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IMAGE TECHNOLOGY LABORATORIES INC

Form 10-Q

November 14, 2008

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2008 or

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

For the transition period from _____ to _____

Commission File Number: 34-00031307

IMAGE TECHNOLOGY LABORATORIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

22-3531373

(State or Other Jurisdiction
of Incorporation or Organization)

(IRS Employer
Identification No.)

602 Enterprise Drive
Kingston, New York 12401

(Address of Principal Executive Offices)

(845) 338-3366

(Registrant's Telephone Number)

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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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 No

As of November 13, 2008, there were 15,238,778 shares of the registrant's common stock outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

BALANCE SHEETS

	SEPTEMBER 30, 2008 (UNAUDITED)
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	\$ 255,458
Accounts receivable	105,336
Prepaid expenses and other current assets	11,302

TOTAL CURRENT ASSETS	372,096
Equipment and improvements, net	91,766
Rent - deposit	6,000

TOTAL ASSETS	\$ 469,862
	=====
LIABILITIES AND STOCKHOLDERS' DEFICIENCY	
CURRENT LIABILITIES:	
Bank line of credit	\$ 60,738
Current portion of long-term debt	120,016
Accounts payable and accrued expenses	156,246

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Deferred revenue	30,000
Accrued compensation payable to stockholders	47,596

TOTAL CURRENT LIABILITIES	414,596
Long-term debt, less current portion	395,085
Notes payable to stockholders	3,684

TOTAL LIABILITIES	813,365
 STOCKHOLDERS' DEFICIENCY:	
Preferred stock, par value \$.01 per share; 5,000,000 shares authorized; Series A 1,500,000 shares issued and outstanding	15,000
Cumulative Convertible Series B 1,087 and 1,000 shares issued and outstanding	10
Common stock, par value \$.01 per share; 50,000,000 shares authorized; 15,238,778 shares issued and outstanding	152,388
Additional paid-in capital	3,779,386
Accumulated deficit	(4,290,287)

TOTAL STOCKHOLDERS' DEFICIENCY	(343,503)

TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY	\$ 469,862
	=====

The accompanying notes are an integral part of the financial statements.

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CONDENSED STATEMENTS OF OPERATIONS THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007 (UNAUDITED)

	THREE MONTHS ENDING SEPTEMBER 30,		END
	2008	2007	2007
	----	----	----
REVENUE:			
Systems / software: license fees and sales	\$ 134,202	\$ 131,114	\$ 54,000
Dividend Income	1,284	5,087	2,000
Service Income	0	0	0
	-----	-----	-----
TOTAL REVENUE	135,486	136,201	56,000
 COST OF REVENUE:			
	11,809	4,209	4,000
	-----	-----	-----
GROSS PROFIT	123,677	131,992	52,000
 COSTS AND EXPENSES:			
Research and development	93,310	103,853	27,000
Sales and marketing	17,719	4,154	2,000
General and administrative (includes interest expense of \$13,542 and \$17,314 for the three months and \$43,195 and \$24,019 for the nine months ending September 30, 2008 and 2007, respectively)	62,945	114,828	24,000
Stock based compensation	2,476	24,483	5,000
	-----	-----	-----
TOTAL COSTS AND EXPENSES	176,450	247,318	60,000

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NET LOSS	\$	(52,773)	\$	(115,326)	\$	(9
NET LOSS PER COMMON SHARE:						
Basic and diluted	\$	(0.00)	\$	(0.01)	\$	
WEIGHTED AVERAGE SHARES OUTSTANDING:						
Basic and diluted		16,738,778		16,738,778		16,73

The accompanying notes are an integral part of the financial statements.

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STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIENCY
NINE MONTHS ENDED SEPTEMBER 30, 2008
(UNAUDITED)

	PREFERRED STOCK SERIES A AND B		COMMON STOCK		ADDI- TIONAL PAID-IN CAPITAL	
	NUMBER OF SHARES	AMOUNT	NUMBER OF SHARES	AMOUNT		
Balance, January 1, 2008	1,501,050	\$15,010	15,238,778	\$152,388	\$3,727,945	\$ (
Amortization of stock option compensation					51,441	
Dividends on Preferred Series B	37	0				
Net loss						
Balance, September 30, 2008	1,501,087	\$15,010	15,238,778	\$ 152,388	\$3,779,386	\$ (

The accompanying notes are an integral part of the financial statements.

