INTERNET PICTURES CORP
Form 10-Q/A
August 14, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended March 31, 2003	Commission File No. 000-26363

Internet Pictures Corporation

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-2213841** (I.R.S. Employer Identification No.)

3160 Crow Canyon Road
San Ramon, California 94583
(Address of principal executive offices, zip code)

Registrant s telephone number, including area code: **(925) 242-4002**

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 o

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

7,557,241 shares of $0.001 par value common stock outstanding as of August 13, 2003.

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This Amendment on Form 10-Q/A is being filed to recalculate the Company s earnings (loss) per common share for the quarter ended March 31, 2003. The only item affected by this amendment is Part I, Item 1, Financial Statements and Part II, Item 6. The only changes reflected herein to amounts previously filed in the Company s Form 10-Q for the quarters ended March 31, 2002 and 2003 relate to the recalculations discussed below. This filing should be read in conjunction with the Company s Form 10-K/A for the year ended December 31, 2002.

As reported in the Company s Form 10-K/A for the year ended December 31, 2002, the Company has revised its unaudited financial statements for the three months ended March 31, 2002 and 2003 to reflect the impact of the cumulative dividend and participation rights of the Company s Series B preferred stock on the calculation of earnings (loss) for those periods. The cumulative dividend, whether or not declared, has been reflected as a reduction in net income (loss) to calculate net income (loss) available to common shareholders. In addition, the participation right of the Series B preferred stock has been considered in the calculation of basic earnings (loss) per share, if dilutive, using the if converted method or the two class method, if more dilutive. The revision of earnings (loss) per share for the periods indicated above had no effect on reported revenues, gross profit, net income (loss) or cash balances in any of the periods. The effect of the restatement of earnings (loss) per share is as follows:

	Three months ended March 31, 2002	Three months ended March 31, 2003
Earnings (loss) per common share		
Basic as reported	$ (0.22)	$ 0.05
Basic restated	$ (0.29)	$ (0.01)
Diluted as reported	$ (0.22)	$ 0.02
Diluted restated	$ (0.29)	$ (0.01)

INTERNET PICTURES CORPORATION
FORM 10-Q/A
FOR THE QUARTER ENDED MARCH 31, 2003
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PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

INTERNET PICTURES CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2002	March 31, 2003
	(1)	(unaudited)
(In thousands)		
ASSETS		
Cash and cash equivalents	$ 3,020	$ 4,729
Restricted cash and short term investments	2,972	1,400
Accounts receivable, net	3,535	2,195
Inventory, net	181	227
Prepaid expenses and other current assets	984	1,250
Total current assets	10,692	9,801
Computer hardware, software and other, net	4,631	4,412
Other long term assets	70	31
Goodwill	3,042	3,042
Total assets	$ 18,435	$ 17,286
LIABILITIES AND STOCKHOLDERS EQUITY CURRENT LIABILITIES:		
Accounts payable	$ 360	$ 996
Accrued liabilities	5,426	3,996
Deferred revenue	85	122
Current portion of obligations under capital leases	2,403	2,259
Total current liabilities	8,274	7,373
Obligations under capital leases, net of current portion	1,459	918
Other long term liabilities	310	230
STOCKHOLDERS EQUITY:		
Preferred stock (Aggregate liquidation value: $24,560 in 2002, $25,000 in 2003)	1	1
Common stock	65	65
Class B common stock		
Additional paid-in capital	513,937	513,937
Accumulated deficit	(505,117)	(504,749)
Accumulated other comprehensive loss	(494)	(489)
Total stockholders equity	8,392	8,765
Total liabilities and stockholders equity	$ 18,435	$ 17,286

(1) The December 31, 2002 balances were derived from the audited financial statements.

See accompanying notes to the unaudited condensed consolidated financial statements.

