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IMAGING TECHNOLOGIES CORP/CA
Form 10-Q
February 06, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2000

or

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

Commission file No. 0-12641

[ITEC LOGO]
IMAGING TECHNOLOGIES CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

33-0021693
(IRS Employer ID No.)

15175 INNOVATION DRIVE
SAN DIEGO, CALIFORNIA 92128
(Address of principal executive offices)

Registrant's Telephone Number, Including Area Code: (858) 613-1300

Check 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 past 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

The number of shares outstanding of the registrant's common stock as of February 1, 2001 was 132,635,582.

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PART I. - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
 (IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

	DECEMBER 31,	
	2000	
Current assets		
Cash	\$ 397	
Accounts receivable	609	
Inventories	158	
Prepaid expenses and other	370	

Total current assets	1,534	
Property and equipment, net	706	
Goodwill	686	
Other	-	

	\$ 2,926	\$
	=====	==

LIABILITIES AND SHAREHOLDERS' EQUITY

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Current liabilities			
Borrowings under bank note payable	\$	4,865	\$
Short-term debt		2,563	
Accounts payable		6,887	
Accrued expenses		1,581	

Total current liabilities		15,896	
Long-term debt		850	

Stockholders' equity (deficit)			
Series A preferred stock, \$1,000 par value, 7,500 shares authorized, 420.5 shares issued and outstanding		420	
Common stock, \$0.005 par value, 200,000,000 shares Authorized, 118,513,745 shares issued and outstanding		592	
Paid-in capital		62,549	
Shareholder loans		(105)	
Accumulated deficit		(77,276)	

Total shareholders' equity (deficit)		(13,820)	

	\$	2,926	\$
		=====	=====

See Notes to Consolidated Financial Statements.

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IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED DECEMBER 31, 2000 AND 1999
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

		2000
Revenues		
Sales of products	\$	556
Licenses and royalties		455

		1,011

Costs and expenses		
Cost of products sold		481
Selling, general, and administrative		1,721
Cost of engineering fees, research, and development		217

		2,419

Income (loss) from operations		(1,408)

Other income (expense):		

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Interest, net		(177)	
Restructuring		-	
Other		-	

		(177)	

Income (loss) before income taxes		(1,585)	
Income tax expense			
Net income (loss)	\$	(1,585)	\$
		=====	
Earnings (loss) per common share			
Basic	\$	(0.01)	\$
		=====	
Diluted	\$	(0.01)	\$
		=====	
Weighted average common shares		112,709	
		=====	
Weighted average common shares - assuming dilution		112,709	
		=====	

See Notes to Consolidated Financial Statements.

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IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

		2000
Revenues		
Sales of products	\$	1,216
Engineering fees		-
Licenses and royalties		632

		1,848

Costs and expenses		
Cost of products sold		924
Selling, general, and administrative		4,072
Cost of engineering fees, research, and development		456

		5,452

Income (loss) from operations		(3,604)

Other income (expense):		

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Interest, net		(358)	
Restructuring, ITEC Europe		-	
Other		-	
		(358)	
Income (loss) before income taxes		(3,962)	
Income tax expense			
Net income (loss)	\$	(3,962)	\$
Earnings (loss) per common share			
Basic	\$	(0.04)	\$
Diluted	\$	(0.04)	\$
Weighted average common shares		107,997	
Weighted average common shares - assuming dilution		107,997	

See Notes to Consolidated Financial Statements.

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IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

		2000	
Cash flows from operating activities			
Net income (loss)	\$	(3,962)	\$
Adjustments to reconcile net income (loss) to net cash from operating activities			
Depreciation and amortization		143	
Amortization of capitalized software		-	
Stock issued for services		618	
Changes in operating assets and liabilities			
Accounts receivable		(355)	
Inventories		45	
Prepaid expenses and other		(37)	
Accounts payable and accrued expenses		767	
Net cash from operating activities		(2,781)	
Cash flows from investing activities			
Capital expenditures		(90)	
Other		150	
Net cash from investing activities		60	

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Cash flows from financing activities			
Net borrowings under bank lines of credit		(900)	
Net borrowings under short-term notes payable		-	
Net borrowings under long-term notes payable		850	
Net proceeds from issuance of common stock		2,877	

Net cash from financing activities		2,827	

Net increase (decrease) in cash		106	
Cash, beginning of period		291	

Cash, end of period	\$	397	\$
		=====	

See Notes to Consolidated Financial Statements.

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IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements of Imaging Technologies Corporation and Subsidiaries (the "Company" or "ITEC") have been prepared pursuant to the rules of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by generally accepted accounting principles. These financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the years ended June 30, 2000, 1999, and 1998 included in the Company's annual report on Form 10-K filed with the SEC. Interim operating results are not necessarily indicative of operating results for any future interim period or for the full year.

