

CONVERSION SERVICES INTERNATIONAL INC
Form 10-Q
May 12, 2011

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

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2011

OR

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

For the Transition Period From _____ to _____

Commission File Number: 001-32623

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

Delaware
(State or other jurisdiction of
incorporation or organization)

20-0101495
(I.R.S. Employer
Identification No.)

100 Eagle Rock Avenue, East Hanover, New Jersey
(Address of principal executive offices)

07936
(Zip Code)

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

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

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

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

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

Edgar Filing: CONVERSION SERVICES INTERNATIONAL INC - Form 10-Q

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Class	Outstanding at May 9, 2011
Common Stock, \$0.001 par value per share	129,373,687 shares

CONVERSION SERVICES INTERNATIONAL, INC.

FORM 10-Q

For the three months ended March 31, 2011

INDEX

	Page
Part I. Financial Information	3
Item 1. Financial Statements	3
a) Condensed Consolidated Balance Sheets as of March 31, 2011 (unaudited) and December 31, 2010 (unaudited)	3
b) Condensed Consolidated Statements of Operations for the three months ended March 31, 2011 (unaudited) and 2010 (unaudited)	4
c) Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2011 (unaudited) and 2010 (unaudited)	5
d) Notes to Condensed Consolidated Financial Statements (unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 4T. Controls and Procedures	18
Part II. Other Information	19
Item 1. Legal Proceedings	19
Item 6. Exhibits	19
Signature	19

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash	\$ 10,123	\$ 285,762
Accounts receivable, net	2,423,531	3,108,506
Accounts receivable from related parties, net	299,814	211,179
Prepaid expenses	119,289	54,628
TOTAL CURRENT ASSETS	2,852,757	3,660,075
PROPERTY AND EQUIPMENT, at cost, net	-	6,798
OTHER ASSETS	30,419	86,576
Total Assets	\$ 2,883,176	\$ 3,753,449
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Line of credit	\$ 2,028,302	\$ 2,395,233
Accounts payable and accrued expenses	1,848,009	1,547,064
Series A redeemable convertible preferred stock	1,900,000	1,868,331
Deferred revenue	332,893	514,262
Short term notes payable	101,382	99,408
TOTAL CURRENT LIABILITIES	6,210,586	6,424,298
Long-term debt, net of current portion	500,000	500,000
Total liabilities	6,710,586	6,924,298
Convertible preferred stock, \$0.001 par value, \$100 stated value, 20,000,000 shares authorized		
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Common stock, \$0.001 par value, 300,000,000 shares authorized; 130,504,902 and 128,475,087 issued and outstanding at March 31, 2011 and December 31, 2010, respectively	130,505	128,475
Series B convertible preferred stock, 20,000 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	1,352,883	1,352,883
Additional paid in capital	68,217,834	68,165,281

Edgar Filing: CONVERSION SERVICES INTERNATIONAL INC - Form 10-Q

Treasury stock, at cost, 1,145,382 shares in treasury as of March 31, 2011 and December 31, 2010, respectively	(423,869)	(423,869)
Accumulated deficit	(73,104,763)	(72,393,619)
Total Stockholders' Deficit	(3,827,410)	(3,170,849)
Total Liabilities and Stockholders' Deficit	\$2,883,176	\$3,753,449

See Notes to Condensed Consolidated Financial Statements

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31,
(Unaudited)

	2011	2010
REVENUE:		
Services	\$2,940,838	\$4,304,349
Related party services	377,016	461,745
Reimbursable expenses	92,184	191,739
Other	50,585	19,000
	3,460,623	4,976,833
COST OF REVENUE:		
Services	2,327,799	3,208,046
Related party services	340,016	430,998
Consultant expenses	104,501	211,560
	2,772,316	3,850,604
GROSS PROFIT	688,307	1,126,229
OPERATING EXPENSES		
Selling and marketing	554,201	685,656
General and administrative	679,597	734,154
Depreciation and amortization	18,750	24,382
	1,252,548	1,444,192
LOSS FROM OPERATIONS	(564,241)	(317,963)
OTHER EXPENSE		
Interest expense, net	(146,903)	(99,147)
	(146,903)	(99,147)
LOSS BEFORE INCOME TAXES	(711,144)	(417,110)
INCOME TAXES	-	-
NET LOSS	(711,144)	(417,110)
Accretion of issuance costs associated with convertible preferred stock	-	(95,000)
Dividends on convertible preferred stock	(21,250)	(45,000)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$(732,394)	\$(557,110)
Basic and diluted loss per common share	\$(0.01)	\$(0.00)
Basic and diluted loss per common share attributable to common stockholders	\$(0.01)	\$(0.00)
Weighted average shares used to compute net loss per common share:		
Basic and diluted	129,264,942	123,369,977
See Notes to Condensed Consolidated Financial Statements		

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31,
(Unaudited)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$(711,144)	\$(417,110)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property and equipment and amortization of leasehold improvements	6,798	9,653
Amortization of deferred financing costs	11,952	14,729
Accretion of convertible preferred stock discount and beneficial conversion feature	31,669	-
Stock based compensation	-	19,909
Increase (decrease) in allowance for doubtful accounts	(21,924)	33,387
Changes in operating assets and liabilities:		
Decrease in accounts receivable	694,658	207,009
Increase in accounts receivable from related parties	(76,394)	(149,434)
(Increase) decrease in prepaid expenses and other assets	(20,455)	21,771
Increase (decrease) in accounts payable and accrued expenses	357,501	(212,033)
(Decrease) increase in deferred revenue	(181,369)	74,765
Net cash provided by (used in) operating activities	91,292	(397,354)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	-	-
Net cash provided by (used in) investing activities	-	-
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net (repayments) borrowings under the line of credit	(366,931)	397,137
Net cash (used in) provided by financing activities	(366,931)	397,137
NET DECREASE IN CASH	(275,639)	(217)
CASH, beginning of period	285,762	96,957
CASH, end of period	\$10,123	\$96,740
See Notes to Condensed Consolidated Financial Statements		

CONVERSION SERVICES INTERNATIONAL, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31,
(Unaudited)

	2011	2010
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	\$80,722	\$88,566
Cash paid for income taxes	-	-
Common stock issued in payment of preferred stock dividends	75,833	68,750
See Notes to Condensed Consolidated Financial Statements.		