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STATEMENTS OF CASH FLOWS
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30	
	2008	2007
OPERATING ACTIVITIES:		
Net loss	\$ (93,158)	\$ (271,622)

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Adjustments to reconcile net loss to net cash provided		
(used) in operating activities: Depreciation and amortization of equipment and improvements		
	44,451	42,408
Stock based compensation	51,441	73,448
Changes in operating assets and liabilities:		
Accounts receivable	66,156	84,005
Prepaid expenses and other current assets	(2,666)	1,966
Accounts payable and accrued expenses	(15,686)	(20,606)
Deferred revenue	5,000	
Accrued compensation payable to stockholders		(8,126)
	-----	-----
NET CASH PROVIDED (USED) IN OPERATING ACTIVITIES	55,538	(98,527)
	-----	-----
INVESTING ACTIVITIES - PURCHASE OF EQUIPMENT AND IMPROVEMENTS	0	(79,702)
FINANCING ACTIVITIES:		
Proceeds from (repayments of) Bank Line of Credit, net	(12,729)	1,421
Proceeds from (repayment of) notes payable and long term debt	(82,847)	574,281
Proceeds from loans from stockholders	0	3,684
	-----	-----
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	(95,576)	579,386
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(40,037)	401,157
	-----	-----
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	295,495	3,263
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 255,458	\$ 404,420
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Interest paid	\$ 43,195	\$ 24,018
	=====	=====

The accompanying notes are an integral part of the financial statements.

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NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION:

In the opinion of management, the accompanying unaudited financial statements reflect all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of Image Technology Laboratories, Inc. (the "Company") as of September 30, 2008, its results of operations for the three and nine month periods ended September 30, 2008 and 2007, changes in stockholders' deficiency for the nine months ended September 30, 2008 and cash flows for the nine months ended September 30, 2008 and 2007. Certain terms used herein are defined in the audited financial statements of the Company as of December 31, 2007 and for the years ended December 31, 2007 and 2006 (the "Audited Financial Statements") included in the Company's 2007 Annual Report on Form 10-KSB previously filed with the Securities and Exchange Commission (the "SEC"). Pursuant to rules and regulations of the SEC, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted from these financial statements unless significant changes have taken place since the end of the most recent fiscal year. Accordingly, the accompanying unaudited financial statements should be read in conjunction with

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the Audited Financial Statements and notes thereto included in the 2007 Form 10-KSB.

The results of operations for the three months and nine months ended September 30, 2008 are not necessarily indicative of the results of operations to be expected for the full year ending December 31, 2008.

These unaudited financial statements have been prepared assuming that the Company will continue as a going concern and, accordingly, do not include any adjustments that might result from the outcome of this uncertainty. The Company's independent registered public accounting firm's report on the financial statements included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2007, contained an explanatory paragraph regarding the Company's ability to continue as a going concern.

RECENT ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 established a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, established a framework for measuring fair value, and expanded disclosure about such fair value measurements. SFAS No. 157 became effective for our financial assets and liabilities on January 1, 2008. The FASB has deferred the implementation of the provisions of SFAS No. 157 relating to certain nonfinancial assets and liabilities until January 1, 2009. SFAS No. 157 did not materially affect how we determine fair value.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS No. 115" ("SFAS No. 159"). This standard permits entities to choose to measure many financial instruments and certain warranty and insurance contracts at fair value on a contract-by-contract basis. SFAS No. 159 became effective on January 1, 2008. We have not elected the fair value option for any of our existing financial instruments on the effective date and have not determined whether or not we will elect this option for any eligible financial instruments we acquire in the future.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," ("SFAS No. 141(R)") and SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS No. 160"). Effective for the Company as of January 1, 2009, SFAS No. 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. Effective January 1, 2009, SFAS No. 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. Management is evaluating the impact of adopting SFAS No. 141(R) and SFAS No. 160, if any, on the Company's financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 expands the disclosure requirements in SFAS No. 133, regarding an entity's derivative instruments and hedging activities. SFAS

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No. 161 is effective on January 1, 2009. Management is evaluating the impact of adopting SFAS No. 161, if any, on the Company's financial statements.

