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IMAGE SOFTWARE INC
Form 10-Q
May 14, 2003

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

- (X) QUARTERLY REPORT PURSUANT TO SECTION 13 OF 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934. For the quarterly period ended 3/31/2003
OR
() TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934. For the transition period from
to

IMAGE SOFTWARE, INC.

(Exact name of Registrant as specific in its charter)

0-12535

(Commission File Number)

COLORADO

84-0866294

(State of Incorporation)

(IRS Employer Identification Numbers)

6025 S. QUEBEC ST. SUITE 300 ENGLEWOOD CO 80111

(303) 694-9180

(Address of principal executive offices)

(Registrant's telephone
number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

NONE

NONE

(Title of Class)

(Name of Exchange)

Securities Registered Pursuant to Section 12(g) of the Act:

COMMON STOCK - \$.004 PAR VALUE

(Title of Class)

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

Indicate by check mark whether the Registrant is an accelerated filer (as
defined in Rule 12b-2 of the Act). Yes No X

As of May 9, 2003, there were 3,274,597 shares of the Registrant's Common
Stock outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

IMAGE SOFTWARE, INC. BALANCE SHEETS

	Unaudited	
	March 31, 2003	December 31, 2002

ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 53,430	\$ 149,738
Receivables:		
Trade (less allowance: 2003, \$10,000; 2002, \$10,000)	537,544	549,455
Inventory	16,276	16,500
Prepaid expenses and other current assets	13,984	16,374
Employee advances	5,763	7,029
	-----	-----
Total current assets	626,997	739,096
PROPERTY AND EQUIPMENT, at cost, net	45,307	48,577
OTHER ASSETS:		
Software development costs, net	710,604	720,916
Inventory	2,958	2,958
Deferred tax asset	50,000	50,000
Other	100	100
	-----	-----
TOTAL ASSETS	\$ 1,435,966	\$ 1,561,647

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	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Line of credit	\$ 200,000	\$ --
Current portion of capital lease obligations	3,663	3,903
Deferred revenue	255,000	281,000
Accounts payable	153,165	278,174
Accrued liabilities	122,912	148,260
	-----	-----
Total current liabilities	734,740	711,337
LONG-TERM OBLIGATIONS:		
Capital lease obligations	7,105	7,325
Line of credit	--	200,000
	-----	-----
	7,105	207,325
SHAREHOLDERS' EQUITY:		
Common stock, \$.004 par value - 10,000,000		
shares authorized;		
shares outstanding: 2003 - 3,184,597; 2002 - 3,146,554	12,738	12,586
Additional paid-in capital	7,245,506	7,238,658
Accumulated deficit	(6,564,123)	(6,608,259)
	-----	-----
Total shareholders' equity	694,121	642,985
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,435,966	\$ 1,561,647
	=====	=====

See Notes to Condensed Financial Statements

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IMAGE SOFTWARE, INC. STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended March 31,	
	2003	2002
	-----	-----
REVENUE		
System sales and software licenses	\$ 151,990	\$ 212,075
Services and annual fees	276,678	305,189
	-----	-----
Total revenue	428,668	517,264
	-----	-----
COST OF REVENUE		
System sales and software licenses	117,817	212,838
Services and annual fees	92,211	121,698
	-----	-----
Total cost of revenue	210,028	334,536
	-----	-----
GROSS PROFIT	218,640	182,728
% of Revenue	51%	35%
OPERATING EXPENSES:		

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Selling, general & administrative	309,422	327,297
	-----	-----
INCOME/(LOSS) FROM OPERATIONS	(90,782)	(144,569)
	-----	-----
OTHER INCOME/(EXPENSE):		
Interest expense	(4,051)	(548)
Interest income	594	803
Other income	138,375	--
	-----	-----
Total other income (expense)	134,918	255
	-----	-----
INCOME/(LOSS) BEFORE INCOME TAXES	44,136	(144,314)
PROVISION FOR INCOME TAXES	--	--
	-----	-----
NET INCOME/(LOSS)	\$ 44,136	\$ (144,314)
	=====	=====
BASIC AND DILUTED INCOME/(LOSS) PER COMMON SHARE:	\$.01	\$ (.05)
	=====	=====
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:	3,175,738	3,146,554
	=====	=====

See Notes to Condensed Financial Statements

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IMAGE SOFTWARE, INC. STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended March 31, 2003	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Earnings/(Loss)	\$ 44,136	\$ (144,314)
Adjustments to reconcile earnings to net cash provided by operating activities:		
Depreciation and amortization	79,893	80,968
Deferred revenue	(26,000)	13,000
Settlement of payable	(138,375)	--
Issuance of stock for services	7,000	--
Changes in assets and liabilities:		
Receivables	11,911	34,309
Inventory	224	(1,127)
Prepaid expenses and other assets	3,656	(3,629)
Accounts payable	13,366	76,886
Accrued liabilities and expenses	(25,348)	(33,960)
	-----	-----