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

Note 1 - Accounting Policies

Organization and Business

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

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

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by the Company and are unaudited. The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results to be expected for any future period or for the full fiscal year. In the opinion of management, all adjustments (consisting of normal recurring adjustments unless otherwise indicated) necessary to present fairly the financial position, results of operations and cash flows at March 31, 2011, and for all periods presented, have been made. Footnote disclosure has been condensed or omitted as permitted by Securities and Exchange Commission rules over interim financial statements.

These condensed consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010 and other reports filed with the Securities and Exchange Commission.

Principles of Consolidation

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

Revenue recognition

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

excess of revenues recognized are recorded as deferred revenues until revenue recognition criteria are met. Reimbursements, including those relating to travel and other out-of-pocket expenses, are included in revenues, and an equivalent amount of reimbursable expenses are included in cost of services.

Fair value of financial instruments

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

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

Concentrations of credit risk

Financial instruments which potentially subject the Company to concentrations of credit risk are cash and accounts receivable arising from its normal business activities. The Company routinely assesses the financial strength of its customers, based upon factors surrounding their credit risk, establishes an allowance for doubtful accounts, and as a consequence believes that its accounts receivable credit risk exposure beyond such allowances is limited. At March 31, 2011, receivables related to Bank of America and Leading Edge Communications (“LEC”), a related party, comprised approximately 41.9% and 11.0% of the Company’s accounts receivable balance, respectively. At December 31, 2010, receivables related to Bank of America and PNC Bank comprised approximately 25.3% and 33.5% of the Company’s accounts receivable balance, respectively.

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

Income taxes

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

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

Prior to recording its income tax liability, the Company makes a determination as to whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. If the more-likely-than-not threshold is met, the tax position is measured to determine the amount to recognize in the financial statements. At March 31, 2011 and December 31, 2010, the Company has no unrecognized tax benefits. As of March 31, 2011 and December 31, 2010, the Company had no accrued interest or penalties related to uncertain tax positions.

Use of estimates

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

Note 2 - Liquidity Issues and Going Concern

The Company has incurred a \$711,144 net loss for the three months ended March 31, 2011 and a loss of \$771,753 for the year ended December 31, 2010. While the Company reported a profit of \$31,956 for the fiscal year ended December 31, 2009, it incurred significant losses for the years ended December 31, 2004 through 2008, negative cash flows from operating activities for the years ended December 31, 2004 through 2008, and had an accumulated deficit of \$73.1 million at March 31, 2011. The Company has relied upon cash from its financing activities to fund its ongoing operations as it has not been able to generate sufficient cash from its operating activities in the past, and there is no assurance that it will be able to do so in the future. Due to this history of losses and operating cash consumption, we cannot predict if we will become profitable or if the Company's business will improve. These factors raise substantial doubt as to its ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As of March 31, 2011, the Company had a cash balance of approximately \$10,123, compared to \$285,762 at December 31, 2010, and a working capital deficiency of \$3.4 million.

The Company executed a revolving line of credit agreement in March 2008 with Access Capital, Inc. ("Access Capital" or "Access"). As of June 30, 2008, the Company was in default of the Loan and Security Agreement and remains in default as of March 31, 2011. As a result of the default, Access had increased the interest rate payable on borrowings under the line of credit to 18% per annum, has notified the Company's clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital. Effective

January 1, 2010, although the Company remained in default with respect to the Access Capital Loan and Security Agreement, Access Capital agreed to reduce the interest rate on borrowings under the line of credit from 18%, to 12% per annum. Refer to footnotes 4 and 11 of the Notes to Condensed Consolidated Financial Statements for further discussion on the Line of Credit.

In February 2006, the Company issued Series A Preferred Stock, in the amount of \$1,900,000, which is redeemable for cash or common stock at the Company's option on February 6, 2011. The Company did not have sufficient cash or available shares to redeem the Series A Preferred and, as a result, is in default with respect to the redemption of this security as of the date of this filing. The Company expects to, at its next annual meeting of shareholders, propose to the Company's stockholders an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of Common Stock in an amount as to allow the Company to pay the redemption price in shares of Common Stock. If and when such a proposal is approved by the Company's shareholders, the Company expects to redeem the Series A Preferred with shares of Common Stock. Until the Company pays the redemption price of the Series A Preferred, holders of the Series A Preferred will continue to receive dividends in the amount of 5% per annum as set forth in the Certificate of Designations.

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

Note 3 –New Accounting Standards

In September 2009, the FASB ratified an amendment to accounting standards addressing revenue recognition for arrangements with multiple revenue-generating activities. The amendment addresses how revenue should be allocated to separate elements that could impact the timing of revenue recognition. The amendment is effective for us on a prospective basis for revenue arrangements entered into or materially modified on or after January 1, 2011, and earlier application is permitted. Adoption of this amendment did not have a significant effect on our financial statements.

