Data Storage Corp
Form 10-Q
May 20, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

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

For the transition period from ___________ to ___________

Commission File No. 001-35384

DATA STORAGE CORPORATION
(Exact name of registrant as specified in its charter)

NEVADA (State or other jurisdiction of incorporation or organization)	98-0530147 (I.R.S. Employer Identification No.)
401 Franklin Avenue Garden City, N.Y (Address of principal executive offices)	11530 (Zip Code)

Registrant's telephone number, including area code: (212) 564-4922

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

Indicate by check mark whether the registrant 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 x No o

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

Large Accelerated Filer	o	Accelerated Filer	o
Non-Accelerated Filer	o	Smaller Reporting Company	x
(Do not check if a smaller reporting company)			

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

As of May 15, 2014, 36,125,845 shares of common stock, par value $0.001 per share, were outstanding.

DATA STORAGE CORPORATION

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PART I

ITEM 1. Financial Statements

DATA STORAGE CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2014 (UNAUDITED)	December 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 146,458	$ 87,675
Accounts receivable (less allowance for doubtful accounts of $15,000 in 2014 and $26,801 in 2013)	366,501	258,567
Prepaid compensation	6,209	9,052
Prepaid expenses and other current assets	101,585	171,584
Total Current Assets	620,753	526,878
Property and Equipment:		
Property and equipment	3,862,847	3,859,528
Less—Accumulated depreciation	(2,844,441)	(2,728,547)
Net Property and Equipment	1,018,406	1,130,981
Other Assets:		
Goodwill	2,201,828	2,201,828
Investment in joint venture – at equity	-	-
Other assets	3,608	3,608
Intangible assets, net	597,521	658,769
Employee loan	48,198	45,730
Total Other Assets	2,851,155	2,909,935
Total Assets	4,490,314	4,567,794
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities:		
Accounts payable and accrued expenses	904,608	984,866
Revolving credit facility	100,292	100,292
Due to related party	218,802	207,848
Dividend payable	351,297	330,811
Deferred revenue	688,688	703,941
Leases payable	817,690	736,636
Loans payable	70,405	47,312
Convertible debt – related parties net of discount	693,653	186,215
Contingent collateral obligation	350,000	356,204
Total Current Liabilities	4,195,435	3,654,125
Deferred rental obligation	2,593	5,187
Due to officer	903,869	801,875

Leases payable long term	21,116	86,180
Convertible debt – related parties	-	500,000
Total Long Term Liabilities	927,578	1,393,242
Total Liabilities	5,123,013	5,047,367
Stockholders’ Deficit:		
Preferred Stock, $.001 par value; 10,000,000 shares authorized; 1,401,786 shares issued and outstanding in each period	1,402	1,402
Common stock, par value $0.001; 250,000,000 shares authorized; 36,125,845 shares issued and outstanding in each period	36,126	36,126
Additional paid in capital	12,574,832	12,540,018
Accumulated deficit	(13,245,059)	(13,057,119)
Total Stockholders' Deficit	(632,699)	(479,573)
Total Liabilities and Stockholders' Deficit	$ 4,490,314	$ 4,567,794

The accompanying notes are an integral part of these condensed consolidated financial statements.

DATA STORAGE CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months Ended March 31, 2014	Three months Ended March 31, 2013
Sales	$ 1,042,963	$ 1,176,178
Cost of sales	620,908	727,114
Gross Profit	422,055	449,064
Selling, general and administrative	550,030	721,395
Loss from Operations	(127,975)	(272,331)
Other Income (Expense)		
Interest income	7	11
Amortization of debt discount	(7,438)	(1,487)
Net loss in equity method investment	-	-
Interest expense	(32,048)	(30,286)
Total Other (Expense)	(39,479)	(31,762)
Loss before provision for income taxes	(167,454)	(304,093)
Provision for income taxes	-	-
Net Loss	(167,454)	(304,093)
Preferred Stock Dividend	(20,486)	(12,500)
Net Loss Attributable to Common Shareholders	$ (187,940)	$ (316,593)
Loss per Share – Basic and Diluted	$ (0.01)	$ (0.01)
Weighted Average Number of Shares - Basic and Diluted	36,125,845	33,165,915

The accompanying notes are an integral part of these condensed consolidated financial statements.