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INTERNET PICTURES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended March 31,	
	2002	**2003**
	(unaudited)	
	(restated)	**(restated)**
(In thousands, except per share data)		
Revenue:		
Transaction services	$ 3,575	$ 5,602
Immersive still solutions	1,219	784
Immersive video solutions		5
Total revenue	4,794	6,391
Cost of revenue:		
Transaction services	1,669	1,782
Immersive still solutions	455	338
Immersive video solutions		4
Total cost of revenue	2,124	2,124
Gross profit	2,670	4,267
Operating expenses:		
Sales and marketing	2,040	1,761
Research and development	1,281	1,260
General and administrative	904	829
Total operating expenses	4,225	3,850
Income (loss) from operations	(1,555)	417
Interest income (expense)	38	(43)
Other	5	(6)
Net income (loss)	(1,512)	368
Preferred stock dividends (restated)	(440)	(440)
Net loss available to common stockholders (restated)	$ (1,952)	$ (72)
Loss per common share, basic and diluted (restated)	$ (0.29)	$ (0.01)
Weighted average common shares, basic and diluted	6,771	6,813

See accompanying notes to the unaudited condensed consolidated financial statements.

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INTERNET PICTURES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three months ended March 31,	
	2002	2003
(In thousands)	**(unaudited)**	
Cash flows from operating activities:		
Net income (loss)	$ (1,512)	$ 368
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	700	936
Provision for doubtful accounts receivable	(22)	(2)
Non-cash compensation expense	53	
Changes in operating assets and liabilities:		
Accounts receivable	(328)	1,342
Inventory	80	(46)
Prepaid expenses and other current assets	(460)	(266)
Other long term assets		40
Accounts payable	(916)	228
Accrued expenses	(154)	61
Deferred revenue	(561)	38
Net cash provided by (used in) operating activities	(3,120)	2,699
Cash flow from investing activities:		
Purchases of computer hardware, software and other	(522)	(310)
Net cash used in investing activities	(522)	(310)
Cash flows from financing activities:		
Proceeds from exercise of stock options	84	
Repayments of capital lease obligations	(275)	(685)
Proceeds from notes receivable from stockholders	179	
Net cash used in financing activities	(12)	(685)
Effect of exchange rate changes on cash	(49)	5
Net increase (decrease) in cash and cash equivalents	(3,703)	1,709
Cash and cash equivalents, beginning of period	11,103	3,020
Cash and cash equivalents, end of period	$ 7,400	$ 4,729

See accompanying notes to the unaudited condensed consolidated financial statements

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited)

1. UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements include the accounts of Internet Pictures Corporation and its wholly-owned subsidiaries, Interactive Pictures Corporation, Interactive Pictures UK Limited, Internet Pictures (Canada), Inc. and PW Technology, Inc. The consolidation of these entities will collectively be referred to as the Company or iPIX. All significant intercompany balances and transactions have been eliminated.

We have prepared these financial statements, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our audited financial statements as of and for the year ended December 31, 2002.

The information furnished reflects all adjustments which management believes are necessary for a fair presentation of our financial position as of March 31, 2003 and the results of our operations and our cash flows for the three month periods ended March 31, 2002 and 2003. All such adjustments are of a normal recurring nature. The results of operations for the three month periods ended March 31, 2002 and 2003 are not necessarily indicative of the results to be expected for the respective full years.

2. CASH EQUIVALENTS, RESTRICTED CASH AND SHORT TERM INVESTMENTS

We consider all highly liquid debt instruments with a remaining maturity at date of purchase of three months or less to be cash equivalents. All other liquid investments are classified as either short term or long term investments. We determine the appropriate classification of investment securities at the time of purchase and reevaluate such designation as of each balance sheet date.

At March 31, 2003, we had $1,400 of investments with a remaining maturity of three months that have been provided as collateral for certain capital lease obligations and, accordingly, classified as restricted short term investments. We will renew the investment for successive six month/one year periods until the capital lease obligation restrictions are removed. At December 31, 2002, restricted cash also included $1,372 related to accrued customer deposits which were paid in full during the quarter ended March 31, 2003.

3. INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per common share is computed by dividing net income (loss) available to common stockholders for the period by the weighted average number of shares of common stock outstanding. Diluted income per common share is computed by dividing net income available to common stockholders for the period by the weighted average number of shares of common stock outstanding, plus potential common stock outstanding during the period. The calculation of basic and diluted income (loss) per common share excludes potential common shares if the effect is antidilutive.

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Holders of Series B Preferred Stock participate on an as-if converted basis in any common stock dividends. As a result of the cumulative nature of the Series B Dividends and the as-if converted feature (see Note 11), net income (loss) is adjusted to reflect the effect of the Series B shares on earnings per common share.