Note 4 - Line of credit

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

The Company was in default of the Loan and Security Agreement as of March 31, 2011 since its working capital was below the minimum required working capital of \$400,000. In the event of a default under the Loan and Security Agreement, Access Capital's remedies include, but are not limited to, the following:

- Access may perform or observe such covenant on behalf and in the name, place and stead of the Company and may take actions which they deem necessary to cure or correct such failure, including, but not limited to, payment of taxes, satisfaction of liens, performance of obligations owed to debtors, procurement of insurance, execution of assignments, security agreements and financing statements and the endorsement of instruments;
- upon the occurrence of, and for so long as any event of default exists, the interest rate is increased to one and one-half percent (1.5%) per month;
- Access may notify the Company's account debtors of their security interest in the accounts, collect them directly and charge the collection costs and expenses to the Company's account;
- at Access Capital's election, following the occurrence of an event of default, they may terminate the Loan and Security Agreement. In the event of early termination after the occurrence of default, the Company would be liable for various early payment fees, penalties and interest;
- Access shall have the right to demand repayment in full of all obligations, whether or not otherwise due, including required prepayment fees, interest, and penalties.

As a result of this default, to date, Access had increased the interest rate payable on borrowings under the line of credit to 18% per annum until December 31, 2009 and then adjusted the interest rate to 12% per annum beginning in January 2010, has notified the Company's clients of their security interest in the amounts due to the Company, and has provided instruction that payments are to be made directly to Access Capital.

As of March 31, 2011, \$2.0 million was outstanding under this line of credit and \$0.2 million was available.

See Note 11 of the Notes to Condensed Consolidated Financial Statements for further discussion regarding the line of credit.

Note 5 - Stock Based Compensation

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

The following summarizes the stock option transactions during 2011:

9

	Shares	Weighted average exercise price
Options outstanding at December 31, 2010	3,997,999	\$ 0.80
Options granted	-	-
Options exercised	-	-
Options canceled	(14,000)	0.73
Options outstanding at March 31, 2011	3,983,999	\$ 0.80

The following table summarizes information concerning outstanding and exercisable Company common stock options at March 31, 2011:

Range of exercise prices	Options outstanding	Weighted average exercise price	Weighted average remaining contractual life	Options exercisable	Weighted average exercise price
\$0.25-\$0.30	1,525,000	\$ 0.258	5.6	1,525,000	\$ 0.258
\$0.46-\$0.60	1,005,000	0.461	4.8	1,005,000	0.461
\$0.83	868,000	0.830	4.6	868,000	0.830
\$2.475-\$3.45	585,999	2.734	3.1	585,999	2.734
	3,983,999			3,983,999	

The Company recorded zero and \$19,909 of expense related to stock options which vested during the three months ended March 31, 2011 and 2010, respectively.

Note 6 – Loss Per Share

Basic loss per share is computed on the basis of the weighted average number of common shares outstanding. Diluted loss per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options using the “treasury stock” method and the effect of convertible debt instruments and warrants as if they had been converted at the beginning of each period presented.

Basic and diluted loss per share was determined as follows:

	For the three months ended March 31,	
	2011	2010
Net loss before income taxes (A)	\$ (711,144)	\$ (417,110)
Net loss (B)	\$ (711,144)	\$ (417,110)
Net loss attributable to common stockholders (C)	\$ (732,394)	\$ (557,110)
Weighted average outstanding shares of common stock (D)	129,264,942	123,369,977
Basic and diluted income (loss) per common share:		
Before income taxes (A/D)	\$ (0.01)	\$ (0.00)
Net loss per common share (B/D)	\$ (0.01)	\$ (0.00)
Net loss per common share attributable to common stockholders (C/D)	\$ (0.01)	\$ (0.00)

For the three month periods ended March 31, 2011 and 2010, 3,983,999 shares and 4,711,999 shares, respectively, attributable to outstanding stock options were excluded from the calculation of diluted loss per share because the effect was antidilutive. Additionally, the effect of 66,172,151 warrants and 36,596 options which were issued prior to March 31, 2010, and outstanding as of March 31, 2011, were excluded from the calculation of diluted loss per share for the three month periods ended March 31, 2011 and 2010, as appropriate, because the effect was antidilutive. Also excluded from the calculation of loss per share because their effect was antidilutive were 16,666,667 shares of common stock underlying the \$500,000 convertible line of credit note to TAG Virgin Islands, Inc. as of March 31, 2011 and 2010, 145,170,038 shares underlying the Series A and 4,000,000 shares underlying the Series B convertible preferred stock.

Note 7 – Preferred Stock

In February 2006, we entered into a Securities Purchase Agreement with investors represented by TAG Virgin Islands, Inc. (“TAG”), pursuant to which we issued 19,000 shares of our newly created Series A Convertible Preferred Stock, \$.001 par value (the “Series A Preferred”). Each share of Series A Preferred has a stated value of \$100.00. We received proceeds of \$1,900,000. The Series A Preferred has a cumulative annual dividend equal to five percent (5%), which is payable semi-annually in cash or common stock, at our election, and is convertible into shares of the Company’s common stock at any time at a price equal to \$0.50 per share (subject to adjustment). In addition, the Series A Preferred has no voting rights, but has liquidation preferences and certain other privileges. Pursuant to the Securities Purchase Agreement, the TAG investors were also granted a warrant to purchase 1,900,000 shares of our common stock exercisable at a price of \$0.60 per share (subject to adjustment), exercisable for a period of five years.

The Company did not have sufficient cash or available shares to redeem the Series A Preferred on the February 1, 2011 redemption date and, as a result, is in default with respect to the redemption of this security as of the date of this filing. The Company expects to, at its next annual meeting of shareholders, propose to the Company’s stockholders an amendment to the Company’s Certificate of Incorporation to increase the number of authorized shares of Common Stock in an amount as to allow the Company to pay the redemption price in shares of Common Stock. If and when such a proposal is approved by the Company’s shareholders, the Company expects to redeem the Series A Preferred with shares of Common Stock. Until the Company pays the redemption price of the Series A Preferred, holders of the Series A Preferred will continue to receive dividends in the amount of 5% per annum as set forth in the Certificate of Designations.