DATA STORAGE CORPORATION AND SUBSIDIARY
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Cash Flows from Operating Activities:		
Net loss	$ (167,454)	$ (304,093)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	177,142	225,032
Amortization of debt discount	7,438	1,487
Non cash interest expense	17,260	12,329
Deferred compensation	2,844	-
Stock based compensation	34,813	58,126
Changes in Assets and Liabilities:		
Accounts receivable	(107,934)	(45,841)
Other assets	-	(1,948)
Prepaid expenses and other current assets	69,999	53,943
Employee loan	(2,470)	-
Accounts payable and accrued expenses	(58,434)	(51,430)
Deferred revenue	(15,253)	(39,389)
Deferred rent	(2,594)	(2,015)
Due to related party	10,954	12,989
Net Cash Used in Operating Activities	(33,689)	(76,914)
Cash Flows from Investing Activities:		
Capital expenditures	(3,318)	-
Net Cash Used in Investing Activities	(3,318)	-
Cash Flows from Financing Activities:		
Issuance of convertible debt	-	100,000
Repayments of capital lease obligations	-	(28,417)
Repayments of loan obligations	-	11,887
Repayment of contingent consideration	(6,204)	(3,105)
Advances from officer	101,994	7,847
Net Cash Provided by Financing Activities	95,790	88,212
Increase in Cash and Cash Equivalents	58,783	11,298
Cash and Cash Equivalents, Beginning of Period	87,675	72,756
Cash and Cash Equivalents, End of Period	$ 146,458	$ 84,054
Cash paid for interest	$ -	$ -
Cash paid for income taxes	$ -	$ -
Non cash investing and financing activities:		

Accrual of preferred stock dividend	$	20,486	$	12,500
Warrants issued with convertible debt	$	-	$	17,851

The accompanying notes are an integral part of these condensed consolidated financial statements.

DATA STORAGE CORPORATION AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
THREE MONTHS ENDED MARCH 31, 2014 AND 2013

Note 1 - Basis of presentation, organization and other matters

Headquartered in Garden City, N.Y., Data Storage Corporation ("DSC" or the "Company") offers its solutions and services to businesses within the healthcare, banking and finance, distribution services, manufacturing, construction, education, and government industries.

DSC derives revenues from long term subscription services and professional services related to implementation of subscription services that provide businesses in the education, government and healthcare industries protection of critical computerized data. In 2009 revenues consisted primarily of offsite data backup, de-duplication, continuous data protection and Cloud Disaster Recovery solutions, protecting information for our clients. In 2010 DSC expanded its solutions based on the asset acquisition of SafeData. In 2012 DSC continued to assimilate organizations, expanded its technology as well as technical group and positioned the new organization for growth. In October 2012 DSC purchased the software and assets of Message Logic. DSC has equipment for cloud storage and cloud computing in our data centers in Illinois, Massachusetts, Rhode Island, and New York. DSC delivers its solutions over highly reliable, redundant and secure fiber optic networks with separate and diverse routes to the Internet. The network and geographical diversity is important to clients seeking storage hosting and disaster recovery solutions, ensuring protection of data and continuity of business in the case of a network interruption.

Condensed Consolidated Financial Statements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results of operations for the full year. The condensed consolidated balance sheet at December 31, 2013 was derived from audited consolidated financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The other information in these condensed consolidated financial statements is unaudited but, in the opinion of management, reflects all adjustments necessary for a fair presentation of the results for the periods covered. All such adjustments are of a normal recurring nature unless disclosed otherwise. These condensed consolidated financial statements, including notes, have been prepared in accordance with the applicable rules of the Securities and Exchange Commission and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and additional information as contained in our Annual Report on Form 10-K for the year ended December 31, 2013.

Liquidity

The financial statements have been prepared using accounting principles generally accepted in the United States of America applicable for a going concern, which assumes that the Company will realize its assets and discharge its liabilities in the ordinary course of business. For the three months ended March 31, 2014, the Company has generated revenues of $1,042,963 but has incurred a net loss attributed to common shareholders of $187,940. Its ability to continue as a going concern is dependent upon achieving sales growth, reduction of operation expenses and ability of the Company to obtain the necessary financing to meet its obligations and pay its liabilities arising from normal business operations when they come due, and upon profitable operations. The Company has been funded by the Mr. Charles M. Piluso, the Company's Chief Executive Officer ("CEO") and largest shareholder since inception as well as several Directors. It is the intention of Mr. Piluso to continue to fund the Company on an as needed basis.

Note 2 - Summary of Significant Accounting Policies

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its subsidiary, Data Storage Corporation, a Delaware Corporation. All significant inter-company transactions and balances have been eliminated in consolidation.