NOTE 2. GOING CONCERN CONSIDERATIONS

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. At December 31, 2000, and for the three months then ended, the Company had a net loss, negative working capital, and a decline in net worth which raise substantial doubt about its ability to continue as a going concern. The Company's losses have resulted primarily from an inability to achieve product sales and contract revenue targets due to insufficient working capital. ITEC's ability to continue operations will depend on positive cash flow, if any, from future operations and on the Company's ability to raise additional funds through equity or debt financing. The Company has cut back and/or discontinued some of its operations and, if it is unable to raise or obtain needed funding, the Company may be forced to discontinue operations generally.

On August 20, 1999, at the request of Imperial Bank, the Company's primary

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lender, the Superior Court of San Diego appointed an operational receiver who took control of the Company's day-to-day operations on August 23, 1999. On June 21, 2000, in connection with a settlement agreement reached with Imperial Bank, the Superior Court of San Diego issued an order dismissing the operational receiver. On October 21, 1999, Nasdaq notified the Company that it no longer complied with the bid price and net tangible assets/market capitalization/net income requirements for continued listing on The Nasdaq SmallCap Market. At a hearing on December 2, 1999, a Nasdaq Listing Qualifications Panel also raised public interest concerns relating to the Company's financial viability. The Company's common stock was delisted from The Nasdaq Stock Market effective with the close of business on March 1, 2000. As a result of being delisted from The Nasdaq SmallCap Market, stockholders may find it more difficult to sell common stock. This lack of liquidity also may make it more difficult to raise capital in the future. Trading of the Company's common stock is now being conducted over-the-counter through the NASD Electronic Bulletin Board and covered by Rule 15c-9 under the Securities Exchange Act of 1934. Under this rule, broker/dealers who recommend these securities to persons other than established customers and accredited investors must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale. Securities are exempt from this rule if the market price is at least \$5.00 per share.

The Securities and Exchange Commission adopted regulations that generally define a "penny stock" as any equity security that has a market price of less than \$5.00 per share. Additionally, if the equity security is not registered or authorized on a national securities exchange or the Nasdaq and the issuer has net tangible assets under \$2,000,000, the equity security also would constitute a "penny stock." Our common stock does constitute a penny stock because our common stock has a market price less than \$5.00 per share, our common stock is no longer quoted on Nasdaq and our net tangible assets do not exceed \$2,000,000. As our common stock falls within the definition of penny stock, these regulations require the delivery, prior to any transaction involving our common stock, of a disclosure schedule explaining the penny stock market and the risks associated with it. Furthermore, the ability of broker/dealers to sell our common stock and the ability of shareholders to sell our common stock in the secondary market would be limited. As a result, the market liquidity for our common stock would be severely and adversely affected. We can provide no assurance that trading in our common stock will not be subject to these or other regulations in the future, which would negatively affect the market for our common stock.

The Company is in the process of reestablishing management control of its operations and resuming its strategic plan. In order to succeed, however, Company must obtain additional funds to provide adequate working capital and finance operations. The Company has engaged a financial advisor to assist with additional fund raising efforts and

to help identify merger and acquisition candidates. There can be no assurance, however, that the Company will be able to comply with the Imperial Bank settlement agreement, meet the conditions under the financing facility, or complete any additional debt or equity financings on favorable terms or at all, or that any such financings, if completed, will be adequate to meet the Company's capital requirements. Any additional equity or convertible debt financings could result in substantial dilution to the Company's stockholders. If adequate funds are not available, the Company may be required to delay, reduce or eliminate some or all of its planned activities, including any potential mergers or acquisitions. The Company's inability to fund its capital requirements would have a material adverse effect on the Company. The financial statements do not include any adjustments that might result from the outcome of

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this uncertainty.

NOTE 3. EARNINGS (LOSS) PER COMMON SHARE

Basic earnings (loss) per common share ("Basic EPS") excludes dilution and is computed by dividing net income (loss) available to common shareholders (the "numerator") by the weighted average number of common shares outstanding (the "denominator") during the period. Diluted earnings (loss) per common share ("Diluted EPS") is similar to the computation of Basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, in computing the dilutive effect of convertible securities, the numerator is adjusted to add back the after-tax amount of interest recognized in the period associated with any convertible debt. The computation of Diluted EPS does not assume exercise or conversion of securities that would have an anti-dilutive effect on net earnings (loss) per share.

NOTE 4. INVENTORIES

	DECEMBER 31, 2000	JUNE 30, 2000
Inventories		
Materials and supplies	\$ 50	\$ 87
Finished goods	108	116
	-----	-----
	\$ 158	\$ 203
	=====	=====

NOTE 5. CONVERTIBLE NOTES PAYABLE

On December 12, 2000, the Company entered into a Convertible Note Purchase Agreement with Amro International, S.A., Balmore Funds, S.A. and Celeste Trust Reg. Pursuant to this agreement, the registrant sold to each of the purchasers convertible promissory notes in the aggregate principal amount of \$850,000 bearing interest at the rate of eight percent (8%) per annum, due December 12, 2003, each convertible into shares of the registrant's common stock. Interest shall be payable, at the option of the purchasers, in cash or shares of common stock. At any time after the issuance of the notes, each note is convertible into such number of shares of common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note as of the date of conversion by (b) the lesser of (x) an amount equal to seventy percent (70%) of the average closing bid prices for the three (3) trading days prior to December 12, 2000 and (y) an amount equal to seventy percent (70%) of the average closing bid prices for the three (3) trading days having the lowest closing bid prices during the thirty (30) trading days prior to the conversion date.

