IMAGING TECHNOLOGIES CORP/CA
Form 10-Q
May 15, 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 MARCH 31, 2001

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	33-0021693
(State or other jurisdiction of incorporation or organization)	(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 |X| No |_|

The number of shares outstanding of the registrant's common stock as of May 14, 2001, was 160,132,065.

TABLE OF CONTENTS

PART I. - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

	MARCH 31, 2000	
Current assets		
Cash	$ 275	
Accounts receivable, net	196	
Inventories	156	
Prepaid expenses and other	376	
Total current assets	1,003	
Property and equipment, net	623	
Goodwill	674	
Other	-	
	$ 2,300	$

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities		
Borrowings under bank note payable	$ 4,265	$
Short-term debt	2,563	
Accounts payable	6,539	
Current portion, long-term debt	175	
Accrued expenses	1,863	
Total current liabilities	15,405	

Long-term debt	-	
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, 155,578,560 shares issued and outstanding	773	
Paid-in capital	65,149	
Shareholder loans	(105)	
Accumulated deficit	(79,342)	
Total shareholders' equity (deficit)	(13,105)	
	$ 2,300	$

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED MARCH 31,
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	2001	2000
Revenues		
Sales of products	$ 1,165	$ 260
Engineering fees	-	240
Licenses and royalties	30	221
	1,195	721
Costs and expenses		
Costs of products sold	1,050	225
Selling, general, and administrative	1,559	822
Cost of engineering fees	223	508
	2,832	1,555
	(1,637)	(834)
Income (loss) from operations		
Other expense		
Interest, net	(65)	(150)
Restructuring	-	(1,362)
	(65)	(1,512)
Income (loss) before income taxes	(1,702)	(2,346)
Income tax expense	-	-
Net income (loss)	$ (1,702)	$ (2,346)
Earnings (loss) per common share		
Basic	$ (.01)	$ (.03)

Diluted	$ (.01)	$ (.03)
Weighted avg. common shares - basic	141,148	90,807
Weighted avg. common shares - diluted	141,148	90,807

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
NINE MONTHS ENDED MARCH 31,
(IN THOUSANDS, EXCEPT SHARE DATA)
(UNAUDITED)

	2001	2000
Revenues		
Sales of products	$ 2,381	$ 1,261
Engineering fees	-	265
Licenses and royalties	662	557
	3,043	2,083
Costs and expenses		
Costs of products sold	1,974	1,822
Selling, general, and administrative	5,631	5,749
Cost of engineering fees	679	2,136
	8,284	9,707
	(5,241)	(7,624)
Income (loss) from operations		
Other expense		
Interest, net	(787)	(329)
Restructuring	-	(1,380)
	(787)	(1,709)
Income (loss) before income taxes	(6,028)	(9,333)
Income tax expense	-	-
Net income (loss)	$ (6,028)	$ (9,333)
Earnings (loss) per common share		
Basic	$ (.05)	$ (.10)
Diluted	$ (.05)	$ (.10)
Weighted avg. common shares - basic	119,045	90,807
Weighted avg. common shares - diluted	119,045	90,807

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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

	2001	
Cash flows from operating activities		
Net income (loss)	$ (6,028)	$ (
Adjustments to reconcile net income (loss) to net cash from operating activities		
Depreciation and amortization	252	
Stock issued for services	871	
Non-cash interest	364	
Changes in operating assets and liabilities		
Accounts receivable	58	
Inventories	47	
Prepaid expenses and other	(43)	
Accounts payable and accrued expenses	701	(
Net cash from operating activities	(3,778)	(
Cash flows from investing activities		
Capital expenditures	(104)	
Other	150	
Net cash from investing activities	46	
Cash flows from financing activities		
Net borrowings under bank lines of credit	(1,500)	
Net borrowings under long-term notes payable	850	
Net proceeds from issuance of common stock	4,366	
Net cash from financing activities	3,716	
Net increase (decrease) in cash	(16)	
Cash, beginning of period	291	
Cash, end of period	$ 275	$

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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 March 31, 2001, 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.

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

The Company has reestablished management control of its operations. In order to succeed with its strategic plan, the Company must obtain additional funds to provide adequate working capital and finance operations. The Company has engaged a financial advisor, i Capital Corporation of Irvine, California, 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 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

	MARCH 31, 2001	JUNE 30, 2000
Inventories	$ 65	$ 87
Finished goods	91	116
	$ 156	$ 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.

The beneficial conversion feature of the Notes Payable results in a non-cash interest expense of $364 thousand.

