomplished in accordance with **Exhibit D**. Landlord is under no obligation to make, or to permit Tenant or Tenant's contractors to make, any structural or other alterations, decorations, additions, improvements or other changes (collectively "Alterations") in or to the Premises except as set forth in **Exhibit D** or otherwise expressly provided in this Lease. Prior to the commencement by Tenant of the construction of any improvements, Tenant shall obtain and deliver to Landlord written, unconditional waivers of mechanics' and materialmen's liens against the Complex from all proposed contractors, subcontractors, laborers and suppliers in connection with such improvements, in form and content reasonably satisfactory to Landlord.

9.2 Tenant shall not make or permit anyone for whom Tenant is responsible to make any Alterations in or to the Premises or the Building, without Landlord's prior written consent. The criteria for such consent shall be determined by the nature of the Alteration and whether same shall have an impact upon the structural integrity of the Building or a Building system of general use, or shall have an impact on a tenant other than the Tenant, in which event, the consent or approval of the Landlord may be granted, conditioned or withheld in the sole and absolute discretion of the Landlord. If the two impacts described in the preceding sentence are not factors, in the reasonable judgment of Landlord, then the consent or approval of the Landlord to an Alteration shall not be unreasonably withheld, conditioned or delayed. Any authorized and approved Alteration made by Tenant shall be made: (a) in a good, workmanlike, first-class and prompt manner; (b) using new materials only; (c) by an experienced, reputable contractor, approved in advance by the Landlord in its reasonable discretion or expressly identified on the Rider, and constructed in accordance with plans and specifications approved in writing by Landlord; (d) in accordance with all applicable legal requirements and requirements of any insurance company insuring the Building or portion thereof; (e) after having obtained any required consent of the holder of any Mortgage (as defined in Section 22.1); (f) after Tenant has obtained public liability and worker's compensation insurance policies approved in writing by Landlord; and (g) after Tenant has obtained and delivered to Landlord written, unconditional waivers of mechanics' and materialmen's liens against the Premises and the Building from all proposed contractors, subcontractors, laborers and material suppliers for all work and materials in connection with such Alteration. Any such Alteration shall be performed in a manner consistent with the Building Rules and Regulations as may be promulgated from time-to-time by the Landlord.

9.3 In the event of an approved Alteration after the initial build-out of Tenant's Premises, Tenant agrees that Tenant shall reimburse Landlord for its actual costs of plan review, construction monitoring and oversight by Landlord. Said reimbursement shall be due within thirty (30) days of Tenant's receipt of Landlord's statement therefor, and shall be considered Additional Rent.

9.4 Liens.

A. *General*. In accordance with the applicable provisions of the Florida Construction Lien Tax and specifically Florida Statutes, Section 713.10, no interest of Landlord whether personally or in the Premises, or in the underlying land or Building of which the Premises are a part, or the leasehold interest aforesaid shall be subject to liens for improvements made by Tenant or caused to be made by Tenant hereunder. Further, Tenant shall have no power or authority to create any lien or permit any lien to attach to the present estate, reversion, or other estate of

Landlord in the Premises or in the Building, and all mechanics, materialmen, contractors, artisans and other parties contracting with Tenant or its representatives or privies as to the Premises or any part of the Premises are hereby charged with notice that they must look to the Tenant to secure payment of any bill for work done or material furnished or for any other purpose during this Lease term. The foregoing provisions are made with express reference to Section 713.10 of the Florida Statutes. Landlord has recorded a notice of the foregoing in the Public Records of Palm Beach County, Florida, pursuant to the provisions of Section 713.10 Florida Statutes.

B. *Default.* Notwithstanding the foregoing, if any construction lien or other lien, attachment, judgment, execution, writ, charge or encumbrance is filed against the Building or the Premises or this leasehold, or any alterations, fixtures or improvements therein or thereto, as a result of any work action or inaction done by or at the direction of Tenant or any of Tenant's Agents, Tenant will discharge same of record within ten (10) days after the filing thereof, failing which Tenant will be in default under this Lease. Further, Tenant agrees to indemnify, defend and save Landlord harmless from and against any damage or loss, including reasonable attorneys' fees, incurred by Landlord as a result of any liens or other claims arising out of or related to work performed in the Premises by or on behalf of Tenant. In such event, without waiving Tenant's default, Landlord, in addition to all other available rights and remedies, without further notice, may discharge the same of record by payment, bonding or otherwise, as Landlord may elect, and upon request Tenant will reimburse Landlord for all costs and expenses so incurred by Landlord plus interest thereon at the rate of eighteen percent (18%) per annum, together with an administrative fee of \$2,500.00.

9.5 Consent to an Alteration shall not constitute consent or authorization by the Landlord to the placement of financing by the Tenant relating to the Alterations that purports to create any security interest in the Building or that purports to subordinate this Lease to any such financing, and any such effort or agreement by Tenant shall constitute an Event of Default.

9.6 Tenant acknowledges and agrees that, during the construction of initial improvements, any subsequent Alterations and thereafter during the operation of the Building, Landlord has authority to coordinate access to loading areas, freight elevators, the roof, shafts, space and other areas of the Building, and that Landlord has authority to adopt reasonable rules and regulations pertaining to same, and to approve such Tenant access. Tenant will also cause its Contractor(s) to coordinate their use of and access to the foregoing with Landlord's Base Building Contractor, which will have authority to approve such access during construction.

#### **ARTICLE 10** **SIGNS**

10.1 Landlord will list Tenant's name in the common area Building directory, if any, and provide Building standard signage on one suite entry door at Tenant's expense. No other sign, advertisement or notice referring to Tenant shall be painted, affixed or otherwise displayed on any part of the exterior or interior of the Building; provided, however, that Tenant may install signs in the interior of the Premises that are not visible from the exterior of the Premises. Tenant shall not display any decoration, fitting or other item visible from the exterior of the Premises without Landlord's prior approval. If any sign or item visible from the exterior of the Premises is displayed without Landlord's approval, then Landlord shall have the right to remove such item at Tenant's expense or to require Tenant to do the same.

10.2 To the extent that Tenant wishes to erect an exterior sign, it may do so only with the prior written consent of the Landlord, which consent may be granted, conditioned or withheld in the sole and absolute discretion of Landlord. If approved, Landlord will establish an annual fee for the value of such signage rights to be paid by Tenant, and Tenant shall also pay the cost of erection of such signage and such erection shall be treated as an Alteration. Upon request by Landlord, Tenant shall remove such signage in accordance with Section 11.2 below.

10.3 Landlord shall have the right to prescribe standards for curtains, drapes, blinds and shades to give the building a uniform appearance from the exterior.

**ARTICLE 11**  
**TENANT'S EQUIPMENT**

11.1 Tenant may, from time to time during the Term or any extension hereof, install, maintain, replace, repair, expand, construct and operate in or upon the Premises and remove therefrom such trade fixtures and equipment as it may deem necessary or appropriate to its business operations; provided, any damage which may be caused to the Premises by the installation, maintenance, replacement, repair, expansion, construction, operation or removal of any of Tenant's trade fixtures or equipment shall be forthwith repaired by Tenant at its expense. Landlord may impose reasonable rules and regulations concerning the location, weight and timing and method of installation of trade fixtures or equipment, wherever installed.

11.2 Tenant covenants and agrees that, if directed by the Landlord at its sole discretion, Tenant shall remove, at Tenant's sole risk and expense, all fixtures and improvements to the Premises upon the expiration of the Lease Term. If so requested by the Landlord, Tenant shall restore the Premises to its original condition, normal wear and tear, and approved structural changes excepted. Tenant shall also exercise extraordinary care in removing such fixtures and improvements so as to eliminate damage to the Building, the premises and property of other tenants and the inconvenience to the operation of the Building and its tenants.

**ARTICLE 12**  
**SECURITY DEPOSIT**

12.1 Simultaneously with Tenant's execution of this Lease, Tenant shall deposit with Landlord the Security Deposit as stated in the Rider. Landlord shall not be required to maintain the Security Deposit in a separate account. Except as may be required by law, Tenant shall not be entitled to interest on the Security Deposit. The Security Deposit shall be security for Tenant's performance of its obligations under this Lease. Within three (3) business days after written notice of Landlord's use of the Security Deposit or portion thereof, Tenant shall deposit with Landlord cash in an amount sufficient to restore the Security Deposit to its amount prior to such use, and Tenant's failure to do so shall constitute a default hereunder. Within approximately thirty (30) days after the later of (a) the expiration or earlier termination of the Lease Term, or (b) Tenant's vacating the Premises, Landlord shall return the Security Deposit less such portion thereof as Landlord shall have used to satisfy Tenant's obligations under this Lease. If Landlord transfers the Security Deposit to any transferee of the Building or Landlord's interest therein, then such transferee shall be liable to Tenant for the return of the Security Deposit, and Landlord shall be released from all liability for the return of the Security Deposit. The holder of any Mortgage shall not be liable for the return of the Security Deposit unless such Mortgage holder actually receives the Security Deposit.

**ARTICLE 13**  
**ACCESS AND INSPECTION**

13.1 Tenant shall permit Landlord and its designees to enter the Premises, with a representative or employee of Tenant, but without charge therefor and without diminution of the rent payable by Tenant, to inspect the Premises, to make such alterations and repairs as Landlord may deem necessary, or to exhibit the Premises to prospective tenants during the last one hundred eighty (180) days of the Lease Term. Tenant shall at all times during its occupancy of the Premises provide Landlord duplicates of the keys to the doors and other points of entry to the Premises. In connection with any such entry, Landlord shall make reasonable efforts to minimize the disruption to Tenant's use of the Premises and shall conform to Tenant's reasonable security requirements. Except in an emergency, Landlord shall give Tenant reasonable prior notice (which shall be in writing, except in an emergency) of any entry into the Premises pursuant to this Section.

**ARTICLE 14**  
**INSURANCE**

14.1 Tenant will not conduct or permit to be conducted any activity, or place any equipment in or about the Premises or the Building, which will, in any way, invalidate the insurance coverage in effect or increase the cost of insurance on or for the Building. If any invalidation of coverage or increase in the cost of insurance is stated by any insurance company or by the applicable Insurance Rating Bureau to be due to any activity or equipment of Tenant in or about the Premises or the Building, such statement shall be conclusive evidence that same is due to such activity or equipment. Tenant shall be liable for any invalidation of coverage or increase in the cost of insurance, and shall reimburse Landlord therefor upon demand. Such sum shall be considered Additional Rent payable with the monthly installment of Rent next becoming due. Notwithstanding Tenant's reimbursement to Landlord, Landlord shall have the right to require Tenant to cease and desist from any actions or inactions causing the invalidation of coverage or increase in the cost of insurance.

14.2 Tenant, at Tenant's expense, shall carry and keep in full force and effect at all times during the Lease Term for the protection of Tenant, Landlord and any other persons designated by Landlord pursuant to Section 14.4 hereof commercial general liability insurance including contractual liability coverage with a combined single limit of at least Three Million Dollars (\$3,000,000.00) for each occurrence of bodily or personal injury, death or property damage and Tenant shall deliver to Landlord a copy of said policy or, at Landlord's option, a binder or certificate showing the same to be in full force and effect. It is understood and agreed that liability coverage provided for hereunder shall extend beyond the Premises to portions of the common area of the Building used from time to time by Tenant, its agents, employees, contractors, invitees, licensees, customers, clients, family members and guests, and, further, shall include contractual liability coverage insuring the indemnity provisions of this Lease.

14.3 Tenant, at Tenant's expense, shall further carry a policy of "all risk" insurance covering all of Tenant's personal property and improvements in the Premises for not less than the full insurable cost and replacement cost of such personal property and improvements without reduction for depreciation. All proceeds of such insurance shall be used solely to restore, repair or replace the Tenant's personal property and improvements in the Premises.

14.4 Said commercial general liability and "all risk" insurance policies and any other insurance policies carried by Tenant with respect to the Premises and/or any common areas accessible to Tenant shall (i) be issued in form acceptable to Landlord by good and solvent insurance companies qualified to do business in the jurisdiction in which the Building is located and otherwise reasonably satisfactory to Landlord, (ii) designate as additional insureds, besides Tenant as named insured, Landlord, Landlord's managing agent, Landlord's lender(s) as may exist from time to time, and any other person from time to time designated in writing by notice from Landlord to Tenant, (iii) be written as primary policy coverage and not contributing with or in excess of any coverage which Landlord may carry, (iv) provide for thirty (30) days' prior written notice to Landlord of any cancellation or other expiration or material modification of such policy or any defaults thereunder, and (v) contain an express waiver of any right of subrogation by the insurance company against Landlord. Neither the issuance of any insurance policy required hereunder nor the minimum limits specified herein with respect to Tenant's insurance coverage shall be deemed to limit or restrict in any way Tenant's liability arising under or out of this Lease.

14.5 Notwithstanding anything to the contrary contained in this Lease, Landlord and Tenant and all parties claiming under them, to the extent covered by insurance (or to the extent such party would have been covered by insurance had such party maintained the insurance required by the terms hereof to be maintained by such party), each hereby waives any and all rights of recovery, claim, action and liability against the other, its agents, officers or employees for any loss or damage that may occur to the Building and Premises, or any improvements thereto, and any personal property owned by them therein, by reason of fire, the elements or any other cause(s) which could be covered by "all risk" property insurance, regardless of cause or origin, including negligence of the other party hereto.

**ARTICLE 15**  
**SERVICES AND UTILITIES**

15.1 Landlord shall provide the following services and utilities in a manner consistent with the standards for quality followed in comparable facilities in the jurisdiction in which the Building is located:

(i) Electrical service to operate the common areas of the Building, and electrical capacity to a point of connection at the Building for Tenant. It is understood and agreed that the cost of separately metering any electrical or other utility service, if any, shall be borne by Tenant, and it is also understood and agreed that to Tenant shall be responsible for paying all costs associated with all utility services to the Premises.

(ii) Heat and air-conditioning for the common areas of the Building during normal hours of operation of the Building as set forth in Section 15.3 below.

(iii) Cold water for drinking, lavatory and toilet purposes at those points of supply provided for nonexclusive general use of other tenants at the Building, and supplies for such lavatory and toilet purposes.

(iv) Operatorless passenger elevator service 24 hours per days, 365 days per year, and freight elevator service (subject to scheduling by Landlord) in common with Landlord and other tenants and their contractors, agents and visitors; provided, however, that Landlord shall have the right to remove elevators from service as they are required for moving freight or for servicing and/or maintaining the elevators and/or the Building.

(v) Access to the Premises and the Building 24 hours per day, 365 days a year, subject to reasonable security regulations (such as providing identification to Building security personnel) imposed by Landlord during non-business hours.

(vi) Replacement of all Building standard lighting tubes and bulbs, if any, located in common areas.

15.2 Landlord agrees to operate and maintain the Building in accordance with the standards for quality followed by other comparable facilities in the jurisdiction in which the Building is located and to provide building security personnel, equipment, procedures and systems in the Building similar to other such comparable facilities. Landlord reserves the right to interrupt, curtail or suspend the services required to be furnished by Landlord under this Article 15 when the necessity therefor arises by reason of accident, emergency, mechanical breakdown, or when required by any Law, or for any other cause beyond the reasonable control of Landlord. Landlord shall use reasonable efforts to complete all repairs or other work so that Tenant's inconvenience resulting therefrom may be for as short a period of time as circumstances will permit.

15.3 Landlord will furnish all services and utilities required by this Lease only during the normal hours of operation of the Building, unless otherwise specified herein, in a manner consistent with industry standards for comparable buildings in the jurisdiction in which the Building is located. The normal hours of operation of the Building are from 7:00 am to 7:00 pm., Monday through Friday. It is understood and agreed that Landlord shall not be liable for failure to furnish, or for delay, suspension or reduction in furnishing, any of the utilities, services or other manner of thing required to be furnished by Landlord hereunder, if such failure to furnish or delay, suspension or reduction in furnishing same is caused by breakdown, maintenance, repairs, strikes, scarcity of labor or materials, acts of God, Landlord's compliance with governmental regulation or legislation or judicial or administrative orders or from any other cause whatsoever; provided, however, that Landlord shall, in the event of a breakdown, use reasonable diligence to repair all equipment owned by Landlord and all building standard equipment furnished by Landlord which is required to provide such utilities and services.

15.4 Landlord agrees to provide and maintain an electronically controlled access system for the common areas of the Building during the Lease Term (“Electronic Access System”); provided, however, that no representation or warranty with respect to the adequacy, completeness or integrity of the Electronic Access System is made by Landlord, and except for losses attributable to Landlord’s gross negligence the risk that any such system or entrance may not be effective, or may malfunction, or be circumvented by a criminal, is assumed by Tenant with respect to Tenant’s property and interest, and Tenant shall obtain insurance coverage to the extent Tenant desires protection against such criminal acts and other losses. Landlord reserves the right to modify, supplement or revise the access system at any time in its sole judgment. Said access system is not intended to serve as security for the Premises or otherwise for individual tenant-occupied spaces or suites.

15.5 Tenant shall have the right to provide and maintain a security system within the Premises in accordance with plans and specifications approved by the Landlord in accordance with the Tenant Work approval process or, in the event that such system is installed after completion of the Tenant Work, in accordance with the approval of Alterations under Article 9 above.

**ARTICLE 16**  
**LIABILITY OF LANDLORD**

16.1 Landlord, its employees and agents shall not be liable to Tenant, any Invitee or any other person or entity for any damage (including indirect and consequential damage), injury, loss or claim (including claims for the interruption of or loss to business) based on or arising out of any cause whatsoever (except as otherwise provided in this Section), including without limitation the following: repair to any portion of the Premises or the Building; interruption in the use of the Premises or any equipment therein; any accident or damage resulting from any use or operation (by Landlord, Tenant or any other person or entity) of elevators or heating, cooling, electrical, sewerage or plumbing equipment or apparatus; termination of this Lease by reason of damage to the Premises or the Building; fire, robbery, theft, vandalism, mysterious disappearance or any other casualty; actions of any other tenant of the Building or of any other person or entity; failure or inability of Landlord to furnish any utility or service specified in this Lease; and leakage in any part of the Premises or the Building, or from water, rain, ice or snow that may leak into, or flow from, any part of the Premises or the Building, or from drains, pipes or plumbing fixtures in the Premises or the Building. Any property stored or placed by Tenant or Invitees in or about the Premises or the Building shall be at the sole risk of Tenant, and Landlord shall not in any manner be held responsible therefor. If any employee of Landlord receives any package or article delivered for Tenant, then such employee shall be acting as Tenant’s agent for such purpose and not as Landlord’s agent. For purposes of this Article, the term “Building” shall be deemed to include the Land. Notwithstanding the foregoing provisions of this Section, Landlord shall not be released from liability, if any, to Tenant for any damage caused by the willful misconduct or gross negligence of Landlord, its employees or agents, to the extent such damage is not covered by insurance carried by Tenant or required to be carried by Tenant.

16.2 Tenant shall indemnify and hold Landlord, its employees and agents harmless from and against all costs, damages, claims, liabilities and expenses (including attorneys’ fees) suffered by or claimed against Landlord, directly or indirectly, based on or arising out of the following except to the extent caused by the willful misconduct of Landlord, its employees or agents: (a) Tenant’s use and occupancy of the Premises or the business conducted by Tenant therein, (b) any act or omission of Tenant or any Invitee, (c) any breach of Tenant’s obligations under this Lease, including failure to surrender the Premises upon the expiration or earlier termination of the Term, or (d) any entry by Tenant or any Invitee upon the Land prior to the Lease Commencement Date.

16.3 If any landlord hereunder transfers the Building or such landlord’s interest therein, then such landlord shall not be liable for any obligation or liability based on or arising out

of any event or condition occurring on or after the date of such transfer. Within fifteen (15) days after any such transferee's request, Tenant shall attorn to such transferee and execute, acknowledge and deliver any requisite or appropriate document submitted to Tenant confirming such attornment.

16.4 Tenant shall not have the right to offset or deduct the amount allegedly owed to Tenant pursuant to any claim against Landlord from any rent or other sum payable to Landlord. Tenant's sole remedy for recovering upon such claim shall be to institute an independent action against Landlord.

16.5 Notwithstanding anything to the contrary contained herein, if Tenant or any Invitee is awarded a money judgment against Landlord, then recourse for satisfaction of such judgment shall be limited to execution against Landlord's estate and interest in the Building. No other asset of Landlord, any member or partner of Landlord or any other person or entity shall be available to satisfy, or be subject to, such judgment, nor shall any such member, partner, person or entity be held to have personal liability for satisfaction of any claim or judgment against Landlord or any member or partner of Landlord.

16.6 Notwithstanding anything to the contrary contained in this Lease, if any provision of this Lease expressly or impliedly obligates Landlord not to unreasonably withhold its consent or approval, an action for declaratory judgment or specific performance will be Tenant's sole right and remedy in any dispute as to whether Landlord has breached such obligation.

16.7 Landlord shall not be liable in any manner to Tenant, its agents, employees, invitees or visitors for any injury or damage to Tenant, Tenant's agents, employees, invitees or visitors, or their property, caused by the criminal or intentional misconduct of third parties or of Tenant, Tenant's employees, agents, invitees or visitors. All claims against Landlord for any such damage or injury are hereby expressly waived by Tenant, and Tenant hereby agrees to hold harmless and indemnify Landlord from all such damages and the expense of defending all claims made by Tenant's employees, agents, invitees, or visitors arising out of such acts.

#### **ARTICLE 17** **RULES**

17.1 Tenant and its Invitees shall at all times abide by and observe the rules set forth in **Exhibit E**. Tenant and its Invitees shall also abide by and observe any other rules that Landlord may reasonably promulgate from time-to-time for the operation and maintenance of the Building, provided that notice thereof is given and such rules are not inconsistent with the provisions of this Lease. Except for Landlord's obligation to enforce the rules in a non-discriminatory manner, nothing contained in this Lease shall be construed as imposing upon Landlord any duty to enforce such rules or any condition or covenant contained in any other lease against any other tenant, and Landlord shall not be liable to Tenant for the violation of such rules or regulations by any other tenant or its invitees.

#### **ARTICLE 18** **DAMAGE OR DESTRUCTION**

18.1 If the Premises or the Building are totally or partially damaged or destroyed, thereby rendering the Premises totally or partially inaccessible or unusable, then Landlord shall diligently repair and restore the Premises and the Building to substantially the same condition they were in prior to such damage or destruction; provided, however, that if in Landlord's reasonable judgment such repair and restoration cannot be completed within one hundred eighty (180) days after the adjustment of the loss in connection with such damage or destruction, then Landlord shall have the right, at its sole option, to terminate this Lease by giving written notice of termination within forty-five (45) days after the occurrence of such damage or destruction.

18.2 If Landlord determines, in its reasonable judgment, that the repairs and restoration cannot be substantially completed within one hundred eighty (180) days after the date of adjustment of the loss in connection with such damage or destruction, Landlord shall promptly

notify Tenant of such determination. For a period of thirty (30) days after receipt of such determination, Tenant shall have the right to terminate this Lease by providing written notice to Landlord. If Tenant does not elect to terminate this Lease within such thirty (30) day period, and provided that Landlord has not elected to terminate this Lease, Landlord shall proceed to repair and restore the Premises and the Building. Notwithstanding the foregoing, Tenant shall not have the right to terminate this Lease if the act or omission of Tenant or any of its Invitees shall have caused the damage or destruction.

18.3 If this Lease is terminated pursuant to Section 18.1 or 18.2 above, then all rent shall be apportioned (based on the portion of the Premises which is usable after such damage or destruction) and paid to the date of termination. If this Lease is not terminated as a result of such damage or destruction, then until such repair and restoration of the Premises are substantially complete, Tenant shall be required to pay the Base Rent and additional rent only for the portion of the Premises that is usable while such repair and restoration are being made. Landlord shall bear the expenses of repairing and restoring the Premises and the Building; provided, however, that Landlord shall not be required to repair or restore any Alteration previously made by Tenant or any of Tenant's trade fixtures, furnishings, equipment or personal property; and provided further that if such damage or destruction was caused by the act or omission of Tenant or any Invitee, then Tenant shall pay the amount by which such expenses exceed the insurance proceeds, if any, actually received by Landlord on account of such damage or destruction.

18.4 Notwithstanding anything herein to the contrary, Landlord shall not be obligated to restore the Premises or the Building and shall have the right to terminate this Lease if (a) the holder of any Mortgage fails or refuses to make insurance proceeds available for such repair and restoration, (b) zoning or other applicable laws or regulations do not permit such repair and restoration, or (c) the cost of repairing and restoring the Building would exceed fifty percent (50%) of the replacement value of the Building, whether or not the Premises are damaged or destroyed, provided the leases of all other tenants in the Building are similarly terminated.

18.5 Notwithstanding the foregoing Sections of this Article 18, Landlord shall not be obligated to restore the Tenant Work which was a part of the work required to be performed under **Exhibit D** attached hereto. Rather, the restoration of such Tenant Work shall be the sole expense and responsibility of Tenant.

## **ARTICLE 19** **CONDEMNATION**

19.1 If (a) one-third or more of the Premises or occupancy thereof shall be permanently taken or condemned by any governmental or quasi-governmental authority for any public or quasi-public use or purpose or sold under threat of such a taking or condemnation (collectively, "condemned"), or (b) there is condemned a portion of the Premises which, in Tenant's good faith and reasonable determination, makes it substantially uneconomic for Tenant to continue to conduct its business operations from or within the Premises (an "Uneconomic Taking"), then in any such event, at the option of Tenant (in the case of (a) or (b) above) or Landlord (in the case of (a) above) made within thirty (30) days after the taking, this Lease shall terminate on the date Tenant or Landlord, as applicable, elects to terminate the Lease and rent shall be apportioned as of such date. If less than one-third of the Premises or occupancy thereof is condemned and such condemnation does not constitute an Uneconomic Taking, then this Lease shall continue in full force and effect as to the part of the Premises not condemned, except that as of the date title vests in such authority Tenant shall not be required to pay the Base Rent and Additional Rent with respect to the part of the Premises condemned.

19.2 All awards, damages and other compensation paid by such authority on account of such condemnation shall belong to Landlord, and Tenant assigns to Landlord all rights to such awards, damages and compensation. Tenant shall not make any claim against Landlord or the authority for any portion of such award, damages or compensation attributable to damage to the Premises, value of the unexpired portion of the Lease Term, loss of profits or goodwill, leasehold improvements or severance damages. Nothing contained herein, however, shall prevent Tenant from pursuing a separate claim against the authority for the value of furnishings and trade



fixtures installed in the Premises at Tenant's expense and for relocation expenses, provided that such claim shall in no way diminish the award, damages or compensation payable to or recoverable by Landlord in connection with such condemnation.

**ARTICLE 20**  
**DEFAULT**

20.1 Each of the following shall constitute an Event of Default: (a) Tenant's failure to make any payment of the Base Rent, Additional Rent or other sum on or before such payment's due date, provided that, on up to two (2) occasions in any twelve (12) month period, there shall exist no Event of Default unless Tenant shall have been given written notice of such failure and shall not have made the payment within five (5) days following the giving of such notice; (b) Tenant's violation or failure to perform or observe any other covenant or condition within thirty (30) days after notice thereof from Landlord; (c) Tenant's vacation or abandonment of the Premises and failure to perform its other obligations hereunder; (d) an Event of Bankruptcy as specified in Article 21 with respect to Tenant, any general partner or member or managing member of Tenant (a "General Partner") or any Guarantor; or (e) Tenant's dissolution or liquidation. If, prior to the commencement of the Lease Term, Tenant notifies Landlord of or otherwise unequivocally demonstrates an intention to repudiate this Lease, Landlord may, at its option, consider such anticipatory repudiation an Event of Default. In addition to any other remedies available to it hereunder or at law or in equity, Landlord may retain all rent paid upon execution of the Lease and the security deposit, if any, to be applied to damages of Landlord incurred as a result of such repudiation, including without limitation attorneys' fees, brokerage fees, costs of reletting, and loss of rent. Tenant shall pay in full for all tenant improvements constructed or installed within the Premises to the date of the breach, and for materials ordered at its request for the Premises. Notwithstanding the foregoing, in the case of a non-monetary default only, if such an asserted default is not reasonably subject to cure within said thirty (30) day period, and provided, that Tenant has commenced a cure within said original thirty (30) period that is reasonably calculated to effect the cure within a reasonable time; and, provided further, that Tenant continues to diligently prosecute its efforts to accomplish the cure, then Tenant shall be granted an additional reasonable time to effect the cure, it being understood that in no event shall any period of permitted cure extend for longer than a total of sixty (60) days, including the original thirty (30) day period.