Additionally, the registrant issued a warrant to each of the purchasers to purchase a number of shares of the registrant's common stock at an exercise price equal to \$.0887 per share. The purchasers may exercise the warrants through December 12, 2005.

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NOTE 6. BUSINESS ACQUISITION

Effective December 1, 2000, the Company acquired all of the outstanding shares of Eduadvantage.com in exchange for 3,500,000 of the Company's common stock. Eduadvantage.com is a California corporation that is primarily engaged in a web-based business. The acquisition has been accounted for as a purchase transaction. The following summarized the net assets acquired:

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Assets	
Receivables	\$ 79
Equipment	3
Goodwill	686

	768
Less assumption of liabilities	(495)

Net assets acquired	\$273
	====

During the quarter ended December 31, 2000, the Company also acquired the rights to certain software in exchange for 1,200,000 shares of its common stock.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q. The discussion of the Company's business contained in this Quarterly Report on Form 10-Q may contain certain projections, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed below at "Risks and Uncertainties." While this outlook represents management's current judgment on the future direction of the business, such risks and uncertainties could cause actual results to differ materially from any future performance suggested below. The Company undertakes no obligation to release publicly the results of any revisions to these forward-looking statements to reflect events or circumstances arising after the date hereof.

OVERVIEW

Imaging Technologies Corporation develops, manufactures, and distributes high-quality digital imaging solutions. The Company produces printer and imaging products for use in graphics and publishing, digital photography and other niche business and technical markets. Beginning with a core technology in the design and development of controllers for non-impact printers and multifunction peripherals, the Company has expanded its product offerings to include monochrome and color printers, external print servers, digital image storage devices, and software to improve the accuracy of color reproduction.

The Company's business continues to be in a significant transitional phase and there are important short-term operational and liquidity challenges. Accordingly, quarter-to-quarter financial comparisons may be of limited usefulness now and for the next several quarters due to these important changes in the Company's business.

Historically, a portion of the Company's income was derived from non-recurring engineering fees and royalty income from a relatively small number of original equipment manufacturing ("OEM") customers. Over the past several years, the Company has experienced shortfalls in income as a result of engineering contracts with OEM manufacturers for products that were never completed by the OEM, were never introduced into the market and shipped or were cancelled by the customer before ITEC completed the deliverables portion of the contract. Failure of these OEMs to achieve significant sales of products incorporating the Company's technology and fluctuations in the timing and volume of such sales had a materially adverse effect on the Company.

The Company's current strategy is to continue to focus on rebuilding its OEM business and develop, commercialize and distribute its own technology

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products, including its software products. The Company intends to continue to develop its target markets and to pursue clearly defined commercial market opportunities in order to leverage its core technologies.

Additionally, the Company has been pursuing certain strategic acquisitions in order to grow its revenues and to pursue new opportunities for revenues and profits.

In December, 2000, the Company acquired all of the outstanding shares of Eduadvantage.com in exchange for shares of the Company's common stock (See Note 6 of the Notes to the Consolidated Financial Statements). Eduadvantage.com is primarily engaged in an Internet business selling educational software to institutions,

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businesses, and end-users. As part of this transaction, the Company also acquired the rights to certain proprietary software. This acquisition furthers the Company's objective to develop and support e-commerce strategies, which also includes the Company's Dealseekers.com unit, which the Company hopes to re-launch later this year. Eduadvantage provides ITEC a vehicle to distribute ITEC products, along with EduAdvantage.com's current products for accounting, desktop publishing, tax software, and virus detection. The acquisition is expected to provide ITEC with incremental revenues.

In November, 2000, ITEC entered into an agreement to acquire a majority interest in Quality Photographic Imaging (formerly known as Quick Pix, Inc.) ("QPI") (OTC: QPIX). QPI was established in 1982 and is a leading visual marketing support firm, located in Southern California. The company provides a spectrum of services to produce final color visuals, both digital and photographic. QPI is a total visual marketing support company servicing a wide range of varied clientele. The acquisition requires QPI shareholder approval, which is pending.

In December, 2000, ITEC signed a definitive agreement to purchase 75 percent of the stock of Pen Interconnect, Inc. (OTC Bulletin Board: PENC - news), Irvine, Calif. Two ITEC business units, EduAdvantage.com and Dealseekers.com, will be combined into Pen Interconnect to create a publicly traded e-commerce company. The agreement is contingent on Pen Interconnect resolving certain judgments, liens and vendor debts and obtaining shareholder approval, prior to the closing, which is anticipated in the next 60 days.

To successfully execute its current strategy, the Company will need to improve its working capital position. The report of the Company's independent auditors accompanying the Company's June 30, 2000 financial statements includes an explanatory paragraph indicating there is a substantial doubt about the Company's ability to continue as a going concern, due primarily to the decreases in the Company's working capital and net worth. At December 30, 2000, and for the three months then ended, the Company had a net loss, negative working capital, and a decline in net worth which continue to raise substantial doubt about its ability to continue as a going concern.