Potential common shares are composed of incremental shares of common stock issuable upon the conversion or exercise of potentially dilutive convertible preferred stock, stock options and warrants. Stock options and warrants with exercise prices above the average common stock closing price during the period are not considered to be potentially dilutive in the calculation of income (loss) per common share.

The following table sets forth the computation of basic and dilutive net loss per common share for the periods indicated:

	Three months ended March 31,	
(In thousands, except per share)	**2002**	**2003**
	(unaudited) (restated)	
NUMERATOR:		
Net income (loss)	$(1,512)	$ 368
Preferred stock dividends	(440)	(440)
Net loss available to common stockholders	$ (1,952)	$ (72)
DENOMINATOR:		
Weighted average shares outstanding basic and diluted	6,771	6,813
LOSS PER COMMON SHARE BASIC AND DILUTED	$ (0.29)	$ (0.01)

The following table sets forth potential common shares that are not included in the diluted net loss per share calculation above because to do so would be antidilutive for the three month periods ended March 31, 2002 and 2003:

(In thousands)	**2002**	**2003**
Stock options	737	12
Convertible preferred stock	10,267	10,267
Warrants	1,381	

For the three month period ended March 31, 2003, our common stock had an average share price of $1.07. As of March 31, 2003, the average exercise price of the warrants to purchase common

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stock is $3.04 and the average exercise price of employee stock options is $7.03. Not included in the table above are (i) 3,217,612 shares issuable upon exercise of options and (ii) 2,438,824 shares issuable upon exercise of warrants, each of which have an exercise price above the average share price during the three month period ended March 31, 2003. Not included in the table above are (i) 1,624,620 shares issuable upon exercise of options and (ii) 1,090,606 shares issuable upon exercise of warrants, each of which have an exercise price above the average share price of $2.53 for the three month period ended March 31, 2002.

4. RESTRUCTURING AND OTHER

During the quarter ended March 31, 2003, the following payments were made against the restructuring accrual:

(Unaudited, in thousands)	Balance at December 31, 2002	Expense in 2003	Payments in 2003	Balance at March 31, 2003
Restructuring provisions:				
Severance	$ 500	$	$ 200	$ 300
Lease obligations	549		90	459
Total	$1,049	$	$ 290	$ 759

5. STOCK-BASED COMPENSATION FAIR VALUE DISCLOSURES

We comply with the disclosure provisions of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 Accounting for Stock-based Compensation (FAS 123). We have elected, however, to continue accounting for stock-based compensation issued to employees using Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Under APB 25, compensation expense is based on the difference, if any, on the date of grant, between the fair value of our stock and the exercise price of the option. Stock and other equity instruments issued to non-employees have been accounted for in accordance with FAS 123 and Emerging Issues Task Force Issue No. 96-18, Accounting for Equity Instruments Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods, or Services, and have been valued using the Black-Scholes model.

Pro forma information regarding our net income (loss) is required by FAS 123 and FAS 148 Accounting for Stock-Based Compensation, Transition and Disclosure , and has been determined as if we had accounted for the stock options under the fair value method of FAS 123.

The computations for pro-forma basic and diluted earnings per share for each quarter follow:

(In thousands, except per share data)	Three months ended March 31, 2002	Three months ended March 31, 2003
	(unaudited) (restated)	
Net loss available for common stockholders	$(1,952)	$ (72)
Add: employee stock compensation expense included in reported net income (loss)		
Less: FAS 123 pro-forma charges	(3,094)	(442)
Adjusted net loss available for common stockholders	$(5,046)	$(514)

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	Three months ended March 31,	
	2002	**2003**
	(restated)	
Basic and diluted loss per common share:		
Loss cumulative for common stockholders	$(0.29)	$(0.01)
Net effect of pro forma charges	(0.46)	(0.06)
Adjusted basic and diluted loss per common share	$(0.75)	$(0.07)

Grants under the Employee Stock Purchase Plan (ESPP) have a look-back feature and a 15% discount and accordingly under FAS 123 would have had compensation expense calculated as a result. The fair value disclosure associated with the ESPP grants is included in the fair value pro-forma information above.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants during the three month periods ending March 31: expected lives of three to four years in 2002 and 2003; risk free interest rate of 4.0% to 4.5% in 2002 and 3.5% to 4.0% in 2003; expected dividends of zero in all periods; and volatility of 184% in 2002 and 115% in 2003.

