IMAGE SOFTWARE INC
Form 10-Q
November 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 9/30/2003

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OF 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period from _____ to _____.

1mage Software, Inc.
(Exact name of Registrant as specified in its charter)

0-12535
(Commission File Number)

Colorado	84-0866294
(State of Incorporation)	(IRS Employer Identification Number)
6025 S. Quebec St. Suite 300 Englewood Co 80111	(303) 694-9180
(Address of principal executive offices)	(Registrant's telephone number, including area code)

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 Exchange Act). Yes No X

As of November 7, 2003, there were 3,274,597 shares of the Registrant's common stock outstanding.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

1mage Software, Inc.
BALANCE SHEETS

ASSETS	September 30, 2003 (Unaudited)	December 31, 2002
CURRENT ASSETS		
Cash and cash equivalents	$ 72,690	$ 149,738
Receivables:		
Trade (less allowance: 2003, $33,000; 2002, $10,000)	479,129	549,455
Inventory	9,660	16,500
Prepaid expenses and other current assets	17,658	16,374
Employee advances	10,176	7,029
Total current assets	589,313	739,096
PROPERTY AND EQUIPMENT, at cost, net	40,787	48,577

OTHER ASSETS		
Software development costs, net	691,908	720,916
Deferred tax asset	50,000	50,000
Loan costs, net	30,249	--
Inventory: long-term	2,958	2,958
Rent deposits	7,841	100
TOTAL ASSETS	$ 1,413,056	$ 1,561,647
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Line of credit - bank	$ 169,018	$ --
Current portion of capital lease obligations	3,663	3,903
Accounts payable	146,074	278,174
Deferred revenue	260,000	281,000
Accrued liabilities	145,715	148,260
Total current liabilities	724,470	711,337
LONG-TERM OBLIGATIONS		
Line of credit-bank	--	200,000
Line of credit-related party	79,600	--
Capital lease obligations	7,105	7,325
	86,705	207,325
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY		
Common stock, $.004 par value - 10,000,000 shares authorized; shares outstanding: 2003-3,274,597; 2002-3,146,554	13,098	12,586
Additional paid-in capital	7,284,035	7,238,658
Accumulated deficit	(6,695,252)	(6,608,259)
Total shareholders' equity	601,881	642,985
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,413,056	$ 1,561,647

See Notes to Condensed Financial Statements.

3

1mage Software, Inc.
STATEMENTS OF INCOME/(LOSS)
(Unaudited)

	Three Months Ended September 30, 2003	2002
REVENUE		
System sales and software licenses	$ 197,940	$ 288,711
Services and annual fees	214,422	366,084
Total revenue	412,362	654,795

COST OF REVENUE		
Software licenses	111,589	130,767
Services and annual fees	71,389	142,225
Total cost of revenue	182,978	272,992
GROSS PROFIT	229,384	381,803
% Of Revenue	56%	58%
OPERATING EXPENSES		
Selling, general & administrative	320,782	336,352
INCOME/(LOSS) FROM OPERATIONS	(91,398)	45,451
OTHER INCOME/(EXPENSE)		
Interest income	45	1,026
Interest expense	(3,730)	(3,220)
Total other income (expense)	(3,685)	(2,194)
INCOME/(LOSS) BEFORE INCOME TAXES	(95,083)	43,257
PROVISION FOR INCOME TAXES	--	--
NET INCOME/(LOSS)	$ (95,083)	$ 43,257
INCOME PER COMMON SHARE:		
BASIC	$ (.03)	$ .01
DILUTED	$ (.03)	$ .01
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:		
BASIC	3,274,597	3,146,554
DILUTED	3,274,597	3,163,833

See Notes to Condensed Financial Statements.

1mage Software, Inc.
STATEMENTS OF INCOME (LOSS)
(Unaudited)
Nine Months Ended September 30,

	2003	2002
REVENUE		
System sales and software licenses	$ 596,224	$ 754,489
Services and annual fees	752,166	1,027,535
Total revenue	1,348,390	1,782,024
COST OF REVENUE:		
Software licenses	363,225	509,924
Services and annual fees	257,094	397,079
Total cost of revenue	620,319	907,003
GROSS PROFIT	728,071	875,021
% Of Revenue	54%	49%
OPERATING EXPENSES		
Selling, general & administrative	943,399	1,056,536
INCOME/(LOSS) FROM OPERATIONS	(215,328)	(181,515)
OTHER INCOME/(EXPENSE):		
Interest income	1,638	2,881
Interest expense	(11,822)	(6,120)
Other income	138,519	--
Total other income (expense)	128,335	(3,239)
INCOME/(LOSS) BEFORE INCOME TAXES	(86,993)	(184,754)
PROVISION FOR INCOME TAXES	--	--
NET INCOME/(LOSS)	$ (86,993)	$ (184,754)
INCOME/(LOSS) PER COMMON SHARE:		
BASIC	$ (.03)	$ (.06)
DILUTED	$ (.03)	$ (.06)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:		
BASIC	3,223,192	3,146,554
DILUTED	3,223,192	3,146,554

See Notes to Condensed Financial Statements.