The Company needs to raise additional funds to operate its business and has been actively pursuing solutions to its liquidity difficulties. To help address these needs, on December 12, 2000, ITEC entered into a Convertible Note Purchase Agreement with several investors for \$850,000. Additionally, the Company issued a warrant to each of the purchasers to purchase a number of shares of the registrant's common stock at an exercise price equal to \$.0887 per share.

The Company has also engaged a financial advisor to assist with

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additional fund raising efforts and to help identify merger and acquisition candidates. There can be no assurance, however, that the Company will be able to obtain additional debt or equity financing on favorable terms or at all, or that any such financings, if completed, will be adequate to meet the Company's capital requirements. Any additional equity or convertible debt financings could result in substantial dilution to the Company's stockholders. If adequate funds are not available, the Company will be required to delay, reduce or eliminate some or all of its planned activities. The Company's inability to fund its capital requirements would have a material adverse effect on the Company. See "Liquidity and Capital Resources" and "Risks and Uncertainties -- Future Capital Needs."

RESULTS OF OPERATIONS NET REVENUES

Revenues were \$1 million and \$309 thousand for the three month period ended December 31, 2000 and 1999, respectively, as increase of 227%. Sales of products were \$556 thousand and \$61 thousand for the three month period ended December 31, 2000 and 1999, respectively, an increase of 811%. Revenues were \$1.8 million and \$1.4 million for the six month period ended December 31, 2000 and 1999, respectively, an increase of 36%. Sales of products were \$1.2 million and \$1 million for the six month period ended December 31, 2000 and 1999, respectively, and increase of 21%. The increase in product sales from the reported periods of 1999 to 2000 was due to an overall increase in the sales activities of the Company since the court-appointed operational receiver was relieved in July, 2000. However, the Company's lack of sufficient working capital has had, and may continue to have a negative adverse effect on printer product sales in particular, and overall revenues in general.

Licensing fees and royalties were \$455 thousand and \$248 thousand for the three month period ended December 31, 2000 and 1999 respectively, an increase of 79%. For the six month period ended December 31, 2000 and 1999, respectively, licensing fees and royalties were \$632 thousand and \$336 thousand, respectively, an increase of 88%. Royalties and licensing fees vary from quarter to quarter and are dependent on the sales of products sold by OEM customers using ITEC technologies. These revenues, however, are expected to decline in the future due to the Company's focus on product sales and the operations of the Company's e-commerce businesses as opposed to technology licensing activities.

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COST OF PRODUCTS SOLD

Cost of products sold were \$481 thousand (87% of product sales) and \$904 thousand (1,481% of product sales) for the period ended December 31, 2000 and 1999, respectively. The increase in margins is primarily due to the absence of the liquidation policies of the court-appointed operational receiver, who was relieved in July, 1999. While the Company expects to improve its margins moving forward, there remain certain challenges related to profitability of its printer products, for which the Company typically outsources its manufacturing. Management hopes to increase margins through more efficient outsourcing for parts and manufacturing, and improving the Company's product mix in favor of higher margin software products.

For the six month period ended December 31, 2000 and 1999, cost of products sold were \$924 thousand (76% of product sales) and \$1.6 million, or 160% of product sales, respectively.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the three month period ended December 31, 2000 and 1999, respectively, were \$1.7 million and \$1.5

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million. Selling, general and administrative expenses for the six month period ended December 31, 2000 and 1999, respectively, were \$4 million and \$4.9 million. Selling, general and administrative expenses have consisted primarily of salaries and commissions of sales and marketing personnel, salaries and related costs for general corporate functions, including finance, accounting, facilities and legal, advertising and other marketing related expenses, and fees for professional services. For the three month period ended December 31, the selling, general, and administrative expenses have increased \$172 thousand (11%) due primarily to reserves for certain account receivable. However, for the six month period ended December 31, 2000 and 1999, the Company has reduced selling, general, and administrative expenses \$855 thousand (17%) due primarily to the elimination of costs associated with the court-appointed operational receiver, who was relieved in July 2000.

COST OF ENGINEERING

Engineering costs, including costs of research and development, were \$217 thousand and \$979 thousand for the quarters ended December 31, 2000 and 1999, respectively; a decrease of \$762 thousand (78%). For the six month period ended December 31, 2000 and 1999, respectively, engineering costs were \$456 thousand and \$1.6 million; a decrease of \$1.1 million (72%). The Company had been reducing its engineering and licensing activities and has re-directed engineering costs toward the development and support of the Company's branded products, including printers and associated digital imaging products.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company has financed its operations primarily through cash generated from operations, debt financing, and from the sale of equity securities.

As a result of some of the Company's financing activities, there has been a significant increase in the number of issued and outstanding shares. During the three months period ended December 31 2000, the Company issued an additional 13 million shares. During the six month period ended December 31, 2000, the Company issued an additional 17 million shares. These shares of common stock were issued for raising capital due to private placements and for corporate expenses in lieu of cash.