20.2 If there shall be an Event of Default, including an Event of Default prior to the Rent Commencement Date, then Landlord shall have the right, at its sole option, to terminate this Lease. In addition, with or without terminating this Lease, Landlord may re-enter, terminate Tenant's right of possession and take possession of the Premises so long as such action is taken under due legal process. The provisions of this Article shall operate as a notice to quit, any other notice to quit or of Landlord's intention to re-enter the Premises being hereby expressly waived. If necessary, Landlord may proceed to recover possession of the Premises under and by virtue of the laws of the jurisdiction in which the Building is located, or by such other proceedings, including re-entry and possession, as may be applicable. If Landlord elects to terminate this Lease and/or elects to terminate Tenant's right of possession, then everything contained in this Lease to be done and performed by Landlord shall cease, without prejudice, however, to Landlord's right to recover from Tenant all rent and other sums accrued through the later of termination or Landlord's recovery of possession. Whether or not this Lease and/or Tenant's right of possession is terminated, Landlord agrees to endeavor, in good faith, to relet the Premises or any part thereof, alone or together with other premises, for such rent and upon such terms and conditions (which may include concessions or free rent and alterations of the Premises) as Landlord, in its sole discretion, may determine, but Landlord shall not be liable for, nor shall Tenant's obligations be diminished by reason of, Landlord's failure to relet the Premises or collect any rent due upon such reletting. Whether or not this Lease is terminated, Tenant nevertheless shall remain liable for any Base Rent, Additional Rent or damages which may be due or sustained prior to such default, all costs, fees and expenses (including without limitation reasonable attorneys' fees, brokerage fees and expenses incurred in placing the Premises in first-class rentable condition) incurred by Landlord in pursuit of its remedies and in renting the Premises to others from time to time. Tenant shall also be liable for additional damages which at Landlord's election shall be either:

(a) an amount equal to the Base Rent and Additional Rent which would have become due during the remainder of the Lease Term, less the amount of rental, if any, which Landlord receives during such period from others to whom the Premises may be rented (other than any Additional Rent payable as a result of any failure of such other person to perform any of its obligations), which damages shall be computed and payable in monthly installments, in advance, on the first day of each calendar month following Tenant's default and continuing until the date on which the Lease Term would have expired but for Tenant's default. Separate suits may be brought to collect any such damages for any month(s), and such suits shall not in any manner prejudice Landlord's right to collect any such damages for any subsequent month(s), or Landlord may defer any such suit until after the expiration of the Lease Term, in which event the cause of action shall be deemed not to have accrued until the expiration of the Lease Term; or

(b) an amount equal to the present value (as of the date of the termination of this Lease) of the difference between (i) the Base Rent and Additional Rent which would have become due during the remainder of the Lease Term, and (ii) the fair market rental value of the Premises for the same period, which damages shall be payable to Landlord in one lump sum on demand. For purpose of this Section, present value shall be computed by discounting at a rate equal to one (1) whole percentage point above the discount rate then in effect at the Federal Reserve Bank of New York (or, if such rate is not reasonably available, such substitute rate as Landlord reasonably shall select).

Tenant waives any right of redemption, re-entry or restoration of the operation of this Lease under any present or future law, including any such rights which Tenant would otherwise have if Tenant shall be dispossessed for any cause.

20.3 Landlord's rights and remedies set forth in this Lease are cumulative and in addition to Landlord's other rights and remedies at law or in equity, including those available as a result of any anticipatory breach of this Lease. Landlord's exercise of any such right or remedy shall not prevent the concurrent or subsequent exercise of any other right or remedy. Landlord's delay or failure to exercise or enforce any of Landlord's rights or remedies or Tenant's obligations shall not constitute a waiver of any such rights, remedies or obligations. Landlord shall not be deemed to have waived any default unless such waiver expressly is set forth in an instrument signed by Landlord. If Landlord waives in writing any default, then such waiver shall not be construed as a waiver of any covenant or condition set forth in this Lease except as to the specific circumstances described in such written waiver. Neither Tenant's payment of a lesser amount than the sum due hereunder nor Tenant's endorsement or statement on any check or letter accompanying such payment shall be deemed an accord and satisfaction, and Landlord may accept the same without prejudice to Landlord's right to recover the balance of such sum or to pursue any other remedy available to Landlord. Landlord's re-entry and acceptance of keys shall not be considered an acceptance of a surrender of this Lease.

20.4 If more than one natural person and/or entity shall execute this Lease as Tenant, then the liability of each such person or entity shall be joint and several. Similarly, if Tenant is a general partnership or other entity the partners or members of which are subject to personal liability, then the liability of each such partner or member shall be joint and several.

20.5 If Tenant fails to make any payment to any third party or to do any act herein required to be made or done by Tenant, then Landlord may, but shall not be required to, make such payment or do such act. Landlord's taking such action shall not be considered a cure of such failure by Tenant or prevent Landlord from pursuing any remedy to which it is otherwise entitled in connection with such failure. If Landlord elects to make such payment or do such act, then all expenses incurred, plus interest thereon at a rate per annum (the "Default Rate") which is five (5) whole percentage points higher than the prime rate published from time to time in the Money Rates section of The Wall Street Journal (or, if such rate is not reasonably available, such substitute rate as Landlord reasonably shall select), from the date incurred to the date of payment thereof by Tenant, shall constitute Additional Rent.

20.6 If Tenant fails to make any payment of the Base Rent, Additional Rent or any other sum payable to Landlord within five (5) days after the date such payment is due and payable, then Tenant shall pay a late charge of five percent (5%) of the amount of such payment. In addition, such payment and such late fee shall bear interest at the Default Rate from the date such payment was due to the date of payment thereof.

**ARTICLE 21**  
**BANKRUPTCY**

21.1 The following shall be Events of Bankruptcy under this Lease: (a) Tenant's, a Guarantor's, a General Partner's, or a Managing Member's becoming insolvent, as that term is defined in Title 11 of the United States Code (the "Bankruptcy Code"), or under the insolvency laws of any state (the "Insolvency Laws"); (b) appointment of a receiver or custodian for any property of Tenant, a Guarantor, a General Partner or a Managing Member, or the institution of a foreclosure or attachment action upon any property of Tenant, a Guarantor, a General Partner; or a Managing Member (c) filing of a voluntary petition by Tenant, a Guarantor, a General Partner or a Managing Member under the provisions of the Bankruptcy Code or Insolvency Laws; (d) filing of an involuntary petition against Tenant, a Guarantor, a General Partner or a Managing Member as the subject debtor under the Bankruptcy Code or Insolvency Laws, which either (i) is not dismissed within thirty (30) days of filing, or (ii) results in the issuance of an order for relief against the debtor; or (e) Tenant's, a Guarantor's, a General Partner's or a Managing Member's making or consenting to an assignment for the benefit of creditors or a composition of creditors.

21.2 (a) Upon occurrence of an Event of Bankruptcy, Landlord shall have all rights and remedies available pursuant to Article 20; provided, however, that while a case in which Tenant is the subject debtor under the Bankruptcy Code is pending, Landlord shall not exercise its rights and remedies pursuant to Article 20 so long as (i) the Bankruptcy Code prohibits the exercise of such rights and remedies, and (ii) Tenant or its trustee in Bankruptcy ("Trustee") is in compliance with the provisions of Section 21.2(b).

(b) If Tenant becomes the subject debtor in a case pending under the Bankruptcy Code, then Landlord's right to terminate this Lease pursuant to Section 21.2(a) shall be subject, to the extent required by the Bankruptcy Code, to any rights of Trustee to assume or assign this Lease pursuant to the Bankruptcy Code. Trustee shall not have the right to assume or assign this Lease unless Trustee promptly (1) cures all defaults under this Lease, (2) compensates Landlord for monetary damages incurred as a result of such defaults, (3) provides adequate assurance of future performance on the part of Tenant as debtor in possession or of the assignee of Tenant, and (4) complies with all other requirements of the Bankruptcy Code. This Lease may be terminated in accordance with Section 21.2(a) if the foregoing criteria for assumption or assignment are not met, or if Tenant, Trustee or such assignee defaults under this Lease after such assumption or assignment. Adequate assurance of future performance, as used in this Section 21.2(b), shall mean that all of the following minimum criteria must be met: (A) Tenant's gross receipts in the ordinary course of business during the thirty (30) day period immediately preceding the initiation of the case under the Bankruptcy Code must be greater than two (2) times the next monthly installment of the Base Rent and additional rent; (B) both the average and median of Tenant's monthly gross receipts in the ordinary course of business during the six (6) month period immediately preceding the initiation of the case under the Bankruptcy Code must be greater than two (2) times the next monthly installment of the Base Rent and additional rent; (C) Tenant must pay its estimated pro rata share of the cost of all services performed or provided by Landlord (whether directly or through agents or contractors and whether or not previously included as part of the Base Rent) in advance of the performance or provision of such services; (D) Trustee must agree that Tenant's business shall be conducted in a first-class manner, and that no liquidating sale, auction or other non-first-class business operation shall be conducted in the Premises; (E) Trustee must agree that the use of the Premises as stated in this Lease shall remain unchanged and that no prohibited use shall be permitted; (F) Trustee must agree that the assumption or assignment of this Lease shall not violate or affect the rights of other tenants in the Building; (G) Trustee must

pay to Landlord at the time the next monthly installment of the Base Rent is due, in addition to such installment, an amount equal to the monthly installments of the Base Rent and additional rent due for the next six (6) months thereafter, such amount to be held as a security deposit; and (H) all assurances of future performance specified in the Bankruptcy Code must be provided.

**ARTICLE 22**  
**SUBORDINATION**

22.1 This Lease is subject and subordinate to the lien, provisions, operation and effect of all mortgages, deeds of trust, ground leases or other security instruments which may now or hereafter encumber the Building or the Land (collectively "Mortgages"), to all funds and indebtedness intended to be secured thereby, and to all renewals, extensions, modifications, recastings or refinancings thereof. Landlord shall obtain for Tenant, however, promptly following a request therefor from time to time, a customary Subordination, Non-Disturbance and Attornment Agreement ("SNDA") from the holder/beneficiary of any Mortgage. The form of such SNDA shall be the holder/beneficiary's customary form (which shall be reasonable) subject to Tenant's reasonable comments necessary to effectuate legally the non-disturbance agreement. The holder of any Mortgage to which this Lease is subordinate shall have the right (subject to any required approval of the holders of any superior Mortgage) at any time to declare this Lease to be superior to the lien, provisions, operation and effect of such Mortgage and Tenant shall execute, acknowledge and deliver all documents required by such holder in confirmation thereof.

22.2 In confirmation of the foregoing subordination, Tenant shall at Landlord's request, but in no event later than ten (10) calendar days following a request therefor, execute and deliver any requisite or appropriate document. Tenant waives the provisions of any statute or rule of law now or hereafter in effect which may give or purport to give Tenant any right to terminate or otherwise adversely affect this Lease or Tenant's obligations in the event any such foreclosure proceeding is prosecuted or completed or in the event the Land, the Building or Landlord's interest therein is sold at a foreclosure sale or by deed in lieu of foreclosure. If this Lease is not extinguished upon such sale or by the purchaser following such sale, then, at the request of such purchaser, Tenant shall attorn to such purchaser and shall recognize such purchaser as the landlord under this Lease. Upon such attornment such purchaser shall not be (a) bound by any payment of the Base Rent or additional rent more than one (1) month in advance, (b) bound by any amendment of this Lease made without the consent of the holder of each Mortgage existing as of the date of such amendment, (c) liable for damages for any breach, act or omission of any prior landlord, or (d) subject to any offsets or defenses which Tenant might have against any prior landlord; provided, however, that after succeeding to Landlord's interest, such purchaser shall perform in accordance with the terms of this Lease all obligations of Landlord arising after the date such purchaser acquires title to the Building. Within fifteen (15) days after the request of such purchaser, Tenant shall execute, acknowledge and deliver any requisite or appropriate document submitted to Tenant confirming such attornment.

22.3 (a) After Tenant receives notice from any person, firm or other entity that it holds a Mortgage on the Building or the Land, no notice from Tenant to Landlord alleging any default by Landlord shall be effective unless and until a copy of the same is given to such holder, provided that Tenant shall have been furnished with the name and address of such holder. Any such holder shall have thirty (30) days after its receipt of notice from Tenant of a default by Landlord under this Lease to cure such default before Tenant may exercise any remedy hereunder. The curing of any of Landlord's defaults by such holder shall be treated as performance by Landlord.

(b) In the event that any lender providing construction interim or permanent financing or any refinancing for the Building requires, as a condition of such financing, that modifications to this Lease be obtained, and provided that such modifications (i) are reasonable; (ii) do not adversely affect in a material manner Tenant's use of the Premises as herein permitted; and (iii) do not increase the rent and other sums to be paid by Tenant hereunder, Landlord may submit to Tenant a written amendment to this Lease incorporating such required changes, and Tenant hereby covenants and agrees to execute, acknowledge and deliver to Landlord such amendment, in form reasonably acceptable to Tenant, within fifteen (15) days of Tenant's receipt

thereof, otherwise same shall be deemed to have been accepted by Tenant and Tenant shall be obliged to execute and deliver said amendment to Landlord within five (5) days after the expiration of the said fifteen (15) day period.

**ARTICLE 23**  
**HOLDING OVER**

23.1 If Tenant does not immediately surrender the Premises upon the expiration or earlier termination of the Lease Term, then Tenant shall become a tenant by the month and the rent shall be increased to equal the greater of (a) fair market rent for the Premises, or (b) double the Base Rent, Additional Rent and other sums that would have been payable pursuant to the provisions of this Lease if the Lease Term had continued during such holdover period. Such rent shall be computed on a monthly basis and shall be payable on the first day of such holdover period and the first day of each calendar month thereafter during such holdover period until the Premises have been vacated. Landlord's acceptance of such rent shall not constitute consent by Landlord to Tenant's holdover possession and shall not in any manner adversely affect Landlord's other rights and remedies, including Landlord's right to evict Tenant and to recover damages.

**ARTICLE 24**  
**COVENANTS OF LANDLORD**

24.1 Landlord covenants that it has the right to enter into this Lease and that if Tenant shall perform timely all of its obligations hereunder, then subject to the provisions of this Lease Tenant shall during the Lease Term peaceably and quietly occupy and enjoy the full possession of the Premises without hindrance by Landlord or any party claiming through or under Landlord.

24.2 Landlord reserves the following rights: (a) to change the street address and name of the Building; (b) to change the arrangement and location of entrances, passageways, doors, doorways, corridors, elevators, stairs, toilets or other public parts of the Building; (c) to erect, use and maintain pipes and conduits in and through the Premises; and (d) to grant to anyone the exclusive right to conduct any particular business in the Building not inconsistent with Tenant's permitted use of the Premises. Landlord shall also have the right to construct a building and/or parking lots or garages on the property owned by Landlord adjacent to the Building and to install connections and/or passageways linking the Building to such neighboring building. Landlord may exercise any or all of the foregoing rights without being deemed to be guilty of an eviction, actual or constructive, or a disturbance of Tenant's business or use or occupancy of the Premises. In addition, Landlord reserves for itself the exclusive use of all portions of the roof of the Building and all interstitial space within the buildings and Complex.

**ARTICLE 25**  
**PARKING**

25.1 During the Lease Term, Tenant shall have the right to use the parking spaces as described in the Rider. Tenant shall not sell, assign or permit anyone other than Tenant's personnel to use any of the aforesaid parking spaces, except in conjunction with a permitted assignment of this Lease or a permitted sublease of the Premises. Tenant and its personnel shall comply with all reasonable rules and regulations promulgated by Landlord or Landlord's parking area manager for the orderly functioning of the Building's parking areas.

**ARTICLE 26**  
**GENERAL PROVISIONS**

26.1 Tenant acknowledges that neither Landlord nor any broker, agent or employee of Landlord has made any representations or promises with respect to the Premises or the Building except as herein expressly set forth, and no right, privilege, easement or license is being acquired by Tenant except as herein expressly set forth.

26.2 Nothing contained in this Lease shall be construed as creating a partnership or joint venture between Landlord and Tenant or to create any other relationship other than that of landlord and tenant.

26.3 Landlord and Tenant each warrant to the other that in connection with this Lease neither has employed or dealt with any broker, agent or finder, other than the Brokers identified in the Rider. Landlord acknowledges that it shall pay any commission or fee due to the Brokers, pursuant to the terms of the Rider or, if existent, a separate written agreement. Tenant shall indemnify and hold Landlord harmless from and against any claim for brokerage or other commissions asserted by any broker, agent or finder employed by Tenant or with whom Tenant has dealt, other than the Brokers.

26.4 At any time and from time to time upon not less than fifteen (15) days' prior written notice, Tenant and each subtenant or assignee of Tenant or occupant of the Premises shall execute, acknowledge and deliver to Landlord and/or any other person or entity designated by Landlord, an estoppel certificate: (a) certifying that this Lease is unmodified and in full force and effect (or if there have been modifications, that this Lease is in full force and effect as modified and stating the modifications); (b) stating the dates to which the rent and any other charges have been paid; (c) stating whether or not, to the best knowledge of Tenant, Landlord is in default in the performance of any obligation of Landlord contained in this Lease, and if so, specifying the nature of such default; (d) stating the address to which notices are to be sent; (e) confirming that this Lease is subject and subordinate to all Mortgages encumbering the Building or the Land; and (f) certifying to such other matters as Landlord may reasonably request. Any such statement may be relied upon by any owner of the Building or the Land, any prospective purchaser of the Building or the Land, or any holder or prospective holder of a Mortgage. Tenant acknowledges that time is of the essence to the delivery of such statements and that Tenant's delay, failure or refusal to deliver such statements may cause damages resulting from, for example, delays in obtaining financing secured by the Building. Upon request, Tenant agrees to furnish Landlord with copies of any 10-Q and 10-K reports filed by tenant with the Securities and Exchange Commission. Landlord agrees, at any time and from time-to-time upon not less than fifteen (15) days' prior written notice, to execute and deliver an estoppel certificate to Tenant certifying to the items referred to in clauses (a) through (d) and (f) above.

**26.5 Landlord, Tenant, and all Guarantors, if any, waive trial by jury in any action, proceeding, claim or counterclaim brought in connection with any matter arising out of or in any way connected with this Lease, the landlord-tenant relationship, Tenant's use or occupancy of the Premises or any claim of injury or damage. Tenant consents to service of process and any pleading relating to any such action at the Premises; provided, however, that nothing herein shall be construed as requiring such service at the Premises. Landlord, Tenant, and all Guarantors, if any, waive any objection to the venue of any action filed in any court situated in the jurisdiction in which the Building is located and waive any right under the doctrine of forum non conveniens or otherwise, to transfer any such action filed in any such court to any other court.**

26.6 All notices or other required communications hereunder shall be in writing and shall be deemed duly given when delivered in person (with receipt therefor), or when sent by Express Mail or overnight courier service (provided a receipt will be obtained) or by certified or registered mail, return receipt requested, postage prepaid, to the following addresses: (i) if to Landlord, care of T-Rex Management Company, 5000 T-Rex Avenue, #100, Boca Raton, Florida 33431, with a copy to William S. Weisman, Esquire, Mandel, Weisman, Heimberg, & Brodie, P.A., 2101 Corporate Boulevard, Suite 300, Boca Raton, Florida 33431; (ii) if to Tenant, at the Tenant Address for Notices identified in the Rider. Either party may change its address for the giving of notices by notice given in accordance with this Section. If Landlord or the holder of any Mortgage notifies Tenant that a copy of each notice to Landlord shall be sent to such holder at a specified address, then Tenant shall send (in the manner specified in this Section and at the same time such notice is sent to Landlord) a copy of each such notice to such holder, and no such notice shall be considered duly sent unless such copy is so sent to such holder.

26.7 Each provision of this Lease shall be valid and enforceable to the fullest extent permitted by law. If any provision of this Lease or the application thereof to any person or circumstance shall to any extent be invalid or unenforceable, then such provision shall be deemed to be replaced by the valid and enforceable provision most substantively similar to such invalid or unenforceable provision, and the remainder of this Lease and the application of such provision to persons or circumstances other than those as to which it is invalid or unenforceable shall not be affected thereby.

26.8 Feminine, masculine or neuter pronouns shall be substituted for those of another form, and the plural or singular shall be substituted for the other number, in any place in which the context may require such substitution.

26.9 The provisions of this Lease shall be binding upon and inure to the benefit of the parties and each of their respective representatives, successors and assigns, subject to the provisions herein restricting assignment or subletting.

26.10 This Lease contains the entire agreement of the parties hereto and supersedes all prior agreements, negotiations, letters of intent, proposals, representations, warranties, understandings and discussions between the parties hereto. Any representation, inducement, warranty, understanding or agreement that is not contained in this Lease shall be of no force or effect. This Lease may be modified or changed in any manner only by an instrument duly signed by both parties.

26.11 This Lease shall be governed by and construed in accordance with the laws of the jurisdiction in which the Building is located.

26.12 Article and section headings are used for convenience and shall not be considered when construing this Lease.

26.13 The submission of an unsigned copy of this document to Tenant shall not constitute an offer or option to lease the Premises. This Lease shall become effective and binding only upon execution and delivery by both Landlord and Tenant.

26.14 Time is of the essence of each provision of this Lease.

26.15 This Lease may be executed in multiple counterparts, each of which shall be deemed an original and all of which together constitute one and the same document.

26.16 This Lease shall not be recorded, except that upon the request of Landlord. Tenant agrees to execute, in recordable form, a short-form memorandum of this Lease, provided that such memorandum shall not contain any of the specific rental terms set forth herein. Such memorandum may be recorded in the land records of the jurisdiction in which the Building is located at Landlord's cost.

26.17 Except as otherwise provided in this Lease, any Additional Rent or other sum owed by Tenant to Landlord, and any cost, expense, damage or liability incurred by Landlord for which Tenant is liable, shall be considered Additional Rent payable pursuant to this Lease and paid by Tenant no later than ten (10) days after the date Landlord notifies Tenant of the amount thereof and supplies reasonable back-up with respect thereto.

26.18 Tenant's liabilities existing as of the expiration or earlier termination of the Lease Term shall survive such expiration or earlier termination. Similarly, Landlord's obligation to refund to Tenant the excess, if any, of the amount of Tenant's estimated payments on account of increases in Operating Charges and Real Estate Taxes for the last calendar year falling wholly or partly within the Lease Term over Tenant's actual liability therefor shall survive the expiration or earlier termination of the Lease Term.

26.19 If either Landlord or Tenant is in any way delayed or prevented from performing any of their respective obligations under this Lease (other than Tenant's obligations to

pay Base Rent and Additional Rent hereunder) due to fire, act of God, governmental act or failure to act, strike, labor dispute, inability to procure materials or any other cause beyond Landlord's or Tenant's reasonable control, as may apply (whether similar or dissimilar to the foregoing events), then the time for performance of such obligation shall be excused for the period of such delay or prevention and extended for a period equal to the period of such delay or prevention.

26.20 Tenant represents that the person executing and delivering this Lease on Tenant's behalf is duly authorized to so act. Simultaneously with the execution of this Lease, Tenant shall deliver to Landlord certified copies of any corporate resolution or partnership consent necessary to evidence the due execution of this Lease on Tenant's behalf, or a letter of Tenant's General Counsel confirming such authorization and that execution and delivery of this Lease is in the ordinary course of Tenant's business.

26.21 This Lease includes and incorporates the Rider and all Exhibits attached hereto.

26.22 This Lease shall, for purposes of applicable law, be deemed a deed of lease executed under seal.

26.23 For so long as there is a cafeteria service in the Complex, Tenant acknowledges and agrees that it may not open or operate a cafeteria or food service of any nature within its Premises. Tenant may obtain food service (on a twenty four hour per day, seven day a week basis) by direct arrangement with the cafeteria operator (it being understood that Landlord is making no representation or warranty that such service will be available at all times on a twenty four hour per day, seven day a week basis).

26.24 Special Events. The Tenant shall not, without the prior written consent of the Landlord, schedule, advertise or undertake any public exposition, promotion or other type of special event at the Premises. Any approval of the Landlord to a special event may include, but not be limited to, at the Landlord's option, to conditions such as guidelines for traffic and pedestrian control, security, parking and other considerations in the interest of maintaining the health and safety for both the Tenant's invitees as well as that of other tenants, all at Tenant's cost and expense. In addition, the Landlord may, in its sole discretion, require the Tenant to have delivered a bond by a surety acceptable to Landlord to guaranty any financial undertakings of any indemnification.

26.25. If Tenant has a lease for other space in the Building, an Event of Default by Tenant under such lease will constitute a default hereunder.

26.26. The Tenant or its parent company, whichever shall be responsible for conducting an accounting audit of Tenant's financial condition, shall submit to Landlord annually, not later than one hundred twenty (120) days after either (i) its 10K report or (ii) fiscal year end, annual audited financial statements.

26.27. In the event of any litigation under this Lease the prevailing party will be reimbursed by the non-prevailing party for all reasonable attorneys' fees and out-of-pocket costs, including through all appellate actions and proceedings, and excluding bankruptcy proceedings.

26.28 Carpooling, Mass Transit and Traffic Control

Tenant acknowledges that, due to the nature and size of the Complex, Landlord may be required by applicable governmental authorities to participate in, and require tenants to participate in, carpool programs, mass transit programs, flexible shift and other flexible time programs, and other traffic reduction programs and measures. Tenant agrees to participate in and comply with such programs and measures required by applicable governmental authorities or agreed to by Landlord with respect to the Complex or Building.

26.29 Association. The Complex and the Building in which the Premises are located are subject to a Declaration of Restrictive Covenants, Easements and Conditions (the



“Declaration”) which governs certain matters with respect to the development, management and maintenance of the Complex and Building and to satisfy requirements with respect to surface water management, drainage and other aspects of the Complex. The Declaration provides for the creation of a property owner’s association (“Association”) to perform certain management, operational and maintenance obligations pursuant thereto. The Association has the authority to and does levy fees and assessments against the Complex, including the Building, to pay for the obligations of the Association. This Lease is subject to the Declaration and to the rights of the Association pursuant thereto. Additionally, fees and assessments of the Association paid by the Landlord are and shall be deemed Operating Expenses for the purpose of determining Overhead Rent. Notwithstanding the foregoing, in no event shall any cost assessed against Tenant under this Section exceed, during any year, an amount equal to ten percent (10%) of the Operating Charges otherwise assessed against Tenant under this Lease.

26.30 Vending Machines. No Tenant shall obtain, or accept for use in the Premises, vending machines or pay telephones, or other similar services from any persons other than those specifically designated by Landlord to offer or distribute such services.

26.31 Confidentiality. Landlord and Tenant acknowledge that the terms and provisions of this Lease have been negotiated based upon a variety of factors, occurring at a coincident point in time, including, but not limited to: (i) the individual principals involved and the financial strength of Tenant, (ii) the nature of Tenant’s business and use of the Premises, (iii) the current leasing market place and the economic conditions affecting rental rates, (iv) the present and projected tenant mix of the Building, and (v) the projected juxtaposition of tenants on the floor(s) upon which the Premises are located and the floors within the Building. Therefore, recognizing the totality, uniqueness, complexity and interrelation of the aforementioned factors, the Tenant agrees to use its commercially reasonable efforts not to disseminate in any manner whatsoever, (whether by word of mouth, mechanical reproduction, physical tender or by any manner of visual or aural transmission or review) the terms and conditions of this Lease to third parties who could in any way be considered presently or in the future as prospective tenants for this or any other leasehold property with which Landlord may be involved.

Additionally, Tenant agrees that information concerning the Landlord and T-Rex Corporate Center @ Boca (previously the Blue Lake Project) and the financial and other terms of this Lease, are confidential and proprietary information and Tenant agrees that it will not duplicate or disclose any such information to any person in any manner unless such duplication, use, or disclosure is specifically authorized by Landlord in writing. Confidential and proprietary information is not meant to include any information that is in the public domain. In addition, Tenant agrees to keep the financial terms and conditions as contained herein confidential, with the following exceptions:

- A. Tenant may disclose the contents of this Lease to its accountants, advisors, potential investors and other third parties similarly situated (“Recipient”), and shall notify such Recipients of the confidentiality provisions contained herein; and
- B. Tenant may disclose such information as required by court order.
- C. Tenant may disclose such information as required by the securities laws and other laws and regulations of the United States of America.
- D. Tenant shall issue no press release or statement to the media regarding this Lease without the Landlord’s prior approval, which approval shall not be unreasonably withheld.