1mage Software, Inc.
STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Earnings/(Loss)	$ (86,993)	$(184,754)
Adjustments to reconcile earnings to net cash provided by operating activities:		
Depreciation and amortization	248,139	243,055
Settlement of payable	(138,375)	--
Deferred revenue	(21,000)	8,000
Issuance of stock for services or fees	7,000	--
Changes in assets and liabilities:		
Trade receivables	70,326	(70,274)
Inventory	6,840	3,317
Prepaid expenses and other assets	(12,172)	(6,002)
Accounts payable	6,275	83,307
Accrued expenses	(2,545)	8,312
Net cash provided by operating activities	77,495	84,961
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(5,809)	(12,595)
Additions to capitalized software	(196,892)	(230,933)
Net cash used for investing activities	(202,701)	(243,528)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings on line of credit-related party	79,600	--
Net borrowings (payments) on line of credit-bank	(30,982)	175,000
Repayment of long-term obligations	(460)	(1,923)
Net cash provided by financing activities	48,158	173,077
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(77,048)	14,510
CASH AND CASH EQUIVALENTS, beginning of period	149,738	212,421
CASH AND CASH EQUIVALENTS, end of period	$ 72,690	$ 226,931

See Notes to Condensed Financial Statements.

6

1mage Software, Inc.

NOTES TO 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 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 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 Company incurred net losses for the three and nine months ended September 30, 2003 and for the nine months ended September 30, 2002, the outstanding stock options are considered antidilutive and have been excluded from the computation of diluted earnings per share. For the three months ended September 30, 2002 approximately 17,000 outstanding stock options are considered dilutive and are included in the denominator for the computation of diluted earnings per share. As the Company incurred net losses for the three and nine months ended September 30, 2003, the outstanding stock purchase warrants are considered antidilutive and have been excluded from the computation of diluted earnings per share.

	For the Three Months Ended September 30,	For the Nine Months E September 30,

	2003	2002	2003	2002
Net income (loss), as reported	$ (95,083)	$ 43,257	$ (86,993)	$(184,75
Less: Total stock-based employee compensation cost determined under the fair value based method, net of income taxes	(23,032)	(25,630)	(66,386)	(71,53
Pro forma net income (loss)	$(118,115)	$ 17,627	$(153,379)	$(256,28
Earnings per share:				
Basic and Diluted - as reported	$ (.03)	$ .01	$ (.03)	$ (.0
Basic and Diluted - pro forma	$ (.04)	$ .01	$ (.05)	$ (.0

LINE OF CREDIT - RELATED PARTY - On April 1, 2003, the Company entered into a $300,000 revolving line-of-credit agreement (the "Agreement") with DEMALE, LLC, an entity owned by certain stockholders of the Company. In connection with the Agreement, the Company issued 90,000 shares of restricted common stock and stock purchase warrants to purchase an additional 90,000 shares of restricted common stock as payment for loan origination costs. The line expires on June 30, 2005 and requires the Company, among other things, to maintain certain financial conditions. At September 30, 2003, there was $79,600 borrowed against this line. The line is secured by substantially all of the Company's assets but is subordinated to the bank line of credit, which holds a prior lien on the same assets. Interest is accrued and payable quarterly at prime plus 1 1/2% (6.5% at September 30, 2003) but may not be less than 7%; therefore, at September 30, 2003, interest was being accrued at 7%.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS FOR THREE MONTHS ENDED SEPTEMBER 30, 2003 VERSUS THREE MONTHS ENDED SEPTEMBER 30, 2002

1mage Software, Inc. (the "Company") reported revenue of $412,000 for the third quarter of 2003. This represented a $243,000 decrease, or 37%, from the $655,000 in revenue posted for the third quarter a year ago. Revenue was down in every category, primarily due to the general economic slowdown. Revenue generated from new customers for third quarter 2003 was $172,000, or 41% less than $291,000 reported for the third quarter of 2002. In addition, revenue from consulting services was $53,000, a 58% decrease from the third quarter last year. Recurring license fees decreased $80,000 or 33%, of which a decrease of $75,000 was attributable to the loss of the Company's largest customer, Reynolds & Reynolds ("Reynolds").

The Company's quarterly revenue of $412,000 does not reflect $139,000 in contracts which were received at the end of the quarter but could not be fulfilled until after the quarter ended. A delay between the receipt of a significant amount of customer orders and fulfillment of those orders by the Company which bridges the end of a quarter is somewhat unusual because of the short time needed to fill orders. The $139,000 in revenue will be recognized in the fourth quarter.