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Net cash provided by (used for) operating activities	(29,537)	22,133
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(1,323)	(9,833)
Additions to capitalized software	(64,988)	(85,783)
	-----	-----
Net cash used for investing activities	(66,311)	(95,616)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of line of credit	--	--
Repayment of long-term obligations	(460)	(608)
	-----	-----
Net cash used for financing activities	(460)	(608)
	-----	-----
DECREASE IN CASH AND CASH EQUIVALENTS	(96,308)	(74,091)
CASH AND CASH EQUIVALENTS, beginning of period	149,738	212,421
	-----	-----
CASH AND CASH EQUIVALENTS, end of period	\$ 53,430	\$ 138,330
	=====	=====

See Notes to Condensed Financial Statements

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IMAGE SOFTWARE, INC. NOTES TO INTERIM FINANCIAL STATEMENTS

GENERAL:

Management has elected to omit substantially all notes to the unaudited interim financial statements. Reference should be made to the Company's annual report on Form 10-K for the year ended December 31, 2002 as this report incorporates the Notes to the Company's year-end financial statements. The condensed balance sheet of the Company as of December 31, 2002 has been derived from the audited balance sheet of the Company as of that date.

UNAUDITED INTERIM INFORMATION:

The unaudited interim financial statements contain all necessary adjustments (consisting of only normal recurring adjustments), which, in the opinion of Management, are necessary for a fair statement of the results for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of those expected for the year.

REVENUE RECOGNITION - Revenue from the sale of software licenses, computer equipment, and existing application software packages is recognized when the software and computer equipment are shipped to the customer, remaining vendor obligations are insignificant, there are no significant uncertainties about customer acceptance and collectibility is probable. Revenue from related services, including installation and software modifications, is recognized upon performance of services. Maintenance revenue is recognized ratably over the maintenance period.

INCOME TAXES - The Company follows the liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109. Under this method, deferred income taxes are recorded based upon differences between the financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in

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effect when the underlying assets or liabilities are received or settled.

The Company has recorded a valuation allowance against the deferred tax assets due to the uncertainty of ultimate realizability.

EARNINGS (LOSS) PER SHARE - Earnings/ (Loss) per share is computed by dividing net income (loss) by the weighted average number of common and equivalent shares outstanding during the period. Outstanding stock options are treated as common stock equivalents for purposes of computing diluted earnings per share. As the average market price during the period was less than the lowest exercisable option price, the outstanding stock options were antidilutive and have been excluded from the computation of diluted earnings per share.

STOCK-BASED COMPENSATION - At December 31, 2002, the Company has three stock-based employee compensation plans, which are described more fully in Note 5. The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the grant date. The following table illustrates the effect on net income and earnings per share if the company had applied the fair value provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

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	For the Three Months Ended March 31	
	2002	2001
	----	----
Net income (loss), as reported	\$ 44,136	\$ (144,314)
Less: Total stock-based employee compensation cost determined under the fair value based method, net of income taxes	(15,073)	(22,952)
	-----	-----
Pro forma net income (loss)	\$ 29,063	\$ (167,266)
	=====	=====
Earnings per share:		
Basic and Diluted - as reported	\$ 0.01	\$ (0.05)
	=====	=====
Basic and Diluted - pro forma	\$ 0.01	\$ (0.05)
	=====	=====

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

RESULTS OF OPERATIONS FOR THREE MONTHS ENDED MARCH 31, 2003 VERSUS MARCH 31, 2002

Image Software, Inc. (the "Company") reported revenue of \$429,000 for the first quarter of 2003, an \$88,000 decrease (17%) from \$517,000 posted for the first quarter in 2002. As a result of the various revenue components, the gross profit on sales in first quarter 2003 increased \$36,000 (20%) over the first quarter of 2002. As a result, the Company posted net income of \$44,000 or \$.01 per share, for the first quarter 2003, as compared to a net loss of \$(144,000), or \$(.05)

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per share, for the same quarter a year ago.

The Company's revenue for direct sales of software licenses of \$106,000 increased \$54,000 (102%) from \$53,000 in 2002, while the revenue for indirect channel software sales decreased \$125,000 (99%) to \$1,000 due to the loss of the Company's largest customer, Reynolds & Reynolds ("Reynolds"). Service revenues for the quarter ended March 31, 2003 were \$72,000, an 84% increase over \$39,000 for the first quarter of 2002 due to revenue from installations and customization services. Revenue from hardware sales of \$44,000 increased \$12,000 (36%) over the same quarter in 2002.

Revenue from recurring annual license fees in the direct sales channel increased \$29,000 (21%), while annual license fee revenue from indirect channels decreased \$90,000, attributable to the loss of Reynolds. Excluding sales to Reynolds of \$212,000 during the first quarter of 2002, total first quarter revenues increased \$123,000 (40%) for the comparable periods.

In first quarter 2003, the Company settled a liability of \$138,000, which is included in other income, that related to a volume sale from a prior year that was tied to the purchase of future software licenses. SG&A expenses of \$309,000 were \$18,000 (6%) less than the same quarter in 2002, primarily due to tight expense controls throughout the Company; offset by a \$17,000 increase in legal expenses as a result of the legal proceedings with Reynolds.