The word “Tenant” shall include the officers, employees, directors and representatives of Tenant, and Tenant covenants and agrees to exercise its commercially reasonable efforts to cause such persons to comply with the terms hereof. Tenant shall be liable for the failure of any such person to comply therewith unless Tenant can demonstrate by clear and convincing evidence that it has exercised best efforts to do so and that, notwithstanding such commercially reasonable efforts, compliance has not been achieved.

26.32 Examination Not Option. Submission of this Lease shall not be deemed to be a reservation of the Premises. Neither Tenant nor Landlord shall be bound by this Lease until Landlord has received a copy of this Lease duly executed by Tenant and has delivered to Tenant a copy of this Lease duly executed by Landlord, and until such delivery Landlord reserves the right to exhibit and lease the Premises to other prospective tenants. Notwithstanding anything to the contrary, Landlord may withhold delivery of possession of the Premises from Tenant until such time as Tenant has paid to Landlord all sums required to be paid by Tenant by the initial date of delivery.

26.33 Relocation of Tenant.

A. *General.* Recognizing that the Building is large and the needs of tenants as to space may vary from time to time, and in order for Landlord to accommodate Tenant and prospective tenants, Landlord expressly reserves the right, effective immediately upon the commencement of the third Lease Year, but not before, at Landlord's sole expense, to move Tenant from the Premises and relocate Tenant in other space of Landlord's choosing of approximately the same dimensions and size within the Building (or additions to the Building or new construction related to the Building or the campus in which Building is located), which other space will be decorated by Landlord at its expense Landlord may use decorations and materials from the existing Premises, or other materials, so that the space in which Tenant is relocated will be comparable in its interior design and decoration to the space from which Tenant is removed.

B. *No Interference.* During the relocation period Landlord will use reasonable efforts not to unduly interfere with Tenant's business activities and Landlord agrees to substantially complete the relocation within a reasonable time under all then existing circumstances.

C. *Premises.* This Lease and each of its terms and conditions will remain in full force and effect and be applicable to any such new space and such new space will be deemed to be the Premises demised hereunder; upon request Tenant will execute such documents which may be requested to evidence, acknowledge and confirm the relocation (but it will be effective even in the absence of such confirmation).

D. *Costs.* Landlord's obligation for expenses of removal and relocation will be the actual cost of relocating and decorating Tenant's new space, and Tenant agrees that Landlord's exercise of its election to remove and relocate Tenant will not release Tenant in whole or in part from its obligations hereunder for the full Lease Term. No rights granted in this Lease to Tenant, including the right of peaceful possession and quiet enjoyment, will be deemed breached or interfered with by reason of Landlord's exercise of the relocation right reserved herein.

E. *Release/Waiver.* Provided that Landlord complies with its obligation under this Section 20, Tenant acknowledges and agrees that Tenant's relocation shall not release Tenant, in whole or in part, from its obligations hereunder for the full Lease Term. Provided that Landlord complies with its obligations under this Section 20, no rights granted in this Lease to Tenant, including the right of peaceful possession and quiet enjoyment, will be deemed breached or interfered with by reason of Landlord's exercise of the right to relocate Tenant as herein reserved.

F. *Notice.* If Landlord exercises its relocation right under this paragraph, (i) Tenant will be given ninety (90) days prior notice in writing and (ii) Landlord will reimburse Tenant for the reasonable cost of telephone relocation necessitated by the exercise of said right of relocation.

IN WITNESS WHEREOF, Landlord and Tenant have executed this Lease, under seal, as of the day and year first above written.

**Landlord:**

**BOCA TECHNOLOGY CENTER, LLC,  
a Florida limited liability company**

**By: T-Rex Boca Owners Corp., a Florida corporation,  
its Managing Member**

**Witness:**

/s/ Joan E. Stavola  
\_\_\_\_\_

/s/ Linda W. Hilton  
\_\_\_\_\_

**Witness:**

/s/ Sylvia Johe  
\_\_\_\_\_

By: /s/ Clifford J. Preminger  
\_\_\_\_\_

Clifford J. Preminger  
Its President

**Tenant:**

By: /s/ S. Modist  
\_\_\_\_\_

Name: Scott J. Modist  
Title: Vice President and C.F.O.

---

**EXHIBIT A**  
**THE BUILDING**

---

**EXHIBIT A-1**  
**PARKING AREAS**

---

**EXHIBIT B-1**  
**THE PREMISES**

**EXHIBIT E**  
**RULES AND REGULATIONS**

This Exhibit is attached to and made a part of that certain Lease Agreement dated as of the 14<sup>th</sup> day of February 2005, (the "Lease"), by and between BOCA TECHNOLOGY CENTER, L.L.C. ("Landlord") and MoreDirect, Inc. ("Tenant").

The following Rules and Regulations have been formulated for the safety and well-being of all tenants of the Building and to ensure compliance with all municipal and other requirements. Strict adherence to these Rules and Regulations is necessary to guarantee that each and every tenant will enjoy a safe and unannoyed occupancy in the Building in accordance with the Lease. Any continuing violation of these Rules and Regulations by Tenant, after notice from Landlord, shall be deemed to be an Event of Default under the Lease.

Landlord may, upon request by any tenant, waive the compliance by such tenant to any of these Rules and Regulations, provided that (i) no waiver shall be effective unless signed by Landlord or Landlord's authorized agent, (ii) any such waiver shall not relieve such tenant from the obligation to comply with such Rule and Regulation in the future unless expressly consented to by Landlord, (iii) no waiver granted to any tenant shall relieve any other tenant from the obligation of complying with the Rules and Regulations unless such other tenant has received a similar waiver in writing from Landlord, and (iv) any such waiver by Landlord shall not relieve Tenant from any obligation or liability of Tenant to Landlord pursuant to the Lease for any loss or damage occasioned as a result of Tenant's failure to comply with any such Rule or Regulation.

1. The sidewalks, entrances, passages, courts, elevators, vestibules, stairways, corridors, halls and other parts of the Building not occupied by any tenant shall not be obstructed or encumbered by any tenant or used for any purpose other than ingress and egress to and from the Premises, and if the Premises are situated on the ground floor of the Building, then Tenant shall, at its own expense, keep the sidewalks and curbs directly in front of the Premises clean and free from ice and snow. Landlord shall have the right to control and operate the public portions of the Building and the facilities furnished for common use of the tenants in such manner as Landlord deems best for the benefit of the tenants generally. No tenant shall permit the visit to the Premises of persons in such numbers or under such conditions as to interfere with the use and enjoyment by other tenants of the entrances, corridors, elevators and other public portions or facilities of the Building.

2. No awnings or other projections shall be attached to any wall of the Building without the prior written consent of Landlord. No drapes, blinds, shades or screens shall be attached to or hung in, or used in connection with, any window or door of the Premises, without the prior written consent of Landlord. Such awnings, projections, curtains, blinds, shades, screens or other fixtures must be of a quality, type, design and color, and attached in the manner, approved by Landlord.

3. No showcases or other articles shall be put in front of or affixed to any part of the exterior of the Building, nor placed in the halls, corridors or vestibules without the prior written consent of Landlord.

4. The water and wash closets and other plumbing fixtures shall not be used for any purposes other than those for which they were constructed, and no sweepings, rubbish, rags, chemicals, paints, cleaning fluids or other substances shall be thrown therein. All damages resulting from any misuse of the fixtures shall be borne by the tenant who, or whose servants, employees, agents, visitors or licensees, shall have caused the same.

5. There shall be no marking, painting, drilling into or in any way defacing the Building or any part of the Premises visible from public areas of the Building. Tenant shall not construct, maintain, use or operate within the Premises any electrical device, wiring or apparatus in connection with a loud speaker system or other sound system, except as reasonably required for its communication system and approved prior to the installation thereof by Landlord. No such loudspeaker or sound system shall be constructed, maintained, used or operated outside of the Premises.

6. No bicycles, vehicles, animals, birds or pets of any kind shall be brought into or kept in or about the Premises, and no cooking (except for hot-plate or microwave cooking by Tenant's employees for their own consumption, the equipment for and location of which are first approved by Landlord) shall be done or permitted by any tenant on the Premises. No tenant shall cause or permit any unusual or objectionable odors to be produced upon or to permeate from the Premises.

7. The use of the Premises by each tenant was approved by Landlord prior to execution of the Lease and such use may not be changed from the Permitted Use without the prior approval of Landlord. No space in the Building shall be used for manufacturing of goods for sale in the ordinary course of business, for the storage of merchandise for sale in the ordinary course of business or for the sale at auction of merchandise, goods or property of any kind.

8. No tenant shall make any unseemly or disturbing noises or disturb or interfere with occupants of the Building or neighboring buildings or Premises or those having business with them whether by the use of any musical instrument, radio, talking machine, unmusical noise, whistling, singing or in any other way. No tenant shall throw anything out of the doors or windows or down the corridors or stairs.

9. No flammable, combustible or explosive fluid, chemical, asbestos or other hazardous substance or any other material harmful to tenants of the Building shall be brought, installed in or kept upon the Premises. No space heaters, fans or individual air conditioning units may be used in the Premises. Any electrical or extension cords deemed to be a fire hazard by Landlord in Landlord's sole discretion shall be removed.

10. No additional locks or bolts of any kind shall be placed upon any of the doors or windows by any tenant nor shall any changes be made in existing locks or the mechanism thereof. The doors leading to the corridors or main halls shall be kept closed during business hours except as they may be used for ingress or egress. Each tenant shall, upon the termination of its tenancy, restore to the Landlord all keys of stores, offices, storage and toilet rooms either furnished to, or otherwise procured by, such tenant, and in the event of the loss of any keys so furnished, such tenant shall pay to Landlord the cost thereof.



---

**SCHEDULE 4.2**  
**WIRE TRANSFER INSTRUCTIONS**

**SCHEDULE 5.1(b)**  
**TENANT'S OPERATING CHARGES**

Operating Charges shall mean all costs and expenses incurred by Landlord in the ownership and operation of the Building, including all of the following: (1) electricity, gas, water, sewer and other utility charges with respect to the operation of common areas of the Building; (2) premiums and other charges for insurance (including, but not limited to, property insurance, rent loss insurance and liability insurance); (3) all market rate management fees incurred in the management of the Building; (4) all costs incurred in connection with service and maintenance contracts; (5) maintenance and repair expenses and supplies; (6) amortization (calculated over the useful life of the improvement, with interest at Landlord's cost of funds or [if the improvement is not financed] at the prime rate reported in The Wall Street Journal) for capital expenditures which have been approved by Tenant or which are made by Landlord for the purpose of complying with legal or insurance requirements or that are intended to result in a net decrease in Operating Charges (hereinafter referred to as "Qualified Capital Expenditures"); (7) salaries, wages, benefits and other expenses of Building personnel; (8) legal fees (except as excluded below), administrative expenses, and accounting, architectural and other professional fees and expenses; (9) costs of any service not provided to the Building on the Lease Commencement Date but thereafter provided by Landlord in the prudent management of the Building; (10) charges for concierge, security, janitorial, char and cleaning services and supplies furnished to the Building; (11) costs associated with the provision or operation of any common facilities and service amenities; (12) the cost of maintaining management, engineering and/or maintenance offices in the Building (including the fair market rental value of the space devoted to such uses); (13) any business, professional and occupational license tax paid by Landlord with respect to the Building; (14) any personal property tax payable with respect to Landlord's property located at the Building that is used in connection with the maintenance, repair, or operation of the Building; and (15) any other expense incurred by Landlord in maintaining, repairing or operating the Building and related property. Operating Charges shall not include the following:

- (i) Principal payments or interest payments on any mortgage, other debt costs and ground rent payments on any ground lease.
- (ii) Leasing commissions paid by Landlord.
- (iii) Cost of repair or other work occasioned by fire, windstorm or other casualty, or by condemnation, to the extent reimbursed by insurance proceeds or condemnation award, and any other costs of items for which Landlord receives reimbursement from a third party.
- (iv) Costs incurred due to renovating, decorating, redecorating or otherwise improving space for tenants in the Building.
- (v) Costs of correcting latent defects (not standard repairs) during the initial warranty period after construction. All repairs and replacements resulting from ordinary wear and tear, use, fire, casualty, vandalism and other matters shall not be deemed to be latent construction defects.
- (vi) Landlord's costs of electricity and other services sold to particular tenants which services are not standard for the Building and for which Landlord is entitled to reimbursement by such particular tenants.
- (vii) Depreciation and amortization of the Building or any fixtures or improvements therein.
- (viii) Expenses in connection with services or other benefits of a type which are not standard for the Building and which are not available to Tenant without specific charge therefor, but which are provided to another tenant or occupant and for which such other tenant or occupant is specifically charged by Landlord.

- (ix) Costs, penalties, fines and associated legal expenses incurred due to violation by Landlord or any tenant in the Building of the terms of any applicable federal, state or local government laws, codes or similar regulations that would not have been incurred but for any such violations by Landlord, it being intended that each party shall be responsible for costs resulting from its own violation of such laws, codes and regulations as the same shall pertain to the Building. Notwithstanding the foregoing, interest or penalties incurred in connection with assessments or taxes which are reasonably contested by Landlord shall be included as an acceptable Operating Charge.
- (x) Costs of Landlord's general overhead and general administrative expenses (individual, partnership or corporate, as the case may be), which costs would not be chargeable to operating expenses of the Building in accordance with generally accepted accounting principles, consistently applied.
- (xi) Any compensation paid to clerks, attendants or other persons in commercial concessions (such as snack bar or restaurant), if any, operated by Landlord.
- (xii) All items and services for which Tenant or any other building tenant specifically reimburses Landlord.
- (xiii) Legal fees in connection with leasing, tenant disputes or enforcement of leases.
- (xiv) Capital expenditures, except Qualified Capital Expenditures.
- (xv) Costs of overtime HVAC service whether provided to the Tenant or any other tenant of the Building.
- (xvi) Costs of repairing, replacing or otherwise correcting defects (including latent defects) in or inadequacies of (but not the costs of ordinary and customary repair for normal wear and tear) the initial design or construction of the Building.
- (xvii) Allowances, concessions, permits, licenses, inspections and other costs and expenses incurred in completing, fixturing, renovating or otherwise improving, decorating or redecorating space for tenants (including Tenant), prospective tenants or other occupants of the Building, or vacant leasable space in the Building, or constructing or finishing demising walls and public corridors with respect to any such space.
- (xviii) Any amount specifically required to be paid by Landlord to Tenant under this Lease, and any cost or expense (A) which is due to Landlord's negligence or willful misconduct, (B) which is incurred pursuant to any Landlord indemnification and/or hold harmless provision, or (C) which is a result of any breach of this Lease or any other lease for space in the Building.
- (xix) Costs incurred in connection with the sale, financing, refinancing, mortgaging, selling or change of ownership of the Land or Building.
- (xx) Costs, fines, interest, penalties, legal fees or costs of litigation incurred due to the late payments of utility bills and other costs of operating the Building incurred by Landlord's failure to make such payments when due.
- (xxi) All amounts which would otherwise be included in Operating Charges which are paid to any affiliate or subsidiary of Landlord, or any representative, employee or agent of same, to the extent the costs of such services exceed the competitive rates for similar services of comparable quality rendered by persons or entities of similar skill, competence and experience. It is hereby acknowledged by Tenant that the management fee in the amount of 5% of gross rentals to be paid to an affiliate of Landlord is a competitive, market rate fee.

(xxii) Increased insurance premiums caused by Landlord's or any other tenant's hazardous acts.

(xxiii) Moving expense costs of tenants of the Building.

(xxiv) Advertising, public relations and promotional costs associated with the promotion or leasing of the Building, and costs of signs in or on the Building identifying the owners of the Building or any tenant of the Building.

(xxv) Costs incurred to correct violations by Landlord of any law, regulation, rule, order or ordinance which was in effect as of the Lease Commencement Date.

(xxvi) Non-cash items, such as interest on capital invested, bad debt losses, rent losses and reserves for such losses.

(xxvii) Electric power costs for which any tenant directly contracts with the local public service company.

In the event a single expenditure pays for the provision of a good or service to both the Building and any neighboring building owned by Landlord, then Operating Charges of the Building shall include only the portion of such payment that is equitably allocable to the Building, as reasonably determined by Landlord.

**Basic Lease Information Rider**  
T-Rex Corporate Center @ Boca Raton

The terms of this Basic Lease Information Rider ("Rider") contain fundamental information relating to the Lease, many of the principal economic terms, the commencement dates, and related obligations. The Rider and the Standard Provisions to Lease are, by this reference, hereby incorporated into one another, and taken together shall be referred to as the Lease. Terms defined herein apply both for the purpose of this Rider and the Lease. Capitalized terms that are defined in the Lease have the same meaning when used in this Rider. In the event of any conflict between the terms of the Rider and the terms of the Standard Provisions to Lease, the terms of the Rider shall control.

1. **Date of Lease: February 15, 2005** ("Effective Date").
2. **Landlord: Boca Technology Center, LLC, a Florida limited liability company.**
3. **Tenant: MoreDirect, Inc., a Florida For Profit Corporation.**
4. **Complex and Building:** The improvements to the real property described and depicted on **Exhibits A and A-1**.
5. **Premises:**
  - A. The Premises are shown on **Exhibit B-1** attached to the Lease.
  - B. From and after the Delivery Date as hereinafter defined, Tenant shall have access to the Premises twenty-four (24) hours per day, seven (7) days per week. Tenant shall

obtain, in advance and at its own cost, all permits and approvals required from any municipal or governmental authority necessary for it to use and occupy the Premises for Tenant's intended purposes. Landlord's prior written approval, not to be unreasonably withheld, shall be obtained with respect to the specific equipment Tenant desires to place in the Premises. Tenant acknowledges that Landlord may have reserved certain risers, pads, roof locations, and similar areas of the Building for lease to tenants who have in excess of building standard need for such areas.

6. **Rentable Area:** The Rentable Area of the Premises consists of approximately **8,826** rentable square feet located in Suite 950 in **Building 4950**, for a total area of **8,826** rentable square feet. At Landlord's or Tenant's request, the Rentable Area of the Premises shall be re-measured by Landlord's architect after possession of the Premises is delivered to Tenant (but before the Rent Commencement Date), and to the extent the Rentable Area is revised as a result of such re-measurement, the Base Rent, Additional Rent and other charges set forth herein shall be equitably and proportionately adjusted (and the parties shall execute a written lease amendment to confirm the changes, if any). In the event of such a re-measurement it is understood and agreed that the determination of Rentable Area shall be made by computing the actual occupied area (typically referred to as usable area) and multiplying it by a factor of 1.15 to equal the Rentable Area. In the event of a renewal of the lease it is agreed that a re-measurement may, in the discretion of Landlord, be made in accordance with the provisions described in this Paragraph 6.

7. **Proportionate Share:** Tenant's Proportionate Share is a fraction, stated in decimal terms, the numerator of which is the Rentable Area of the Premises and the denominator of which is 1,710,235. Tenant's Proportionate Share is agreed to be **0.52%**.

8. **Lease Commencement Date and Delivery Date:** The Lease Commencement Date and the Effective Date shall be the same date. Landlord shall deliver actual physical possession to Tenant for the purpose of Tenant's construction of its approved initial tenant improvements and, thereafter, for the purpose of Tenant's move-in to the Premises, on **February 15, 2005** ("Delivery Date").

9. **Rent Commencement Date:** The Rent Commencement Date is **April 1, 2005**. Landlord agrees to abate the Base Rent for the first three months of the Lease Term. Effective on the Rent Commencement Date, however, it is agreed that Tenant shall commence payment of Additional Rent, as applicable, without abatement or set-off. Starting July 1, 2005 Tenant will be responsible for payment of Base Rent and Additional Rent.

10. **Expiration Date:** June 30, 2010.

11. **Lease Term:** From the Lease Commencement Date to the Expiration Date, unless extended or sooner terminated in accordance with the Lease.

12. **Base Rent:** Beginning on the Rent Commencement Date, Tenant shall pay Base Rent in the amount of **\$11.00** per rentable square foot, or **NINETY SEVEN THOUSAND EIGHTY SIX Dollars (\$97,086)** per annum, payable to Landlord in twelve (12) equal monthly installments of **EIGHT THOUSAND NINETY Dollars and 50/100<sup>th</sup> (\$8,090.50)**, plus applicable sales taxes and applicable local taxes (“Base Rent”). During the Lease Term, on the anniversary date of the Rent Commencement date, the Base Rent for the ensuing year shall be, without further notice thereof, increased annually by **four percent (4%)** over the Base Rent for the Lease Year just concluded, and the monthly installments shall be adjusted in conformity therewith.

13. **Additional Rent:** Additional Rent consists of Tenant’s Proportionate Share of the sum of Operating Charges, the Real Estate Taxes and any other expenses passed through to Tenant under the Lease, as more fully set forth in Article 5 of the Lease.

14. **Operating Charges:** As described in Article 5 of the Lease. Notwithstanding the provisions of Article 5 of the Lease, in no event shall Tenant’s Proportionate Share of Controllable Operating Charges be increased by more than five percent (5%) annually, applied cumulatively, from that charged to Tenant for the immediately preceding Lease Year. “Controllable” Operating Charges are defined to mean all Operating Expenses EXCEPT: (i) real estate taxes, (ii) electricity charges and fees and (iii) insurance premiums and fees.

15. **Real Estate Taxes:** As described in Article 5 of the Lease.

16. **Prepaid Rent and Security Deposit Paid:** Upon execution hereof Tenant shall deliver to Landlord prepaid rent in the amount of **TWENTY FOUR THOUSAND SIX HUNDRED SEVENTY FOUR and 18/100 Dollars (\$24,674.18)**, applied to the first and last month of Base Rent and Additional Rent, inclusive of taxes, due hereunder. Tenant shall also deliver to Landlord, simultaneously therewith, **TWELVE THOUSAND THREE HUNDRED THIRTY SEVEN and 09/100 Dollars (\$12,337.09)** as a Security Deposit. This amount being equal to one month of Base Rent and Additional Rent.

17. **Use of Premises:** Tenant may use the Premises for general office use and must be in compliance with the “LIRP” zoning classification currently in place.

18. **Parking Spaces:** Tenant’s use of parking during the Lease term shall be subject to the requirements of Article 25 of the Standard Provisions to Lease. Tenant shall have the right to use parking spaces in accordance with the Boca Raton Zoning Code (the “Code”) providing for parking at a ratio of 3 spaces per 1,000 square feet of space. Landlord agrees to reserve four (4) parking spaces in a relatively close proximity to the main entrance of the 4950 Building and four (4) additional spaces in area designated by Landlord. Landlord has current parking modification plans that contemplate the addition of new surface parking spaces.

19. **Tenant’s Address for Notices:**

MoreDirect, Inc.  
T-Rex Corporate Center  
4950 Communications Avenue, Suit 950  
Boca Raton, FL 33431

20. **Tenant’s Representative For Build-Out:**

21. **Tenant’s Approved Contractor (from Landlord’s Approved List):**

**Pass International, Inc.**  
**350 NW 12<sup>th</sup> Avenue, Suite 200**  
**Deerfield Beach, FL 33442**

22. **Broker(s):** Tenant acknowledges that it has dealt with no real estate broker or other person or firm which may claim a commission or fee in connection with this Lease other than CB Richard Ellis, Inc. and Jack Lupo Realty, Inc. and that this provision is subject to Section 26.3 of the Standard Provisions to Lease.

23. **Tenant Work and Tenant Access:** Tenant accepts the Premises “as is” and acknowledges that Landlord shall have no obligation to perform any work relating to tenant improvements within the Premises. Tenant shall be granted access to the Premises for the purpose of performing its Tenant Work. Landlord agrees to provide Tenant an allowance of FIFTY FIVE THOUSAND Dollars (\$55,000.00) (“Landlord Contribution”) to be used towards Tenant’s improvements of the Premises. Landlord shall pay Tenant’s Approved Contractor directly, based on Tenant’s submission to Landlord on an approved draw schedule. Landlord must receive the draw schedule before the 25<sup>th</sup> day of the month. The Landlord Contribution shall not apply to Tenant’s expense for a dedicated air conditioning unit or system to its server room or to a fire prevention/suppression system in its server room. Landlord makes no representations as to the existence of chilled water lines existing above the area intended to be used by Tenant as its server room.

All Tenant Work must be done in accordance with the Lease and Tenant shall be required to permit said work, if required. Neither Tenant nor its Approved Contractor may commence any Tenant Work until Tenant has received Landlord’s written approval of all of Tenant’s plans and specifications for such work, all permits and other governmental approvals required therefor, and the approval of Tenant’s proposed contractor.

24. **Management.** The Building shall be professionally managed for Landlord by a management company selected by Landlord, which may be affiliated with Landlord.

25. **Tenant Execution and Delivery.** Notwithstanding anything to the contrary herein or in the Lease, Tenant expressly covenants and agrees that the execution and delivery of this Rider and the Lease by Tenant constitutes an offer by Tenant to lease the Premises on the terms and conditions stated in the Rider and Lease, and that Tenant may not withdraw this offer to lease unless Landlord fails to execute and deliver fully executed counterparts of the Rider and Lease on or before 5:00 pm (EST), February 15, 2005. Tenant acknowledges that execution of this Lease by Landlord is subject to the written approval of Landlord’s lender.

26. **Landlord Testing.** It is understood and agreed that from time-to-time and at any time, providing that Landlord notifies Tenant at least forty eight (48) hours in advance, Landlord may test building equipment, including but not limited to stand-by electric power equipment and facilities, and Landlord shall not be liable in the event of any temporary interruption of service arising from or relating to such testing.

27. **Extension Option.** Landlord grants to Tenant an option (the “Option”) to extend the term of this Lease for two (2) additional periods of three (3) years (the “Renewal Term”) under the terms set forth below. Tenant shall not be entitled to exercise the Option unless each of the following conditions shall be fully satisfied at the time of its exercise: (i) the Lease shall be in full force and effect; (ii) the Tenant originally named in this Lease or a permitted assignee shall be in possession of the entire Premises; and (iii) Tenant shall not have been in default under any of the material terms, provisions, covenants or conditions of the Lease. In order to exercise the Option, Tenant must first give written request to Landlord, not less than six (6) months prior to the Expiration Date of the Lease Term, for delivery of Landlord’s determination of Market Rent, as defined below. Base Rent for the Renewal Term shall be equal to the Market Rent, as determined in accordance with this section (“Market Rent”). Within thirty (30) days following its receipt of Tenant’s request, Landlord shall advise Tenant of Market Rent for each year of the Renewal Term. Landlord shall determine Market Rent (including escalations for each successive year of the Renewal Term) in its reasonable judgment. Landlord’s determination of the Market Rent shall be based, as Landlord reasonably deems appropriate, upon then current and projected rents for space in the Building, adjusted for any special conditions applicable to such space and leases, for location, length of term, amount of space and other factors Landlord deems relevant in computing rents for space in the Building, including adjustments for anticipated inflation. If Landlord and Tenant are unable to agree upon Market Rent, Tenant may nevertheless exercise its option by notifying Landlord, within 30 days from the date on which Tenant was first advised by Landlord of its initial determination of Market Rent, that Tenant has elected to exercise the Option at the Market Rent determined by Landlord subject to a reservation of Tenant’s right to arbitrate Landlord’s determination of Market Rent in accordance with this Section. If the parties cannot agree in writing on Market Rent and Tenant timely exercises the Option, then within thirty (30) days after Tenant’s exercise of the Option, Tenant and Landlord shall each select a licensed MAI appraiser with at least ten (10) years substantial commercial leasing expertise particularly in this area of Palm Beach County, Florida and notify the other party of such selection. The selected appraisers shall in turn select a similar third appraiser who will determine Market Rent. The

parties shall share equally the cost of the third appraiser. If either party fails to timely select an appraiser and notify the other party of such selection, the other party's timely selected appraiser shall unilaterally determine Market Rent. If Tenant elects to exercise the Option subject to its reservation to contest Market Rent, Tenant shall nonetheless on the commencement of the Renewal Term begin paying Base Rent at Market Rent determined by Landlord. If Market Rent is ultimately determined to be other than the amount initially determined by Landlord, the next due payment or payments of Rent shall be appropriately adjusted to reflect such overpayment or underpayment retroactive to commencement of the Renewal Term. If Tenant exercises the Option as provided, the Expiration Date of the Lease shall be extended for the length of the Renewal Term and Base Rent shall be adjusted to Market Rent. If Tenant shall fail to timely exercise the Option as provided, Tenant shall be deemed to have waived its right to exercise the Option and to occupy the Premises beyond the initial Term of the Lease.

