IMAGE SOFTWARE INC
Form 10-Q
May 17, 2002

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 3/31/2002

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 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)

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 ___

As of May 10, 2002, there were 3,146,554 shares of the Registrant's common stock outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

1MAGE SOFTWARE, INC.
BALANCE SHEETS

	Unaudited March 31, 2002	December 31, 2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 138,330	$ 212,421
Receivables:		
Trade (less allowance: 2002, $10,000; 2001, $10,000	387,668	421,977
Inventory	10,197	9,070
Deferred tax asset	50,000	50,000
Prepaid expenses and other current assets	19,226	15,597
Total current assets	605,421	709,065
PROPERTY AND EQUIPMENT, at cost, net	62,043	57,878
OTHER ASSETS:		
Software development costs, net	736,089	725,606
Other	3,058	3,058
TOTAL ASSETS	$ 1,406,611	$ 1,495,607

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Line of credit	$ --	$ --
Current portion of capital lease obligations	1,784	1,784
Deferred revenue	246,000	233,000
Accounts payable	264,764	187,878
Accrued liabilities	112,550	146,510
Total current liabilities	625,098	569,172
LONG-TERM OBLIGATIONS:		
Capital lease obligations	485	1,093
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Common stock, $.004 par value - 10,000,000 shares authorized; shares outstanding: 2002 and 2001 - 3,146,554	12,586	12,586
Additional paid-in capital	7,238,658	7,238,658
Accumulated deficit	(6,470,216)	(6,325,902)
Total shareholders' equity	781,028	925,342
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 1,406,611	$ 1,495,607

See Notes to Condensed Financial Statements

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1MAGE SOFTWARE, INC.
STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31, 2002	2001
REVENUE		
System sales and software licenses	$ 212,075	$ 329,209
Services and annual fees	305,189	503,188
Total revenue	517,264	832,397
COST OF REVENUE:		
System sales and software licenses	212,838	88,453
Services and annual fees	121,698	125,525
Total cost of revenue	334,536	213,978
GROSS PROFIT	182,728	618,419
% of Revenue	35%	74%
OPERATING EXPENSES:		
Selling, general & administrative	327,297	390,494
INCOME/(LOSS) FROM OPERATIONS	(144,569)	227,925

OTHER INCOME/(EXPENSE):		
Interest income	803	1,755
Interest expense	(548)	(7,838)
Total other income (expense)	255	(6,083)
INCOME/(LOSS) BEFORE INCOME TAXES	(144,314)	221,842
PROVISION FOR INCOME TAXES	--	--
NET INCOME/(LOSS)	$ (144,314)	$ 221,842
BASIC AND DILUTED INCOME/(LOSS) PER COMMON SHARE:	$ (.05)	$ .07
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING:	3,146,554	3,146,554

See Notes to Condensed Financial Statements

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1MAGE SOFTWARE, INC.
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31, 2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Earnings/(Loss)	$ (144,314)	$ 221,842
Adjustments to reconcile earnings to net cash provided by operating activities:		
Depreciation and amortization	80,968	82,269
Changes in assets and liabilities:		
Receivables	34,309	(206,588)
Inventory	(1,127)	(1,725)
Prepaid expenses and other assets	(3,629)	2,808
Accounts payable	76,886	(11,686)
Accrued liabilities and deferred revenue	(20,960)	34,081
Net cash provided by operating activities	22,133	121,001
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(9,833)	(6,867)
Additions to capitalized software	(85,783)	(66,407)
Net cash used for investing activities	(95,616)	(73,274)

CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of line of credit	--	(50,000)
Repayment of long-term obligations	(608)	(491)
Net cash used for financing activities	(608)	(50,491)
DECREASE IN CASH AND CASH EQUIVALENTS	(74,091)	(2,764)
CASH AND CASH EQUIVALENTS, beginning of period	212,421	150,457
CASH AND CASH EQUIVALENTS, end of period	$ 138,330	$ 147,693

See Notes to Condensed Financial Statements

1MAGE 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, 2001 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, 2001 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 (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.

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

RESULTS OF OPERATIONS FOR THREE MONTHS ENDED MARCH 31, 2002 VERSUS MARCH 31, 2001

1mage Software, Inc. (the "Company") reported revenue of $517,264 for the first quarter of 2002, a 38% decrease from $832,397 posted for the first quarter in 2001. Sales of software licenses decreased 45% or $149,239, which the Company attributes to the global economic slowdown in the technology sector since September 11, 2001. Annual license fees decreased 38% or $165,730 compared to the first quarter in 2001 due to the cancellation of a Subscription & Maintenance agreement with the Company's largest customer that previously required a lump sum payment of $203,000 in the first quarter. Service revenues for the quarter ended March 31, 2002 were $32,269 less than $71,500 for the first quarter of 2001 due to the decrease in software license revenue. The cost of system sales and software licenses exceeded the revenue earned from this category due to the higher sales of low-margin third party software and $75,300 of fixed amortization costs for deferred software development. SG&A expenses of $327,297 for the first quarter were 16% lower than the first quarter of 2001, primarily due to decreased commissions and bonuses. The Company posted a first quarter 2002 net loss of $(144,314), or $(.05) per share, as compared to net earnings of $221,842, or $.07 per share, for the same quarter last year.