Note 8 - Major Customers

During the three months ended March 31, 2011, the Company had sales relating to three major customers, Bank of America, PNC Bank and LEC, a related party which comprised 33.6%, 15.2% and 10.9% of revenues, respectively, and totaled approximately \$2,064,687. Amounts due from services provided to these customers included in accounts receivable was approximately \$1,636,510 at March 31, 2011. As of March 31, 2011, receivables related to Bank of America, PNC Bank and LEC accounted for approximately 41.9%, 7.4% and 11.0% of the Company’s accounts receivable balance, respectively.

During the three months ended March 31, 2010, the Company had sales relating to two major customers, PNC Bank and Bank of America which comprised 29.5% and 10.6% of revenues, respectively, and totaled approximately \$1,995,312. Amounts due from services provided to these customers included in accounts receivable was approximately \$1,601,604 at March 31, 2010. As of March 31, 2010, receivables related to PNC Bank and Bank of America accounted for approximately 23.0% and 16.5% of the Company’s accounts receivable balance, respectively.

Note 9 - Commitments and Contingencies

Legal Proceedings

As of March 31, 2011, the Company has a claim pending in the Superior Court of New Jersey Law Division-Civil Part, Morris County, in which the Company sued National Digital Medical Archive, Inc. (hereinafter “Defendant” or “NDMA”), for services rendered to NDMA by the Company in 2009. This case arises out of NDMA's failure to pay the Company approximately \$0.4 million pursuant to a Professional Services Agreement, dated August 13, 2008, between CSI and NDMA (hereinafter the “Agreement”), and the Agreement’s two accompanying Statements of Work, dated June 12, 2008 and August 29, 2008, that were time and materials based projects (hereinafter collectively with the Agreement referred to as the “SOWs”). NDMA interposed an answer and asserted multiple affirmative defenses and

counterclaimed against the Company for approximately \$4.5 million based on the Company's alleged non-performance under the SOWs and for approximately \$3.8 million for unjust enrichment which is pled in the alternative. Discovery has just started in this case. A mediation is scheduled for late May 2011. A trial in this action will not occur until the fall of 2011. The Company believes it has meritorious claims for non-payment pending against NDMA and the Company will also vigorously defend against NDMA's counterclaims.

Lease Commitments

Future minimum lease payments due under all operating lease agreements as of March 31, 2011 are as follows:

Years Ending March 31	Office
2012	\$ 147,373
2013	141,873
2014	141,873
2015	106,405
Thereafter	-
	\$ 537,524

The Company's corporate headquarters are located at 100 Eagle Rock Avenue, East Hanover, New Jersey 07936, where it operates under an amended lease agreement expiring December 31, 2015. The Company leases approximately 9,137 square feet of office space in this facility. Monthly rent with respect to our East Hanover, New Jersey facility for the period beginning January 1, 2011 and ending December 31, 2015 is \$11,822.75. In addition to minimum rentals, the Company is liable for its proportionate share of real estate taxes and operating expenses, as defined. The Company also rents office space from HQ Global Workplaces, LLC at 401 North Tryon Street, Charlotte, North Carolina 28202, where it operates under a one year lease agreement expiring December 31, 2011. The monthly rent for this space is approximately \$625.

Note 10 - Related Party Transactions

Refer to footnote 8 for the related party transaction disclosure as a major customer.

As of March 31, 2011, the balance outstanding with respect to the loan from Glenn Peipert, our former Executive Vice President and Chief Operating Officer, to the Company was approximately \$0.1 million, which accrues interest at a simple rate of 8% per annum.

Note 11 - Subsequent Events

These financial statements were approved by management and the board of directors through the issuance date and management has evaluated subsequent events through the issuance date.

On April 6, 2011, Access Capital, Inc. ("Access Capital") and Conversion Services International, Inc. (the "Company") entered into an amendment to that certain Loan and Security Agreement, which was dated as of March 31, 2008. Under the original Loan and Security Agreement, Access Capital provided the Company with a revolving line of credit of up to a maximum of \$3,500,000, based upon collateral availability, and has a 90% advance rate against eligible accounts receivable. The line of credit was for a three year term and had a base interest rate of prime plus 2.75% and a default rate of 18%.

Under the Amended Loan and Security Agreement, Access Capital provided the Company with a revolving line of credit of up to a maximum of \$3,500,000, based upon collateral availability, and has a 90% advance rate against eligible accounts receivable. The line of credit is for a three year term. The line of credit has a base interest rate of prime plus 8.75% and provides for interest rate reductions based upon the Company's achievement of cash flow goals. The interest rate is reduced by between 0.50% and 3.00% based upon the Company's achievement of positive cumulative cash flow of between \$250,000 and \$1,500,000. The default interest rate is 3% above the applicable rate at the time of the default. "Cash Flow" as defined in the Amended Loan and Security Agreement means, the net income (as defined by GAAP) of the Company, plus any non-cash charges, less payments (i) to the Company's officers or related persons, (ii) under capital leases and (iii) for capital expenditures.

Also under the Amended Loan and Security Agreement, the Company would not be required to meet certain working capital amounts, but rather, the Company is required to maintain positive Cash Flow on up to a rolling six month basis. Starting April, 2011, the end of each month (each a "Test Date"), the Company is required to maintain positive Cash Flow for the period ending on the Test Date, and commencing from the later of (i) April 1, 2011 or (ii) six months prior to the Test Date. For example, on September 30, 2011, the Company is required to maintain positive Cash Flow for the period from April 1, 2011 to September 30, 2011. On November 30, 2011, the Company would be required to maintain positive Cash Flow for the period ending June 1, 2011 to November 30, 2011.