As of December 31, 2000, the Company had negative working capital of \$14.4 million, an increase of approximately \$100 thousand (1%) in working capital as compared to June 30, 1999.

Net cash used in operating activities decreased 39% to \$2.8 million during the six month period ended December 31, 2000, from \$4.6 million during the year-earlier period, due primarily to a 43% decrease in the Company's net loss during the period.

Net cash from investing activities was \$60 thousand during the six month period ended December 31, 2000. There was no such activity in the corresponding six month period in the prior year. The difference was due primarily to prepaid expenses and capital expenditures in the period.

Net cash from financing activities was \$2.8 million for the six month period ended December 31, 2000, a decrease of \$1.8 million or 39%. The decrease is due primarily to a reduction in proceeds from the sale of common stock, because the trading price of the Company's common stock fell substantially during the period.

The Company has no material commitments for capital expenditures. The Company's 5% convertible

preferred stock (which ranks prior to the Company's common stock), carries cumulative dividends, when and as declared, at an annual rate of \$50.00 per share. The aggregate amount of such dividends in arrears at December 31, 2000, was approximately \$646 thousand.

The Company's capital requirements depend on numerous factors, including market acceptance of the Company's products, the scope and success of the Company's product development efforts, the resources the Company devotes to marketing and selling its products, and other factors. The report of the Company's independent auditors accompanying the Company's June 30, 2000 financial statements includes an explanatory paragraph indicating there is a substantial doubt about the Company's ability to continue as a going concern, due primarily to the decreases in the Company's working capital and net worth. (Also see Note 2 to the Consolidate Financial Statements.)

RISKS AND UNCERTAINTIES

NEED FOR FUTURE CAPITAL

ITEC's business has not been profitable in the recent past and it may not be profitable in the future. The Company may incur losses on a quarterly or annual basis for a number of reasons, some within and others outside its control. See "Potential Fluctuation in Our Quarterly Performance." The growth of the Company's business will require the commitment of substantial capital resources. If funds are not available from operations, the Company will need additional funds. ITEC may seek such additional funding through public and private financing, including debt or equity financing. Adequate funds for these purposes, whether through financial markets or from other sources, may not be available when needed. Even if funds are available, the terms under which the funds are available may not be acceptable to the Company. Insufficient funds may require the delay, reduction, or elimination of some or all of the Company's planned activities. Also see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources."

POTENTIAL FLUCTUATION IN QUARTERLY PERFORMANCE

Quarterly operating results can fluctuate significantly depending on a number of factors, any one of which could have a material adverse effect on the Company's results of operations. The factors include: the timing of product announcements and subsequent introductions of new or enhanced products by the Company and by its competitors, the availability and cost of components, the timing and mix of shipments of the Company's products, the market acceptance of new products, seasonality, currency fluctuations, changes in the Company's prices and in the Company's competitors' prices, price protection offered to distributors and OEMs for product price reductions, the timing of expenditures for staffing and related support costs, the extent and success of advertising, research and development expenditures, and changes in general economic conditions.

The Company may experience significant quarterly fluctuations in revenues and operating expenses as it introduces new products. In addition, component purchases, production and spending levels are based upon management's forecast of future demand for the Company's products. Accordingly, any inaccuracy in the Company's forecasts could adversely affect its financial condition and results of operations. Demand for the Company's products could be adversely affected by a slowdown in the overall demand for computer systems, printer products or digitally printed images. The Company's failure to complete shipments during a quarter could have a material adverse effect on its results of operations for that quarter. Quarterly results are not necessarily indicative

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of future performance for any particular period.

HIGHLY COMPETITIVE INDUSTRY

The markets for ITEC products are highly competitive and rapidly changing. Some of the Company's current and prospective competitors have significantly greater financial, technical, manufacturing and marketing resources than ITEC. The Company's ability to compete in its markets depends on a number of factors, some within and others outside its control. These factors include: the frequency and success of product introductions by the Company and by its competitors, the selling prices of ITEC products and of its competitors' products, the performance of ITEC products and of its competitors' products, product distribution by ITEC and by its competitors, ITEC's marketing ability and the marketing ability of its competitors, and the quality of customer support offered by ITEC and by its competitors.

A key element of ITEC's strategy is to provide competitively priced, quality products. The Company cannot be certain that its products will continue to be competitively priced. The Company has reduced prices on certain products in the past and will likely continue to do so in the future. Price reductions, if not offset by similar reductions in product costs, will reduce gross margins and may adversely affect the Company's financial condition and results of operations.

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SHORT PRODUCT LIVES AND TECHNOLOGICAL CHANGE

The markets for ITEC's products are characterized by rapidly evolving technology, frequent new product introductions and significant price competition. Consequently, short product life cycles and reductions in product selling prices due to competitive pressures over the life of a product are common. The future success of the Company will depend on its ability to continue to develop and manufacture competitive products and achieve cost reductions for existing products. In addition, the Company monitors new technology developments and coordinates with suppliers, distributors and dealers to enhance its existing products and to lower costs. Advances in technology will require increased investment in product development to maintain the Company's market position. If the Company is unable to develop and manufacture new, competitive products in a timely manner, its financial condition and results of operations will be adversely affected.