NOTE 2 - LOSS PER SHARE:

The Company presents "basic" earnings (loss) per common share and, if applicable, "diluted" earnings (loss) per common share pursuant to the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). Basic earnings (loss) per common share is calculated by dividing net income or loss applicable to common stock by the weighted average number of common shares outstanding during each period. The calculation of diluted earnings (loss) per common share is similar to that of basic earnings (loss) per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, such as those issuable upon the exercise of stock options and warrants, were issued during the period. The rights of the Company's preferred and common stockholders are substantially equivalent. The Company has included the 1,500,000 Preferred Series A shares outstanding in the weighted average number of common shares outstanding in the computation of basic loss per share for the year ended December 31, 2007 in accordance with the "two class" method of computing earnings (loss) per share set forth in SFAS 128.

Since the Company had a net loss for the three months and nine months ended September 30, 2008, the assumed effects of the exercise of outstanding options, warrants or the conversion of preferred stock into common shares at September 30, 2008 were not considered in the computation of loss per share as they would have been anti-dilutive.

Potential common shares outstanding as of September 30, 2008 and 2007:

	September 30, 2008	September 30, 2007
Warrants	230,000	230,000
Options	3,100,000	3,100,000
Conversion of Preferred Series B	2,934,900	2,799,900

As of September 30, 2008 and 2007, potentially dilutive shares totaled 6,264,900 and 6,129,900 respectively.

NOTE 3 - WORKING CAPITAL LOAN AGREEMENT:

During September 2002, the Company entered into a one-year working capital loan agreement with a financial institution for borrowings of up to \$75,000. The agreement automatically renews annually unless one of the parties gives appropriate notice for cancellation. Outstanding borrowings bear interest payable monthly at 1% above the prime rate, and are guaranteed by the Estate of the Company's former principal stockholder. At September 30, 2008, there was \$60,738 outstanding under this agreement.

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In June 2007, the Company entered into a five-year Accounts Receivable loan agreement with PowerLease Solutions, LLC and NetBank to borrow \$650,000 at a 9.5% annual interest rate. Monthly payments are \$13,651 and the loan is co-signed by the Company's principal stockholder. As of September 30, 2008, there was \$515,101 outstanding under this agreement.

NOTE 4 - NOTES PAYABLE TO STOCKHOLDERS:

During November and December 2004, Dr. David Ryon, the Company's principal stockholder, President, and Chief Executive Officer, until his death in December

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2004, loaned the Company an aggregate of \$105,000. In December 2004, to memorialize this loan, he executed, as President and Chief Executive Officer, on behalf of the Company, a demand promissory note payable to himself and bearing interest at 10% per annum. He also executed a security agreement, for himself on behalf of the Company, granting to himself a security interest in all of the Company's assets not previously encumbered as security for full payment under the note. Prior to April 12, 2005, the Company negotiated with the Estate of Dr. David Ryon a 24-month payment schedule, beginning in January 2006. The Company's Board of Directors approved the revised terms of the promissory note on April 12, 2005. In December 2005, the Estate of Dr. Ryon loaned the Company an additional \$36,000 under an amendment to the December 2004 promissory note and the payment schedule was renegotiated to begin in January 2007. Additional amounts were loaned to the Company in March 2006 for \$22,500, in August 2006 for \$57,672 and in September 2006 for \$153,375. These amounts, along with other previous loans to the Company by the largest stockholder totaling \$374,548 were converted to 1000 shares of Cumulative Convertible Preferred Stock Series B in late September 2006, and all accrued interest was forgiven. Cumulative Convertible Preferred Stock Series B can be converted to common stock of Image Technology Laboratories at a ratio of one share of Cumulative Convertible Preferred Stock Series B to 2,700 shares of common stock. Either the stockholder or the Company may elect to force conversion after two years from issuance in units of 100 shares of Cumulative Convertible Preferred Stock Series B. The Company may also elect to repurchase the Cumulative Convertible Preferred Stock Series B in units of 100 shares of Cumulative Convertible Preferred Stock Series B at any time for \$432 per share of Cumulative Convertible Preferred Stock Series B. Fixed dividend is accumulated as 12.5 additional shares of Cumulative Convertible Preferred Stock Series B per quarter. The underlying common stock, should the Company or shareholder elect to convert, is unregistered. The voting rights are set at one vote per share of Cumulative Convertible Preferred Stock Series B. The issuance described above was made in reliance upon the exemptions from registration set forth in Section 4(2) of the Securities Act relating to sales by an issuer not involving any public offering. None of the foregoing transactions involved a distribution or public offering. No underwriters were engaged in connection with the foregoing issuances of securities, and no underwriting commissions or discounts were paid. At September 30, 2008, 1,087 shares of Preferred Stock Series B are outstanding. Such shares may be converted at the option of the holder or the Company to 2,934,900 shares of Common stock beginning in September 2008. Prior to conversion, such shares may be redeemed by the Company at \$432 per share or \$469,584 at any time until forced conversion by either party into Common stock.