6. COMMITMENTS AND CONTINGENCIES

Commitments

The table below shows our contractual obligations as of March 31, 2003:

(In thousands)		Payments Due by Period			
	Total	**Remainder of 2003**	**2004 & 2005**	**2006 & 2007**	**After 2007**
Capital leases	$ 3,398	$1,889	$1,509	$	$
Operating leases	7,000	2,404	3,761	771	64
Total	$10,398	$4,293	$5,270	$ 771	$ 64

Contingencies

On November 15, 2002, a First Amended Consolidated Complaint for violation of federal securities laws was filed against Homestore.com, Inc. (Homestore) by the California Teachers

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Retirement System (CalSTRS). The Complaint is a class action lawsuit filed on behalf of stockholders of Homestore which flows from alleged misstatements and omissions made by Homestore and the other named defendants, which include us. The Complaint alleges that during 2001, Homestore and iPIX entered into fraudulent reciprocal transactions intended to artificially bolster and maintain Homestore s and our respective stock prices. The Complaint alleges that Homestore s public statements with respect to these transactions are attributable to us and violate Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. We joined with other co-defendants and filed a joint motion to dismiss, alleging that the Complaint fails to state a claim upon which relief may be granted, among other things. On March 7, 2003, the United States District Court for the District of Central California granted our motion to dismiss, with prejudice. However, CalSTRS may appeal this dismissal in accordance with the federal rules of procedure.

We are not currently a party to any legal proceedings the adverse outcome of which, individually or in the aggregate, we believe could have a material adverse effect on our business, financial condition, results of operations or cash flows.

7. SEGMENTS

We currently have three reportable segments. The accounting policies of the segments are the same as those of the Company. Management evaluates the performance of the segments and allocates resources to them based on evaluations of the segment s revenues and gross profit. There are no inter-segment revenues. We do not make allocations of corporate costs to the individual segments and do not identify separate assets of the segments in making decisions regarding the performance or the allocation of resources to them.

Information about the reported segments is as follows:

	Three months ended March 31,	
(In thousands)	**2002**	**2003**
	(unaudited)	
Revenue:		
Transaction services	$3,575	$5,602
Immersive still solutions	1,219	784
Immersive video solutions		5
Total	$4,794	$6,391
Cost of revenue:		
Transaction services	$1,669	$1,782
Immersive still solutions	455	338
Immersive video solutions		4
Total	$2,124	$2,124

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8. EFFECT OF NEW ACCOUNTING PRONOUNCEMENTS

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45). FIN 45 requires that a liability be recorded in the guarantor s balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity s product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, while the disclosure requirements are applicable in 2002. The adoption of FIN 45 did not have a material impact on our results of operation or financial condition and did not result in any additional liabilities as of March 31, 2003 associated with guarantees covered by this interpretation. In addition to guarantees, we have entered into agreements indemnifying certain parties with respect to our potential infringement of other party s intellectual property. Due to the nature of the indemnifications, our maximum exposure under these agreements cannot be estimated. We have not recorded any amounts for those indemnities because they are not probable or estimable at this time.

In November 2002, the EITF reached consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables (EITF 00-21). EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We do not believe that the adoption of this standard will have a material effect on our financial position or results of operations.

In December 2002, the FASB issued FAS No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure (FAS 148). FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. FAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, FAS 148 requires disclosure of the pro forma effect in interim financial statements. The disclosure requirements of FAS 148 are contained in Note 6. We will continue to apply the provisions of APB 25 and disclose the fair value information on a pro-forma basis.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We do not believe that the adoption of this standard will have a material effect on our financial position or results of operations.

9. CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents, short term investments and accounts receivable. Cash, cash equivalents and short term investments are deposited with high quality financial institutions. Our accounts receivable are derived from revenue earned from customers located in the U.S. and abroad. We perform ongoing credit evaluations of our customers financial condition and we do not require collateral from our customers.