**IN WITNESS WHEREOF**, the parties hereto have executed this Basic Lease Information Rider on this 14th day of February 2005, intending that it be, and the same hereby is, incorporated into and made a part of the T-Rex Corporate Center @ Boca Lease.

**WITNESSES:**

/s/ Joan E. Stavola

\_\_\_\_\_  
Print Name: Joan E. Stavola

/s/ Linda W. Hilton

\_\_\_\_\_  
Print Name: Linda W. Hilton

**Attest:**

/s/ Sylvia Johe

\_\_\_\_\_

**LANDLORD:**

**BOCA TECHNOLOGY CENTER LLC,  
a Florida limited liability company  
By: T-Rex Boca Owners Corp., a Florida  
Corporation, its Managing Member**

**By: /s/ Clifford J. Preminger**

\_\_\_\_\_  
**Clifford J. Preminger  
Its President**

**Tenant: MoreDirect, Inc.**

**By: /s/ Scott Modist**

\_\_\_\_\_  
**Its Vice President & CFO**



**AMENDMENT NO. 5 TO LEASE**

THIS AGREEMENT made this 28<sup>th</sup> day of February, 2005, by and between EWE WAREHOUSE INVESTMENTS V, LTD., as Lessor and MERRIMACK SERVICES CORPORATION dba PC CONNECTION SERVICES, as Lessee located at 2780-2880 Old State Route 73, Wilmington, Ohio 45177.

## W I T N E S S E T H:

WHEREAS, Lessor and Lessee entered into a Lease dated September 27, 1990 as amended June 28, 1996, July 31, 1998, June 26, 2000, and July 31, 2002 and

WHEREAS, the Lessor and Lessee desire to amend the Lease of approximately 102,400 square feet to extend the term, revise the rent.

NOW THEREFORE, the Lease is amended as follows.

1. Article 1. TERM. shall be revised as follows.

Effective March 1, 2005, the term of this Lease shall be extended for an additional two (2) years for a total term of sixteen (16) years, two (2) months, commencing January 1, 1991 and ending February 28, 2007, both dates inclusive.

2. Lessee warrants that Lessee has accepted and is now in possession of the Premises and that the Lease is valid and presently in full force and effect. Lessee accepts the Premises in its present "as is" condition.

3. Article 4. RENT. shall be revised as follows.

For the two (2) year period commencing March 1, 2005 and ending February 28, 2007, Lessee shall pay to the Lessor as Annual Rent for the Leased Premises the sum of FIVE HUNDRED FIFTY-EIGHT THOUSAND EIGHT HUNDRED SIXTY-FOUR AND 04/100 DOLLARS (\$548,864.04) which shall be paid in equal monthly installments of FORTY-FIVE THOUSAND SEVEN HUNDRED THIRTY-EIGHT AND 67/100 DOLLARS (\$45,738.67), due and payable on the first day of each month, in advance, without demand.

4. Except as expressly amended herein, all other terms and conditions of the Lease remain in full force and effect.

IN WITNESS WHEREOF, the Lessor and Lessee have affixed their signatures to duplicates of this Amendment, this 25<sup>th</sup> day of February 2005, as to Lessee and this 28<sup>th</sup> day of February, 2005, as to Lessor.

Signed and acknowledged  
in the presence of:

/s/ Barbara J. Gilmore

Barbara J. Gilmore

Print Name

/s/ Michelle Atkinson

Michelle Atkinson

Print Name

/s/ Eileen A. Gagnon

Eileen A. Gagnon

Print Name

Print Name

STATE OF OHIO, COUNTY OF MONTGOMERY, SS:

The foregoing instrument was acknowledged before me this 28th day of February 2005, by Chuck McCosh, President of MILLER-VALENTINE REALTY, INC.

/s/ Rita A. Hughes

NOTARY PUBLIC

STATE OF New Hampshire, COUNTY OF Hillsborough, SS:

The foregoing instrument was acknowledged before me this 25th day of February, 2005, by Robert A. Pratt, the Director of Facilities of MERRIMACK SERVICES CORPORATION, a corporation on behalf of said corporation.

/s/ Dolores R. Collins

NOTARY PUBLIC

LESSOR: EWE WAREHOUSE INVESTMENTS V, LTD.  
BY MILLER-VALENTINE REALTY, INC.  
ITS MANAGING AGENT

By: /s/ Chuck McCosh

Title: Chuck McCosh  
President

LESSEE: MERRIMACK SERVICES CORPORATION  
dba PC CONNECTION SERVICES

By: /s/ Robert A. Pratt

Title: Director of Facilities

SUBLEASE  
BETWEEN  
222 INTERNATIONAL, LIMITED PARTNERSHIP  
AS  
“SUBLESSOR”  
AND  
MERRIMACK SERVICES CORPORATION  
AS  
“SUBLESSEE”  
222 INTERNATIONAL DRIVE  
SUITE # 125  
PORTSMOUTH, NEW HAMPSHIRE 03801  
DATED AS OF MARCH 4, 2005

TABLE OF CONTENTS

ARTICLE		PAGE
SUBLEASE		4
RECITALS		5
ARTICLE 1.	PREMISES	7
ARTICLE 2.	CONDITION OF SUBLEASED PREMISES	8
ARTICLE 3.	TERM	9
ARTICLE 4.	BASIC RENT	9
ARTICLE 5.	IMPOSITIONS	13
ARTICLE 6.	SURRENDER OF SUBLEASED PREMISES	13
ARTICLE 7.	INSURANCE	14
ARTICLE 8.	USE OF SUBLEASED PREMISES	16
ARTICLE 9.	LIENS	18
ARTICLE 10.	ALTERATIONS - SIGNS	19
ARTICLE 11.	RIGHT OF SUBLESSOR TO INSPECT AND REPAIR	20
ARTICLE 12.	GENERAL INDEMNIFICATION BY SUBLESSEE	22
ARTICLE 13.	UTILITIES	23
ARTICLE 14.	INSTALLATION AND ALTERATIONS BY SUBLESSEE, REPAIRS AND SERVICES TO BE FURNISHED BY SUBLESSOR	24
ARTICLE 15.	ACCESS TO PREMISES	27
ARTICLE 16.	DAMAGE OR DESTRUCTION	28
ARTICLE 17.	EMINENT DOMAIN	28
ARTICLE 18.	DEFAULTS	29
ARTICLE 19.	SUBORDINATION TO MORTGAGES	30
ARTICLE 20.	CERTIFICATE	31
ARTICLE 21.	DELEGATION - ASSIGNMENT - SUBLEASES-MORTGAGE	31
ARTICLE 22.	ENVIRONMENTAL PROTECTION	32
ARTICLE 23.	HOLDING OVER	37
ARTICLE 24.	WAIVERS	37
ARTICLE 25.	QUIET ENJOYMENT	37
ARTICLE 26.	FAILURE OF PERFORMANCE	38
ARTICLE 27.	INTERPRETATION	38
ARTICLE 28.	NOTICES	39
ARTICLE 29.	DISPUTES AND LITIGATION	39
ARTICLE 30.	MISCELLANEOUS	39

EXHIBITS TO SUBLEASE

Exhibit

- 1 - PRIMARY SUBLEASE
- 2 - APPLICATION AND ACCEPTANCE
- 3 - MASTER LEASE BETWEEN PEASE DEVELOPMENT AUTHORITY AND AIR FORCE
- 4 - FEDERAL FACILITIES AGREEMENT
- 5 - PLANS DESIGNATING THE SUBLEASED PREMISES
- 6 - ALTERATIONS
- 7 - LIST OF ENVIRONMENTAL LAWS AND REGULATIONS
- 8 - CERTIFICATE OF GOOD STANDING
- 9 - FAA REQUIREMENTS
- 10 - SUBORDINATION AND NON-DISTURBANCE AGREEMENT
- 11 - RULES AND REGULATIONS
- 12 - OPERATING EXPENSES

**SUBLEASE**

THIS SUBLEASE ("Sublease") is made by and between **222 International, Limited Partnership**, ("Sublessor") and **Merrimack Services Corporation**, ("Sublessee"). (Sublessor and Sublessee may be referred to jointly as the "Parties.")

**SUMMARY OF BASIC LEASE PROVISIONS AND RECITALS**

**Summary of Basic Lease Provisions and Recitals**

The Summary of Basic Lease Provisions and Recitals contains the basis of this sublease between Sublessor and Sublessee named below. Articles, Sections and Paragraphs of the Sublease define and expand the Basic Terms, and are to be read in conjunction with the Basic Terms.

1. **Date of Lease:** March 4, 2005
2. **Sublessor:** 222 International, Limited Partnership
3. **Property Manager:** CPManagement, Inc., Three Mound Court, Merrimack, NH 03054
4. **Sublessee:** Merrimack Services Corporation for the benefit of its affiliated company, PC Connection Sales Corporation.
5. **Property:** The property is comprised of the building; and the land parcel on which it is located known as 222 International Drive, Portsmouth, New Hampshire, including the parking lot and other improvements (the "Building").
6. **Subleased Premises:** 16,018 square feet of the Building shown on Exhibit #5.
7. **Lease Term:** Five (5) years beginning on May 1., 2005 or such other date as specified in Article 3 of this Sublease and ending on April 30, 2010.

**Options to Extend:** Two (2) Three (3) year options.

8. **Permitted Uses:** General Office and telephone Call Center for PC Connection Sales Corporation and related uses which must conform to the light industrial / manufacturing uses authorized by the Pease Development Authority.
9. **Sublessee's Guarantees:**
10. **Initial Security Deposit:** Sixteen Thousand, Two Hundred and 00/100 (\$16,200.00) Dollars (one month's rent obligation).
11. **Parking:** Sublessee shall have the immediate use of up to 75 parking spaces with the progressive use of up to 160 parking spaces (the "Allocation") to use in common with other subtenants of the Building. Visitor and handicapped parking spaces are so marked. The Sublessee acknowledges that this Allocation exceeds the standard number of spaces

normally allotted at the Building. Should Sublessor, at its sole discretion, determine that Sublessee's parking regularly adversely affects the parking availability to other subtenants at the Building, Sublessee agrees to fund the construction of additional parking for the Building at a budgeted rate of \$480.00 per additional constructed space with variances to this amount to be mutually agreed upon at the time. Sublessor shall notify Sublessee of its intent to require the construction of new parking spaces. Sublessee shall then be required to pay as Additional Rent the costs as set forth.

12. Base Rent: One Hundred Twenty Eight Thousand, One Hundred Forty Four and 00/100 (\$128,144.00) Dollars annually; Ten Thousand, Six Hundred Seventy Eight and 67/100 (\$10,678.67) Dollars monthly; \$8.00 per rentable square foot, as adjusted pursuant to Section 4.02. The manner and timing of the payment of Base Rent is in accordance with Section 4.01.
13. Other Periodic Payments : As described under Article 4.
14. Sublessee's Prorata Share: 25.61% of Building's 62,545 rentable square feet.
15. Initial Public Liability Insurance: \$2,000,000 minimum Commercial General Liability coverage - \$1,000,000 in automobile coverage and Worker's Compensation coverage at statutory minimum levels.

#### RECITALS

A. 222 International, Limited Partnership, entered into a Sublease dated September 7, 1999 with the Pease Development Authority ("PDA"), an agency of the State of New Hampshire established pursuant to RSA ch 12-G for premises located at the Pease International Tradeport in Portsmouth, New Hampshire described as follows: The premises shown on a Plan entitled "Subdivision Plan of Land at 222 International Drive at Pease International Tradeport, Portsmouth, New Hampshire" recorded in the Rockingham County Registry of Deeds as Plan #D-28060, a copy of which Sublease is attached hereto as Exhibit 1 (the "Primary Sublease"). The Primary Sublease is subject and subordinate to all agreements made between PDA and the United States of America or the United States Air Force including, but not limited to, the Master Lease, the Application, the Acceptance and the FFA, all as hereinafter defined.

B. PDA anticipates acquiring fee title to the portion of the former Pease Air Force Base hereinafter designate Premises I and Premises II from the United States of America ("Government or Air Force") by public benefit transfer (i.e. transfer without consideration) pursuant to the general authority contained in 49 U.S.C. Sections 47151-47153 and other applicable provisions of law. (Together, Premises I and Premises II constitute the entirety of the Airport (the "Airport" or "Pease"). The terms of such acquisition are set forth in an Amended Application for Public Benefit Transfer executed by PDA ("Application") and accepted by the Air Force on April 14, 1992 (the "Acceptance"), as the same has been subsequently amended by Amendment No. 1 dated March 24, 1994 and executed June 27, 1997 ("Amendment No. 1"). The Amended Application was approved December 12, 1995 and confirmed March 18, 1997, and the Air Force executed an acceptance of the Amended Application on June 26, 1997

("Acceptance II"). The Acceptance and Acceptance II may be referred to collectively as the "Acceptances". Pending final disposition of the Airport in accordance with the terms of the Amended Application and Acceptances, PDA and Air Force have entered into a Lease as of April 14, 1992 for the Airport District, a Supplement No. 1 thereto dated August 4, 1992, a Supplement No. 2 thereto dated July 15, 1993 and a Supplement No. 3 thereto dated June 27, 1997 (collectively the "Master Lease"). The Subleased Premises presently located within the Airport District and are located in Premises II. The Parties acknowledge that the Application, Acceptance and Master Lease impose certain requirements on Sublessor with respect to subleases which are addressed in the terms and attached to this Sublease as Exhibit 2 and 3, the terms Application, Acceptance and Master Lease shall include any amendments to said documents. The Parties acknowledge that a Federal Facilities Agreement ("FFA") required under Section 120 of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. § 9601 et seq., was entered into by the Air Force, the New Hampshire Department of Environmental Services ("NHDES") and the United States Environmental Protection Agency ("EPA") regarding certain contamination at Pease and that FFA also imposes certain requirements upon Sublessor and Sublessee which are addressed in the terms and conditions of this Sublease. A copy of the FFA is attached to this Sublease as Exhibit 4. Unless the context refers specifically to the document constituting Exhibit 4, the term FFA shall include any amendments to said document.

C. Sublessor is 222 International, Limited Partnership and is duly organized and existing under the laws of the State of Delaware with a principal place of business at Two International Drive, Pease International Tradeport, Portsmouth, New Hampshire, and is qualified to do business in the State of New Hampshire.

D. Sublessee Merrimack Services Corporation and PC Connection Sales Corporation are duly organized and existing under the laws of the State of Delaware with a principal place of business at 730 Milford Road, Merrimack, New Hampshire, and is qualified to do business in the State of New Hampshire.

E. Manager: C.P. Management, Inc., 3 Mound Court, Merrimack, NH 03054



NOW, THEREFORE, in consideration of the covenants herein contained and other valuable consideration, the receipt of which is hereby acknowledged, Sublessor and Sublessee hereby agree as follows:

ARTICLE 1.

PREMISES

1.1. Description of Subleased Premises

Sublessor, for and in consideration of the rents and covenants herein specified to be paid and performed by Sublessee, hereby leases to Sublessee, and Sublessee hereby hires from Sublessor, the premises described generally below and more particularly on the plans attached as Exhibit 5 (the "Subleased Premises" or the "Premises"): consisting of approximately 16,018 square feet as adjusted by the final as built of square footage of the lease premises and located at 222 International Drive, Portsmouth, New Hampshire..

Excluded from the Subleased Premises are property or other rights obtained by a utility supplier from PDA pursuant to a sublease or other agreement in connection with the provision of utility lines and or utility services at the Airport.

Appurtenant Rights and Reservations. (a) Sublessee shall have, as appurtenant to the Premises, the non-exclusive right to use, and permit its invitees to use in common with others, public or common lobbies, hallways, and common walkways necessary for access to the Building, and if the portion of the Premises on any floor includes less than the entire floor, the common toilets, corridors and elevator lobby of such floor; but Sublessee shall have no other appurtenant rights and all such rights shall always be subject to reasonable rules and regulations from time to time established by Sublessor pursuant to Section 14.7 and to the right of Sublessor to designate and change from time to time areas and facilities so to be used.

(b) Excepted and excluded from the Premises are the ceiling, floor, perimeter walls and exterior windows, except the inner surfaces thereof, but the entry doors (and related glass and finish work) to the Premises are a part thereof; and Sublessee agrees that Sublessor shall have the right to place in the Premises (but in such manner as to reduce to a minimum interference with Sublessee's use of the Premises) interior storm windows, subcontrol devices (by way of illustration, an electric sub panel, etc.), utility lines, pipes, equipment and the like, in, over and upon the Premises. Sublessee shall install and maintain, as Sublessor may require, proper access panels in any hung ceilings or walls as may be installed by Sublessee in the Premises to afford access to any facilities above the ceiling or within or behind the walls.

1.2. Easements - Rights-of-Way

This Sublease is subject to existing easements and rights-of-way of record, the Utility Sublease and License Agreement dated July 31, 1992 by and between PDA and Public Service Company of New Hampshire ("PSNH"), the utility Sublease and License Agreement dated May 10, 1995 by PDA and New England Telephone and Telegraph Company ("NETEL"); (iii) the Wastewater Disposal and Water Service Facilities Sublease and License Agreement dated as of January 1, 1993 and amended July 1, 1998 by and between PDA and the City of Portsmouth ("COP") and (iv) the Pipeline Easement and Transfer Agreement dated August 12, 1998 by and

between PDA, Portland Natural Gas Transmission System and Maritime & Northeast Pipeline, L.L.C. and such other agreements as PDA shall reasonably require for the provision of utilities and the operation, maintenance and repair of the Airport.

The Government reserves for the use and benefit of the public, an avigation easement and a right of way for the free and unobstructed passage of aircraft in the airspace above the surface of the Airport, together with the right to cause in such airspace such sound, vibrations, fumes, dust, fuel particles, and all other effects as may be caused by the operation of aircraft, now known or hereafter used, for the navigation through or flight in the said airspace, and for use of said airspace for landing on, taking off from, or operating on the Airport.

### 13. Access

Sublessee shall have in common with other Airport tenants and authorized Airport users the right to use the entrances, exits and roadways designated by PDA for common use at the Airport, subordinate, however, to PDA's rights to manage the common areas and roadways, which rights of PDA shall include, without limitation, the right to impose reasonable rules and regulations, and to add, delete, alter, or otherwise modify the designation and use of all parking areas, entrances, exits, roadways and other areas of the Airport.

The rights of Sublessee under this Section 1.3 shall be subordinate to PDA's rights, to manage the common areas and roadways which rights shall include, without limitation, the right to impose reasonable rules and regulations relating to use of the common areas and roadways and the right to add, delete, alter or otherwise modify the designation and use of all parking areas, entrances, exits, roadways and other areas of the Airport, provided, however, that during the term of this Sublease, Sublessee shall have reasonable access the Premises.

## ARTICLE 2.

### CONDITION OF SUBLEASED PREMISES

2.1. The Sublessor warrants that all permits and approvals necessary to the construction of the building have been obtained and that certificates of occupancy shall be obtained prior to the Sublessee occupancy of the subleased premises.

2.2. Sublessee hereby acknowledges and agrees to accept the Premises on the Commencement Date in its then "as is" condition without representation or warranty of Sublessor of any kind, either express or implied. Sublessor hereby extends to the Sublessee the benefit of any warranties given by any contractor or subcontractor of the Sublessor, as shall pertain to the subleased premises.

2.3. Sublessee acknowledges to the extent it performs any Alterations (as defined in Section 10.1) or other improvements at the Subleased Premises, it will be responsible for assuring that such Alterations or other improvements comply with Article 10 and PDA Land Use Controls, as hereinafter defined, and for obtaining any required building permits or certificates of occupancy with respect to such Alterations or other improvements.

ARTICLE 3.

TERM

3.1. This Sublease shall be for a base term of five (5) year(s) (“Base Term”) which term shall commence upon May 1, 2005, (Term Commencement Date”) and shall expire at midnight on April 30, 2010, unless terminated earlier or extended in accordance with the provisions of this Sublease. Sublessee shall have up to two (2) three (3) year option(s) exercisable by it at its sole discretion, which options, if exercised, shall extend the Base Term for an additional six (6) year period, except as otherwise provided in Section 3.2.

3.2. As a condition precedent to the exercise by Sublessee of any of its options to extend the term of this Sublease, Sublessee shall give a written notice (“Option Notice”) to Sublessor of its exercise of each such option at least six (6) months prior to the end of the Base Term or any applicable Extension Period.

3.3. The options to extend the term hereby granted may not be exercised at any time during which Sublessee has subleased a portion or all of the premises or if Sublessee is in default under any of the terms of this Sublease.

3.4. Unless the context clearly indicates otherwise when used in this Sublease the phrase “term of this Sublease” shall mean the Base Term plus any duly exercised allowable extensions thereof.

ARTICLE 4.

BASIC RENT

4.1. The basic annual rent shall be One Hundred Twenty Eight Thousand, One Hundred Forty Four and 00/100 (\$128,144.00) Dollars annually; Ten Thousand, Six Hundred Seventy Eight and 67/100 (\$10,678.67) Dollars monthly; \$8.00 per rentable square foot.

4.2 Security Deposit

Upon the execution of this lease, the Sublessee shall pay the sum of \$16,200.00 (one month’s rent) as a security deposit for the performance by the Sublessee of its obligations hereunder.

4.3. Basic Rent due under Section 4.1 shall commence upon the Term Commencement Date. The annual Basic Rent shall be payable in each case in equal monthly installments of one twelfth thereof in advance on the first day of each month without offset in lawful money of the United States at the office of Sublessor at the Airport or at such other address as Sublessor may hereafter designate. In addition, Sublessee agrees to pay when due, such other amounts that may be required to be paid as additional rent. Sublessee’s rent obligation for any fractional portion of a calendar month at the beginning or end of the term of this Sublease shall be a similar fraction of the rental due for an entire month.

4.4. As of each Adjustment Date (as hereinafter defined), the Basic Rent shall be adjusted as provided in Section 4.4 to reflect changes in the Consumer Price Index for All Urban Consumers applicable to the Boston area (all items 1982 - 1984 = 100) published by the United States Department of Labor, Bureau of Labor Statistics (the "Index").

On the first day following the expiration of the first year of the term of this Sublease and on the first day of each subsequent year (individually an "Adjustment Date" and collectively the "Adjustment Dates"), Basic Rent shall be subject to adjustment for the remainder of the term of this Sublease as follows:

(1) For the first annual adjustment (commencing on the first day following the expiration of the first year of the term of this Sublease), the basis for computing such adjustment shall be the Index most recently published prior to the beginning of the first year of the term ("Beginning Index"). If the Index most recently published prior to the first Adjustment Date ("Extension Index") has increased over the Beginning Index, the Basic Rent for the one-year period commencing as of such first Adjustment Date shall be the result obtained by multiplying the annual Basic Rent in effect on the day of the Adjustment Date (i.e. the annual rental for year one by a fraction, the numerator of which is the Extension Index and the denominator of which is the Beginning Index.

(2) For all subsequent annual adjustments, the rent shall be adjusted in the same manner as that for the first annual adjustment provided; however, that the rental base shall be the rental in effect just prior to the then applicable Adjustment Date, the Extension Index for the preceding period shall be the Beginning Index and the Extension Index shall be the index most recently published prior to the then applicable Adjustment Date. On each Adjustment Date, the Parties shall execute an acknowledgment reflecting the new rent. Failure to execute such an acknowledgment shall not affect either the validity of this Sublease or the effective date of any adjustment to the rent hereunder.

(3) If for any Adjustment Date the Index most recently published following the Adjustment Date has not increased over, or has decreased from, the Beginning Index for that period, no escalation in rent shall be required on that Adjustment Date, and the rent shall remain at its then current rate until the next Adjustment Date.

If the Index is changed in any manner, including without limitation, a change in the base year, the Index shall be converted in accordance with the conversion factor published by the United States Department of Labor, Bureau of Labor Statistics. If the Index is discontinued or revised during the term of this Sublease, such other government index or computation with which it is replaced shall be used in order to obtain substantially the same result as would be obtained if the Index had not been discontinued or revised. If the Parties shall be unable to agree upon a successor index, the Parties shall refer the choice of a successor index to arbitration in accordance with the rules of the American Arbitration Association.

#### 4.5. OPERATING EXPENSES

4.5 ADDITIONAL RENT. Sublessee agrees to pay to Sublessor as Additional Rent the Operating Expenses, Utility Expenses and Taxes as defined in this Section 4.5.

**4.5.1 Definitions.** For the purpose of this Article, the following terms shall have the following respective meanings:

- (i) **Operating Year:** Each calendar year in which any part of the Term of this Sublease shall fall.
- (ii) **Operating Expenses:** The aggregate costs or expenses reasonably incurred by Sublessor with respect to the operation, administration, insuring, cleaning, repair, maintenance and management of the Property (but specifically excluding Utility Expenses) all as set forth in Exhibit 12 annexed hereto, provided that, if during any portion of the Operating Year for which Operating Expenses are to be computed, less than all of the Premises Rentable Area was occupied by Sublessee or if Sublessor is not supplying all sublessees with the services being supplied hereunder, actual Operating Expenses incurred shall be reasonably extrapolated by Sublessor on an item by item basis to the estimated Operating Expenses that would have been incurred if the Premises were fully occupied for such Year and such services were being supplied to all sublessees, and such extrapolated amount shall, for the purposes hereof, be deemed to be the Operating Expenses for such Year.
- (iii) **Utility Expenses:** The aggregate costs or expenses reasonably incurred by Sublessor with respect to supplying electricity (other than electricity supplied to those portions of the Premises leased to sublessees), oil, steam, gas, water and sewer and other utilities supplied to the Property and not paid or directly by sublessees, provided that, if during any portion of the Operating Year for which Utility Expenses are to be computed, less than all Building Rentable Area was occupied by sublessees or if Sublessor is not supplying all sublessees with the utilities being supplied hereunder, actual utility expenses incurred shall be reasonably extrapolated by Sublessor on an item by item basis to the estimated Utility Expenses that would have been incurred if the Premises were fully occupied for such Year and such utilities were being supplied to all sublessees, and such extrapolated amount shall, for the purposes hereof, be deemed to be the Utility Expenses for such Year.
- (iv) **Taxes:** "Taxes" shall mean all real estate taxes, special assessments and betterment assessments assessed with respect to the Premises for any Tax Year.
- (v) **Land Rent:** The rent charged to and paid by Sublessor to the PDA, or any successor authority, under the Primary Sublease assessed with respect to the Premises for any Operating Year.

**4.5.2 Sublessee's Payments.** Sublessee shall pay as Additional Rent to Sublessor in accordance with the schedule set forth in Section 4.5.3 during the Initial Term hereof and on the same schedule applicable to Base Rent under Section 4.3, an amount equal to the total amount of Sublessor's Operating Expenses, Utility Expenses, Land Rent and Taxes or each Operating Year Multiplied by the Sublessee's Pro Rata Share.

#### 4.5.3 Estimated Expenses.

- (a) Estimated Expense Payments. Sublessor shall present prior to the beginning of each calendar year during the term of this Sublease, a reasonable estimation of Sublessor's Pro Rata Share of Operating Expenses, Utility Expenses, Land Rent and Taxes allocable to the Subleased Premises; Sublessee shall pay in each ensuing calendar month one-twelfth (1/12) of the amount of such Sublessor's estimated expenses allocable to the Subleased Premises. A final reconciliation shall be made by Sublessor at the end of each calendar year by applying the amount of such interim payments to the amounts otherwise due upon presentation of the annual statement rendered to Sublessee on or before March 31<sup>st</sup> of each Operating Year.
- (b) Records. Sublessor agrees to keep in its principal office true and accurate records of such Operating Expenses. Sublessee shall have the right for a period of six months following receipt of any statement rendered under Section 4.5.3 (a) to examine the records on which such statement is based. In the event of any dispute with respect to any amount due under either Section 4.5, either party may refer to the dispute to arbitration pursuant to Article 29 hereof.

#### 4.6. RENT DURING OPTION PERIOD

In the event that the Sublessee shall exercise its option(s) to renew, the annual rent at the commencement of the option period(s) shall be at 100% the Fair Market Rental Rate.