In April 2011, the Company executed Unsecured Notes Payable agreements (the "Notes") with Sam Sodano, Vice President of Professional Services, William Hendry, Vice President and CFO and Radel Associates, LLC whereby an

aggregate of \$100,000 was loaned to the Company. The Notes are due March 1, 2012, bear interest at 5% per annum and provide for repayment of principal and interest on a monthly basis beginning in June 2011. These Notes are subordinated to Access Capital.

On May 3, 2011, Scott Newman submitted his resignation from his position as Director and Chairman of the Board of Directors of the Company.

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

Special Note About Forward-Looking Statements

Certain statements in Management's Discussion and Analysis ("MD&A"), other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words "believes," "project," "expects," "anticipates," "estimates," "intends," "strategy," "plan," "may," "will," "would," "will be," "will continue," "may result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview of our Business

Conversion Services International, Inc. provides professional services to the Global 2000, as well as mid-market clientele relating to strategic consulting, business intelligence/data warehousing and data management and, through strategic partners, the sale of software. The Company's services based clients are primarily in the financial services, pharmaceutical, healthcare and telecommunications industries, although it has clients in other industries as well. The Company's clients are primarily located in the northeastern United States.

The Company began operations in 1990. Its services were originally focused on e-business solutions and data warehousing. In the late 1990s, the Company strategically repositioned itself to capitalize on its data warehousing expertise in the fast growing business intelligence/data warehousing space. The Company became a public company via its merger with a wholly owned subsidiary of LCS Group, Inc., effective January 30, 2004.

The Company's core strategy includes capitalizing on the already established in-house business intelligence/data warehousing ("BI/DW") technical expertise and its strategic consulting division. This is expected to result in organic growth through the addition of new customers.

The Company derives a majority of its revenue from professional services engagements. Its revenue depends on the Company's ability to generate new business, in addition to preserving present client engagements. The general domestic economic conditions in the industries the Company serves, the pace of technological change, and the business requirements and practices of its clients and potential clients directly affect our ability to accomplish these goals. When economic conditions decline, companies generally decrease their technology budgets and reduce the amount of spending on the type of information technology (IT) consulting provided by the Company. The Company's revenue is also impacted by the rate per hour it is able to charge for its services and by the size and chargeability, or utilization rate, of its professional workforce. If the Company is unable to maintain its billing rates or sustain appropriate utilization rates for its professionals, its overall profitability may decline. Several large clients have changed their business practices with respect to consulting services. Such clients now require that we contract with their vendor management organizations in order to continue to perform services. These organizations charge fees generally based upon the hourly rates being charged to the end client. Our revenues and gross margins are being negatively affected by this practice.

The Company will continue to focus on a variety of growth initiatives in order to improve its market share and increase revenue. Moreover, as the Company endeavors to achieve top line growth, through entry on new approved vendor lists, penetrating new vertical markets, and expanding its time and material business, the Company will concentrate its efforts on improving margins and driving earnings to the bottom line.

The Company's most significant costs are personnel expenses, which consist of consultant fees, benefits and payroll-related expenses.

Results of Operations

The following table sets forth selected financial data for the periods indicated:

	Selected Statement of Operations Data for the three months ended March 31,	
	2011	2010
Net revenue	\$ 3,460,623	\$ 4,976,833
Gross profit	688,307	1,126,229

Edgar Filing: CONVERSION SERVICES INTERNATIONAL INC - Form 10-Q

Net loss	(711,144)	(417,110)
Net loss attributable to common stockholders	(732,394)	(557,110)
Basic and diluted loss per common share:		
Net loss per common share	\$ (0.01)	\$ (0.00)
Net loss per common share attributable to common stockholders	\$ (0.01)	\$ (0.00)

Selected Statement of Financial Position

Data as of

December 31,

March 31, 2011

2010

Working capital deficiency	\$ (3,357,829)	\$ (2,764,223)
Total assets	2,883,176	3,753,449
Total stockholders' deficit	(3,827,410)	(3,170,849)

Three Months Ended March 31, 2011 and 2010

Revenue

The Company's revenue is primarily comprised of billings to clients for consulting hours worked on client projects. Revenue of \$3.5 million for the three months ended March 31, 2011, decreased by \$1.5 million, or 30.5% as compared to revenue of \$5.0 million for the three months ended March 31, 2010, respectively.

Revenue for the Company is categorized by strategic consulting, business intelligence/data warehousing and data management. The chart below reflects revenue by line of business for the three months ended March 31, 2011 and 2010:

	For the three months ended March 31,					
	2011			2010		
	\$	% of total revenues		\$	% of total revenues	
Strategic Consulting	\$ 1,282,857	37.1 %		\$ 1,478,107	29.7 %	
Business Intelligence / Data						
Warehousing	1,657,982	47.9 %		2,826,242	56.8 %	
Data Management	377,016	10.9 %		461,745	9.3 %	
Reimbursable expenses	92,183	2.6 %		191,739	3.8 %	
Other	50,585	1.5 %		19,000	0.4 %	
	\$ 3,460,623	100.0 %		\$ 4,976,833	100.0 %	

Strategic consulting

The strategic consulting line of business includes work related to planning and assessing people, process and technology for clients, performing gap analysis, making recommendations regarding technology and business process improvements to assist clients to realize their business goals and maximize their investments in both people and technology. The Company performs strategic consulting work through its Business Transformation Solutions division.

Strategic consulting revenue of \$1.3 million, or 37.1% of total revenue, for the three months ended March 31, 2011 decreased by \$0.2 million, or 13.2%, as compared to revenue of \$1.5 million, or 29.7% of total revenue, for the three months ended March 31, 2010. This decrease is primarily due to a \$0.7 million decrease in revenue related to a project at PNC Bank that began in April 2009 and concluded in third quarter of 2010. Additionally, revenue declined by \$0.1 million related to prior year projects for clients that were also completed in the prior year. This decrease was partially offset by a \$0.6 million increase in revenue from Bank of America as compared to the prior year. In the strategic consulting line of business, there was a 7.4% increase in average consultant headcount, a 24.9% increase in billable hours and a 25.2% increase in utilization. The average bill rate decreased 33.2% as compared to the prior year.