See the discussion of the effect of the loss of Reynolds in "Liquidity and Capital Resources" below.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash and cash equivalents of \$53,000 decreased approximately \$96,000 during the three months ended March 31, 2003 as compared to December 31, 2002. During 2003, the Company used cash of \$65,000 for deferred development expenses. The Company had deficit working capital of \$108,000 as of March 31, 2003. Included in current liabilities is \$255,000 for Deferred Revenue, which represents payments on annual maintenance contracts that will be earned over the next twelve months. The Company's \$200,000 bank line of credit was fully drawn at March 31, 2003 and on December 31, 2002. The line matures in February, 2004 and is collateralized by all accounts receivable and general intangibles of the Company.

On April 30, 2003, the Company closed on a Revolving Credit Loan Agreement dated effective April 1, 2003 with DEMALE, LLC, a Colorado limited liability company, under which DEMALE agreed to provide the Company with a line of credit of up to \$300,000 at 1 1/2% above prime rate as published by U.S. Bank. DEMALE has three members, David R. DeYoung, the Company's President and Chief Executive Officer, John G. Mazza, a Director and a more than 5% shareholder of the Company, and Spencer D. Lehman, a more than 5% shareholder of the Company. The Company

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issued a total of 90,000 shares of its common stock to DEMALE's members and also granted them warrants to purchase 90,000 shares of common stock at an exercise price of \$.18 per share. The loan matures on June 30, 2005 and is secured by a junior security interest in the collateral backing the bank line of credit. Principal and interest on the loan is convertible into shares of common stock at maturity and, under certain circumstances, the Company can force conversion of the outstanding balance on the loan. As of May 14, 2003 there were no borrowings outstanding on the line.

As noted above in "Results of Operations", the termination by Reynolds of its

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1996 Subscription and Maintenance Agreement and the resulting loss of Reynolds as a customer has already had a significantly adverse impact on the Company's revenue. There has been a corresponding adverse impact on cash flow and liquidity. The Company has not replaced all of the revenue lost as a result of the termination of the 1996 contract by Reynolds' subsequent actions. However, it is possible that some portion of that lost revenue will be awarded to the Company in the ongoing litigation between the Company and Reynolds. Naturally, the Company cannot predict the outcome of that litigation nor can there be any assurance that the Company will ever obtain a meaningful recovery from Reynolds.

The Company's financial resources include cash on hand, revenues from operations, and management of funds available on its revolving lines of credit. In the Company's judgment, sufficient financial resources are available to meet current working capital needs.

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FORWARD LOOKING STATEMENTS

Some of the statements made herein are not historical facts and may be considered "forward looking statements." All forward-looking statements are, of course, subject to varying levels of uncertainty. In particular, statements which suggest or predict future events or state the Company's expectations or assumptions as to future events may prove to be partially or entirely inaccurate, depending on any of a variety of factors, such as adverse economic conditions, new technological developments, competitive developments, competitive pressures, changes in the management, personnel, financial condition or business objectives of one or more of the Company's customers, increased governmental regulation or other actions affecting the Company or its customers as well as other factors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK INAPPLICABLE

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and participation of the Company's Chief Executive Officer and Chief Financial Officer (the "Officers") of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-14. Based upon that evaluation, the Officers concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings, including this report.

Internal Controls

There were no significant changes made in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

PART II: OTHER INFORMATION

ITEM 1.	LEGAL PROCEEDINGS	INAPPLICABLE
ITEM 2.	CHANGES IN SECURITIES AND USE OF PROCEEDS	INAPPLICABLE
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	INAPPLICABLE
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	INAPPLICABLE
ITEM 5.	OTHER INFORMATION	INAPPLICABLE

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBIT TABLE

99.1 CERTIFICATION OF PERIODIC REPORT FOR CEO

99.2 CERTIFICATION OF PERIODIC REPORT FOR CFO

(B) REPORTS ON FORM 8-K

There were no reports filed on Form 8-K for the quarter ended March 31, 2003.

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SIGNATURES

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.

IMAGE SOFTWARE, INC.

(Registrant)

Date: 5/14/2003

/S/ DAVID R. DEYOUNG

David R. DeYoung
President, Principal and Chief
Executive Officer

Date: 5/14/2003

/S/ MARY ANNE DEYOUNG

Mary Anne DeYoung
Vice President, Finance and Principal
Financial Officer

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CERTIFICATIONS

I, David R. DeYoung, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Image Software, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

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a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 5/14/2003

/S/ DAVID R. DEYOUNG

David R. DeYoung
President and Principal and Chief Executive Officer

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CERTIFICATIONS

I, Mary Anne DeYoung, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Image Software, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material

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information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: 5/14/2003

/S/ MARY ANNE DEYOUNG

Mary Anne DeYoung
Vice President, Finance and
Principal Financial Officer