In September 2005, the Company borrowed \$50,000 from a member of the Company's Board of Directors as part of a Bridge Loan Agreement that included the issuance of warrants to purchase 50,000 shares of Common Stock of the Company. The five-year warrants have an exercise price of \$0.33 per share. The Bridge Loan had an annual interest rate of 14%. The principal of \$50,000 was repaid in July 2007; \$5,000 of the accrued interest was paid in September 2007 and a final accrued interest payment of \$5,000 was made in March 2008.

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NOTE 5 - STOCK OPTIONS

The Company did not grant any options under the Company's option plan during the nine-month period ended September 30, 2008.

In accordance with the provisions of Statement of Financial Accounting Standards No. 123R, the Company expenses the fair value of employee stock options over the vesting period of such options. Amortization of stock compensation was \$51,441 and \$73,449 for the nine month periods ended September 30, 2008 and 2007,

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respectively (\$2,476 and \$24,483 for the three month periods ended September 30, 2008 and 2007).

NOTE 6 - WARRANTS

As of September 30, 2008, the Company had 230,000 warrants outstanding at an exercise price of \$0.33 per share. The warrants expire in 2010.

NOTE 7 - FIXED DIVIDENDS

The Company's largest stockholder accumulated 12 additional shares of Cumulative Convertible Preferred Stock Series B on January 1, 2008 as Fixed Dividends. An additional 13 shares were accumulated on April 1, 2008 and 12 shares were accumulated on July 1, 2008.

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

OVERVIEW

The following is a discussion of certain factors affecting Image Technology Laboratories, Inc.'s results of operations, assets, liquidity and capital resources. You should read the following discussion and analysis in conjunction with Image Technology Laboratories, Inc.'s unaudited financial statements and related notes, which are included elsewhere in this filing.

Image Technology Laboratories, Inc. ("we", "our" or the "Company") is a medical image and information management company in the healthcare information systems market. We were incorporated in Delaware on December 5, 1997. The Company has developed a single database "Radiology Information System and Picture Archiving and Communications System" known as RIS/PACS for use in the secure management of patient information and diagnostic images. Our lead product is the WarpSpeed system. Through its unique, modular architecture the Company has created a total radiology business solution that is readily scaled and easily upgraded. These features will allow the Company to provide products tailored to the size of its customers and to keep its customers at the forefront of future technological advances by enabling the Company to easily update existing systems.

We expect that we will derive our future revenues primarily from sales of our WarpSpeed system and associated maintenance charges along with Application Service Provider (ASP) usage fees. We obtained our first contract for the sale of WarpSpeed and related hardware and maintenance services in August 2002. We continue to refine and enhance the capabilities of our WarpSpeed system.

With the exception of the quarter ending March 31, 2008, we have had recurring losses and negative cash flows from our operating activities since inception. We have cash of \$255,458 and a working capital deficit of \$42,500 as of September 30, 2008.

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RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 COMPARED WITH THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007

REVENUE:

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For the three months ended September 30, 2008, our total revenue was \$135,486, a slight decrease from the \$136,201 in the year's comparable period. For the nine months ended September 30, 2008, our total revenue was \$552,134, a \$208,313 increase from the \$343,821 revenue in the prior year's comparable period, largely attributed to additional ASP usage fees and sales of enhancements to our existing customer base.