LIQUIDITY AND CAPITAL RESOURCES

The Company's largest customer, The Reynolds and Reynolds Company ("Reynolds"), terminated its 1996 Subscription and Maintenance Agreement with the Company in the first quarter of 2002. Reynolds and the Company are currently involved in various legal proceedings to determine the effect of that termination on Reynolds' rights, if any, to continue licensing the Company's software to its customers and the amount of licensing and other fees to be paid to the Company on account of such licenses. See Part II, Item 1, Legal Proceedings below.

While the Company cannot predict the outcome of its various legal proceedings with Reynolds, Reynolds' decision to terminate the 1996 Agreement had a material adverse effect on the Company's cash flow and liquid assets in the first quarter of 2002 and may have a similar effect in future periods. In the absence of its termination of the 1996 agreement, Reynolds would have made a payment to the Company of $203,000 in the first quarter of 2002. In addition, the out-of-pocket costs and other indirect expenses of the legal proceedings between the Company and Reynolds may have a material adverse impact on the Company's financial resources, liquid assets, and operating results in one or more future reporting periods.

As of March 31, 2002, cash on hand decreased $74,091 from $212,421 at December 31, 2001, primarily due to cash flows from operating activities falling short of cash used for additions to capitalized software. On February 24, 2002, the Company's $200,000 line of credit agreement was extended for another year. There were no borrowings against the line of credit at March 31, 2002.

The Company's financial resources include cash on hand, revenues from operations, and management of funds available on its revolving line of credit. In the Company's judgment, sufficient financial resources are available to meet current working capital needs. The Company's line of credit expires February 24, 2003 and bears interest at prime plus 1.5% and is secured by the Company's accounts receivables and general intangibles.

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.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

In May 1994, the Company entered into a software license agreement (the "1994 Agreement") with The Reynolds and Reynolds Company ("Reynolds") which provides software as well as other products and services to automobile dealers and other customers. In 1996, the Company entered into a subscription and maintenance agreement with Reynolds (the "1996 Agreement") providing for the payment of annual subscription and maintenance fees to the Company for subsequent releases of the Company's software not covered by the 1994 Agreement.

On January 18, 2002, Reynolds notified the Company of its intent to terminate the 1996 Agreement on April 22, 2002. Reynolds and the Company subsequently entered into negotiations aimed at determining what amounts would be payable to the Company for post-termination licenses of certain products and for the continuation of existing licenses. When the parties failed to reach agreement on these issues, on April 10, 2002, Reynolds demanded mediation before the American Arbitration Association in Dayton, Ohio pursuant to the 1994 Agreement. The Company declined to submit to mediation on the grounds that the parties' dispute related to the 1996 Agreement, which agreement did not require mediation or arbitration. Reynolds then informed the Company for the first time that it would be taking the position that it had a perpetual license to all software previously provided by the Company to Reynolds or its licensees notwithstanding the termination of the 1996 Agreement. Shortly thereafter, the Company filed a civil action in Colorado state district court for the City and County of Denver, 1MAGE SOFTWARE, INC. v. THE REYNOLDS & REYNOLDS CO., ET AL., No. 02-CV-3268, seeking a declaratory judgment against Reynolds and certain of its Colorado licensees to the effect that, contrary to Reynolds' claims, Reynolds and its licensees, do not have a perpetual license to the software provided by the Company pursuant to the 1996 Agreement.

Reynolds subsequently filed an action in federal district court in Colorado seeking to remove the Company's declaratory judgment action from state court to federal court in Colorado. 1MAGE SOFTWARE, INC. v. THE REYNOLDS & REYNOLDS CO., ET AL., Civ. No. 02-K-780. The Company opposed Reynolds' removal petition and asked the federal court to remand the case back to state court, which it did on April 23, 2002.

On May 3, 2002, Reynolds filed an action in federal district court in Ohio seeking an order compelling the Company to mediate and, if necessary, arbitrate its dispute with Reynolds pursuant to the 1994 Agreement and staying the declaratory action brought by the Company in Colorado state court. THE REYNOLDS & REYNOLDS CO. v. 1MAGE SOFTWARE, INC., No. C 3-02-206, S.D. Ohio (Dayton Division).

While the Company does not believe it is required to submit its dispute with Reynolds to mediation or arbitration because it arises from the 1996 Agreement rather than the 1994 Agreement, it may elect to do so in order to control the costs of litigation, which are already substantial. The Company cannot predict the results of any mediation, arbitration or litigation with Reynolds but it is likely that the license fees or other revenues paid to the Company by Reynolds over the next few years will be less than in recent years. It is also possible, however, that those revenues will increase in the short term, particularly if the Company ultimately prevails in the various legal proceedings against Reynolds. On the other hand, the burden imposed by these legal proceedings, including the out of pocket costs and the diversion of the Company's other limited resources, is likely to have a material adverse effect on the Company's results of operations so long as the dispute remains unresolved.

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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 Inapplicable

(B) Reports on Form 8-K

There were no reports filed on Form 8-K for the quarter ended March 31, 2002.

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: 5/16/2002

/S/ MARY ANNE DEYOUNG

Mary Anne DeYoung
Chief Financial Officer

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