The "Fair Market Rental Rate" shall mean the fair market net rent for the Subleased Premises, as of six months prior to the commencement date of each of the Option Periods, which fair market net rent applicable to tenants of comparable financial standing for space of comparable size in comparable buildings in Portsmouth, New Hampshire under leases similar to this Sublease, which amount shall take into account (a) any amount relating to the payment of amounts similar to those amounts paid by Sublessee as Additional Rent payments under Section 4.5 of this Sublease, (b) any value attributable to any leasehold improvements made in or to the Subleased Premises paid for by Sublessor, (c) any value attributable to rent credits or similar inducements customarily given new tenants in comparable buildings in Portsmouth, New Hampshire, and (d) any amount relating to the payment of brokerage commissions or other expenses incurred by Sublessor in connection with the negotiation and execution of this Sublease The Fair Market Rental Rate, or the basic rent charges during the final year of the then current term shall determine the first years option period rent.

In addition, the basic rent shall be adjusted during the option period in the same manner as adjusted during the initial term of the lease, as provided above. All other additional rent shall also be paid, as provided in Section 4.4 above.

ARTICLE 5

IMPOSITIONS

5.1. During the term of this Sublease, Sublessor shall pay when due, all taxes, charges, excises, license and permit fees, assessments, and other governmental charges, general and special, ordinary and extraordinary, unforeseen, as well as foreseen, of any kind and nature whatsoever, which during the term of this Sublease are assessed or imposed upon or become due and payable or a lien upon the land and buildings of which the Subleased Premises are a part.

5.2 Abatement. If Sublessor shall receive any tax refund or reimbursement of Taxes or sum in lieu thereof with respect to any Tax Year which is not due to vacancies in the Building, then out of any balance remaining thereof after deducting Sublessor's expenses reasonably incurred in obtaining such refund, Sublessor shall, provided there does not then exist a Default of Sublessee, credit an amount equal to such refund or reimbursement or sum in lieu thereof (exclusive of any interest) multiplied by the Pro Rata Share against the obligations of Sublessee next falling due under this Article IV or if no such amounts are due, refund the balance to the Sublessee upon receipt.

ARTICLE 6.

SURRENDER OF SUBLEASED PREMISES

6.1. On the expiration or termination of this Sublease, Sublessee shall surrender to Sublessor the Subleased Premises, including all improvements and fixtures therein whether leased to or otherwise owned by Sublessee, broom clean and in good order, condition and repair, reasonable wear and tear excepted, together with all alterations, decorations, additions and improvements that may have been made in, to or on the Subleased Premises, except that Sublessee shall be allowed to remove its personal property or any improvements made by Sublessee at its sole expense that can be removed without damage to any buildings, facilities or other improvements to the Subleased Premises. The Subleased Premises, including the improvements and fixtures therein, shall be delivered free and clear of all subtenancies, liens and encumbrances, other than those, if any, permitted hereby or otherwise created or consented to by Sublessor, and, if requested to do so, Sublessee shall execute, acknowledge and deliver to Sublessor such instruments of further assurance as in the opinion of Sublessor are necessary or desirable to confirm or perfect Sublessor's right, title and interest in and to the Subleased Premises including said improvements and fixtures. On or before the end of the Sublease term, Sublessee shall remove all of Sublessee's personal and other property allowed to be removed hereunder, and all such property not removed shall be deemed abandoned by Sublessee and may be utilized or disposed of by Sublessor without any liability to Sublessee. Sublessee's obligation under this Article 6 shall survive the expiration or termination of this Sublease.

INSURANCE

7.1.Public Liability Insurance. Sublessee agrees to maintain in full force from the date upon which Sublessee first enters the Premises for any reason, throughout the Term of this Sublease, and thereafter so long as Sublessee is in occupancy of any part of the Premises, a policy of general liability and property damage insurance (including broad form contractual liability, independent contractor's hazard and completed operations coverage) under which Sublessor, Manager (and such other persons as are in privity of estate with Sublessor as may be set out in notice from time to time) and Sublessee are named as additional insureds, and under which the insurer agrees to defend, indemnify and hold Sublessor, Manager, and those in privity of estate with Sublessor, harmless from and against all cost, expense and/or liability arising out of or based upon any and all claims, accidents, injuries and damages set forth in Article 12. Each such policy shall be non-cancelable and non-amendable with respect to Sublessor, Manager and Sublessor's said designees without thirty (30) days' prior notice to Sublessor and shall be as follows:

- (1) Comprehensive general liability insurance to a limit of not less than two million (\$2,000,000) dollars, endorsed for products and completed operations liability insurance, on an "occurrence basis" against claims for "personal injury", including without limitation, bodily injury, death or property damages, occurring upon, in or about the land and buildings of which the Subleased Premises are a part as required pursuant to the Primary Sublease.
- (2) Worker's compensation and employer's liability insurance in an amount and form which meets all applicable requirements of the labor laws of the State of New Hampshire, as amended from time to time, and which specifically covers the persons and risks involved in this Sublease.
- (3) Automobile liability insurance in amounts approved from time to time by Sublessor, but not less than one million (\$1,000,000) dollars combined single limit for owned, hired and non-owned automobiles.

7.2. All policies of insurance required to be carried under this Article shall be effected under valid and enforceable policies, in such forms and amounts as may, from time to time, be required under this Sublease, issued by insurers of recognized responsibility which are authorized to transact such insurance coverage in the State of New Hampshire, and which have been approved in writing by Sublessor, which approval shall not be withheld unreasonably. Except for workman's compensation coverage, all such policies of insurance shall be for the mutual benefit of Sublessor, PDA, the United States of America and Sublessee as named additional insureds. Upon the execution of this Sublease (and thereafter not less than fifteen (15) days prior to the expiration date of each policy furnished pursuant to this Article) the original of each policy required to be furnished pursuant to this Article (or, with the consent of Sublessor, which consent shall not be unreasonably withheld, in the case of comprehensive general liability insurance and products liability insurance, a certificate of the insurer reasonably satisfactory to Sublessor) bearing a notation evidencing the payment of the premium or accompanied by other evidence reasonably satisfactory to Sublessor of such payment, shall be delivered by Sublessee to Sublessor.



7.3. All policies of insurance shall provide for loss thereunder to be adjusted and payable to Sublessor or Sublessee in accordance with the terms of this Sublease.

7.4. Each such policy or certificate therefor issued by the insurer shall to the extent obtainable contain (i) a provision that no act or omission of Sublessee, or any employee, officer or agent of Sublessee, which would otherwise result in forfeiture or reduction of the insurance therein provided shall affect or limit the obligation of the insurance company to pay the amount of any loss sustained, and (ii) an agreement by the insurer that such policy shall not be canceled without at least thirty (30) days prior written notice by registered mail to Sublessor and PDA and (iii) provide that the insurer shall have no right of subrogation against the United States of America or PDA.

7.5. All policies of insurance required to be maintained by Sublessee shall have attached thereto the Lender's Loss Payable Endorsement, or its equivalent, or a loss payable clause acceptable to Sublessor, for the benefit of any Mortgagee, but the right of any Mortgagee to the payment of insurance proceeds shall at all times be subject to the provisions of this Sublease with respect to the application of the proceeds of such insurance.

7.6. Sublessee shall observe and comply with the requirements of all policies of insurance at any time in force with respect to the Subleased Premises and Sublessee shall also perform and satisfy the requirements of the companies writing such policies so that at all times companies of good standing reasonably satisfactory to Sublessor shall be willing to write or to continue such insurance. Sublessee shall, in the event of any violations or attempted violations of the provisions of this Section 7.6 by a subtenant, take steps, immediately upon knowledge of such violation or attempted violation, to remedy or prevent the same as the case may be.

7.7. Any insurance provided for in this Sublease may be effected by a policy or policies of blanket insurance or may be continued in such form until otherwise required by Sublessor; provided, however, that the amount of the total insurance allocated to the Subleased Premises shall be such as to furnish in protection the equivalent of separate policies in the amounts herein required, and provided further that in all other respects, any such policy or policies shall comply with the other provisions of this Sublease. In any such case it shall not be necessary to deliver the original of any such blanket policy to Sublessor, but Sublessee shall deliver to Sublessor and to any Mortgagee a certificate or duplicate of such policy in form and content acceptable to Sublessor.

7.8. Sublessee's Risk. To the maximum extent this agreement may be made effective according to law, Sublessee agrees to use and occupy the Premises and to use such other portions of the Property as Sublessee is herein given the right to use at Sublessee's own risk; and Sublessor shall have no responsibility or liability for any loss of or damage to Sublessee's Removable Property or for any inconvenience, annoyance, interruption or injury to business arising from Sublessor's making any repairs or changes which Sublessor is permitted by this Sublease or required by law to make in or to any portion of the Premises or other sections of the Property, or in or to the fixtures, equipment or appurtenances thereof, except where the Sublessor is negligent in making such repairs. Sublessee shall carry "all-risk" property insurance on a "replacement cost" basis (including so-called improvements and betterments), or be self insured (with respect to the Sublessee's removal property), and provide a mutual waiver of subrogation for both parties. The provisions of this Section shall be applicable from and after the execution of this Sublease and until the end of the Term of this Sublease, and during such further period as Sublessee may use or be in occupancy of any part of the Premises or of the Building.

7.9. Injury Caused By Third Parties. To the maximum extent this agreement may be made effective according to law, Sublessee agrees that Sublessor shall not be responsible or liable to Sublessee, or to those claiming by, through or under Sublessee, for any loss or damage that may be occasioned by or through the acts or omissions of persons occupying adjoining premises or any part of the premises adjacent to or connecting with the Premises or any part of the Property or otherwise, except for Sublessor's gross negligence or as a result of Sublessor's breach of its obligations under the Sublease. The provisions of this Section shall survive the expiration or any earlier termination of this Sublease.

ARTICLE 8.

USE OF SUBLEASED PREMISES

8.1. The sole purpose for which Sublessee may use the Subleased Premises is for general office and telephone call center for PC Connection Sales Corporation, and related uses and for no other uses without Sublessor's and PDA's prior written consent. Sublessee shall not use, or permit to be used, the Subleased Premises for any other purpose without the prior express written consent of Sublessor and PDA. Sublessor's and PDA's consent shall be subject to the execution of an appropriate agreement which shall include a provision requiring the payment of established fees and charges that may be applicable to any such additional uses consented to by Sublessor and PDA. Sublessee is prohibited from any use of the Subleased Premises not specifically granted in this Section 8.1.

8.2. Sublessee recognizes that the uses authorized in Section 8.1 are not granted on an exclusive basis and that Sublessor and PDA may enter into subleases or other agreements with other tenants or users at areas of the building in which the Subleased Premises are a part or other areas of the Airport for similar, identical, or competing uses. No provision of this Sublease shall be construed as granting or authorizing the granting of an exclusive right within the meaning of Section 308 of the Federal Aviation Act as the same may be amended from time to time.

8.3. Sublessee agrees that it will keep the Premises in a neat, clean and orderly condition in accordance the provisions of Chapters 300 through 500 of the Pease Development Authority Zoning Requirements, Site Plan Review Regulations and Subdivision Regulations (collectively the "Land Use Controls") and such other rules and regulations from time to time promulgated, provided that Sublessee shall not be bound by any such rules and regulations until such time as it receives a copy thereof. Sublessor agrees to cause trash receptacles to be emptied and trash removed at Sublessor's sole cost and expense.

8.4. Sublessee warrants that it holds all certificates, permits, licenses or other entitlements required by federal, state or local laws in order to allow Sublessee to conduct the permitted uses hereunder, and that the same are and will be kept current, valid and complete. Sublessee further warrants that it shall at all times abide by and conform with all terms of the same and that it shall give immediate notice to Sublessor of any additions, renewals, amendments, suspensions or

revocations. In the use and occupation of the Subleased Premises and the conduct of such business thereon, Sublessee, at its sole cost and expense, shall promptly comply with all present and future laws, ordinances, orders, rules, regulations and requirements of all federal, state and municipal governments, courts, departments, commissions and boards, any national, state or local Board of Fire Underwriters, or any other body exercising functions similar to those of any of the foregoing.

8.5. Sublessee shall have the right to contest by appropriate proceedings diligently conducted in good faith, without cost or expense to Sublessor, the validity or application of any law, ordinance, order, rule, regulation or requirement of the nature referred to in this Article. If compliance with any such law, ordinance, order, rule, regulation or requirement may be delayed on the basis of an order from a court of competent jurisdiction pending the prosecution of any such proceeding without the incurrence of any lien, charge or liability of any kind against the Subleased Premises or Sublessee's interest therein and without subjecting Sublessor to any liability, civil or criminal, for failure so to comply therewith, Sublessee may delay compliance therewith consistent with such court order. Even if such lien, charge or civil liability would be incurred by reason of any such delay, Sublessee may, with the prior written consent of Sublessor, contest as aforesaid and delay as aforesaid, provided that such contest or delay does not subject Sublessor to criminal liability, damages or expense and provided that Sublessee: (i) furnishes to Sublessor security, reasonably satisfactory to Sublessor, against any loss or injury by reason of such contest or delay; and (ii) prosecutes the contest with due diligence.

Sublessor and PDA shall not be required to join in any proceedings referred to in this Section unless the provisions of any applicable laws, rules or regulations at the time in effect shall require that such proceedings be brought by and/or in the name of Sublessor and/or PDA and Sublessor and/or PDA determines that such action is in its best interests, in which event Sublessor and/or PDA shall join in the proceedings, or permit the same to be brought in its name, if Sublessee shall pay all expenses in connection therewith.

8.6. Responsibility for compliance with all Federal, State and local laws as required by this Article rests exclusively with the Sublessee. Sublessor assumes no enforcement or supervisory responsibility except with respect to matters committed to its jurisdiction and authority.

8.7. Sublessee's use of the Subleased Premises shall be orderly and efficient and shall not cause any disruptions to other Airport activities or other tenants in the building in which the Subleased Premises are a part. Sublessee shall not cause or maintain any nuisance on the Subleased Premises. Sublessee shall conduct all of its activities hereunder in an environmentally responsible manner.

8.8. Sublessee shall have the right to obtain supplies or services from suppliers, vendors or contractors of its own choice at the Subleased Premises, provided that PDA in the Primary Sublease reserved the right to prohibit persons from engaging in "aeronautical activities" (as defined in Advisory Circular AC 150/5190-2A of the Federal Aviation Administration) or the provision of ground transportation services at the Airport except in accordance with concession contracts or operating agreements entered into between PDA and said persons.

8.9. Sublessee acknowledges that PDA is subject to certain restrictions on the use of the Airport Property in accordance with Conditions 6, 10, 17, 23 and 25A of the Master Lease.

Notwithstanding any other provision of this Sublease or the Primary Sublease, the Sublessee shall also comply with and be subject to the restrictions in Conditions 6,10, 17, 23 and 25A of the Master Lease to the extent applicable to the Subleased Premises or any rights granted to Sublessee under Sublease in the same manner and to the same extent as PDA is obligated in its capacity as Lessee under the Master Lease.

8.10. Sublessee agrees to conform to the following provisions during the Term of this Sublease: (i) Sublessee shall cause all freight to be delivered to or removed from the Building and the Premises in accordance with reasonable rules and regulations established by Sublessor therefor; (ii) Sublessee will not place on the exterior of the Premises (including both interior and exterior surfaces of doors and interior surfaces of windows) or on any part of the Building outside the Premises, any signs, symbol, advertisements or the like visible to public view outside of the Premises. Sublessor will not unreasonably withhold consent for signs or lettering on the entry doors to the Premises provided such signs conform to building standards adopted by Sublessor and Sublessee has submitted a sketch of the sign to be placed on such entry doors. (iii) Sublessee shall not perform any act or carry on any practice which may injure the Premises, or any other part of the Building, or cause offensive odors or loud noise or constitute a nuisance or menace to any other Sublessee or sublessees or other persons in the Building; (iv) Sublessee shall, at its sole cost and expense: (x) in its use of the Premises, the Building or the Land, comply with the requirements of all applicable governmental laws, rules and regulations including, without limitation, the Americans with Disabilities Act of 1990, as amended (the "ADA") and (y) In the event of any Sublessee's work or improvements, pay for and perform any work necessary to bring the Premises, the Building or the Land into compliance with the ADA which work is required due to the Sublessee's use of the Premises, the Building or the Land for retail purposes; and (v) Sublessee shall continuously throughout the Term of this Sublease occupy the Premises for the Permitted Uses and for no other purposes. The Sublessor hereby certifies that the initial construction of the building and Sublessor's fit up of the leased premises conform to all ADA requirements.

## ARTICLE 9

### LIENS

9.1. During the term of this Sublease, Sublessee shall not permit to remain, and shall promptly discharge, at its cost and expense, all liens, encumbrances and charges upon the Subleased Premises or any part thereof; provided, that the existence of any mechanics', laborers', materialmen's, suppliers' or vendors' liens or rights thereto shall not constitute a violation of this Article if payment is not yet due under the applicable contract. Sublessee shall, however, have the right to contest with due diligence the validity or amount of any lien or claimed lien, if Sublessee shall give to Sublessor such security as Sublessor may reasonably require to insure payment thereof and prevent any sale, foreclosure or forfeiture of Sublessee's interest in the Subleased Premises or any portion thereof by reason of such nonpayment. On final determination of the lien or claim for lien, Sublessee shall immediately pay any judgment rendered with all proper costs and charges and shall have the lien released or judgment satisfied at Sublessee's own expense, and if Sublessee shall fail to do so, Sublessor may at its option pay any such final judgment and clear the Subleased Premises therefrom. If Sublessee shall fail to contest with due diligence the validity or amount of any such lien or claimed lien, or to give Sublessor security as hereinabove provided, Sublessor may, but shall not be required to, contest the validity or amount of any such lien or claimed lien or settle or compromise the same without inquiring into the validity of the claim or the reasonableness of the amount thereof.

9.2. Should any lien be filed against the Subleased Premises or the building in which the Subleased Premises are a part, or should any action of any character affecting the title thereto be commenced, Sublessee shall give to Sublessor written notice thereof as soon as notice of such lien or action comes to the knowledge of Sublessee.

#### ARTICLE 10

##### ALTERATIONS – SIGNS

10.1. Sublessee shall not place or construct any improvements, changes, structures, alterations or additions (cumulatively referred to in this Article as “Alterations”) in, to, or upon the Subleased Premises without Sublessor’s and PDA’s written consent. Unless Sublessee is subject to an earlier notice requirement under the PDA’s land use controls or other applicable requirements with respect to the information required under this section, any request for Sublessor’s and PDA’s consent shall be made upon sixty (60) days written notice and shall be accompanied by preliminary engineering or architectural plans or, if consented to by Sublessor and PDA, working drawings. If Sublessor and PDA each grants its consent, all such work shall be done at Sublessee’s sole cost and expense, subject, in all cases, to the following covenants:

- (1) All work and Alterations shall be done in compliance with all applicable governmental regulations, codes, standards or other requirements, including fire, safety and building codes and Land Use Regulations promulgated by PDA and with the provisions of Article 22 of this Sublease. This obligation shall include compliance with all applicable provisions of the FFA (as defined in Article 22), including obligations imposed upon Sublessor in respect to construction and construction related work.
- (2) All Alterations shall be of such a character as not to materially reduce the value and usefulness of any of the buildings or other improvements below their value and usefulness immediately before such Alteration. All work performed hereunder shall be performed in a good and workmanlike manner, shall conform to drawings and specifications approved by Sublessor and PDA and shall not be disruptive of the overall operation of the Airport. All contractors engaged by Sublessee to perform such work shall employ labor that can work in harmony with all elements of labor at the Airport.
- (3) During the period of construction of any alteration, Sublessee or any contractor, subcontractor or sublessee of Sublessee shall maintain or cause to be maintained the following insurance:
  - (i) The comprehensive general liability and automobile insurance provided for in Article 7 and shall be maintained for the limits specified thereunder and shall provide coverage for the mutual benefit of Sublessor, PDA, the

United States of America and Sublessee as named or additional insured (as is appropriate) in connection with any Alteration permitted pursuant to this Article 10.

- (ii) Fire and any other applicable insurance provided for in Article 7 which if not then covered under the provisions of existing policies shall be covered by special endorsement thereto in respect to any Alteration, including all materials and equipment therefor incorporated in, on, or about the Subleased Premises ( including excavations, foundations, and footings) under broad form all risk builder's risk completed value form or equivalent thereof; and
- (iii) Worker's compensation insurance covering all persons employed in connections with the work and with respect to whom death or bodily injury claims could be asserted against PDA, Sublessor, Sublessee or the Subleased Premises, with statutory limits as then required under the laws of the State of New Hampshire.

(4) Sublessee shall provide Sublessor and PDA with MYLAR as-built drawings when any Alteration authorized hereunder is completed.

10.2. Sublessee may erect and maintain suitable signs only with the Subleased Premises and upon receiving the prior written approval of Sublessor and PDA. Sublessee shall submit drawings of proposed signs and information on the number, size, type, and location, all of which Sublessor and PDA may review for harmony and conformity with the overall structure and architectural and aesthetic setting of the building in which the Subleased Premises are a part and the Airport as well as with PDA's own land use control regulations and may approve or disapprove accordingly.

10.3. Notwithstanding any other provision of this Sublease, the right of Sublessee to place or construct Alterations in, to, or upon the Subleased Premises shall be subject to Condition 17 of the Master Lease.

10.4. In addition to the requirements to provide notice to Sublessor and PDA under this Article 10 in respect to any Alteration, Sublessee shall also provide notice to Air Force, EPA and NHDES in the same manner and to the extent required of PDA under Condition 10.16 of the Master Lease. In undertaking any Alteration Sublessee shall comply with Condition 10.17 of the Master Lease to the same extent required of Sublessor and PDA.

## ARTICLE 11

### RIGHT OF SUBLESSOR TO INSPECT AND REPAIR

11.1. Sublessee will permit Sublessor and/or PDA and their authorized agents and representatives to enter the Subleased Premises at all reasonable times and upon reasonable

notice for the purpose of: (i) inspecting the same; and (ii) making any necessary repairs and performing any other work that may be necessary by reason of Sublessee's failure to comply with the terms of this Sublease within ten (10) days after written notice from Sublessor, unless an emergency situation (as determined in Sublessor's and/or PDA's sole discretion) requires earlier action by Sublessor. Nothing herein shall imply any duty upon the part of Sublessor and/or PDA to do any such work and performance thereof by Sublessor and/or PDA shall not constitute a waiver of Sublessee's default in failing to perform the same. Sublessor and/or PDA may during the progress of such work keep and store in or on the Subleased Premises all necessary materials, tools, supplies and equipment. Sublessor and/or PDA shall not be liable for inconvenience, annoyance, disturbance, loss of business or other damage of Sublessee by reason of making such repairs or the performance of any such work, on or account of bringing materials, tools, supplies or equipment into or through the Subleased Premises during the course thereof and the obligations of Sublessee under this Sublease shall not be affected thereby. Nothing herein shall limit the provisions of Article 8.

11.2. Sublessee acknowledges that from time to time PDA may undertake construction, repair or other activities related to the operation, maintenance and repair of the Airport which will require temporary accommodation by Sublessee. Sublessee agrees to accommodate PDA in such matters, even though Sublessee's own activities may be inconvenienced or partially impaired, and Sublessee agrees that no liability shall attach to PDA, its members, employees or agents by reason of such inconvenience or impairment, unless such activities of PDA hereunder are performed in a negligent manner.

11.3. Sublessee shall allow PDA and any agency of the United States, its officers, agents, employees and contractors to enter upon the Subleased Premises for any purposes not inconsistent with Sublessee's quiet use and enjoyment, including but not limited to the purpose of inspection. Notwithstanding the preceding sentence, in the event the Air Force as Lessor under the Master Lease (or any other agency having a right of entry under the Federal Facilities Agreement (FFA) as defined in Section 22.8) or PDA as Sublessor under the Primary Lease determines that immediate entry is required for safety, environmental, operations or security purposes they may effect such entry without prior notice. The Sublessee shall have no claim against PDA or against the United States or any officer, agent, employee or contractor thereof on account of any such entries.

ARTICLE 12

GENERAL INDEMNIFICATION BY SUBLESSEE

12.1. In addition to any other obligation of Sublessee under this Sublease to indemnify, defend and hold harmless Sublessor, its principals, agents and employees, etc., Sublessee agrees to indemnify, defend and hold harmless Sublessor against and from any and all claims, judgments, damages, penalties, fines, assessments, costs and expenses, liabilities and losses (including, without limitation, diminution in value of the Premises, damages for the loss or restriction on the use of the Premises, sums paid in settlement of claims, attorneys' fees, consultants' fees and experts' fees) resulting or arising during the term of this Sublease:

(1) from any condition of the Premises resulting from the use of the Premises by the Sublessee;

(2) from any breach or default on the part of Sublessee in the performance of any covenant or agreement on the part of Sublessee to be performed pursuant to the terms of this Sublease, or from any act or omission of Sublessee, or any of its agents, contractors, servants, employees, sublessees, licensees or invitees; or

(3) from any accident, injury, loss or damage whatsoever caused by any act or omissions of Sublessee, or any of its agents, contractors, servants, employees (but not ex-employees), sublessees, licensees or invitees, to any person or property occurring during the term of this Sublease, on or about the Subleased Premises (including ramp and parking areas), or upon the land, streets, curbs or parking areas adjacent thereto.

In the event that any action or proceeding is brought against Sublessor by reason of any matter for which Sublessee has hereby agreed to indemnify, defend, or hold harmless Sublessor, Sublessee, upon notice from Sublessor, covenants to resist or defend such action or proceeding with counsel acceptable to Sublessor.

12.2. The term "Person" as used in this Article shall include individuals, corporations, partnerships, governmental units and any other legal entity entitled to bring a claim, action or other demand or proceeding on its own behalf or on behalf of any other entity.

12.3. The Sublessee also expressly waives any claims against the United States of America, including the Air Force, and further agrees to indemnify, save, hold harmless and defend the Air Force to the same extent required of PDA under the Master Lease.

12.4. The Sublessee also expressly waives any claims against PDA and the State of New Hampshire and further agrees to indemnify, save, hold harmless and defend PDA and the State of New Hampshire to the same extent required of the Sublessor under the Primary Sublease.



UTILITIES

13.1. Sublessor shall bring or shall cause utility lines to be brought to the Subleased Premises at the points existing as of the Term Commencement Date or such other points as may be designated by Sublessor (in consultation with Sublessee). The utility lines shall have the capacities existing as of the Term Commencement Date which Sublessee acknowledges are sufficient to enable Sublessee to obtain for the Subleased Premises, as of the date of commencement of Sublessee's activities, sufficient water, electricity, telephone and sewer service. Sublessee shall not at any time overburden or exceed the capacity of the mains, feeders, ducts, conduits, or other facilities by which such utilities are supplied to, distributed in or serve the Subleased Premises. If Sublessee desires to install any equipment which shall require additional utility facilities or utility facilities of a greater capacity than the facilities provided by Sublessor, such installation shall be subject to Sublessor's and PDA's prior written approval of Sublessee's plans and specifications therefor, which approval shall not be unreasonably withheld. If such installation is approved by Sublessor and PDA and if Sublessor and PDA agrees to provide any additional facilities to accommodate Sublessee's installation, Sublessee agrees to pay Sublessor and/or PDA, in advance and on demand, the cost for providing such additional utility facilities or utility facilities of greater capacity.

PDA under the Primary Sublease also reserved the right to run such utility lines as it deems necessary in connection with the development of the Airport to, from, or through the Subleased Premises, provided, however, that PDA in exercising such reserved right shall provide reasonable prior notice and the opportunity to confer with PDA and shall exercise reasonable efforts to avoid or minimize interference with use of the Subleased Premises.

PDA under the Primary Sublease, at its sole discretion, shall have the right from time to time, to alter the method and source of supply of the above enumerated utilities to the Subleased Premises and Sublessee agrees to execute and deliver to PDA such documentation as may be required to effect such alteration. Sublessee agrees to pay all charges for the above enumerated utilities supplied by Sublessor, public utility or public authority, or any other person, firm or corporation which are separately metered to the Subleased Premises.