COST OF REVENUE:

For the three and nine months ended September 30, 2008, direct cost of revenue was \$11,809 and \$45,287, which includes depreciation associated with equipment used in our ASP installations. For the three and nine months ending September 30, 2007, our cost of revenue was \$ 4,209 and \$5,150, which did not include depreciation associated with equipment used in our ASP installations.

SALES AND MARKETING EXPENSES:

During the three months ended September 30, 2008, we incurred sales and marketing expenses of \$17,719, as compared with sales and marketing expenses of \$4,154 during the same period of 2007. During the nine months ended September 30, 2008 we incurred sales and marketing expenses of \$25,792, as compared with sales and marketing expenses of \$11,518 during the same period of 2007, a increase of \$14,274. The Company has focused its efforts on controlling costs while identifying appropriate sales personnel and resources. These costs are expected to grow as the company executes its business plan.

NET LOSS:

We realized a net loss of \$52,773 for the three months ended September 30, 2008 as compared with a loss of \$115,326 for the three months ended September 30, 2007. Net loss for the nine months ended September 30, 2008 was \$93,158 as compared with a net loss of \$271,622 for the same period in 2007. The Company continues to aggressively manage costs while it focuses on increasing revenues from sales of systems / software.

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LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2008, our total assets were \$469,862, a decrease of \$147,979 from total assets of \$617,841 on December 31, 2007.

As of September 30, 2008, we had cash and cash equivalents and a working capital deficit of \$255,458 and \$42,500, respectively

Net cash provided by our operating activities for the nine months ending September 30, 2008 of \$55,538 was substantially attributable to non-cash charges and a decrease in accounts receivable of \$66,156 offset by a decrease in accounts payable of \$15,686. The net cash used in financing activities included \$12,729 for repayment of our bank line of credit and \$82,846 for repayment of our accounts receivable loan.

The foregoing activities, i.e., operating and financing, resulted in our net cash decrease of \$40,037 for the nine months ended September 30, 2008.

In September 2002, we applied for, and received, a line of credit from M & T Bank, renewable annually, in the amount of \$75,000. As of September 30, 2008, we have \$60,738 outstanding under that loan.

In September 2005, the Company borrowed \$50,000 from a member of the Company's

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Board of Directors as part of a Bridge Loan Agreement that included the issuance of warrants to purchase 50,000 shares of Common Stock of the Company. The five-year warrants have an exercise price of \$0.33 per share. The Bridge Loan had an annual interest rate of 14%. The principal of \$50,000 was repaid in July 2007; \$5,000 of the accrued interest was paid in September 2007 and a final accrued interest payment of \$5,000 was made in March 2008.

In December 2005, our largest stockholder loaned the Company an additional \$36,000 under an amendment to the December 2004 promissory note. An additional \$22,500 was borrowed from our largest stockholder in March 2006. These amounts were converted to Cumulative Convertible Preferred Series B stock issued to our largest stockholder in late September 2006.

In September 2006, the Company entered into a settlement agreement with Dr. Carlton Phelps, our former vice president of finance and administration, chief financial officer, secretary and treasurer. Pursuant to the Settlement Agreement, the Company paid Dr. Phelps a total of \$153,375 consisting of attorneys' fees awarded by the arbitrator and confirmed by the court plus interest calculated at a rate of nine percent per annum from September 4, 2004 until September 1, 2006. The Company filed an 8-K detailing this event with the Securities and Exchange Commission on October 4, 2006. In September 2006, the Company's largest stockholder loaned the Company \$153,375, the proceeds of which were used to satisfy the \$153,375 settlement with Dr. Phelps. This amount was converted to Cumulative Convertible Preferred Series B stock issued to our largest stockholder in late September 2006.

In June 2007, the Company entered into a five-year Accounts Receivable loan agreement with PowerLease Solutions, LLC and NetBank to borrow \$650,000 at a 9.5% annual interest rate. Monthly payments are \$13,651 and the loan is co-signed by the Company's principal stockholder. As of June 30, 2008, there was \$515,101 outstanding under this agreement. Fixed fees paid during 2007 to PowerLease were \$10,402.