Equity Investments

Equity investments in which the Company exercises significant influence but does not control and is not the primary beneficiary are accounted for using the equity method. The Company's share of its equity method investee’s earnings or losses are included in other income in the accompanying Condensed Consolidated Statements of Operations.

Use of Estimates

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

Estimated Fair Value of Financial Instruments

The Company's financial instruments include cash, accounts receivable, accounts payable, line of credit and due to related parties. Management believes the estimated fair value of these accounts at March 31, 2014 approximate their carrying value as reflected in the balance sheets due to the short-term nature of these instruments or the use of market interest rates for debt instruments. The carrying values of certain of the Company’s notes payable and capital lease obligations approximate their fair values based upon a comparison of the interest rate and terms of such debt given the level of risk to the rates and terms of similar debt currently available to the Company in the marketplace.

Goodwill and Other Intangibles

In accordance with GAAP, the Company tests goodwill and other intangible assets for impairment on at least an annual basis. Goodwill impairment exists if the net book value of a reporting unit exceeds its estimated fair value. The impairment testing is performed in two steps: (i) the Company determines impairment by comparing the fair value of a reporting unit with its carrying value, and (ii) if there is an impairment, the Company measures the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. To determine the fair value of these intangible assets, the Company uses many assumptions and estimates using a market participant approach that directly impact the results of the testing. In making these assumptions and estimates, the Company uses industry accepted valuation models and set criteria that are reviewed and approved by various levels of management.

In September 2011, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2011-08, "Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment", to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The Company adopted ASU 2011-08 in fiscal 2013 and thus performed a qualitative assessment. This adoption did not have a material impact on the Company's condensed consolidated financial statements.

Revenue Recognition

The Company’s revenues consist principally of cloud storage and cloud computing revenues, SaaS and IaaS. Storage revenues consist of monthly charges related to the storage of materials or data (generally on a per unit basis). Sales are generally recorded in the month the service is provided. For customers who are billed on an annual basis, deferred revenue is recorded and amortized over the life of the contract. Set up fees charged in connection with storage contracts are deferred and recognized on a straight line basis over the life of the contract.

Net Income (Loss) Per Common Share

In accordance with FASB ASC 260-10-5 Earnings Per Share, basic income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing net income (loss) adjusted for income or loss that would result from the assumed conversion of potential common shares from contracts that may be settled in stock or cash by the weighted average number of shares of common stock, common stock equivalents and potentially dilutive securities outstanding during each period. The inclusion of the potential common shares to be issued have an anti-dilutive effect on diluted loss per share and therefore they are not included in the calculation. Potentially dilutive securities at March 31, 2014 include 5,255,964 options and 133,334 warrants.

Note 3 - Property and Equipment

Property and equipment, at cost, consist of the following:

	March 31, 2014	December 31, 2013
Storage equipment	$ 2,205,243	$ 2,205,243
Website and software	622,667	622,667
Furniture and fixtures	23,861	23,861
Computer hardware and software	91,687	91,687
Data Center Equipment	919,389	916,070
	3,862,847	3,859,528
Less: Accumulated depreciation	2,844,441	2,728,547
Net property and equipment	$ 1,018,406	$ 1,130,981

Depreciation expense for the three months ended March 31, 2014 and 2013 was $115,894 and $163,784, respectively.

Note 4 - Goodwill and Intangible Assets

Goodwill and intangible assets consisted of the following:

		March 31, 2014	
	Estimated life in years	Gross amount	Accumulated Amortization
Goodwill	Indefinite	$ 2,201,828	-
Intangible Assets			
Intangible assets not subject to amortization			
Trademarks	Indefinite	294,268	-
Intangible assets subject to amortization			
Customer list	5 - 15	897,274	607,675
Non-compete agreements	4	262,147	248,493
Total Intangible Assets		1,453,689	856,168
Total Goodwill and Intangible Assets		$ 3,655,517	$ 856,168

Scheduled amortization over the next five years as follows:

For The Twelve Months ending March 31,	
2014	$ 193,108
2015	61,639
2016	30,635
2017	17,871
Total	$ 303,253

Amortization expense for the three months ended March 31, 2014 and 2013 was $61,248 and $61,248 respectively.

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Note 5 – Investment in At Equity

The Company has a 50% non-controlling ownership interest in Secure Infrastructure & Services, LLC who provides infrastructure-as-a-Service (IaaS) for IBM iSeries and AIX v7 systems, Power HA services and network infrastructure hardware and services as needed to support the IaaS and PowerHA implementation and ongoing needs for customers and services sold under the Company. ASC 810 requires the Company to evaluate non-consolidated entities periodically and as circumstances change to determine if an implied controlling interest exists. During Fiscal 2013, the Company evaluated this equity investment and concluded that this is a variable interest entity and the Company is not the primary beneficiary. Secure Infrastructure & Services, LLC's fiscal year end is December 31.