PDA under the Primary Sublease, shall have the option to supply any of the above-enumerated utilities to the Subleased Premises. If PDA shall elect to supply any of such utilities to the Subleased Premises, Sublessee will purchase its requirements for such services tendered by PDA, and Sublessee will pay PDA, within ten (10) days after mailing by PDA to Sublessee of statements therefor, at the applicable rates determined by PDA from time to time which PDA agrees shall not be in excess of the public utility rates for the same service, if applicable, to other aviation tenants at the Airport. If PDA so elects to supply any of such utilities, Sublessee shall execute and deliver to PDA, within ten (10) days after request therefor, any documentation reasonably required by PDA to effect such change in the method of furnishing of such utilities.

13.2. Sublessor shall be responsible for providing any meters or other devices for the measurement of utilities supplied to the Subleased Premises. Sublessee shall be solely responsible for and promptly pay, as and when the same become due and payable, all charges for water, sewer, electricity, gas, telephone and any other utility used or consumed in the Subleased Premises and supplied by PDA, any public utility or authority or any other person, firm or corporation which are separately metered to the Subleased Premises.

13.3. All work and construction under this Article shall comply with the provisions of Article 10 of this Sublease applicable to construction work.

#### ARTICLE 14

##### INSTALLATION AND ALTERATIONS BY SUBLESSEE, REPAIRS AND SERVICES TO BE FURNISHED BY SUBLESSOR.

14.1. Installation and Alterations by Sublessee, etc. Sublessee shall make no alterations, additions (including, for the purposes hereof, wall-to-wall carpeting), or improvements in or to the Premises without Sublessor's prior written consent. Any such alterations, additions or improvements shall (i) be in accordance with complete plans and specifications prepared by Sublessee and approved in advance by Sublessor; (ii) be performed in a good and workmanlike manner and in compliance with all applicable laws; (iii) be performed and completed in the manner required herein; (iv) be made at Sublessee's sole expense and at such times as Sublessor may from time to time designate; and (v) become a part of the Premises and the property of Sublessor. It is agreed and understood that Sublessor shall have the right to review and approve all changes to any plans which Sublessor shall have approved pursuant to this Section. It is also agreed and understood that Sublessor shall not be deemed to be unreasonable in denying its consent to alterations, additions and improvements to the Premises which affect "Base Building Systems" (as said term is hereafter defined). As used herein, the term "Base Building Systems" shall mean (i) any mechanical, electrical or plumbing system or component of the Building (including the Premises) (ii) the exterior of the Building (iii) the Building HVAC distribution system (iii) any fire safety prevention/suppression system and (iv) any structural element or component of the Building.

14.2. All articles of personal property and all business fixtures, machinery and equipment and furniture owned or installed by Sublessee solely at its expense in the Premises (" Sublessee 's Removable Property") shall remain the property of Sublessee and may be removed by Sublessee at any time prior to the expiration of this Sublease, provided that Sublessee, at its expense, shall repair any damage to the Building caused by such removal.

14.3. All of the Sublessee's alterations, additions and installation of furnishings shall be coordinated with any work being performed by Sublessor and in such manner as to maintain harmonious labor relations and not damage the Property or interfere with Building construction or operation and, except for installation of furnishings, shall be performed by Sublessor's general contractor or, at Sublessor's election, by contractors or workmen first approved by Sublessor. Installation and moving of furnishings, equipment and the like shall be performed only with labor compatible with that being employed by Sublessor for work in or to the Building and not to employ or permit the use of any labor or otherwise take any action which might result in a labor

dispute involving personnel providing services in the Building. Except for work by Sublessor's general contractor, Sublessee before its work is started shall secure all licenses and permits necessary therefor.

14.4. In connection with the performance of any alterations, improvements, changes or additions to the Premises as contemplated by Article IV or Section 5.2 of this Sublease, in the event that any such improvement, alteration, change or addition to the Premises to be performed by Sublessee (the "Sublessee's Work") affects so-called "Base Building Systems" and to the extent that such Work is not performed by Sublessor or a general contractor employed directly by Sublessor, Sublessee hereby agrees to use the services of a construction management firm designated by Sublessor to oversee, coordinate and review all aspects of any such Work. Base Building Systems, as used herein shall mean all systems and services serving the Premises including HVAC units, controls and ducts (but excluding HVAC systems installed by Sublessee), sprinklers and all Building fire protection systems, electrical systems installed by Sublessor, plumbing and plumbing fixtures installed by Sublessor, and all structural elements including exterior windows and doors. The cost and expense of the services of such construction manager shall be borne by Sublessee but only to the extent that such costs and expenses are comparable to and competitive with the costs and expenses charged by other firms engaged in construction management and oversight services in the general geographic location of the Building for services of a similar scope and type.

14.5. Sublessor Repairs. (a) Except as otherwise provided in this Sublease, Sublessor agrees to keep in good order, condition and repair the roof, public areas, exterior walls (including exterior glass) and structure of the Building (including plumbing, mechanical and electrical systems installed by Sublessor but excluding any systems installed specifically for Sublessee's benefit or used exclusively by Sublessee) and the HVAC system serving the Premises, all insofar as they affect the Premises, except that Sublessor shall in no event be responsible to Sublessee for the condition of glass in the Premises or for the doors (or related glass and finish work) leading to the Premises, or for any condition in the Premises or the Building caused by any act or neglect of Sublessee, its agents, employees, invitees or contractors. Sublessor shall not be responsible to make any improvements or repairs to the Building other than as expressly in this Section, unless expressly provided otherwise in this Sublease. All costs and expenses incurred by Sublessor in performing its obligations under this Section shall be included in Operating Expenses.

14.6. Any services which Sublessor is required to furnish pursuant to the provisions of this Sublease may, at Sublessor's option be furnished from time to time, in whole or in part, by employees of Sublessor or by the Manager of the Property or by one or more third persons and Sublessor further reserves the right to require Sublessee to enter into agreements with such persons in form and content approved by Sublessor for the furnishing of such services. Sublessor shall cause the paved portions of the Property to be kept reasonably free and clear of snow, ice and refuse and shall cause the landscaped areas of the Property to be maintained in a reasonably attractive appearance.

14.7. Sublessee's Agreement (a) Sublessee will keep neat and clean and maintain in good order, condition and repair the Premises and every part thereof, excepting only those repairs for which Sublessor is responsible under the terms of this Sublease, and reasonable wear and tear of the Premises, and damage by fire or other casualty and as a consequence of the exercise of the power of eminent domain; and shall surrender the Premises, at the end of the Term, in such condition.

Sublessee shall continually during the Term of this Sublease maintain the Premises in accordance with all laws, codes and ordinances from time to time in effect and all directions, rules and regulations of the proper officers of governmental agencies having jurisdiction, and shall, at Sublessee's own expense, obtain all permits, licenses and the like required by applicable law. Sublessee shall be responsible for the cost of repairs which may be necessary by reason of damage to the Building caused by any act or neglect of Sublessee or its agents, employees, contractors or invitees (including any damage by fire or any other casualty arising therefrom).

(b) If repairs are required to be made by Sublessee pursuant to the terms hereof, Sublessor may demand that Sublessee make the same forthwith, and if Sublessee refuses or neglects to commence such repairs and complete the same with reasonable dispatch after such demand, Sublessor may (but shall not be required to do so) make or cause such repairs to be made (the provisions of Section 14.18 being applicable to the costs thereof) and shall not be responsible to Sublessee for any loss or damage that may accrue to Sublessee's stock or business by reason thereof. Notwithstanding the foregoing, Sublessor may elect to take action hereunder immediately and without notice to Sublessee if Sublessor reasonably believes an emergency to exist.

14.8. Floor Load - Heavy Machinery. (a) Sublessee shall not place a load upon any floor in the Premises exceeding the floor load per square foot of area which such floor was designed to carry and which is allowed by law. Sublessor reserves the right to prescribe the weight and position of all business machines and mechanical equipment, including safes, which shall be placed so as to distribute the weight. Business machines and mechanical equipment shall be placed and maintained by Sublessee at Sublessee's expense in settings sufficient, in Sublessor's judgment, to absorb and prevent vibration, noise and annoyance. Sublessee shall not move any safe, heavy machinery, heavy equipment, freight, bulky matter or fixtures into or out of the Building without Sublessor's prior consent, which consent may include a requirement to provide insurance, naming Sublessor as an insured, in such amounts as Sublessor may deem reasonable.

(b) If such safe, machinery, equipment, freight, bulky matter or fixtures requires special handling, Sublessee agrees to employ only persons holding a Master Rigger's License to do such work, and that all work in connection therewith shall comply with applicable laws and regulations. Any such moving shall be at the sole risk and hazard of Sublessee, and Sublessee will exonerate, indemnify and save Sublessor harmless against and from any liability, loss, injury, claim or suit resulting directly or indirectly from such moving.

14.9 Electricity. (a) Sublessor shall permit Sublessor's existing wires, pipes, risers, conduits and other electrical equipment of Sublessor to be used for the purpose of providing electrical service to the Premises. All electrical service to the premises will be separately metered and paid directly by the Sublessee. Sublessee covenants and agrees that its electrical usage and consumption will not disproportionately "siphon off" electrical service necessary for other sublessees of the Building and that its total connected load will not exceed the maximum load from time to time permitted by applicable governmental regulations nor the design criteria of the existing Building electrical capacity. Sublessor shall not in any way be liable or responsible to Sublessee for any loss or damage or expense which Sublessee may sustain or incur if, during the Term of this Sublease, either the quantity or character of electric current is changed or electric current is no longer available or suitable for Sublessee's requirements due to a factor or cause beyond Sublessor's control. Sublessee shall purchase and install all lamps, tubes, bulbs, starters and ballasts. Sublessee shall pay all charges for electricity, HVAC, gas and other utilities used or consumed in the Premises. Sublessee shall bear the cost of repair and maintenance of any electric or gas meter used or to be installed in (or serving) the Premises.

(b) In order to insure that the foregoing requirements are not exceeded and to avert possible adverse affect on the Building's electrical system, Sublessee shall not, without Sublessor's prior consent, connect any fixtures, appliances or equipment to the Building's electrical distribution system which operates on a voltage in excess of 120 volts nominal. If Sublessor shall consent to the connection of any such fixtures, appliances or equipment, all additional risers or other electrical facilities or equipment required therefor shall be provided by Sublessor and the cost thereof shall be paid by Sublessee upon Sublessor's demand as Additional Rent. From time to time during the Term of this Sublease, Sublessor shall have the right to have an electrical consultant selected by Sublessor make a survey of Sublessee's electric usage, the result of which shall be conclusive and binding upon Sublessor and Sublessee. In the event that such survey shows that Sublessee has exceeded the requirements set forth in paragraph (a), in addition to any other rights Sublessor may have hereunder, Sublessee shall, upon demand, reimburse Sublessor for the costs of such survey.

14.10. All work, repairs, alterations or modifications undertaken pursuant to this Article 14 shall be subject to the provisions of Article 10 of this Sublease

#### ARTICLE 15

##### ACCESS TO PREMISES

Sublessor and its agents shall have the right to enter upon the Subleased Premises, or any part thereof, without charge, at all reasonable times, and upon forty-eight hour prior notice, and in case of emergency at any time, to inspect the same, to show the Subleased Premises to perspective purchasers or tenants, to make or facilitate any repairs, alterations, additions, or improvements to the Subleased Premises. Nothing in this Article contained shall obligate Sublessor to make any repairs, alterations, additions or improvements. Sublessee shall not be entitled to any abatement or reduction of rent or damages by reason of any of the foregoing. No forcible entry shall be made by Sublessor unless such entry shall be reasonably necessary to prevent serious injury, loss, or damage to persons or property. Sublessor shall repair any damage to property of Sublessee, or anyone claiming under Sublessee, caused by or resulting from Sublessor's making any such repairs, alterations, additions, or improvements, except only such damage as shall result from the making of such repairs, alterations, additions, or improvements, which Sublessor shall make as a result of the default, fault, or negligence of Sublessee, or anyone claiming under Sublessee. For the period commencing six (6) months prior to the expiration of the term of this Sublease, and provided that Sublessee has not exercised its Option to Renew, Sublessor may maintain "For Rent" signs on the front or any part of the exterior of the Subleased Premises.

ARTICLE 16

DAMAGE OR DESTRUCTION

16.1. Sublessor's Right of Termination. If the Premises or the Building are substantially damaged by fire or casualty (the term "substantially damaged" meaning damage of such a character that the same cannot, in ordinary course, reasonably be expected to be repaired within sixty (60) days from the time the repair work would commence), or if any part of the Building is taken by any exercise of the right of eminent domain, then Sublessor shall have the right to terminate this Sublease (even if Sublessor's entire interest in the Premises may have been divested) by giving notice of Sublessor's election so to do within 90 days after the occurrence of such casualty or the effective date of such taking, whereupon this Sublease shall terminate thirty (30) days after the date of such notice with the same force and effect as if such date were the date originally established as the expiration date hereof.

16.2. Restoration. If this Sublease shall not be terminated pursuant to Section 16.1, Sublessor shall thereafter use due diligence to restore the Premises (excluding any alterations, additions or improvements made by Sublessee) to proper condition for Sublessee's use and occupation, provided that Sublessor's obligation shall be limited to the amount of insurance proceeds available therefor. If, for any reason, such restoration shall not be substantially completed within six months after the expiration of the 90 day period referred to in Section 16.1 (which six-month period may be extended for such periods of time as Sublessor is prevented from proceeding with or completing such restoration for any cause beyond Sublessor's reasonable control, but in no event for more than an additional three months), Sublessee shall have the right to terminate this Sublease by giving notice to Sublessor thereof within thirty (30) days after the expiration of such period (as so extended). Upon the giving of such notice, this Sublease shall cease and come to an end without further liability or obligation on the part of either party unless, within such 30-day period, Sublessor substantially completes such restoration. Such right of termination shall be Sublessee's sole and exclusive remedy at law or in equity for Sublessor's failure so to complete such restoration. During the period of such restoration, if the Sublessee shall not have reasonable use and occupancy of the premises, the rent shall be abated during that period or portion thereof.

ARTICLE 17

EMINENT DOMAIN

17.1. If after the execution of the Sublease and prior to the expiration of the term of this Sublease, the whole of the Subleased Premises shall be taken under the power of eminent domain, then the term of this Sublease shall cease as of the time when Sublessor shall be divested of its title in the Subleased Premises, and minimum rent shall be apportioned and adjusted as of the time of termination.

17.2. If only a part of the Subleased Premises shall be taken under the power of eminent domain, then if as a result thereof the Subleased Premises shall not be reasonably adequate for the operation of the business conducted in the Subleased Premises prior to the taking, Sublessor or Sublessee may, at its election, terminate the term of this Sublease by giving the other notice of the exercise of its election within twenty (20) days after it shall receive notice of such taking, and the termination shall be effective as of the time that Sublessee is dispossessed, and base rent shall be apportioned and adjusted as of the time of termination. If only a part of the Subleased

Premises shall be taken under the power of eminent domain, and if the term of this Sublease shall not be terminated as aforesaid, then the term of this Sublease shall continue in full force and effect, and Sublessor shall, within a reasonable time after possession is required for public use, repair and rebuild what may remain of the leased Premises so as to put the same into condition for use and occupancy by Sublessee, and a just proportion of the base rent according to the nature and extent of the injury to the Subleased Premises shall be abated for the balance of the term of this Sublease and in addition business interruption and/or relocation aware are to be paid out of the taking shall be the property of and shall be paid to the Sublessee.

17.3. Sublessor reserves to itself, and Sublessee assigns to Sublessor, all rights to damages accruing on account of any taking under the power of eminent domain or by reason of any act of any public or quasi public authority for which damages are payable. Sublessee agrees to execute such instruments of assignment as may be reasonably required by Sublessor in any proceeding for the recovery of damages that may be recovered in such proceeding. It is agreed and understood, however, the Sublessor does not reserve to itself, and Sublessee does not assign to Sublessor, any damages payable for movable trade fixtures installed by Sublessee or anybody claiming under Sublessee at its own cost and expense.

#### ARTICLE 18

##### DEFAULT

18.1. If Sublessee shall default in the payment of rent or other payments required of Sublessee, and if Sublessee shall fail to cure said default within seven (7) business days after receipt of written notice of said default from Sublessor; or if Sublessee shall default in the performance or observance of any other agreement or condition on its part to be performed or observed, and if Sublessee shall fail to cure said default within fifteen (15) business days after receipt of written notice of said default from Sublessor; or if any person shall levy upon, or take this leasehold interest or any part hereof, upon execution, attachment, or their process of law; or if Sublessee shall make an assignment of its property for the benefit of creditors; or if Sublessee shall file voluntary bankruptcy; or if any bankruptcy or insolvency proceedings shall be commenced by Sublessee or an involuntary bankruptcy shall be filed against the Sublessee which remains undischarged for a period of 60 days, or if a receiver, trustee, or assignee shall be appointed for the whole or any part of the Sublessee's property, then Sublessor may exercise any or all remedies available under this Sublease or at law. The Sublessee shall be liable for a 5% late fee applicable to any amounts due under this Sublease, from the due date of such payment.

18.2. In the case of such termination, Sublessee will indemnify Sublessor each month against all loss of rent, and all obligations which Sublessor may incur by reasons of any such termination, between the time of termination and the expiration of the term of this Sublease; or at the election of Sublessor, exercised at the time of the termination or at any time thereafter, Sublessee will indemnify Sublessor, each month until the exercise of the election, against all loss of rent and other obligations which Sublessor may incur by reason of such termination, during the period between the time of the termination and the exercise of the election, and upon the exercise of the election Sublessee will pay to Sublessor as damages such amount as at the time of

the exercise of the election represents the amount by which the rental value of the leased Premises for the period from the exercise of the election until the expiration of the term shall be less than the amount of rent and other payments provided herein to be paid by Sublessee to Sublessor during said period. It is understood and agreed that at the time of the termination, or at any time thereafter, the Sublessor shall diligently perform the legal obligation to relet the premises for a term which may expire after the expiration of the term of this Sublease, without releasing Sublessee from any liability whatsoever, only for the term of this Sublease, but not for the longer re-let term. The Sublessee shall be liable for any expenses incurred by Sublessor in connection with obtaining possession of the Subleased Premises, with removing from the Subleased Premises property of Sublessee and persons claiming under it (including warehouse charges), with putting the Subleased Premises into a condition reletting similar to its condition at the commencement of this lease, reasonable wear and tear excepted, and with any reletting, including, but without limitation, reasonable attorneys' fees and brokers' fees, and that any monies collected from any reletting shall be applied first to the foregoing expenses and then to the payment of rent and all other payments due from Sublessee to Sublessor. The Sublessor shall, commensurate with any demand for payment of any of the above as to expenses or rent, provide the Sublessee with an itemization of all such items as a condition to the Sublessee's obligations to make payment.

#### ARTICLE 19

##### SUBORDINATION TO MORTGAGES

Sublessee agrees that upon the request of Sublessor it will subordinate this Sublease and the lien hereof to the lien of any present or future mortgage or mortgages upon the Subleased Premises, any property of which the Subleased Premises are a part, or upon any ground lease of such property or upon any part thereof, irrespective of the time of execution or time of recording of any sub mortgage or mortgages. Sublessee agrees that it will, upon the request of Sublessor, execute, acknowledge and deliver any and all instruments deemed by Sublessor necessary or desirable to give effect or notice of such subordination. Sublessee also agrees that if it shall fail at any time to execute, acknowledge, or deliver any instrument requested by Sublessor under this Article, Sublessor may, only after seven (7) days notice to the Sublessee, in addition to any other remedies available to it, execute, acknowledge, and deliver such instrument as the attorney in fact of Sublessee and in Sublessee's name, and Sublessee hereby makes, constitutes, and irrevocably appoints Sublessor as its attorney in fact for that purpose. The word "mortgage" as used herein includes mortgages, deeds of trust, or other similar instruments and modifications, consolidations, extensions, renewals, replacements and substitutes thereof. At the request of the holder of any mortgage upon the Subleased Premises or any property of which the Subleased Premises is a part may subordinate the lien of such mortgage to this Sublease, thereby making this Sublease superior to such mortgage, by recording in the Rockingham County Registry of Deeds, a Notice of Subordination or other document of like effect, executed unilaterally by such mortgage. Whether the lien of any mortgage are a part shall be superior or subordinate to this Sublease and the lien hereof, Sublessee agrees that, if requested by Sublessor or the holder of such mortgage, it will attorn to the holder of such mortgage or anyone claiming under such holder and their respective successors and assigns in the event of foreclosure of or similar action taken under such mortgage.



ARTICLE 20

CERTIFICATE

Within ten (10) days after written request therefor by Sublessor, Sublessee agrees to deliver to Sublessor or to any mortgagee a certificate stating (if such be the case) that Sublessee has entered into occupancy of the Subleased Premises in accordance with the provisions of this Sublease, that this Sublease is in full force and effect (if such be the case), that Sublessor has performed the construction required of Sublessor, and any other information reasonably requested.

ARTICLE 21

DELEGATION, ASSIGNMENT, SUBLEASES, MORTGAGE

21.1. Delegation. Sublessee shall not have the right to delegate any of its responsibilities or obligations under this Sublease.

21.2. Assignment. Sublessee may, subject to Condition 20 of the Master Lease, without the approval of Sublessor, assign its rights under this Sublease to a related corporation as long as Sublessee retains at least fifty-one percent (51%) controlling interest in such related corporation. All other assignments shall be subject to approval of Sublessor and PDA, which approval shall not be withheld unreasonably.

21.3. Subleases. Sublessee may not enter into any sublease of the Subleased Premises without Sublessor's prior written approval. Any request for Sublessor's approval shall be made at least forty-five (45) days prior to the commencement of such tenancy and shall provide detailed information concerning the identity and financial condition of the proposed sublessee and the terms and conditions of the proposed sublease. Sublessor shall not unreasonably withhold its consent to such sublease if: (1) the use of the Subleased Premises associated with any sublease(s) is permitted under Article 8, (2) the sublease(s) are consistent with the terms and conditions of this Sublease and the Primary Sublease; provided, however, that Sublessee may rent the subleased area at rentals deemed appropriate by Sublessee, (3) Sublessee remains primarily liable to Sublessor to pay rent and to perform all other obligations to be performed by Sublessee under this Sublease, (4) the proposed sublessee is financially and operationally responsible and (5) PDA has given its approval to the proposed sublease. [In the event the rent for the Subleased Premises exceeds the rental charged to Sublessee under Article 4, Sublessee shall remit sixty percent (60%) of such excess to Sublessor upon receipt by Sublessee; provided, however, that any rental received by Sublessee during a period in which no rental is due to Sublessor shall be paid in its entirety to Sublessor. Sublessor acknowledges that the use of the Premises by PC Connection Sales Corporation is contemplated by this Sublease and does not constitute a sublease under this Section.

21.4. Continuing Liability of Sublessee. No subletting, assignment or transfer, whether Sublessor's consent is required or otherwise given hereunder, shall release Sublessee's obligations or alter the primary liability of Sublessee to pay the rent and to perform all other obligations to be performed by Sublessee hereunder. The acceptance of rent by Sublessor from any other person shall not be deemed to be a waiver by Sublessor of any provision hereof. Consent to one assignment or subletting shall not be deemed consent to any subsequent

assignment or subletting. If any assignee of Sublessee or any successor of Sublessee defaults in the performance of any of the terms hereof, Sublessor may proceed directly against Sublessee without the necessity of exhausting remedies against such assignee or successor. If Sublessee assigns this Sublease, or sublets all or a portion of the Subleased Premises, or requests the consent of Sublessor to any assignment or subletting, or if Sublessee requests the consent of Sublessor for any act that Sublessee proposes to do, then Sublessee shall pay Sublessor's reasonable processing fee and reimburse Sublessor for all reasonable attorneys' fees incurred in connection therewith. Any assignment or subletting of the Subleased Premises that is not in compliance with the provisions of this Article XXI shall be void and shall, at the option of Sublessor, terminate this Sublease.

21.5. Notwithstanding any other provision of this Sublease, any assignment or sublease shall comply with the provision of Article XXII including the notice requirements of Condition 10.8 of the FFA (as that term is defined in Section 22.8) and the terms and conditions of the Primary Sublease.

21.6. Mortgages. Except as otherwise expressly agreed to by PDA in writing, Sublessee shall not have the right to engage in any financing or other transaction creating any mortgage upon the Subleased Premises. Any approval of PDA shall be expressly subject to Condition 21 of the Master Lease and the provisions of the Primary Sublease.

## ARTICLE 22

### ENVIRONMENTAL PROTECTION

22.1. Sublessee and any sublessee or assignee of Sublessee shall comply with all federal, state, and local laws, regulations, and standards that are or may become applicable to Sublessee's or Sublessee's or assignee's activities at the Subleased Premises, including but not limited to, the applicable environmental laws and regulations identified in Exhibit 7, as amended from time to time.

22.2. Sublessee and any sublessee or assignee of Sublessee shall be solely responsible for obtaining at their cost and expense any environmental permits required for their operations under this Sublease or any sublease or assignment, independent of any existing Airport permits.

22.3. Sublessee shall indemnify, defend and hold harmless Sublessor, PDA and the Air Force against and from all claims, judgments, damages, penalties, fines, costs and expenses, liabilities and losses (including, without limitation, diminution in value of the Premises, damages for the loss or restriction on the use of the Premises, and sums paid in settlement of claims, attorneys' fees, consultants' fees and experts' fees), resulting or arising from discharges, emissions, spills, releases, storage, or disposal of any Hazardous Substances, or any other action by the Sublessee, or any sublessee or assignee of the Sublessee, giving rise to Sublessor or PDA or Air Force liability, civil or criminal, or responsibility under federal, state or local environmental laws.

This indemnification of Sublessor and PDA and Air Force by Sublessee includes, without limitation, any and all claims, judgment, damages, penalties, fines, costs and expenses, liabilities and losses incurred by Sublessor or PDA or Air Force in connection with any investigation of

site conditions, or any remedial or removal action or other site restoration work required by any federal, state or local governmental unit or other person for or pertaining to any discharges, emissions, spills, releases, storage or disposal of Hazardous Substances arising or resulting from any act or omission of the Sublessee or any sublessee or assignee of the Sublessee at the Subleased Premises after the Occupancy Date. "Occupancy Date" as used herein shall mean the earlier of the first day of Sublessee's occupancy or use of the Subleased Premises or the date of execution of this Sublease. "Occupancy" or "Use" shall mean any activity or presence including preparation and construction in or upon the Subleased Premises.

The provisions of this Section shall survive the expiration or termination of the Sublease, and the Sublessee's obligations hereunder shall apply whenever the Sublessor or the Air Force incurs costs or liabilities for the Sublessee's actions of the types described in this Article.

22.4. Notwithstanding any other provision of this Sublease, Sublessee and its sublessees and assignees do not assume any liability or responsibility for environmental impacts and damage caused by the use by the Air Force of Hazardous Substances on any portion of the Airport, including the Subleased Premises. The Sublessee and its sublessees and assignees have no obligation to undertake the defense, remediation and cleanup, including the liability and responsibility for the costs of damages, penalties, legal and investigative services solely arising out of any claim or action in existence now, or which may be brought in the future by any person, including governmental units against the Air Force, because of any use of, or release from, any portion of the Airport (including the Subleased Premises) of any Hazardous Substances prior to the Occupancy Date.

22.5. As used in this Sublease, the term "Hazardous Substances" means any hazardous or toxic substance, material or waste, oil or petroleum product, which is or becomes regulated by any local governmental authority, the State of New Hampshire or the United States Government, excluding normal office products. The term "Hazardous Substances" includes, without limitation, any material or substance which is (i) defined as a "hazardous waste," under New Hampshire RSA ch.147-A, (ii) defined as a "hazardous substance" under New Hampshire RSA ch.147-B, (iii) oil, gasoline or other petroleum product, (iv) asbestos, (v) listed under or defined as hazardous substance pursuant to Part Hc. P 1905 ("Hazardous Waste Rules") of the New Hampshire Code of Administrative Rules, (vi) designated as a "hazardous substance" pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. §1317, (vii) defined as a "hazardous waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. §6901 et seq. (42 U.S.C. §6903), or (viii) defined as a "hazardous substance" pursuant to Section 101 of the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §9601 et seq. (42 U.S.C. §9601) and (ix) so defined in the regulations adopted and publications promulgated pursuant to any of such laws, or as such laws or regulations may be further amended, modified or supplemented (collectively "Hazardous Substance Laws").

As used in this Sublease, the terms "release" and "storage" shall have the meanings provided in RSA 147-B:2, as amended, and the term "disposal" shall have the meaning provided in RSA 147-A:2.