SG&A expenses of $321,000 for the third quarter of 2003 were 4% lower, or $15,000, than $336,000 reported for the third quarter of 2002, due to reduced expenses in nearly every category. The Company reported a net loss of $(95,000) for the third quarter 2003, or $(.03) per share, as compared to net income of $43,000, or $.01 per share, for the same quarter last year.

The total downturn of $(137,000) or $(.04) per share, can be attributed to the $243,000 decrease in revenues offset by reduced SG&A and other expenses.

	Three Months Ended 9/30/03	Three Months Ended 9/30/02	Increase/ (Decrease) $	Increase/ (Decrease) %
Revenue (as reported)	$ 412,362	$ 654,795	$ (242,433)	(37%)
Less: Reynolds revenue	0	(74,755)	(74,755)	(100%)
Revenue excluding Reynolds	$ 412,362	$ 580,040	$ (167,678)	(29%)

RESULTS OF OPERATIONS FOR NINE MONTHS ENDED SEPTEMBER 30, 2003 VERSUS NINE MONTHS ENDED SEPTEMBER 30, 2002

The Company reported revenue of $1.3 million for the nine months ended September 30, 2003, a decrease of $434,000, or 24%, over $1.8 million reported for the first nine months in 2002. A significant portion of this decrease can be attributed to the loss of the Company's largest customer, which accounted for $387,000 of the decrease. Without the loss of this customer, total revenue for 2003 would have decreased by only 3%. Revenue from consulting services was $163,000 or 36% lower than the $255,000 in consulting revenue reported for the nine months in 2002. Most of this decline resulted from the timing of the third quarter business, which may vary from quarter to quarter. While the software revenue was included in the quarter, significant consulting services could not be

recognized until the service is performed. However, total revenue generated from new customers for the nine months ended September 30, 2003, was $550,000, a 5% increase compared to $523,000 in 2002. Gross profit on revenue for the first three quarters of 2003 is 54%, as compared to 49% for the same period last year.

SG&A expenses were $113,000 lower (or 11%) for the nine months ended September 30, 2003, primarily due to across the board reductions. The Company reported a net loss of $(87,000), or $(.03) per share for the nine months ended

September 30, 2003, as compared to a net loss of $(185,000), or $(.06) per share, for the same period in 2002.

The reduced loss for the first nine months of 2003, an improvement of $98,000, is attributable to SG&A expense reductions and other cost savings which more than offset the $(434,000) reduction in revenues for the period.

In first quarter 2003, the Company settled a liability of $139,000, 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.

	Nine Months Ended 9/30/03	Nine Months Ended 9/30/02	Increase/ (Decrease) $	Increase/ (Decrease) %
Revenue (as reported)	$ 1,348,390	$ 1,782,024	$ (433,634)	(24%)
Less: Reynolds revenue	13,318	400,651	(387,333)	(97%)
Revenue excluding Reynolds	$ 1,335,072	$ 1,381,373	$ (46,301)	(3%)

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 $73,000 at September 30, 2003 represented a decrease of approximately $77,000, as compared to December 31, 2002. During 2003, the Company used cash of $197,000 for deferred development expenses. The Company had a working capital deficit of $135,000 as of September 30, 2003. The Company believes there is sufficient working capital to operate the business because the "Deferred Revenue" liability consists of $260,000 that is not immediately due and payable; rather it represents payments on annual maintenance contracts that will be earned over the next twelve months. As the ongoing litigation between the Company and Reynolds is being handled by legal counsel on a contingency basis plus direct expenses, legal fees incurred by the Company related to the Reynolds litigation are not due or payable until the litigation has been settled, at which time the fees will be deducted from the proceeds, if any. Management believes that the Company has the liquidity to fund the direct expenses related to the litigation.

The Company's bank line of credit was $169,018 at September 30, 2003, compared to $200,000 at December 31, 2002. The line matures in February 2004 and is collateralized by all accounts receivable and general intangibles of the Company.

In addition, the Company has a line of credit of up to $300,000 with DEMALE, LLC. As of September 30, 2003, there were borrowings of $79,600 against this line. The loan is secured by a junior interest in the collateral backing the bank line of credit.

As noted above in "Results of Operations", the termination by Reynolds of its 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 yet replaced all of the revenue lost as a result of the termination of the 1996 contract and 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.

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
Item 6.	Exhibits and Reports on Form 8-K	

(A) Exhibit Table

31.1 Certificate of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certificate of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certificate of CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(B) Reports on Form 8-K

There were no reports filed on Form 8-K for the quarter ended September 30, 2003.

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.

1mage Software, Inc.
(Registrant)

Date: 11/14/2003 /s/ DAVID R. DEYOUNG

David R. DeYoung
President, Principal and Chief Executive Officer

Date: 11/14/2003 /s/ MARY ANNE DEYOUNG

Mary Anne DeYoung
Vice President, Finance and Principal Financial Officer