Business intelligence / Data warehousing

The business intelligence line of business includes work performed with various applications and technologies for gathering, storing, analyzing and providing clients with access to data in order to allow enterprise users to make better and quicker business decisions. The data warehousing line of business includes work performed for client companies to provide a consolidated view of high quality enterprise information. CSI provides services in the data warehouse and data mart design, development and implementation, prepares proof of concepts, implements data warehouse solutions and integrates enterprise information. Since the business intelligence and data warehousing work overlap and the Company has performed engagements which include both business intelligence and data warehousing components,

the Company tracks this work as a single line of business and reports the results as a single line of business.

Business intelligence/data warehousing (“BI/DW”) revenue of \$1.7 million, or 47.9% of total revenue, for the three months ended March 31, 2011 decreased by \$1.1 million, or 41.3%, as compared to revenue of \$2.8 million, or 56.8% of total revenue, for the three months ended March 31, 2010. This decrease is primarily due to a \$1.3 million reduction in revenue related to prior year projects that completed in the prior period and a \$0.3 million decrease in revenue related to projects that continued from the prior year. These revenue reductions were partially offset by \$0.5 million of new project revenue obtained during the quarter. Overall, the BI/DW line of business had a 44.3% decrease in average consultant headcount, a 36.4% decrease in billable hours, and a 7.0% decrease in the average bill rate as compared to the prior period.

Data management

The data management line of business includes such activities as Enterprise Information Architecture, Metadata Management, Data Quality/Cleansing/ Profiling. The Company performs these activities through its exclusive subcontractor agreement with its related party, LEC.

Data management revenue of \$0.4 million, or 10.9% of total revenue, for the three months ended March 31, 2011 decreased by \$0.1 million, or 18.3%, as compared to revenue of \$0.5 million, or 9.3% of total revenue, for the three months ended March 31, 2010. The revenue for the quarter decreased as compared to the prior year due to a 22.6% decrease in billable hours and a 15.1% decrease in the utilization rate, which was partially offset by a 5.2% increase in the average bill rate.

Cost of revenue

Cost of revenue includes payroll and benefit and other direct costs for the Company's consultants. Cost of revenue was \$2.8 million, or 80.1% of revenue for the three months ended March 31, 2011, representing a decrease of \$1.1 million, or 28.0%, as compared to \$3.9 million, or 77.4% of revenue for the three months ended March 31, 2010.

Cost of services was \$2.3 million, or 79.2% of services revenue for the three months ended March 31, 2011, representing a decrease of \$0.9 million, or 27.4%, as compared to \$3.2 million, or 74.5% of services revenue for the three months ended March 31, 2010. Cost of services decreased during the three months ended March 31, 2011 as compared to the prior year due to a decrease in services revenue during the period, accounting for a \$1.0 million decrease in cost of services. Partially offsetting this decrease were costs related to several consultants that were not billable during the period which accounted for \$0.1 million of increased cost as compared to the prior year. The Company had an average of 63 consultants in the current period and 88 in the prior year period, resulting in a 28.4% decrease in consultant headcount.

Cost of related party services was \$0.3 million, or 90.2% of related party services revenue, for the three months ended March 31, 2011, representing a decrease of \$0.1 million, or 21.1%, as compared to \$0.4 million, or 93.3% of related party services revenue, for the three months ended March 31, 2010. The Company had 13 consultants performing services for the related party in the current period and 14 in the prior year period, resulting in a 7.1% decrease in consultant headcount.

Gross profit

Gross profit was \$0.7 million, or 19.9% of revenue for the three months ended March 31, 2011, representing a decrease of \$0.4 million, or 38.9%, as compared to \$1.1 million, or 22.6% of revenue for the three months ended March 31, 2010.

Gross profit from services was \$0.6 million, or 20.8% of services revenue for the three months ended March 31, 2011, representing a decrease of \$0.5 million from the prior year's gross profit from services of \$1.1 million, or 25.5% of services revenue. The decrease in the gross profit from services as a percentage of services revenue has been outlined previously in the revenue and cost of revenue discussions.

Gross profit from related party services was \$37,000, or 9.8% of related party services revenue for the three months ended March 31, 2011, representing an increase of \$6,253 from the prior year's gross profit of \$30,747, or 6.7% of related party services revenue for the three months ended March 31, 2010. The increase in the gross profit from related party services as a percentage of related party services revenue has been outlined previously in the revenue and cost of revenue discussions.

Selling and marketing

Selling and marketing expenses include payroll, employee benefits and other headcount-related costs associated with sales and marketing personnel and advertising, promotions, tradeshow, seminars and other programs. Selling and marketing expenses were \$0.6 million, or 16.0% of revenue, for the three months ended March 31, 2011, decreasing by \$0.1 million, or 19.2%, as compared to \$0.7 million, or 13.8% of revenue, for the three months ended March 31, 2010.

Selling and marketing expense for the three months ended March 31, 2011 decreased by \$0.1 million as compared to the prior year due primarily to a \$0.1 million reduction in payroll and payroll related expenses due to a reduction in headcount and reduced commission expense as compared to the prior year.

General and administrative

General and administrative costs include payroll, employee benefits and other headcount-related costs associated with the finance, legal, facilities, certain human resources and other administrative headcount, and legal and other professional and administrative fees. General and administrative costs were \$0.7 million, or 19.6% of revenue, for the three months ended March 31, 2011, declining \$54,557, as compared to \$0.7 million, or 14.8% of revenue, for the three months ended March 31, 2010. This decline is primarily due to expense reductions of \$113,986 in expense categories including payroll and payroll related costs, bad debt expense, rent and utilities, and travel which were partially offset by expense increases of \$59,429 in expense categories including insurance and accounting and legal expense.