DEVELOPING MARKETS AND APPLICATIONS

The markets for ITEC products are relatively new and are still developing. Management believes that there has been growing market acceptance for color printers, color management software and supplies. The Company cannot be certain, however, that these markets will continue to grow. Other technologies are constantly evolving and improving. The Company cannot be certain that products based on these other technologies will not have a material adverse effect on the demand for its products.

DEPENDENCE UPON SUPPLIERS

At present, many of ITEC's products use technology licensed from outside suppliers. The Company relies heavily on these suppliers for upgrades and support. In the case of ITEC font products, the Company licenses the fonts from outside suppliers, who also own the intellectual property rights to the fonts. The Company's reliance on third-party suppliers involves many risks, including limited control over potential hardware and software incompatibilities with ITEC products. Furthermore, the Company cannot be certain that all of the

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suppliers of products it markets will continue to license their products to ITEC, or that these suppliers will not license their products to other companies simultaneously.

RISKS RELATED TO ACQUISITIONS

In order to grow the business, the Company may acquire businesses that management believes are complementary. To successfully implement this strategy, the Company must identify suitable acquisition candidates, acquire these candidates on acceptable terms, integrate their operations and technology successfully with the Company, retain existing customers and maintain the goodwill of the acquired business. The Company may fail in its efforts to implement one or more of these tasks. Moreover, in pursuing acquisition opportunities, the Company may compete for acquisition targets with other companies with similar growth strategies. Some of these competitors may be larger and have greater financial and other resources than those of the Company. Competition for these acquisition targets likely could also result in increased prices of acquisition targets and a diminished pool of companies available for acquisition. Overall financial performance will be materially and adversely affected if the Company is unable to manage internal or acquisition-based growth effectively.

Acquisitions involve a number of risks, including: integrating acquired products and technologies in a timely manner; integrating businesses and employees with the Company's business; managing geographically-dispersed operations; reductions in the Company's reported operating results from acquisition-related charges and amortization of goodwill; potential increases in stock compensation expense and increased compensation expense resulting from newly-hired employees; the diversion of management attention; the assumption of unknown liabilities; potential disputes with the sellers of one or more acquired entities; the Company's inability to maintain customers or goodwill of an acquired business; the need to divest unwanted assets or products; and the possible failure to retain key acquired personnel.

Client satisfaction or performance problems with an acquired business could also have a material adverse effect on the Company's reputation, and any acquired business could significantly under perform relative to expectations. The Company is currently facing all of these challenges and its ability to meet them over the long term has not been established. As a result, the Company cannot be certain that it will be able to integrate acquired businesses, products or technologies successfully or in a timely manner in accordance with its strategic objectives, which could have a material adverse effect on overall financial performance.

In addition, if the Company issues equity securities as consideration for any future acquisitions, existing stockholders will experience ownership dilution and these equity securities may have rights, preferences or privileges superior to those of ITEC common stock. See "Future Capital Needs."

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DEPENDENCE ON KEY PERSONNEL

The success of the Company is dependent, in part, upon its ability to attract and retain qualified management and technical personnel. Competition for these personnel is intense, and the Company will be adversely affected if it is unable to attract additional key employees or if it loses one or more key employees. The Company may not be able to retain its key personnel.

COMPONENT AVAILABILITY AND COST; DEPENDENCE ON SINGLE SOURCES

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The Company presently out-sources the production of some of its manufactured products through a number of vendors located in California. These vendors assemble products, using components purchased by the Company from other sources or from their own inventory. The terms of supply contracts are negotiated separately in each instance. Although the Company has not experienced any difficulty over the past several years in engaging contractors or in purchasing components, present vendors may not have sufficient capacity to meet projected market demand for ITEC products and alternative production sources may not be available without undue disruption.

Contract vendors generally perform multi-step quality control testing prior to shipping their products to the Company. The Company, in turn, includes appropriate software, performs additional tests on the products, then packages and ships products into the distribution channels. In addition to buying such items as printed circuit boards and other components from outside vendors, the Company purchases and/or licenses software programs, including operating systems and intellectual property modules (pre-written software code to execute a specifically defined operation). The Company purchases these products from vendors who have licenses to sell the software to the Company from the originators of the software, and have, from time to time, directly licensed system software that is either embedded or otherwise incorporated in certain ITEC products.

While most components are available locally from multiple vendors, certain components used in ITEC products are only available from single sources. Although alternative suppliers are readily available for many components, for some components the process of qualifying replacement suppliers, replacing tooling or ordering and receiving replacement components could take several months and cause substantial disruption to operations. Any significant increase in component prices or decrease in component availability could have a material adverse effect on the Company's business and overall financial performance.