The following table summarizes the revenue from customers in excess of 10% of total revenues:

	Three months ended March 31,	
	2002	2003
	(unaudited)	
Homestore	21%	4%
eBay	55%	84%

At March 31, 2003, Homestore and eBay represented 0% and 80% of accounts receivable, respectively. All amounts due from eBay as of March 31, 2003, were collected during April 2003. At December 31, 2002, Homestore and eBay represented 0% and 83% of accounts receivable, respectively. Our principal agreements with Homestore and eBay, expire on June 30, 2003 and September 30, 2003, respectively. We are currently negotiating the terms of an extension or amendment with Homestore and can not give any assurances that any new agreement, extension of similar agreement will be reached.

We are also discussing terms of our future relationship with eBay. Under the discussed terms, we may receive aggregate consideration of up to $15 million, and may no longer receive any revenues from, or provide any services to, eBay after September 30, 2003. We believe that transaction fees from eBay will continue to increase as a percentage of revenue through September 30, 2003 as more eBay customers utilize our service on the eBay auction Web site. Although we may provide eBay with assistance in transferring operating and program management responsibilities after expiration of the current agreement, we can not give any assurance that such an agreement will be reached. In addition, if we experience significant changes in the terms of our relationships with other current or prospective customers, delays in payments from customers or the subsequent loss of another major customer, it would have a material adverse effect on our business.

10. RELATED PARTY TRANSACTIONS

During 2001, our CEO at that time, Mr. Phillips resigned as our chairman and chief executive officer. Pursuant to a separation agreement, Mr. Phillips received a severance payment in the amount of $1,300, in the following increments: (i) $200 was paid on May 25, 2001; (ii) $200 was paid on September 1, 2001; (iii) $200 was paid on January 1, 2002; (iv) $200 was paid on June 1, 2002; (v) $200 was paid on January 2, 2003; (vi) $200 will be paid on or before June 1, 2003 and (vii) $100 will be paid on or before September 1, 2003.

IPIX International

In the third quarter of 2002, we entered into license, distribution and trademark agreements with Soroof International, a Saudi Arabia-based corporation (Soroof). Under the agreements, Soroof will be the exclusive distributor for iPIX immersive still products, including the iPIX GPS Mapping System, outside of North America and Asia through its newly established entity, iPIX International (iPIX-I). The agreement, effective July 1, 2002, expires December 31, 2007, unless renewed. iPIX-I has an exclusive license to develop integrated solutions for markets including real estate, travel and tourism and other markets in which online marketing is critical. We will also provide certain hosting services during the term of the agreements. Soroof has committed to certain minimum quarterly royalties during the term of the agreement. Should these minimum royalties not be met, we have the right to terminate our agreements with Soroof.

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iPIX has a minority equity interest in iPIX-I, however, iPIX does not have the ability to exercise significant influence over iPIX-I operations. We account for our investment in iPIX-I on the cost basis. We did not make any capital contributions to iPIX-I and we have no commitments to fund iPIX-I. We do have the right, however, but not the obligation, to purchase iPIX-I from Soroof after December 31, 2005 for consideration as defined in the agreement. During the quarter ended March 31, 2003, we recognized $220 of revenue under these agreements.

Transactions with eBay, Inc.

Pursuant to an agreement dated April 19, 2000, as amended, we provide to eBay, Inc., which currently beneficially owns more than 10% of our common stock, image management services to eBay s online auction Web sites. Pursuant to that agreement, we issued eBay a warrant to purchase 60,000 shares of common stock at an exercise price of $203.80 per share. The warrant expires on April 19, 2010. Under this agreement, we generated revenues of $2,626 and $5,350 for the quarters ended March 31, 2002 and 2003, respectively. Under this agreement, we were required to pay marketing fees to eBay of $16,000 over a two-year period. As of September 26, 2001, we had paid $9,500 of the $16,000 commitment and we agreed to extend the additional $6,500 of payments through September 2003. As of March 31, 2003, we have $2,000 of the commitment remaining. In accordance with EITF 01-09 Accounting for consideration given by a vendor to a customer (including a reseller of the vendor s products) , $500 of these fees was offset against revenue which amount represented the excess over the fair value of the benefit received during the quarter ended March 31, 2003.