We require cash to fund our working capital needs and capital expenditures, as well as to meet existing commitments. Such commitments include payments of existing loans including our line of credit, and \$3,000 per month pursuant to a five-year lease commitment ending in December 2012 for our operations center in Kingston, New York. At times, in order to help in maximizing our working capital, our directors, officers and employees have contributed to capital or deferred compensation due under their agreements. It is anticipated, but not assured, that, should the need arise such contributions or deferrals might be available to us in the future. Additionally, we are considering outside sources of equity funds and other types of financing in order to help support our anticipated growth. There can be no assurance that such efforts will be successful.

Management believes that as a result of the proceeds from financing activities in 2007, anticipated cash flow generated by sales of its WarpSpeed RIS/PACS solution and cash flows generated from our installed ASP base, the Company will be able to continue to meet its obligations as they become due through at least December 31, 2008. Management also believes that if needed, the Company will be able to obtain additional capital resources from financing through financial institutions and other unrelated sources and/or through additional related party loans and private placements. However, there can be no assurance that the Company will become profitable or that financing will be available. Accordingly, the accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amount and classification of liabilities that may result from the outcome

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of this uncertainty.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In September 2005, the Company borrowed \$50,000 from a member of the Company's Board of Directors as part of a Bridge Loan Agreement that included the issuance of warrants to purchase 50,000 shares of Common Stock of the Company. The five-year warrants have an exercise price of \$0.33 per share. The Bridge Loan had an annual interest rate of 14%. The principal of \$50,000 was repaid in July 2007; \$5,000 of the accrued interest was paid in September 2007 and a final accrued interest payment of \$5,000 was made in March 2008.

In December 2005, the Estate of Dr. Ryon loaned the Company an additional \$36,000 under an amendment to the December 2004 promissory note. Additional amounts were loaned to the Company in March 2006 for \$22,500, in August 2006 for \$57,672 and in September 2006 for \$153,375.26. These amounts, along with other previous loans to the Company by the largest stockholder totaling \$374,548 were converted to 1000 shares of Cumulative Convertible Preferred Series B stock in late September 2006, and all accrued interest was forgiven. Cumulative Convertible Preferred Stock Series B can be converted to common stock of Image Technology Laboratories at a ratio of one share of Cumulative Convertible Preferred Stock Series B to 2,700 shares of common stock. Either the stockholder or the Company may elect to force conversion after two years from issuance in units of 100 shares of Cumulative Convertible Preferred Stock Series B. The Company may also elect to repurchase the Cumulative Convertible Preferred Stock Series B in units of 100 shares of Cumulative Convertible Preferred Stock Series B at any time for \$432 per share of Cumulative Convertible Preferred Stock Series B. Fixed dividend is accumulated as 12.5 additional shares of Cumulative Convertible Preferred Stock Series B per quarter. The underlying common stock, should the Company or shareholder elect to convert, is unregistered. The voting rights are set at one vote per share of Cumulative Convertible Preferred Stock Series B. The issuance described above was made in reliance upon the exemptions from registration set forth in Section 4(2) of the Securities Act relating to sales by an issuer not involving any public offering. None of the foregoing transactions involved a distribution or public offering. No underwriters were engaged in connection with the foregoing issuances of securities, and no underwriting commissions or discounts were paid. At September 30, 2008, 1,087 shares of Preferred Stock Series B are outstanding. Such shares may be converted at the option of the holder or the Company to 2,934,900 shares of Common stock beginning in September 2008. Prior to conversion, such shares may be redeemed by the Company at \$432 per share or \$469,584 at any time until forced conversion by either party into Common stock.

In September 2006, the Company entered into a settlement agreement with Dr. Carlton Phelps, our former vice president of finance and administration, chief financial officer, secretary and treasurer. Pursuant to the Settlement Agreement, the Company paid Dr. Phelps a total of \$153,375 consisting of attorneys' fees awarded by the arbitrator and confirmed by the court plus interest calculated at a rate of nine percent per annum from September 4, 2004 until September 1, 2006. The Company filed an 8-K detailing this event with the Securities and Exchange Commission on October 4, 2006.