POSSIBILITY OF CHALLENGE TO PRODUCTS OR INTELLECTUAL PROPERTY RIGHTS

The Company currently holds no patents. The Company's software products, hardware designs, and circuit layouts are copyrighted. However, copyright protection does not prevent other companies from emulating the features and benefits provided by its software, hardware designs or the integration of the two. The Company protects its software source code as trade secrets and makes its proprietary source code available to OEM customers only under limited circumstances and specific security and confidentiality constraints. In many product hardware designs, the Company develops application-specific integrated circuits (ASICs) which encapsulate proprietary technology and are installed on the circuit board. This can serve to significantly reduce the risk of duplication by competitors, but in no way ensures that a competitor will be unable to replicate a feature or the benefit in a similar product.

Competitors may assert that the Company infringes their patent rights. If the Company fails to establish that it has not violated the asserted rights, it could be prohibited from marketing the products that incorporate the technology and it could be liable for damages. The Company could also incur substantial costs to redesign its products or to defend any legal action taken against it. The Company has obtained U.S. registration for several of its trade names or trademarks, including: PCPI, NewGen, ColorBlind, LaserImage, ColorImage, ImageScript and ImageFont. These trade names are used to distinguish the Company's products in the marketplace.

RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS

The Company conducts business globally. Accordingly, future results could be adversely affected by a variety of uncontrollable and changing factors

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including: foreign currency exchange fluctuations; regulatory, political or economic conditions in a specific country or region; the imposition of governmental controls; export license requirements; restrictions on the export of critical technology; trade restrictions; changes in tariffs; government spending patterns; natural disasters; difficulties in staffing and managing international operations; and difficulties in collecting accounts receivable.

In addition, the laws of certain countries do not protect ITEC products and intellectual property rights to the same extent as the laws of the United States.

DEPENDENCE ON EXPORT SALES

The Company intends to pursue international markets as key avenues for growth and to increase the percentage of sales generated in international markets. In the Company's past few fiscal years, sales outside the

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United States represented over half of its net sales. The Company expects sales outside the United States to continue to represent a significant portion of its sales. As the Company continues to expand its international sales and operations, the business and overall financial performance may be adversely affected by factors such as those described under "Risks Associated with International Operations."

RELIANCE ON INDIRECT DISTRIBUTION

ITEC products are marketed and sold through an established distribution channel of value added resellers, manufacturers' representatives, retail vendors, and systems integrators. The Company has a network of dealers and distributors in the United States and Canada, in the European Community and on the European Continent, as well as a growing number of resellers in Africa, Asia, the Middle East, Latin America, and Australia. The Company supports its worldwide distribution network and end-user customers through centralized manufacturing, distribution, and repair operations headquartered in San Diego. As of December 31, 2000, the Company directly employed fifteen individuals involved in marketing and sales activities.

Sales are principally made through distributors, which may carry competing product lines. These distributors could reduce or discontinue sales of ITEC products, which could materially and adversely affect the Company. These independent distributors may not devote the resources necessary to provide effective sales and marketing support of ITEC products. In addition, the Company is dependent upon the continued viability and financial stability of these distributors, many of which are small organizations with limited capital. These distributors, in turn, are substantially dependent on general economic conditions and other unique factors affecting the Company's markets. Management believes that the future growth and success of the Company will continue to depend in large part upon its distribution channels. The business could be materially and adversely affected if the Company's distributors fail to pay amounts to the Company that exceed reserves it has established. To expand its distribution channels, the Company has entered into select OEM arrangements that allow it to address specific market segments or geographic areas. To prevent inventory write-downs in the event that OEM customers do not purchase products as anticipated, the Company may need to convert such products to make them salable to other customers.

VOLATILITY OF STOCK PRICE

The market price of ITEC's common stock historically has fluctuated

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significantly. The Company's stock price could fluctuate significantly in the future based upon any number of factors such as: general stock market trends; announcements of developments related to ITEC's business; fluctuations in the Company's operating results; a shortfall in revenues or earnings compared to the estimates of securities analysts; announcements of technological innovations, new products or enhancements by the Company or its competitors, general conditions in the computer peripheral market and the imaging markets served by the Company; general conditions in the worldwide economy; developments in patents or other intellectual property rights; and developments in the Company's relationships with its customers and suppliers.

In addition, in recent years the stock market in general, and the market for shares of technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. Similarly, the market price of ITEC common stock may fluctuate significantly based upon factors unrelated to the Company's operating performance.

ABSENCE OF DIVIDENDS

The Company has not paid any cash dividends on its common stock to date and it does not anticipate paying cash dividends in the foreseeable future.

APPOINTMENT AND REMOVAL OF OPERATIONAL RECEIVER

On August 20, 1999, at the request of Imperial Bank, the Company's primary lender, the Superior Court, San Diego appointed an operational receiver. On August 23, 1999, the operational receiver took control of ITEC's day-to-day operations. Through further equity infusion, primarily in the form of the exercise of warrants to purchase ITEC common stock, operations have continued, and on June 21, 2000, the Superior Court, San Diego issued an order dismissing the operational receiver. However, in the future, without additional funding sufficient to satisfy Imperial Bank and other creditors, as well as providing for working capital, there can be no assurances that such operations can continue. In addition, the Company may not be able to satisfy all conditions required to sell shares under the Private Equity Line of Credit Agreement. In that case, the Company would likely need to raise money from other sources in order to continue to fund operations. Such alternative funding may not be available. If such

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funding is not obtained, the Company will need to reduce or suspend operations.