22.6. Sublessor's rights under this Sublease and PDA's rights under the Primary Sublease specifically include the right for Sublessor and PDA to inspect the Subleased Premises and any

buildings or other facilities thereon for compliance with environmental, safety, and occupational health laws and regulations, whether or not the Sublessor or PDA is responsible for enforcing them. Such inspections are without prejudice to the right of duly constituted enforcement officials to make such inspections.

22.7. Notwithstanding any other provision of this Sublease and pursuant to the Primary Sublease, PDA is not responsible for any removal or containment of asbestos. If Sublessee and any sublessee or assignee intend to make any improvements or repairs that require the removal of asbestos, an appropriate asbestos disposal plan must be incorporated in the plans and specifications. The asbestos disposal plan shall identify the proposed disposal site for the asbestos. In addition, non-friable asbestos which becomes friable through or as a consequence of the activities of Sublessee will be abated by Sublessee at its sole cost and expense. The Sublessor hereby certifies that the leased premises and the building containing the leased premises are free of any asbestos materials.

22.8. Sublessor and Sublessee acknowledge that the Airport has been identified as a National Priority List (NPL) Site under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) of 1980, as amended. Sublessee acknowledges that Sublessor has provided it with a copy of the Pease Federal Facility Agreement (“FFA”) entered into by EPA, and the Air Force on April 24, 1991, and Modification No. 1 thereto, effective March 18, 1993, agrees that it will comply with the terms of the FFA to the extent the same may be applicable to the Subleased Premises and that should any conflict arise between the terms of the FFA and the provisions of this Sublease, the terms of the FFA will take precedence. The Sublessee further agrees that the Sublessor and PDA assume no liability to the Sublessee or any sublessee or assignee of Sublessee should implementation of the FFA interfere with their use of the Subleased Premises. The Sublessee and its sublessee(s) and assignee(s) shall have no claim on account of any such interference against the Sublessor, or PDA or any officer, agent, employee or contractor thereof, other than a claim to Sublessor for abatement of rent.

22.9. The Air Force, EPA, and NHDES and their officers, agents, employees, contractors, and subcontractors have the right, upon reasonable notice to the Sublessee and any sublessee or assignee, to enter upon the Subleased Premises for the purposes enumerated in this subparagraph and for such other purposes consistent with the FFA:

- (1) to conduct investigations and surveys, including, where necessary, drilling, testpitting, borings and other activities related to the Pease Installation Restoration Program (“IRP”) or the FFA;
- (2) to inspect field activities of the Air Force and its contractors and subcontractors in implementing the IRP or the FFA;
- (3) to conduct any test or survey required by the EPA or NHDES relating to the implementation of the FFA or environmental conditions at the Subleased Premises or to verify any data submitted to the EPA or NHDES by the Air Force relating to such conditions;
- (4) to construct, operate, maintain or undertake any other response or remedial action as required or necessary under the IRP or the FFA, including, but not limited to monitoring wells, pumping wells and treatment facilities.

22.10. Sublessee and its sublessees and assignees agree to comply with the provisions of any health or safety plan in effect under the IRP or the FFA during the course of any of the above described response or remedial actions. Any inspection, survey, investigation, or other response or remedial action will, to the extent practicable, be coordinated with representatives designated by the Sublessee and any sublessee or assignee. Sublessee and any sublessee or assignee shall have no claim on account of such entries against the State as defined in FFA or any officer, agent, employee, contractor, or subcontractor thereof.

22.11. Sublessee further agrees that in the event of any authorized sublease or assignment of the Subleased Premises, it shall provide to the Air Force, EPA and NHDES by certified mail a copy of the agreement of sublease or assignment of the Subleased Premises within fourteen (14) days after the effective date of such transaction. Sublessee may delete the financial terms and any other proprietary information from any sublease or assignment submitted to the above mentioned entities.

22.12. The Airport air emissions offsets and Air Force accumulation points for hazardous and other wastes will not be made available to Sublessee. Sublessee shall be responsible for obtaining from some other source(s) any air pollution credits that may be required to offset emissions resulting from its activities under the Sublease.

22.13. Any permit required under Hazardous Substance Laws for the management of Hazardous Substances stored or generated by Sublessee or any sublessee or assignee of Sublessee shall be obtained by Sublessee or its sublessees or assignee and shall be limited to generation and transportation. Any violation of this requirement shall be deemed a material breach of this Sublease. Sublessee shall provide at its own expense such hazardous waste storage facilities, complying with all laws and regulations, as it needs for management of its hazardous waste.

22.14. Sublessee, and any sublessee or assignee of Sublessee whose operations utilize Hazardous Substances, shall have a completed and approved plan for responding to Hazardous Substances spills prior to commencement of operations on the Subleased Premises. Such plan shall be independent of, but not inconsistent with, any plan or other standard of PDA applicable to the Airport and except for initial fire response and/or spill containment, shall not rely on use of the Airport or Sublessor personnel or equipment. Should the Sublessor provide any personnel or equipment, whether for initial fire response and/or spill containment or otherwise, on request of the Sublessee, or because the Sublessee was not, in the opinion of Sublessor, conducting timely cleanup actions, the Sublessee agrees to reimburse the Sublessor for its costs.

22.15. Sublessee, and any sublessee or assignee of Sublessee, must maintain and make available to PDA, the Air Force, EPA and NHDES all records, inspections logs, and manifests that tract the generation, handling, storage, treatment and disposal of hazardous waste, as well as all other records required by applicable laws and requirements. PDA and the Air Force reserve the right to inspect the Subleased Premises and Sublessee's, its sublessee's or assignee's records for compliance with Federal, State, local laws, regulations, and other requirements relating to the generation, handling, storage, treatment and disposal of hazardous waste, as well as the discharge or release of hazardous substances. Violations may be reported by PDA and the Air Force to appropriate regulatory agencies, as required by applicable law. The Sublessee, its sublessees or

assignees shall be liable for the payment of any fines and penalties or costs which may accrue to the United States of America or PDA as a result of the actions of Sublessee, its sublessees or assignees, respectively.

22.16 Prior to the storage, mixing, or application of any pesticide, as that term is defined under the Federal Insecticide, Fungicide, and Rodenticide Act, the Sublessee, its sublessees and assignees shall prepare a plan for storage, mixing and application of pesticides ("Pesticide Management Plan"). The Pesticide Management Plan shall be sufficient to meet all applicable Federal, State and local pesticide requirements. The Sublessee, its sublessees and assignees shall store, mix and apply all pesticides within the Subleased Premises only in strict compliance with the Pesticide Management Plan. The pesticides will only be applied by a licensed applicator.

22.17 The Sublessee, its sublessees and assignees must notify the Sublessor and the Site Manager of its intent to possess, store, or use any licensed or licensable source or byproduct materials, as those terms are defined under the Atomic Energy Act and its implementing regulations; of Sublessee's, its sublessees and assignees intent to possess, use or store radium; and of Sublessee's, its sublessees and assignees intent to possess or use any equipment producing ionizing radiation and subject to specific licensing requirements or other individual regulations, at least sixty (60) days prior to the entry of such materials or equipment upon the Airport. Upon notification, the Sublessor and the Site Manager may impose such requirements, including prohibition of possession, use, or storage, as deemed necessary to adequately protect health and human environment. Thereafter, the Sublessee must notify the Sublessor and the Site Manager of the presence of all licensed or licensable source or other byproduct materials, of the presence of all radium, and of the presence of all equipment producing ionizing radiation and subject to specific licensing requirements or other individual regulation; provided, however, that the Sublessee, its sublessees and assignees need not make either of the above notifications to the Sublessor and the Site Manager with respect to source and byproduct material which is exempt from regulation under the Atomic Energy Act. The Sublessee shall not, under any circumstances, use, own, possess or allow the presence of special nuclear material on the Subleased Premises.

ARTICLE 23

HOLDING OVER

Holding Over. Any holding over by Sublessee after the expiration of the Term of this Sublease shall be treated as a daily tenancy at sufferance at a rate equal to the then fair rental value of the Subleased Premises but in no event less than twice the sum of (i) Basic Rent and (ii) Additional Rent in effect on the expiration date. Sublessee shall also pay to Sublessor all damages, direct and/or indirect (including any loss of a Sublessee or rental income), sustained by reason of any such holding over. Otherwise, such holding over shall be on the terms and conditions set forth in this Sublease as far as applicable. The Sublessor may, but shall not be required to, and only on written notice to Sublessee after the expiration of the Term hereof, elect to treat such holding over as an extension of the Term of this Sublease for a period of up to one (1) year, as designated by Sublessor, such extension to be on the terms and conditions set forth in this Section.

ARTICLE 24

WAIVERS

Failure of Sublessor to complain of any act or omission on the part of Sublessee, no matter how long the same may continue, shall not be deemed to be a waiver by Sublessor of any of its rights hereunder. No waiver by Sublessor at any time, express or implied, or any breach of any provision of this Sublease shall be deemed a waiver of a breach of any other provision of this Sublease or a consent of any subsequent breach of the same or any other provision. If any action by Sublessee shall require Sublessor's consent or approval, Sublessor's consent to or approval of such action on any one occasion shall not be deemed a consent to or approval of said action on any subsequent occasion or a consent to or approval of any other action on the same or any subsequent occasion. No payment by Sublessee or acceptance by Sublessor of a lesser amount than shall be due from Sublessee to Sublessor shall be deemed to be anything but payment on account, and the acceptance by Sublessor of a check for a lesser amount with an endorsement or statement thereon, or upon letter accompanying said check that said lesser amount is payment in full, shall not be deemed an accord and satisfaction, and Sublessor may accept said check without prejudice to recover the balance due or pursue any other remedy. Any and all rights and remedies which Sublessor may have under this Sublease or by operation of law, either at law or in equity, upon any breach, shall be distinct, separate and cumulative, and shall not be deemed inconsistent with each other; and no one of them, whether exercised by Sublessor or not, shall be deemed to be in exclusion of any other; and any two or more of all such rights and remedies may be exercised at the same time.

ARTICLE 25

QUIET ENJOYMENT

Sublessor agrees that upon Sublessee's paying the rent and performing and observing the agreements, conditions and other provisions on its part to be performed and observed, Sublessee shall and may peaceably and quietly have, hold, and enjoy the Subleased Premises during the

term of this Sublease without any manner of hindrance or molestation from Sublessor or anyone claiming under Sublessor, subject, however, to the terms of this Sublease and any instruments having a prior lien.

ARTICLE 26

FAILURE OF PERFORMANCE

If Sublessee shall default in the performance or observance of any agreement or condition of this Sublease contained on its part to be performed or observed, other than an obligation to pay money, and shall not cure such default within fifteen (15) days after written notice from Sublessor specifying the default (or shall not within said period commence to cure such default and thereafter prosecute the curing of such default to completion with due diligence), Sublessor may, at its option, without waiving any claim for damages for breach of agreement, at any time thereafter cure such default for the account of Sublessee, and any amount paid or any contractual liability incurred by Sublessor in so doing shall be deemed paid or incurred for the account of Sublessee, and Sublessee agrees to reimburse Sublessor therefor or save Sublessor harmless therefrom; provided that Sublessor may cure any such default as aforesaid prior to the expiration of said waiting period after notice to Sublessee, if the curing of such default prior to the expiration of said waiting period is reasonably necessary to protect the real estate or Sublessor's interest therein, or to prevent injury or damage to persons or property. If Sublessee shall fail to reimburse Sublessor upon demand for any amount paid for the account of Sublessee hereunder, said amount, plus interest therefrom from the date of Sublessor's demand at the Lease Interest Rate, shall be added to and become due as a part of the next payment of rent due hereunder.

ARTICLE 27

INTERPRETATIONS

27.1. This instrument contains the entire and only agreement between the parties, and no oral statements or representations or prior written matter not contained in this instrument shall have any force or effect. This Sublease shall not be modified in any way except by a writing subscribed by both parties.

27.2. Wherever in this Sublease it is provided that the consent or approval of either party must be obtained in order to authorize any act or course of conduct by the other party, the party whose consent or approval is necessary may grant or withhold said consent or approval, except where expressly provided to the contrary in this Sublease, at its sole and absolute discretion and with or without explanation of the reason or reasons for granting or withholding the same.

27.3. In the event of a breach of this Sublease by either party, the prevailing party shall be entitled to reasonable attorneys fees and costs.

27.4 This Sublease shall be governed by the laws of the State of New Hampshire.



ARTICLE 28

NOTICES

All notices and other communications authorized or required hereunder shall be in writing and shall be given by mailing the same certified or registered mail, return receipt requested, postage prepaid, or first class mail, postage prepaid or by mailing the same by Express Mail or by having the same delivered by a commercial delivery service to the following address:

If to Sublessor: 222 International, Limited Partnership  
c/o CPManagement, Inc.  
Three Mound Court  
Merrimack, NH 03054

If to Sublessee: Merrimack Services Corporation  
Attn: Director of Facilities  
730 Milford Road  
Merrimack, NH 03054-4631

ARTICLE 29

DISPUTES AND LITIGATION

29.1. Except as provided below: In the event of a dispute between the parties, it shall be a condition precedent to the initiation of any formal litigation in a court of competent jurisdiction that the parties shall have meet face to face in a good faith effort to resolve the dispute directly between them. In the event that they are unsuccessful, each party agrees to submit the dispute to alternative dispute resolution, initially by mediation, and the parties shall equally share the expense of such mediation.

In the event that mediation is unsuccessful, the parties shall then submit the dispute to arbitration (binding if the parties agree) in accordance with the Rules of the American Arbitration Association. In the event that arbitration fails, and provided that the parties have participated in the alternative dispute resolution, provisions hereof in good faith, the aggrieved party may then commence litigation.

29.2. The foregoing alternative dispute resolution provisions shall not apply in the event that either party reasonably requires immediate ex parte and/or injunctive relief from a Court of competent jurisdiction.

ARTICLE 30

MISCELLANEOUS

30.1. Any actions or proceedings with respect to any matters arising under or growing out of this Sublease shall be instituted and prosecuted only in the courts located in the State of New Hampshire. Nothing contained in this Article or any other provision of this Sublease shall be deemed to constitute a waiver of the sovereign immunity of the State of New Hampshire, which immunity is hereby reserved to PDA and to the State of New Hampshire.

30.2. Sublessee shall faithfully observe and comply with such rules and regulations as the PDA may adopt for the operation of the Airport and such rules and regulations as Sublessor may adopt for the operation of the building and lot of which the Subleased Premises are a part, which rules and regulations are reasonable and nondiscriminatory as well as all modifications thereof and additions thereto. PDA shall not be responsible to Sublessee for the violation or nonperformance by any other Sublessee of the PDA of such airport rules and regulations, and Sublessor shall not be responsible to Sublessee for the violation or nonperformance by any other Sublessee of Sublessor of any of such rules and regulations pertaining to the building and the lot of which the Subleased Premises are a part.

30.3. Sublessee agrees to conform to such additional provisions required, from time to time, by the FAA ("FAA Requirements") or its successor with respect to the operation of the Airport, or a portion thereof. The current FAA Requirements are attached hereto as Exhibit 9 and incorporated herein by reference.

30.4. This Sublease is subject and subordinate to any agreements heretofore or hereafter made between PDA and the United States or the Air Force, the execution of which is required to enable or permit transfer of rights or property to PDA for airport purposes or expenditure of federal grant funds for airport improvement, maintenance or development, including, without limitation, the Application and Acceptance, Master Lease and FFA. Sublessee shall abide by requirements of any agreement between PDA and the United States or the Air Force applicable to the Subleased Premises or Sublessee's activities at the Airport and shall consent to amendments and modifications of this Sublease if required by such agreements or as a condition of Sublessor's entry into such agreements.

This Sublease is further subject and subordinate to the Primary Sublease between PDA and Sublessor, and Sublessee shall abide by the provisions of the Primary Sublease applicable to the Subleased Premises or Sublessee's activities at the Airport and shall consent to amendments and modifications of this Sublease if required by the Primary Sublease.

30.5. Sublessee acknowledges that PDA, in its sole discretion, shall determine and may from time to time change the routes of surface ingress and egress connecting the Subleased Premises. PDA also reserves the right to further develop the Airport, or such portion of the Airport as is owned or controlled by PDA, as it sees fit, regardless of the desires or views of Sublessee and without interference or hindrance.

30.6. The Sublessee herein covenants by and for itself, its heirs, executors, administrators, and assigns, and all persons claiming under or through it, that this Sublease is made and accepted upon and subject to the following conditions:

That there shall be no discrimination against or segregation of any person or group of persons, on account of race, color, creed, national origin, or ancestry, in the leasing, subleasing, transferring, use, occupancy, tenure, or enjoyment of the Premises herein leased nor shall the Sublessee, or any person claiming under or through it, establish or permit any such practice or practices of discrimination or segregation with reference to the selection, location, number, use, or occupancy, of tenants, lessees, sublessees, subtenants, or vendees in the Subleased Premises herein leased.

30.7. All obligations of Sublessee to indemnify, defend and hold harmless Sublessor, PDA and the Air Force and to make any monetary payment to Sublessor, PDA and the Air Force shall survive the termination or expiration of this Sublease.

30.8. Sublessor's Liability. (a) With respect to any services or utilities to be furnished by Sublessor to Sublessee, Sublessor shall in no event be liable for failure to furnish the same when prevented from doing so by force, major strike, lockout, breakdown, accident, order or regulation of or by any governmental authority, or failure of supply, or inability by the exercise of reasonable diligence to obtain supplies, parts or employees necessary to furnish such services, or because of war or other emergency, or for any cause beyond Sublessor's reasonable control, or for any cause due to any act or neglect of Sublessee or Sublessee's servants, agents, employees, licensees or any person claiming by, through or under Sublessee; nor shall any such failure give rise to any claim in Sublessee's favor that Sublessee has been evicted, either constructively or actually, partially or wholly.

(b) In no event shall Sublessor ever be liable to Sublessee for any loss of business or any other indirect or consequential damages suffered by Sublessee from whatever cause.

(c) With respect to any repairs or restoration which are required or permitted to be made by Sublessor, the same may be made during normal business hours and Sublessor shall have no liability for damages to Sublessee for inconvenience, annoyance or interruption of business arising therefrom.

30.9. Rules and Regulations. Sublessee shall abide by rules and regulations set forth in Exhibit 11 attached hereto and those rules and regulations from time to time established by Sublessor, it being agreed that such rules and regulations will be established and applied by Sublessor in a non-discriminatory fashion, such that all rules and regulations shall be generally applicable to other sublessees of the Building of similar nature to the Sublessee named herein. Sublessor agrees to use reasonable efforts to insure that any such rules and regulations are uniformly enforced, but Sublessor shall not be liable to Sublessee for violation of the same by any other Sublessee or occupant of the Building, or persons having business with them. In the event that there shall be any conflict between such rules and regulations and the provisions of this Sublease, the provisions of this Sublease shall control.

30.10. Additional Charges. If Sublessee shall fail to pay when due any sums under this Sublease designated or payable as an additional charge, Sublessor shall have the same rights and remedies as Sublessor has hereunder for failure to pay Basic Rent.

30.11. Brokerage. Sublessee warrants and represents that Sublessee has dealt with no broker in connection with the consummation of this Sublease other than (None) (the "Broker") and, in the event of any brokerage claims against Sublessor predicated upon prior dealings with Sublessee, Sublessee agrees to defend the same and indemnify Sublessor against any such claim (except any claim by the Broker).

EXECUTION

IN WITNESS WHEREOF, Sublessor and Sublessee have executed this Sublease effective as of the 8 day of March, 2005.

**222 INTERNATIONAL, LIMITED PARTNERSHIP**

By: /s/ Daniel L. Plummer

\_\_\_\_\_

Its: **Co-Manager**

\_\_\_\_\_

"Sublessor"

**MERRIMACK SERVICES CORPORATION**

/s/ Robert A. Pratt

\_\_\_\_\_

By: Robert A. Pratt

\_\_\_\_\_

Its: Director of Facilities

\_\_\_\_\_

"Sublessee"

STATE OF NEW HAMPSHIRE

: ss.

COUNTY OF [ Rockingham ]

On this 8 day of March , 2005, before me, Renee Riedel , a Notary Public in and for said County and State, personally appeared Daniel L. Plummer , personally known to me (or proved to me on the basis of satisfactory evidence) to be the Co-Manager of 222 International, Limited Partnership , and on oath stated that he was authorized to execute this instrument and acknowledged it to be his free and voluntary act for the uses and purposes set forth herein.

/s/ Renee Riedel

\_\_\_\_\_

Notary Public in and for said County and State

STATE OF [ New Hampshire ]

: ss.

COUNTY OF [ Hillsborough ]

On this 4 day of March , 2005, before me, Dolores Collins , a Notary Public in and for said County and State, personally appeared [Robert A. Pratt], personally known to me (or proved to me on the basis of satisfactory evidence) to be the [Director] of [Facilities] and on oath stated that he was authorized to execute this instrument and acknowledged it to be his free and voluntary act for the uses and purposes set forth herein.

Notary Public in and for said County and State

/s/ Dolores R. Collins, Hillsborough, NH

\_\_\_\_\_

PRIMARY SUBLEASE

APPLICATION AND ACCEPTANCE

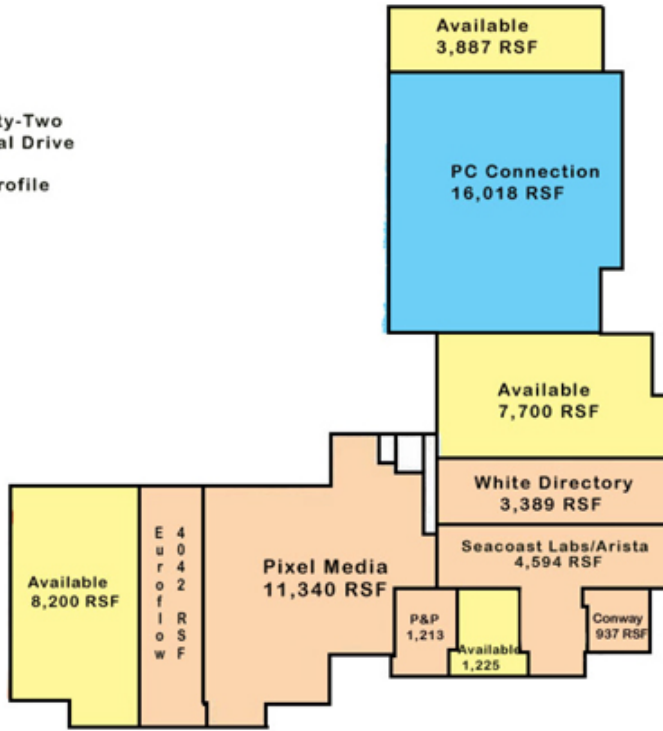
MASTER LEASE BETWEEN PEASE DEVELOPMENT AUTHORITY AND AIR FORCE

FEDERAL FACILITIES AGREEMENT



PLANS DESIGNATING THE SUBLEASED PREMISES

Two-Twenty-Two  
International Drive  
Tenant Profile



ALTERATIONS

Sublessor will provide the Subleased Premises to Sublessee in "as-is" condition except for the following:

1. Sublessor to remove walls in three offices to create an open area and patch/paint walls, and patch ceilings as required.
2. Sublessor to replace carpet in the open area.
3. Relocate the doorway at existing Break Room (will require elimination of one wing of the existing counter) and patch walls and floor were affected.

LIST OF ENVIRONMENTAL LAWS AND REGULATIONS

- Air Quality:
- (a) Clean Air Act & Amendments, 42 U.S.C. 7401-7642
  - (b) 40 CFR Parts 50-52, 61, 62, 65-67, 81
  - (c) RSA ch. 125-C, Air Pollution Control, and rules adopted thereunder
  - (d) RSA ch. 125-H, Air Toxic Control Act, and rules adopted thereunder
- Hazardous Materials:
- (a) Hazardous Materials Transportation Act, 49 U.S.C. 1801-1813, and Department of Transportation Regulations thereunder
  - (b) Emergency Planning and Community Right-To-Know Act, 42 U.S.C. 11001-11050
  - (c) 49 CFR Parts 100-179
  - (d) 40 CFR Part 302
  - (e) RSA ch. 277-A, Toxic Substances in the Workplace, and rules adopted thereunder
- Hazardous Waste:
- (a) Resource Conservation and Recovery Act (RCRA) of 1976 and RCRA Amendments of 1984, 42 U.S.C. 6901-6991i
  - (b) Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980, as amended, 42 U.S.C. 9601-9675
  - (c) 40 CFR Parts 260-271, 300, 302
  - (d) RSA ch. 147-A, Hazardous Waste Management and rules adopted thereunder
- Water Quality:
- (a) Federal Water Pollution Control Act (Clean Water Act) and Amendments, 33 U.S.C. 1251-1387
  - (b) Safe Drinking Water Act, as amended, 42 U.S.C. 300f-300j-26 40 CFR Title 100-143, 401 and 403
  - (c) RSA ch. 146-A, Oil Spillage in Public Waters, and rules adopted thereunder
  - (d) RSA ch. 485, New Hampshire Safe Drinking Water Act, and rules adopted thereunder
  - (e) RSA ch. 485-A, Pollution and Waste Disposal, and rules adopted thereunder

CERTIFICATE OF GOOD STANDING

**TO BE PROVIDED BY SUBLESSEE.**

SUBLEASE PROVISIONS REQUIRED BY  
THE FEDERAL AVIATION ADMINISTRATION

1. Sublessee, for himself, his heirs, personal representatives, successors in interest, and assigns, as a part of the consideration hereof, does hereby agree that in the event facilities are constructed, maintained, or otherwise operated on the Subleased Premises, for a purpose for which a United States Department of Transportation ("DOT") program or activity is extended or for another purpose involving the provision of similar services or benefits, Sublessee shall maintain and operate such facilities and services in compliance with all other requirements imposed pursuant to Title 49, Code of Federal Regulations, DOT, Subtitle A, Office of the Secretary, Part 21, Nondiscrimination in Federally Assisted Programs of the Department of Transportation Effectuation of Title VI of the Civil Rights Act of 1964, and as said Regulations may be amended.
2. Sublessee, for himself, his personal representative, successors in interest, and assigns, as a part of the consideration hereof, does hereby agree that: (i) no person on the grounds of race, color, or national origin shall be excluded from participation in, denied the benefits of, or otherwise be subjected to discrimination in the use of said facilities; (ii) that in the construction of any improvements on, over, or under such land and the furnishing of services thereon, no person on the grounds of race, color, or national origin shall be excluded from participation in, denied the benefits of, or otherwise be excluded from participation in, denied the benefits of, or otherwise be subject to discrimination; and (iii) that the Sublessee shall use the premises in compliance with all other requirements imposed by or pursuant to Title 49, Code of Federal Regulations, Department of Transportation, Subtitle A, Office of the Secretary, Part 21, Nondiscrimination in Federally-Assisted Programs of the Department of Transportation Effectuation of Title VI of the Civil Rights Act of 1964, and as said Regulation may be amended.
3. That in the event of breach of any of the above nondiscrimination covenants, Sublessor shall have the right to terminate the Sublease, and to reenter and repossess said land and the facilities thereon, and hold the same as if said lease, had never been made or issued. This provision does not become effective until the procedures of 49 CFR Part 21 are allowed and completed including expiration of appeal rights.
4. Sublessee shall furnish its accommodations and/or services on a fair, equal and not unjustly discriminatory basis to all users thereof and it shall charge fair, reasonable and not unjustly discriminatory prices for each unit or service; PROVIDED THAT the Sublessee may be allowed to make reasonable and nondiscriminatory discounts, rebates or other similar type of price reductions to volume purchasers.
5. Non-compliance with Provision 4 above shall constitute a material breach thereof and in the event of such noncompliance Sublessor shall have the right to terminate this Sublease, and the estate hereby created without liability therefore or at the election of the Sublessor or the United States either or both of Sublessor or the United States shall have the right to judicially enforce provisions.
6. Sublessee agrees that it shall insert the above five provisions in any lease agreement, by which said Sublessee grants a right or privilege to any person, firm or corporation to render accommodations and/or services to the public on the Subleased Premises.