In September of 2006, the Company sold 2,309,583 shares of common stock at a price of \$0.10 to a group of seven accredited investors in a private placement under Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D there under. These unregistered shares of common stock were issued with registration rights. The proceeds of this sale of common stock were used to repurchase 2,309,583 shares of common stock at a price of \$0.10 from Dr. Carlton

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Phelps, our former vice president of finance, chief financial officer, secretary and treasurer. The 2,309,583 shares of stock repurchased from Dr. Phelps by the Company were cancelled upon their tender. An 8-K was filed with the Securities and Exchange Commission on October 4, 2006. The net effect of the repurchase and subsequent cancellation of 2,309,583 shares of common stock as described above in combination with the sale of 2,309,583 shares of common stock as described above resulted in no change to the number of shares of common stock outstanding due to this transaction.

FORWARD-LOOKING STATEMENTS

When used in the Quarterly Report on Form 10-Q, the words "may", "will", "should", "expect", "believe", "anticipate", "continue", "estimate", "project", "intend" and similar expressions are intended to identify forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act regarding events, conditions and financial trends that may affect our future plans of operations, business strategy, results of operations and financial condition. We wish to ensure that such statements are accompanied by meaningful cautionary statements pursuant to the safe harbor established in the Private Securities Litigation Reform Act of 1995. Prospective investors are cautioned that any forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties and that actual results may differ materially from those included within the forward-looking statements as a result of various factors including our ability to consummate, and the terms of, acquisitions, if any. Such forward-looking statements should, therefore, be considered in light of various important factors, including those set forth herein and others set forth from time to time in our reports and registration statements filed with the Securities and Exchange Commission (the "Commission"). We disclaim any intent or obligation to update such forward-looking statements.

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ITEM 3 - QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4 - CONTROLS AND PROCEDURES

(A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Our Chief Technology Officer, who also serves as our Principal Accounting Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e) as of the end of the period covered by this report (the "Evaluation Date")), have concluded that as of the Evaluation Date, our disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this quarterly report on Form 10-Q was being prepared.

(B) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the most recently completed fiscal quarter, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None.

ITEM 1A - RISK FACTORS

Not applicable.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company converted a total of \$374,548 of debt owed to our largest shareholder to 1000 shares of Image Technology Laboratories Cumulative Convertible Preferred Stock Series B issued to same stockholder in late September 2006. Cumulative Convertible Preferred Stock Series B can be converted to common stock of Image Technology Laboratories at a ratio of one share of Cumulative Convertible Preferred Stock Series B to 2,700 shares of common stock. Either the stockholder or the Company may elect to force conversion after two years in units of 100 shares of Cumulative Convertible Preferred Stock Series B. The Company may also elect to repurchase the Cumulative Convertible Preferred Stock Series B in units of 100 shares of Cumulative Convertible Preferred Stock Series B at any time for \$432 per share of Cumulative Convertible Preferred Stock Series B. Fixed dividend is accumulated as 12.5 additional shares of Cumulative Convertible Preferred Stock Series B per quarter. The underlying common stock, should the Company or stockholder elect to convert, is unregistered. The voting rights are set at one vote per share of Cumulative Convertible Preferred Stock Series B.

The issuances described above were made in reliance upon the exemptions from registration set forth in Section 4(2) of the Securities Act relating to sales by an issuer not involving any public offering. None of the foregoing transactions involved a distribution or public offering. No underwriters were engaged in connection with the foregoing issuances of securities, and no underwriting commissions or discounts were paid.

Our largest stockholder accumulated 12 additional shares of Cumulative Convertible Preferred Stock Series B on July 1, 2008 under the terms described above as Fixed Dividends.

At September 30, 2008, 1,087 shares of Preferred Stock Series B are outstanding. Such shares may be converted at the option of the holder or the Company to 2,934,900 shares of Common stock beginning in September 2008. Prior to conversion, such shares may be redeemed by the Company at \$432 per share or \$469,584 at any time until forced conversion by either party into Common stock.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5 - OTHER INFORMATION

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None.

ITEM 6 - EXHIBITS

EXHIBITS.

- 31.1 Certification of Chief Technology Officer and Principal Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Technology Officer and Principal Accounting Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

In accordance with the requirements of the Securities Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

/S/ LEWIS M. EDWARDS

LEWIS M. EDWARDS,
CHAIRMAN,
EXECUTIVE VICE-PRESIDENT,
CHIEF TECHNOLOGY OFFICER, AND
PRINCIPAL ACCOUNTING OFFICER
NOVEMBER 14, 2008