NASDAQ LISTING AND LIQUIDITY OF COMMON STOCK

The Nasdaq(R) SmallCap(R) Market and Nasdaq Marketplace Rules require an issuer to evidence a minimum of \$2,000,000 in net tangible assets, a \$35,000,000 market capitalization or \$500,000 in net income in the latest fiscal year or in two of the last three fiscal years, and a \$1.00 per share bid price, respectively. On October 21, 1999, Nasdaq notified the Company that it no longer complied with the bid price and net tangible assets/market capitalization/net income requirements for continued listing on The Nasdaq SmallCap Market. At a hearing on December 2, 1999, a Nasdaq Listing Qualifications Panel also raised public interest concerns relating to the Company's financial viability. While the Panel acknowledged that ITEC was in technical compliance with the bid price and market capitalization requirements, the Panel was of the opinion that the continued listing of ITEC common stock on The Nasdaq Stock Market was no longer appropriate. This conclusion was based on the Panel's concerns regarding the future viability of the Company. ITEC common stock was delisted from The Nasdaq Stock Market effective with the close of business on March 1, 2000. As a result

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of being delisted from The Nasdaq SmallCap Market, stockholders may find it more difficult to sell ITEC common stock. This lack of liquidity also may make it more difficult for the Company to raise capital in the future.

Trading of ITEC common stock is now being conducted over-the-counter through the NASD Electronic Bulletin Board and covered by Rule 15c-9 under the Securities Exchange Act of 1934. Under this rule, broker/dealers who recommend these securities to persons other than established customers and accredited investors must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale. Securities are exempt from this rule if the market price is at least \$5.00 per share.

The Securities and Exchange Commission adopted regulations that generally define a "penny stock" as any equity security that has a market price of less than \$5.00 per share. Additionally, if the equity security is not registered or authorized on a national securities exchange or the Nasdaq and the issuer has net tangible assets under \$2,000,000, the equity security also would constitute a "penny stock." Our common stock does constitute a penny stock because our common stock has a market price less than \$5.00 per share, our common stock is no longer quoted on Nasdaq, and our net tangible assets do not exceed \$2,000,000. As ITEC common stock falls within the definition of penny stock, these regulations require the delivery, prior to any transaction involving ITEC common stock, of a disclosure schedule explaining the penny stock market and the risks associated with it. Furthermore, the ability of broker/dealers to sell ITEC common stock and the ability of shareholders to sell ITEC common stock in the secondary market would be limited. As a result, the market liquidity for ITEC common stock would be severely and adversely affected. The Company can provide no assurance that trading in ITEC common stock will not be subject to these or other regulations in the future, which would negatively affect the market for ITEC common stock.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On or about October 7, 1999, the law firms of Weiss & Yourman and Stull, Stull & Brody made a public announcement that they had filed a lawsuit against the Company and certain current and past officers and/or directors, alleging violation of federal securities laws during the period of April 21, 1998 through October 9, 1998. On or about November 17, 1999, the lawsuit, filed in the name of Nahid Nazarian Behfarin, on her own behalf and others purported to be similarly situated, was served on the Company. A motion to dismiss the lawsuit has been filed on behalf of the Company and those individual defendants that have been served. The Court will consider the motion at a hearing scheduled for February 12, 2001. The Company believes these claims are without merit and intends to vigorously defend against them on its own behalf as well as on behalf of the other defendants.

Throughout fiscal 1999 and 2000, and through the date of this filing, various creditors of the Company have made claims and/or served the Company with lawsuits alleging the failure of the Company to pay its obligations to them in a total amount exceeding \$2.5 million. The lawsuits are in various stages. Some

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have resulted in judgments being entered against the Company. Should the Company be required to pay the full amount demanded in each of these claims and lawsuits, such a requirement would have a material adverse impact on the operations of the Company. However, the superior security interest held by Imperial Bank has prevented these creditors from collecting on their judgments.

Furthermore, from time to time, the Company may be involved in litigation relating to claims arising out of its operations in the normal course of business.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

10(a) Agreement to Acquire Shares, dated December 1, 2000, between ITEC and Quik Pix, Inc.

10(b) Agreement to Acquire Shares, dated December 17, 2000, between ITEC and Pen Interconnect, Inc.

10(c) Share Purchase Agreement, dated December 1, 2000, between ITEC and EdAdvantage.com, Inc.

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Reports on Form 8-K

The Company filed a report on Form 8-K dated December 13, 2000, related to the placement of a Convertible Note Purchase Agreement with Amro International, S.A., Balmore Funds, S.A., and Celeste Trust Reg.

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.

Dated: February 2, 2001

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IMAGING TECHNOLOGIES CORPORATION (Registrant)

By: /s/ BRIAN BONAR

Brian Bonar
Chief Executive Officer
and Chairman of the Board of Directors

By: /s/ SCOTT KIEFER

Scott Kiefer
Principal Financial and Accounting Officer