Depreciation and amortization

Depreciation expense is recorded on the Company's property and equipment which is generally depreciated over a period between three to seven years. Amortization of leasehold improvements is taken over the shorter of the estimated useful life of the asset or the remaining term of the lease. The Company amortizes deferred financing costs utilizing the effective interest method over the term of the related debt instrument. Depreciation and amortization expenses were \$18,750 and \$24,382 for the three months ended March 31, 2011 and 2010, respectively.

Other income (expense)

Interest expense during the three months ended March 31, 2011 and 2010 was \$146,903 and \$99,147, respectively. Interest expense increased by \$47,756 as compared to the prior year period due to a reclassification of the accretion of issuance costs and the dividends related to the Series A convertible preferred stock to interest expense.

Liquidity and Capital Resources

The Company has incurred a \$711,144 net loss for the three months ended March 31, 2011 and a loss of \$771,753 for the year ended December 31, 2010. While the Company reported a profit of \$31,956 for the fiscal year ended December 31, 2009, it incurred significant losses for the years ended December 31, 2004 through 2008, negative cash flows from operating activities for the years ended December 31, 2004 through 2008, and had an accumulated deficit of \$73.1 million at March 31, 2011. The Company has relied upon cash from its financing activities to fund its ongoing operations as it has not been able to generate sufficient cash from its operating activities in the past, and there is no assurance that it will be able to do so in the future. Due to this history of losses and operating cash consumption, we cannot predict if we will become profitable or if the Company's business will improve. These factors raise substantial doubt as to its ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As of March 31, 2011, the Company had a cash balance of approximately \$10,123, compared to \$285,762 at December 31, 2010, and a working capital deficiency of \$3.4 million.

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

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

In February 2006, the Company issued Series A Preferred Stock, in the amount of \$1,900,000, which is redeemable for cash or common stock at the Company's option on February 6, 2011. The Company did not have sufficient cash or available shares to redeem the Series A Preferred and, as a result, is in default with respect to the redemption of this security as of the date of this filing. The Company expects to, at its next annual meeting of shareholders, propose to the Company's stockholders an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of Common Stock in an amount as to allow the Company to pay the redemption price in shares of Common Stock. If and when such a proposal is approved by the Company's shareholders, the Company expects to redeem the Series A Preferred with shares of Common Stock. Until the Company pays the redemption price of the Series A Preferred, holders of the Series A Preferred will continue to receive dividends in the amount of 5% per annum as set forth in the Certificate of Designations.

The Company's working capital deficit was \$3.4 million as of March 31, 2011 which represented a \$0.6 million increase in the working capital deficit when compared to the working capital deficit of \$2.8 million as of December

31, 2010. The \$0.6 million increase in the working capital deficit is due to a \$0.6 million reduction in accounts receivable and prepaid expenses, a \$0.3 million increase in accounts payable and accrued expenses and a \$0.3 million reduction in cash, which was partially offset by a \$0.4 million reduction in the Access Capital line of credit balance and a \$0.2 million reduction in deferred revenue.

Cash provided by operating activities during the three months ended March 31, 2011 was approximately \$0.1 million compared to cash used in operating activities of \$0.4 million for the three months ended March 31, 2010. The \$0.5 million decrease in cash used in operating activities was primarily the result of a \$0.6 million reduction in cash used by accounts receivable and a \$0.5 million reduction in cash used by accounts payable, partially offset by a \$0.3 million increase in cash used by the Company's net loss adjusted for non-cash charges/credits recorded in income, such as depreciation, amortization, stock based compensation and bad debt expense and a \$0.3 million increase in cash used by deferred revenue as compared to the prior year period.

There was no cash used in investing activities in either the current or prior period.

Cash used in financing activities was \$0.4 million during the three month periods ended March 31, 2011 and cash provided by financing activities was \$0.4 million during the three months ended March 31, 2010. During the current period, the cash used in financing activities was due to repayments of the Company's revolving line of credit as a result of the reduced collateral base. The cash provided by financing activities during the three months ended March 31, 2010 was due to additional borrowings under the Company's revolving line of credit agreement with Access Capital.

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

There are currently no material commitments for capital expenditures.

As of March 31, 2011 and December 31, 2010, the Company had accounts receivable due from LEC of approximately \$0.3 million and \$0.2 million, respectively. There are no known collection problems with respect to LEC.

For the three months ended March 31, 2011 and 2010, we invoiced LEC \$0.4 million and \$0.5 million, respectively, for the services of consultants subcontracted to LEC by us. The majority of its billing is derived from Fortune 100 clients.

The following is a summary of the debt instruments outstanding as of March 31, 2011:

Lender	Type of facility	Outstanding as of March 31, 2011 (not including interest) (all numbers approximate)	Remaining Availability (if applicable)
Access Capital, Inc.	Line of Credit	\$ 2,028,302	\$ 230,023
TAG Virgin Islands, Inc. Investors – due April 30, 2012	Convertible Promissory Notes	\$ 500,000	\$ -
Glenn Peipert	Promissory Note	\$ 101,000	\$ -
TOTAL		\$ 2,629,302	\$ 230,023

Additionally, the Company has two series of preferred stock outstanding as follows:

Holder	Type of Instrument	Principal amount outstanding as of March 31, 2011
TAG Virgin Islands, Inc. Investors	Series A Convertible Preferred Stock	\$ 1,900,000
Matthew J. Szulik	Series B Convertible Preferred Stock	\$ 2,000,000
TOTAL		\$ 3,900,000

In February 2006, we entered into a Securities Purchase Agreement with investors represented by TAG Virgin Islands, Inc. (“TAG”), pursuant to which we issued 19,000 shares of our newly created Series A Convertible Preferred Stock, \$.001 par value (the “Series A Preferred”). Each share of Series A Preferred has a stated value of \$100.00. We

received proceeds of \$1,900,000. The Series A Preferred has a cumulative annual dividend equal to five percent (5%), which is payable semi-annually in cash or common stock, at our election, and is convertible into shares of the Company's common stock at any time at a price equal to \$0.50 per share (subject to adjustment). In addition, the Series A Preferred has no voting rights, but has liquidation preferences and certain other privileges. Pursuant to the Securities Purchase Agreement, the TAG investors were also granted a warrant to purchase 1,900,000 shares of our common stock exercisable at a price of \$0.60 per share (subject to adjustment), exercisable for a period of five years.