7. Sublessee assures that it will undertake an affirmative action program as required by 14 CFR Part 152, Subpart E, to insure that no person shall on the grounds of race, creed, color, national origin, or sex be excluded from participating in any employment activities covered in 14 CFR Part 152, Subpart E. Sublessee assures that no person shall be excluded on these grounds from participating in or receiving the services or benefits of any program or activity covered by this subpart. Sublessee assures that it will require that its covered suborganizations provide assurance to the Sublessor, that they similarly will undertake affirmative action programs and that they will require assurances from their suborganizations, as required by 14 CFR Part 152, Subpart E, to the same effect.
8. Sublessor reserves the right to further develop or improve the landing area of the airport as it sees fit, regardless of the desires or view of the Sublessee and without interference or hindrance.
9. Sublessor reserves the right, but shall not be obligated to the Sublessee to maintain and keep in repair the landing area of the airport and all publicly-owned facilities of the airport, together with the right to direct and control all activities of the Sublessee in this regard.
10. This Sublease shall be subordinate to the provisions and requirements of any existing or future agreement between the Sublessor and the United States, relative to the development, operation or maintenance of the airport.
11. There is hereby reserved to Sublessor, its successors and assigns, for the use and benefit of the public, a right of flight for the passage of aircraft in the airspace above the surface of the Subleased Premises. This public right of flight shall include the right to cause in said airspace any noise inherent in the operation of any aircraft used for navigation or flight through the said airspace or landing at, taking off from or operation on the airport.
12. Sublessee agrees to comply with the notification and review requirements covered in Part 77 of the Federal Aviation Regulations in the event future construction of building is planned for the Subleased Premises, or in the event of any planned modification or alteration of any present or future building or structure situated on Subleased Premises.
13. Sublessee, by accepting this Sublease expressly agrees for itself, its successors and assigns that it shall not erect nor permit the erection of any structure or object nor permit the growth of any tree on the land leased hereunder above the mean sea level elevation of [\_\_\_\_\_] feet. In the event the aforesaid covenants are breached, Sublessor reserves the right to enter upon the Premises and to remove the offending structure or object and cut the offending tree, all of which shall be at the expense of the Sublessee.
14. Sublessee, by accepting this Sublease, agrees for itself, its successors and assigns that it will not make use of the Subleased Premises in any manner which might interfere with the landing and taking off of aircraft from the airport or otherwise constitute a hazard. In the event the aforesaid covenant is breached, Sublessor reserves the right to enter upon the Subleased Premises, and cause the abatement of such interference at the expense of the Sublessee.
15. It is understood and agreed that nothing herein contained shall be construed to grant or authorize the granting of an exclusive right within the meaning of Section 308a of the Federal Aviation Act of 1958 (49 U.S.C. 1349a).

16. This Sublease and all the provisions hereof shall be subject to whatever right the United States Government now has or in the future may have or acquire, affecting the control, operation, regulation and taking over of said airport or the exclusive or non-exclusive use of the airport by the United States during the time of war or national emergency.

EXHIBIT 10  
SUBORDINATION, NONDISTURBANCE AND ATTORNMENT AGREEMENT

THIS SUBORDINATION, NON-DISTURBANCE AND ATTORNMENT AGREEMENT (the "Agreement") is made as of the \_\_\_ day \_\_\_\_\_, 2002 by and between BEAR, STEARNS FUNDING, INC., having an address at 245 Park Avenue, New York, New York 10167 ("Lender") and «Company», having an address at «Address1», «City», «State» «Zip» ("Tenant").

RECITALS:

A. Tenant is the holder of a leasehold estate in a portion of the property known as **222 International Drive**, located at **Pease International Tradeport, Portsmouth, New Hampshire**, as more particularly described on Schedule A (the "Property") under and pursuant to the provisions of a certain lease dated «LeaseDate» between, **222 International, Limited Partnership** as landlord ("Landlord") and Tenant or its predecessor in interest, as tenant (as amended through the date hereof, the "Lease");

B. The Property is or is to be encumbered by one or more mortgages, deeds of trust, deeds to secure debt or similar security agreements (collectively, the "Security Instrument") from Landlord, or its successor in interest, in favor of Lender; and

C. Tenant has agreed to subordinate the Lease to the Security Instrument and to the lien thereof and Lender has agreed to grant non-disturbance to Tenant under the Lease on the terms and conditions hereinafter set forth.

**AGREEMENT:**

NOW, THEREFORE, the parties hereto mutually agree as follows:

1. Subordination. The Lease shall be subject and subordinate in all respects to the lien and terms of the Security Instrument, to any and all advances to be made thereunder and to all renewals, modifications, consolidations, replacements and extensions thereof.

2. Nondisturbance. So long as Tenant pays all rents and other charges as specified in the Lease and is not otherwise in default (beyond applicable notice and cure periods) of any of its obligations and covenants pursuant to the Lease, Lender agrees for itself and its successors in interest and for any other person acquiring title to the Property through a foreclosure (an "Acquiring Party"), that Tenant's possession of the premises as described in the Lease will not be disturbed during the term of the Lease, as said term may be extended pursuant to the terms of the Lease or as said premises may be expanded as specified in the Lease, by reason of a foreclosure. For purposes of this agreement, a "foreclosure" shall include (but not be limited to) a sheriff's or trustee's sale under the power of sale contained in the Security Instrument, the termination of any superior lease of the Property and any other transfer of the Landlord's interest in the Property under peril of foreclosure, including, without limitation to the generality of the foregoing, an assignment or sale in lieu of foreclosure.

3. Attornment. Tenant agrees to attorn to, accept and recognize any Acquiring Party as the landlord under the Lease pursuant to the provisions expressly set forth therein for the then remaining balance of the term of the Lease, and any extensions thereof as made pursuant to the Lease. The foregoing provision shall be self-operative and shall not require the execution of any further instrument or agreement by Tenant as a condition to its effectiveness. Tenant agrees, however, to execute and deliver, at any time and from time to time, upon the request of the Lender or any Acquiring Party any reasonable instrument which may be necessary or appropriate to evidence such attornment.



4. **No Liability.** Notwithstanding anything to the contrary contained herein or in the Lease, it is specifically understood and agreed that neither the Lender, any receiver nor any Acquiring Party shall be:

(a) liable for any act, omission, negligence or default of any prior landlord (other than to cure defaults of a continuing nature with respect to the maintenance or repair of the demised premises or the Property); provided, however, that any Acquiring Party shall be liable and responsible for the performance of all covenants and obligations of landlord under the Lease accruing from and after the date that it takes title to the Property; or

(b) except as set forth in (a), above, liable for any failure of any prior landlord to construct any improvements;

(c) subject to any offsets, credits, claims or defenses which Tenant might have against any prior landlord; or

(d) bound by any rent or additional rent which is payable on a monthly basis and which Tenant might have paid for more than one (1) month in advance to any prior landlord; or

(e) be liable to Tenant hereunder or under the terms of the Lease beyond its interest in the Property.

(f) liable or responsible for or with respect to the retention, application and or/return to the Tenant of any security deposit paid to Borrower or any prior Landlord, unless and until Lender or such Acquiring Party has actually received for its own account as landlord the full amount of such security deposit.

Notwithstanding the foregoing, Tenant reserves its rights to any and all claims or causes of action against such prior landlord for prior losses or damages and against the successor landlord for all losses or damages arising from and after the date that such successor landlord takes title to the Property.

5. **Rent.** Tenant has notice that the Lease and the rents and all other sums due thereunder have been assigned to Lender as security for the loan secured by the Security Instrument. In the event Lender notifies Tenant of the occurrence of a default under the Security Instrument and demands that Tenant pay its rents and all other sums due or to become due under the Lease directly to Lender, Tenant shall honor such demand and pay its rent and all other sums due under the Lease directly to Lender or as otherwise authorized in writing by Lender. Landlord hereby irrevocably authorizes Tenant to make the foregoing payments to Lender upon such notice and demand.

6. **Lender to Receive Notices.** Tenant shall notify Lender of any default by Landlord under the Lease which would entitle Tenant to cancel the Lease, and agrees that, notwithstanding any provisions of the Lease to the contrary, no notice of cancellation thereof shall be effective unless Lender shall have received notice of default giving rise to such cancellation and shall have failed within sixty (60) days after receipt of such notice to cure such default, or if such default cannot be cured within sixty (60) days, shall have failed within sixty (60) days after receipt of such notice to commence and thereafter diligently pursue any action necessary to cure such default.

7. **NOTICES.** All notices or other written communications hereunder shall be deemed to have been properly given (i) upon delivery, if delivered in person with receipt acknowledged by the recipient thereof, (ii) one (1) Business Day (hereinafter defined) after having been deposited for overnight delivery with any reputable overnight courier service, or (iii) three (3) Business Days after having been deposited in any post office or mail depository regularly maintained by the U.S. Postal Service and sent

by registered or certified mail, postage prepaid, return receipt requested, addressed to the receiving party at its address set forth above, and:

if to Tenant, to  
the attention of: \_Corporate Counsel and to the Director of Facilities

if to Lender:  
to the attention of: Bear Stearns Funding, Inc.  
its successors and/or assigns  
245 Park Avenue  
New York, NY 10167  
Attention: J. Christopher Hoeffel

or addressed as such party may from time to time designate by written notice to the other parties. For purposes of this Paragraph 7, the term "Business Day" shall mean any day other than Saturday, Sunday or any other day on which banks are required or authorized to close in New York, New York.

Either party by notice to the other may designate additional or different addresses for subsequent notices or communications.

8. Successors. The obligations and rights of the parties pursuant to this Agreement shall bind and inure to the benefit of the successors, assigns, heirs and legal representatives of the respective parties. In addition, Tenant acknowledges that all references herein to Landlord shall mean the owner of the landlord's interest in the Lease, even if said owner shall be different than the Landlord named in the Recitals.

9. Duplicate Originals; Counterparts. This Agreement may be executed in any number of duplicate originals and each duplicate original shall be deemed to be an original. This Agreement may be executed in several counterparts, each of which counterparts shall be deemed an original instrument and all of which together shall constitute a single Agreement. The failure of any party hereto to execute this Agreement, or any counterpart hereof, shall not relieve the other signatories from their obligations hereunder.

IN WITNESS WHEREOF, Lender and Tenant have duly executed this Agreement as of the date first above written.

**LENDER:**

**BEAR, STEARNS FUNDING, INC.**, a Delaware corporation

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

**TENANT:**

«Company»

\_\_\_\_\_  
Name: \_\_\_\_\_

Title: \_\_\_\_\_

The undersigned as the Landlord named in the Recitals or as successor thereto hereby accepts and agrees to be bound by the provisions of Paragraph 5 hereof.

**222 International, Limited Partnership, a**

Delaware Limited Partnership

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

STATE OF [ ]

COUNTY OF [ ]

On this the \_\_ day of \_\_\_\_\_, 2002, before me, the undersigned officer, personally appeared \_\_\_\_\_, who acknowledged himself to be the \_\_\_\_\_ of Bear Stearns Funding, Inc., and that he as such \_\_\_\_\_, being authorized so to do, executed the foregoing instrument for the purposes therein contained on behalf of the bank.

\_\_\_\_\_  
Notary Public/Justice of the Peace  
Print Name:  
My Commission Expires:

STATE OF [ ]

COUNTY OF [ ]

On this the \_\_ day of \_\_\_\_\_, 2002, before me, the undersigned officer, personally appeared, \_\_\_\_\_, the duly authorized \_\_\_\_\_ of \_\_\_\_\_, a \_\_\_\_\_ who acknowledged that he executed the foregoing on behalf of the said company.

Notary Public/Justice of the Peace  
Print Name:  
My Commission Expires:

STATE OF NEW HAMPSHIRE  
COUNTY OF ROCKINGHAM

On this the \_\_ day of \_\_\_\_\_, 2002, before me, the undersigned officer, personally appeared, \_\_\_\_\_, the duly authorized Managing Partner of 222 International, Limited Partnership, a Delaware Limited Partnership, who acknowledged that he executed the foregoing on behalf of the said limited partnership.

Notary Public/Justice of the Peace  
Print Name:  
My Commission Expires:

EXHIBIT 11  
RULES AND REGULATIONS

1. Except as specifically provided in the Sublease to which these Rules and Regulations are attached, no sign, placard, picture, advertisement, name or notice shall be installed or displayed on any part of the outside or inside of the building or Project without the prior written consent of Sublessor. Sublessor shall have the right to remove, at Sublessee's expense and without notice, any sign installed or displayed in violation of this rule. All approved signs or lettering on doors and walls shall be printed, painted, affixed or inscribed at the expense of Sublessee by a person approved by Sublessor.
2. If Sublessor objects in writing to any curtains, blinds, shades, screens or hanging plants or other similar objects attached to or used in connection with any window or door of the Premises, or placed on any windowsill, which is visible from the exterior of the Premises, Sublessee shall immediately discontinue such use. Sublessee shall not place anything against or near glass partitions or doors or windows, which may appear unsightly from outside the Premises.
3. Sublessee shall not obstruct any sidewalks, halls, passages, exits, entrances, elevators, escalators or stairways of the Project. The halls, passages, exits, entrances, shopping malls, elevators, escalators and stairways are not open to the general public, but are open, subject to reasonable regulations, to Sublessee's business invitees. Sublessor shall in all cases retain the right to control and prevent access thereto of all persons whose presence in the judgment of Sublessor would be prejudicial to the safety, character, reputation and interest of the Project and its Sublessees: provided that nothing herein contained shall be construed to prevent such access to persons with whom any Sublessee normally deals in the ordinary course of its business, unless such persons are engaged in illegal or unlawful activities. No Sublessee and no employee or invitee of any Sublessee shall go upon the roof(s) of the Project.
4. The directory of the building or Project, if any, will be provided exclusively for the display of the name and location of Sublessees only and Sublessor reserves the right to exclude any other names therefrom.
5. Sublessor will furnish Sublessee, free of charge, with two keys to each door lock in the Premises. Sublessor may make reasonable charge for any additional keys. Sublessee shall not make or have made additional keys, and Sublessee shall not alter any lock or install a new additional lock or bolt on any door of its Premises. Sublessee, upon the termination of its tenancy, shall deliver to Sublessor the keys of all doors which have been furnished to Sublessee, and in the event of loss of any keys so furnished, shall pay Sublessor therefor.
6. If Sublessee requires telegraphic, telephonic, burglar alarm or similar services, it shall first obtain, and comply with, Sublessor's instructions in their installation.
7. No deliveries shall be made which impede or interfere with other Sublessees or the operation of the building.
8. Sublessee shall not place a load upon any floor of the Premises, which exceeds the load per square foot, which such floor was designed to carry and which is allowed by law. Sublessor shall have the right to prescribe the weight, size and position of all equipment; materials, furniture or other property brought into the building. Heavy objects shall, if necessary by Sublessor, stand on such platforms as determined by Sublessor to be necessary to properly distribute the weight, which platforms shall be provided at Sublessee's expense. Business machines and mechanical

equipment belonging to Sublessee, which cause noise or vibration that may be transmitted to the structure of the building or to any space therein to such a degree as to be objectionable to Sublessor or to any Sublessees in the building, shall be placed and maintained by Sublessee, at Sublessee's expense, on vibration eliminators or other devices sufficient to eliminate noise or vibration. The persons employed to move such equipment in or out of the building must be acceptable to Sublessor. Sublessor will not be responsible for loss of, or damage to, any such equipment or other property from any cause, and all damage done to the building by maintaining or moving such equipment or other property shall be repaired at the expense of Sublessee.

9. Sublessee shall not use or keep in the Premises any kerosene, gasoline or inflammable or combustible fluid or material other than those limited quantities necessary for the operation or maintenance of office equipment. Sublessee shall not use or permit to be used in the Premises any foul or noxious gas or substance, or permit or allow the Premises to be occupied or used in a manner offensive or objectionable to Sublessor or other occupants of the building by reason of noise, odors or vibrations, nor shall Sublessee bring into or keep in or about the Premises any birds or animals.
10. Sublessee shall not use any method of heating or air conditioning other than that supplied by Sublessor, unless industry standard supplemental heating or cooling.
11. Sublessor reserves the right, exercisable without notice and without liability to Sublessee, to change the name and street address of the building.
12. Sublessee shall close and lock the doors of its Premises and entirely shut off all water faucets or other apparatus, and electricity, gas or air outlets before Sublessee and its employees leave the Premises. Sublessee shall be responsible for any damage or injuries sustained by other Sublessees or occupants of the building or by Sublessor for noncompliance with this rule.
13. The toilet rooms, toilets, urinals, wash bowls and other apparatus shall not be used for any purpose other than that for which they were constructed and no foreign substance of any kind whatsoever shall be thrown therein. The expense of any breakage, stoppage or damage resulting from the violation of this rule shall be borne by the Sublessee who, or whose employees or invitees shall have caused it.
14. Sublessee shall not sell, or permit the sale at retail of newspapers, magazines, periodicals, theater tickets or any other goods or merchandise to the general public in or on the Premises. Sublessee shall not make any room-to-room solicitation of business from other Sublessees in the Project. Sublessee shall not use the Premises for any business or activity other than that specifically provided for in Sublessee's Sublease.
15. Sublessee shall not install any radio or television antenna, loudspeaker or other devices on the roof(s) or exterior walls of the building or Project. Sublessee shall not interfere with radio or television broadcasting or reception from or in the Project or elsewhere.
16. Sublessee shall not mark, drive nails, screw or drill into the partitions, woodwork or plaster or in any way deface the Premises or any part thereof, except in accordance with the provisions of the Sublease pertaining to alterations. Pictures, artwork and bulletin boards may be hung provided proper materials are used. Sublessor reserves the right to direct electricians as to where and how telephones and telegraph wires are to be introduced to the Premises. Sublessee shall not cut or bore holes for wires. Sublessee shall not affix any floor covering to the floor of the Premises in any manner except as approved by Sublessor. Sublessee shall repair any damage resulting from noncompliance with this rule.

17. Sublessee shall not install, maintain or operate upon the Premises any vending machines without the written consent of Sublessor.
18. Canvassing, soliciting and distribution of handbills or any other written material and peddling in the Project are prohibited, and Sublessee shall cooperate to prevent such activities.
19. Sublessor reserves the right to exclude or expel from the Project any person whom, in Sublessor's judgement, is intoxicated or under the influence of liquor or drugs or who is in violation of any of the Rules and Regulations of the Building.
20. No cooking shall be done or permitted on the Premises without Sublessor's consent, except that use by Sublessee of Underwriters' Laboratory approved equipment for brewing coffee, tea, hot chocolate and similar beverages or use of microwave ovens for employee use shall be permitted, provided that such equipment and use is in accordance with all applicable, federal, state, county and city laws, codes, ordinances, rules and regulations.
21. Without the written consent of Sublessor, Sublessee shall not use the name of the building or Project in connection with or in promoting or advertising the business of Sublessee except as Sublessee's address.
22. Sublessee shall comply with all safety, fire protection and evacuation procedures and regulations established by Sublessor or any governmental agency.
23. Sublessee assumes any and all responsibility for protecting its Premises from theft, robbery and pilferage, which includes keeping doors locked and other means of entry to the Premises closed.
24. Sublessee's requirements will be attended to only upon appropriate application to the Project management office by an authorized individual. Employees of Sublessor shall not perform any work or do anything outside of their regular duties unless under special instructions from Sublessor, and no employee of Sublessor will admit any person (Sublessee or otherwise) to any office without specific instructions from Sublessor.
25. Sublessor may waive any one or more of these Rules and Regulations for the benefit of Sublessee or any other Sublessee, but no such waiver by Sublessor shall be construed as a waiver of such Rules and Regulations in favor of Sublessee or any other Sublessee, nor prevent Sublessor from thereafter enforcing any such Rules and Regulations against any or all of the Sublessees of the Project.
26. These Rules and Regulations are in addition to, and shall not be construed to in any way modify or amend in whole or in part, the terms, covenants, agreements and conditions of the Sublease.
27. Sublessor reserves the right to make such other and reasonable Rules and Regulations as, in its judgment, may from time to time be needed for safety and security, for care and cleanliness of the Project and for the preservation of good order therein. Sublessee agrees to abide by all such Rules and Regulations herein above stated and any additional rules and regulations which are adopted.
28. Sublessee shall be responsible for the observance of all the foregoing rules by Sublessee's employees, agents, clients, customers, invitees and guests.

**EXHIBIT 12**

**2005 ESTIMATED COMMON AREA MAINTENANCE & REAL ESTATE TAXES**

<u>EXPENSE CATAGORY</u>	<u>AMOUNT</u>	<u>PRICE PER SQUARE FOOT</u>
ELECTRICITY COMMON	\$5,843.98	\$0.09
WATER & SEWER	\$7,426.05	\$0.12
GAS/PROPANE COMMON	\$0.00	\$0.00
LANDSCAPING	\$16,294.26	\$0.26
TRASH REMOVAL	\$5,165.95	\$0.08
CLEANING - COMMON AREA	\$0.00	\$0.00
CLEANING - OTHER	\$0.00	\$0.00
ELECTRICAL	\$500.00	\$0.01
HVAC	\$9,000.00	\$0.14
PLUMBING	\$500.00	\$0.01
EXTERMINATING	\$0.00	\$0.00
MECHANICAL	\$0.00	\$0.00
SUPPLIES	\$1,000.00	\$0.02
LABOR	\$5,500.00	\$0.09
PAINTING	\$1,000.00	\$0.02
SNOW REMOVAL	\$12,914.87	\$0.21
FIRE/LIFE SAFETY	\$500.00	\$0.01
PARKING LOT	\$688.79	\$0.01
ROOF REPAIR	\$0.00	\$0.00
WINDOW WASHING	\$1,119.29	\$0.02
DOORS/LOCKS/KEYS	\$500.00	\$0.01
OTHER	\$600.00	\$0.01
LAND RENT	\$85,686.00	\$1.37
INSURANCE	\$6,506.94	\$0.10
MANAGEMENT FEES	\$29,102.00	\$0.47
GENERAL & ADMIN	\$1,560.00	\$0.02
<b>TOTAL EXPENSES</b>	<b>\$191,408.13</b>	<b>\$3.06</b>
<b>REAL ESTATE TAXES</b>	<b>\$67,597.00</b>	<b>\$1.08</b>
<b>TOTAL CAM &amp; TAX</b>	<b>\$259,005.13</b>	<b>\$4.14</b>



## Summary of Compensation for Executive Officers

PC Connection, Inc.'s (the "Company's") executive officers consist of: (i) Patricia Gallup, President, Chief Executive Officer, and Chairman; (ii) Robert Wilkins, Executive Vice President; (iii) Bradley G. Mousseau, Vice President of Human Resources; and (iv) Jack L. Ferguson, Treasurer and Interim Chief Financial Officer. In addition, Mark A. Gavin, our former Senior Vice President and Chief Financial Officer resigned from the Company on October 21, 2004.

The Compensation Committee annually sets the compensation of the Chief Executive Officer. The Compensation Committee also reviews the recommendations of the Chief Executive Officer regarding the compensation of the Company's other executive officers. The Compensation Committee seeks to achieve three broad goals in connection with the Company's compensation philosophy and decisions regarding compensation. First, the Company is committed to providing executive compensation designed to attract, retain, and motivate executives who contribute to the long-term success of the Company and are capable of leading the Company in achieving its business objectives in the competitive and rapidly changing industry in which the Company operates. Second, the Company wants to reward executives for the achievement of business objectives of the Company and/or the individual executive's particular area of responsibility. By tying compensation in part to achievement, the Company believes that a performance-oriented environment is created for the Company's executives. Finally, compensation is intended to provide executives with an equity interest in the Company so as to link a meaningful portion of the compensation of the Company's executives with the performance of the Company's Common Stock.

Each executive's total compensation depends upon the executive's performance against specific objectives. These objectives include both quantitative factors related to the Company's short-term financial objectives and qualitative factors such as (a) demonstrated leadership ability, (b) management development, (c) compliance with Company policies, and (d) anticipation of and response to changing market and economic conditions, to enhance the Company's ability to operate profitably. Compensation for the Company's executives generally consists of three elements:

- salary—levels are generally set by reviewing compensation for competitive positions in the market and considering the executive's level of responsibility, qualifications, and experience, as well as the Company's financial performance and the individual's performance;
- bonus—amounts are generally based on achievement of the Company's performance goals in any given year; and
- stock option grants—options provide long-term incentives to promote and identify long-term interests between the Company's employees and its stockholders and to assist in the retention of executives.

There were no stock options granted in 2004. The following table sets forth certain compensation information for 2004 and 2005 for our Chief Executive Officer and the three other most highly compensated executive officers of the Company, and one other executive officer who ceased serving as an executive officer during part of 2004:

		Salary(\$)	Bonus(\$)
Patricia Gallup President, Chief Executive Officer, and Chairman	2004	430,000	—
	2005	430,000	
Robert Wilkins Executive Vice President	2004	403,462	—
	2005	415,000	
Mark A. Gavin <sup>(1)</sup> Senior Vice President of Finance and Chief Financial Officer	2004	260,000	—
	2005	n/a	n/a
Bradley G. Mousseau Vice President of Human Resources	2004	190,480	30,000
	2005	200,000	
Jack L. Ferguson <sup>(2)</sup> Treasurer and Interim Chief Financial Officer	2004	153,250 <sup>(3)</sup>	9,800
	2005	260,750	

<sup>(1)</sup> In connection with his resignation, Mr. Gavin was paid an additional \$12,000 for vacation pay.

<sup>(2)</sup> Upon Mr. Gavin's resignation, Mr. Ferguson was appointed Chief Financial Officer on an interim basis.

<sup>(3)</sup> Mr. Ferguson's 2004 salary reflects an additional amount of \$22,500 for the period during which he served as Interim Chief Financial Officer.

**Summary Compensation for Non-Employee Directors**

Effective January 1, 2004, directors who are not employees of PC Connection, Inc receive a \$1,833 monthly cash retainer. In addition to this retainer, non-employee directors receive a fee of \$1,500 for each Board and committee meeting attended, unless the committee meeting is attended on a day of the Board meeting, in which case they receive \$1,000 for each committee meeting attended. In addition, these directors receive reimbursement for all reasonable expenses incurred in attending Board and committee meetings. Non-employee directors are also eligible to participate in our 1997 Stock Incentive Plan. Our non-employee directors are Bruce Barone, Joseph Baute, and Peter Baxter.

We did not issue any stock option grants to non-employee directors in 2004. The following table describes the cash payments made to non-employee directors during 2004:

Director	Cash Payments for Annual Retainer	Cash Payments for Board and Committees
Bruce Barone	\$ 22,000	\$ 31,500
Joseph Baute	22,000	31,500
Peter Baxter	22,000	30,000

**CORPORATE ORGANIZATIONAL STRUCTURE:**

PC Connection, Inc., a Delaware corporation, is the parent company of the following wholly owned subsidiaries:

1. PC Connection Sales Corporation, a Delaware corporation.
2. PC Connection Sales of Massachusetts, Inc., a Delaware corporation. (subsidiary of PC Connection Sales Corporation).
3. Merrimack Services Corporation, a Delaware corporation.
4. GovConnection, Inc. (formerly Comteq Federal, Inc.), a Maryland corporation.
5. MoreDirect, Inc., a Florida corporation.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-40172, 333-50845, 333-50847, 333-66450, 333-69981, 333-83943, 333-91584, and 333-106652 on Form S-8 of our report dated March 21, 2005, relating to the financial statements and financial statement schedules of PC Connection, Inc. appearing in this Annual Report on Form 10-K of PC Connection, Inc. for the year ended December 31, 2004.

Deloitte & Touche LLP

Boston, Massachusetts

March 30, 2005

## CERTIFICATIONS

I, Patricia Gallup, certify that:

1. I have reviewed this Annual Report on Form 10-K of PC Connection, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) [Not Applicable];
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2005

/s/ PATRICIA GALLUP

---

Patricia Gallup  
Chairman and Chief Executive Officer

## CERTIFICATIONS

I, Jack Ferguson, certify that:

1. I have reviewed this Annual Report on Form 10-K of PC Connection, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) [Not Applicable];
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 31, 2005

/s/ JACK FERGUSON

---

Jack Ferguson  
Treasurer and Interim Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of PC Connection, Inc. (the "Company") for the year ended December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Patricia Gallup, Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 31, 2005

/s/ PATRICIA GALLUP  
Patricia Gallup  
Chairman and Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the annual report on Form 10-K of PC Connection, Inc. (the "Company") for the year ended December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Jack Ferguson, Treasurer and Interim Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 31, 2005

/s/ JACK FERGUSON

---

Jack Ferguson  
Treasurer and Interim Chief Financial Officer