The following presents unaudited summary financial information for Secure Infrastructure & Services, LLC. Such summary financial information has been provided herein based upon the individual significance of this unconsolidated equity investment to the consolidated financial information of the Company.

	March 31, 2014
Current assets	$100,308
Non-current assets	$38,013
Current liabilities	$141,083
Members' equity	$(2,762)

The investment balance carried on the Company's balance sheet amounts to $0 as of March 31, 2014.

	Three Months Ended March 31, 2014
Net sales	$ 132,000
Gross profit	$ 46,200
Operating expenses	$ 46,200
Net income(loss)	$ -

The Company's share of the net income from Secure Infrastructure & Services, LLC for the three months ended March 31, 2014 was $0.

Note 6 – Capital Lease Obligations

The Company acquired capital leases in the acquisition of SafeData. The economic substance of the leases is that the Company is financing the acquisitions through the leases and accordingly, they are recorded in the Company's assets and liabilities. The leases are payable to Systems Trading, Inc. and IBM with combined monthly installments of $32,783 through various dates in 2011 and 2015. The leases are secured with the computer equipment. Interest rates on capitalized leases vary from 6%-12% and are imputed based on the lower of the Company's incremental borrowing rate at the inception of each lease or the lessor's implicit rate of return.

Future minimum lease payments under the capital leases are as follows:

As of March 31, 2014	$	851,005
Less amount representing interest		(12,199)
Total obligations under capital leases		838,806
Less current portion of obligations under capital leases		(817,690)
Long-term obligations under capital leases	$	21,116

Long-term obligations under capital leases at March 31, 2014 mature as follows:

For the twelve months ending March 31,		
2015	$	817,690
2016		21,116
	$	838,806

The assets held under the capital leases are included in property and equipment as follows:

Equipment	$ 1,571,784
Less: accumulated depreciation	(989,212)
	$ 582,572

Note 7 - Commitments and Contingencies

Revolving Credit Facility

On January 31, 2008 the Company entered into a revolving credit line with a bank. The credit facility provides for $100,000 at prime plus .5%, 3.75% at March 31, 2014, and is secured by all assets of the Company and personally guaranteed by the Company's principal shareholder. As of March 31, 2014, the Company owed $100,292 under this agreement.

Loan Payable

On August 4, 2010, the Company entered into a note payable with Systems Trading, LLC in settlement of past due balances owed to SafeData related to certain capital leases. The note bears interest at 4%, and is due in 24 equal installments of $11,927 commencing February 4, 2011 through January 4, 2013. The note payable is in arrears and has a balance as of March 31, 2014 is $70,405.

Contingent Collateral Obligation

In connection with the 2012 acquisition of Message Logic, LLC, the Company acquired software subject to a UCC filing in the amount of $350,000 plus accrued interest. The company believes that it will pay this lien regardless of whether they are required to pay any of the contingent purchase price and accordingly the liability has been recorded on the Company's balance sheet.

Operating Leases

The Company currently leases office space in Garden City, NY, and Warwick, RI and data centers in Westbury, NY and Waltham, MA.

The Company leases a data center in Westbury, NY on a month to month basis. Monthly rent is $1,500, plus utilities and the lease is with the Chairman of the Company.

The Company leases space in a data center in Waltham, MA. The lease calls for monthly payments under an annually renewable contract for space and services. The payments are approximately $29,000 per month depending upon services used and the current contract expires June 30, 2014.

The lease for office space in Garden City, NY calls for escalating monthly payments ranging from $6,056 to $6,617 plus a portion of the operating expenses through June 2014

Minimum obligations under these lease agreements are as follows:

For the twelve months ending March 31,	
2015	$ 47,742
2016	27,888

2017		29,384
2018		29,520
Thereafter		2,460
	$	136,994

Rent expense for the three months ended March 31, 2014 and March 31, 2013 was $27,570 and $40,661 respectively.

Note 8 - Related Party Transactions

Due to related party represents rent accrued to a partnership controlled by Mr. Piluso for the New York Data Center in New York. The rent expense for the data center is $1,500 per month.

As of March 31, 2014 the Company owed Mr. Piluso $903,869. These advances bear no interest and have no stated terms of repayment.

Note 9 &#82