The Company did not have sufficient cash or available shares to redeem the Series A Preferred on the February 1, 2011 redemption date and, as a result, is in default with respect to the redemption of this security as of the date of this filing. The Company expects to, at its next annual meeting of shareholders, propose to the Company's stockholders an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of Common Stock in an amount as to allow the Company to pay the redemption price in shares of Common Stock. If and when such a proposal is approved by the Company's shareholders, the Company expects to redeem the Series A Preferred with shares of Common Stock. Until the Company pays the redemption price of the Series A Preferred, holders of the Series A Preferred will continue to receive dividends in the amount of 5% per annum as set forth in the Certificate of Designations.

New Accounting Standards

In September 2009, the FASB ratified an amendment to accounting standards addressing revenue recognition for arrangements with multiple revenue-generating activities. The amendment addresses how revenue should be allocated to separate elements that could impact the timing of revenue recognition. The amendment is effective for us on a prospective basis for revenue arrangements entered into or materially modified on or after January 1, 2011, and earlier application is permitted. Adoption of this amendment did not have a significant effect on our financial statements.

Application of Critical Accounting Policies

Revenue recognition

Our revenue recognition policy is significant because revenues are a key component of our results from operations. In addition, revenue recognition determines the timing of certain expenses, such as incentive compensation. We follow very specific and detailed guidelines in measuring revenue; however, certain judgments and estimates affect the application of the revenue policy. Revenue results are difficult to predict and any shortfall in revenue or delay in recognizing revenue could cause operating results to vary significantly from quarter to quarter and could result in future operating losses or reduced net income.

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

The Company recognizes revenue in accordance with generally accepted accounting principles. As a result, in the event that collectability from a client is not reasonably assured, revenue is recognized on the cash basis.

Deferred Income Taxes

Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. We record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. We have considered future taxable income and prudent and feasible tax planning strategies in determining the need for a valuation allowance. A valuation allowance is maintained by the Company due to the impact of the current years net operating loss (NOL). In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment to the deferred tax assets would be charged to net income in the period such determination is made. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, the previously provided valuation allowance would be reversed. Our current valuation allowance relates predominately to benefits derived from the utilization of our NOL's.

Item 4T. Controls and Procedures

Evaluation of disclosure controls and procedures.

As of the end of the period covered by this Quarterly Report, the Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer ("the Certifying Officers"), conducted evaluations of the Company's disclosure controls and procedures. As defined under Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the term "disclosure controls and procedures" means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer 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 Commission's rules and forms. Disclosure controls and procedures include without

limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including the Certifying Officers, to allow timely decisions regarding required disclosures. Based on this evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were not effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Exchange Act and the rules and regulations promulgated thereunder.

The Chief Executive Officer's and Chief Financial Officer's conclusion regarding the Company's disclosure controls and procedures is based solely on management's conclusion that the Company's internal control over financial reporting as identified in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 continues to be ineffective as of March 31, 2011. In connection with our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, our management assessed the effectiveness of the Company's internal control over financial reporting was not effective based on management's identification of a lack of segregation of duties due to the small number of employees dealing with general administrative and financial matters and general controls over information security and user access. Also, the Company's Chief Financial Officer is the only person with an appropriate level of accounting knowledge, experience and training in the selection, application and implementation of generally accepted accounting principles as it relates to complex transactions and financial reporting requirements.

Changes in internal control over financial reporting.

During the first quarter of 2011, the Company implemented a new project accounting module within its Microsoft Dynamics accounting system. This implementation has required changes to the billing and accounts payable processes within the Company. These changes have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As of March 31, 2011, the Company has a claim pending in the Superior Court of New Jersey Law Division-Civil Part, Morris County, in which the Company sued National Digital Medical Archive, Inc. (hereinafter “Defendant” or “NDMA”), for services rendered to NDMA by the Company in 2009. This case arises out of NDMA's failure to pay the Company approximately \$0.4 million pursuant to a Professional Services Agreement, dated August 13, 2008, between CSI and NDMA (hereinafter the “Agreement”), and the Agreement’s two accompanying Statements of Work, dated June 12, 2008 and August 29, 2008, that were time and materials based projects (hereinafter collectively with the Agreement referred to as the “SOWs”). NDMA interposed an answer and asserted multiple affirmative defenses and counterclaimed against the Company for approximately \$4.5 million based on the Company’s alleged non-performance under the SOWs and for approximately \$3.8 million for unjust enrichment which is pled in the alternative. Discovery has just started in this case. A mediation is scheduled for late May 2011. A trial in this action will not occur until the fall of 2011. The Company believes it has meritorious claims for non-payment pending against NDMA and the Company will also vigorously defend against NDMA's counterclaims.

Item 6. Exhibits

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934

32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350

32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350

SIGNATURE

Pursuant to the requirements 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.

Conversion Services International, Inc.

Date: May 12, 2010

By: /s/ Lori Cohen
Lori Cohen
President and Chief Executive Officer