In 2001 and 2002, we sold to eBay, and eBay leased back to us, certain computer equipment utilized to provide image management services to eBay and other customers. The purchase price for the equipment was approximately $5,334. The transactions resulted in no gain or loss to iPIX. Pursuant to lease schedules covering this equipment, we will pay eBay annual lease payments of approximately $1,380, $779 and $106 in the duration of 2003, 2004 and 2005, respectively. In the quarter ending March 31, 2003, we paid eBay $503 pursuant to these lease schedules.

11. LIQUIDATION PREFERENCE AND PREFERRED STOCK DIVIDENDS

On September 26, 2001, Image Investor Portfolio, a separate series of Memphis Angels, LLC (Image) and certain strategic investors completed the purchase of 1,115,080 shares of the Series B Preferred Stock for total consideration of $22.3 million.

Each share of the Series B Preferred Stock is convertible into approximately 9.2 shares of our Common Stock and is entitled to vote on matters submitted to holders of Common Stock on an as-converted basis. At any time that the holders of the Series B Preferred Stock hold more than 50% of our voting stock, a voluntary liquidation, dissolution or winding up of the Company must be approved by at least five of the seven members of our board of directors.

Holders of Series B Preferred Stock, in preference to holders of any other series of Preferred Stock and in preference to the holders of Common Stock (collectively, Junior Securities), accrue dividends at the rate of eight percent (8%) of the price paid per annum on each outstanding share of Series B Preferred Stock (Series B Dividends). The Series B Dividends are cumulative, accrue daily and shall by payable, when and if declared by the Board, upon conversion or as an accretion to the Liquidation Preference, as defined below. Accrued Series B Dividends may be paid in cash or common stock, at the election of the Series B Preferred stockholder. Holders of Series B Preferred Stock participate on an as-if converted basis in any common stock dividends.

Upon any liquidation event, before any distribution or payment shall be made to the holders of any Junior Securities, the holders of Series B Preferred Stock shall be entitled to be paid out of the assets of the Company legally available for distribution, or the consideration received in such Transaction, an amount per share of Series B Preferred Stock equal to the price paid plus all accrued and unpaid Series B Dividends for each share of Series B Preferred Stock held by them (the Liquidation Preference). If, upon any such liquidation event, the assets of the Company are insufficient to make payment in full to all holders of Series B Preferred Stock of the Liquidation Preference, then such assets shall be distributed among the holders of Series B Preferred Stock at the time outstanding, ratably in proportion to the full amounts to which they would otherwise be respectively entitled.

As of March 31, 2003, the Liquidation Preference was $25.0 million, which includes the $2.7 million in accrued dividends in arrears on the Series B Preferred Stock which have not been declared to be paid.

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12. RECALCULATION OF EARNINGS PER SHARE

As reported in our Form 10-K/A for the year ended December 31, 2002, we have revised our unaudited financial statements for the three months ended March 31, 2002 and 2003 to reflect the impact of the cumulative dividend and participation rights of our Series B Preferred Stock on the calculation of earnings (loss) per share for those periods. The cumulative dividend, whether or not declared, has been reflected as a reduction in net income (loss) to calculate net income (loss) available to common shareholders. In addition, the participation right of the preferred stock has been considered in the calculation of basic earnings (loss) per share, if dilutive, using the if converted method or the two class method, if more dilutive. The revision of earnings (loss) per share for the periods indicated above had no effect on reported revenues, gross profit, net income (loss) or cash balances in any of the periods. The effect of the restatement of earnings (loss) per share is as follows:

	Three months ended March 31, 2002	Three months ended March 31, 2003
Earnings (loss) per common share		
Basic as reported	$ (0.22)	$ 0.05
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Diluted as reported	$ (0.22)	$ 0.02
Diluted restated	$ (0.29)	$ (0.01)

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PART II OTHER INFORMATION

Item 6. Exhibits And Reports On Form 8-K

a) Exhibits

Exhibit 31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

b) Reports On Form 8-K

None

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INTERNET PICTURES CORPORATION

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.

DATE: August 14, 2003	INTERNET PICTURES CORPORATION (Registrant)
	/s/ Paul Farmer
	Paul Farmer Authorized Officer Chief Financial Officer and Chief Accounting Officer

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INDEX TO EXHIBITS FOR FORM 10-Q

FOR QUARTER ENDED MARCH 31, 2003

EXHIBIT NO.	EXHIBIT DESCRIPTION
Exhibit 99.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 99.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002