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 experience short-term operational and liquidity challenges. Management continues to modify its strategic business plan in an effort to stabilize its operations and return to positive cash flow in the short-term, and profitability in the future. Accordingly, quarter-to-quarter financial comparisons may be of limited usefulness now and for the next several quarters due to ongoing 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 turn away from the uncertainties of providing engineering services to OEM customers, which rely on a future revenue stream, to that of selling 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 Eduadvantage.com, which is primarily engaged in sales of educational software to institutions, businesses, and end-users via the Internet. As part of acquisition, the Company also acquired the rights to certain proprietary software to process transactions on the Internet. The Eduadvantage acquisition is expected to advance the Company's objective to develop and support e-commerce strategies, including the future launch of Dealseekers.com. Eduadvantage also provides the Company a vehicle to distribute certain ITEC products, along with EduAdvantage.com's current software products for accounting, desktop publishing, tax software, and virus detection.

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. Under the terms of the acquisition agreement, ITEC will assume certain debts of QPI in the approximate amount of $1.3 million. The acquisition requires QPI shareholder approval, which is pending.

In December 2000, ITEC signed a definitive agreement to purchase a majority interest in Pen Interconnect, Inc., Irvine, Calif. However, the acquisition was terminated in February 2000.

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 March 31, 2001, 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 an aggregate of 150,443 shares of the registrant's common stock at an exercise price equal to $.0887 per share. (Also see Note 5 to the Consolidated Financial Statements.)

The Company has also 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 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 $1.2 million and $721 thousand for the three-month period ended March 31, 2001 and 2000, respectively, as increase of 65%. Sales of products were $1.2 million and $260 thousand for the three month period ended March 31, 2001 and 2000, respectively, an increase of 248%.

For the nine-month period ended March 31, 2001 and 2000, respectively, revenues were $3.04 million and $2.08 million, an increase of 46%. Sales of products were $2.4 million and $1.3 million for the nine-month period ended March 31, 2001 and 2000, respectively, and increase of 89%. The increase in product sales from the reported periods of 2000 to 2001 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 $30 thousand and $221 thousand for the three-month period ended March 31, 2001 and 2000 respectively, a decrease of 86%. For the nine-month period ended March 31, 2001 and 2000, respectively, licensing fees and royalties were $662 thousand and $557 thousand, respectively, an increase of 19%. 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.

COST OF PRODUCTS SOLD

Cost of products sold were $1.05 million (90% of product sales) and $225 thousand (87% of product sales) for the three-month period ended March 31, 2001 and 2000, respectively. The decrease in margins is primarily due to the sale of some end-of-life products at substantial discounts. 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 out-sources 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 nine-month period ended March 31, 2001 and 2000, cost of products sold were $1.97 million (83% of product sales) and $1.82 million (144% of product sales), respectively. The increase in overall margins in the nine-month comparative periods relate to the departure, in June 2000, of the court-appointed operational receiver

10

who, in order to recover the maximum amount of money from the Company, sold some of the Company's products at or below cost.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

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.

Selling, general and administrative expenses for the three-month period ended March 31, 2001 and 2000, respectively, were $1.6 million and $822 thousand. In the current three-month period, selling, general, and administrative expenses increased $737 thousand (90%) from the year-earlier quarter. The increase was due primarily to settlements of legal matters.

Selling, general and administrative expenses for the nine-month period ended March 31, 2001 and 2000, respectively, were $5.6 million and $5.7 million. In the current nine-month period, the Company reduced selling, general, and administrative expenses $118 thousand (2%) due primarily to staff reductions, which were offset, in part, by the settlement of certain legal matters.

COSTS OF RESEARCH AND DEVELOPMENT

Costs of research and development were $223 thousand and $508 thousand for the quarters ended March 31, 2001 and 2000, respectively; a decrease of $285 thousand (56%). For the nine-month period ended March 31, 2001 and 2000, respectively, research and development costs were $679 thousand and $2.1 million, a decrease of $1.5 million (68%). Over the past year, the Company had been reducing its engineering and licensing activities and has re-directed research and development 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-month period ended March 31, 2001, the Company issued an additional 37 million shares. During the nine-month period ended March 31, 2001, the Company issued an additional 53 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 March 31, 2001, the Company had negative working capital of $14.4, an increase of approximately $130 thousand (1%) in working capital as compared to June 30, 2000.

Net cash used in operating activities decreased 44% to $3.8 million during the nine-month period ended March 31, 2001, from $6.7 million during the year-earlier period, due primarily to a $3.3 million (35%) decrease in the Company's net loss during the period.

Net cash from investing activities was $46 thousand during the nine-month period ended March 31, 2001. There was no such activity in the corresponding nine-month period in the prior year. The difference was due primarily to increased capital expenditures in the period.

Net cash from financing activities was $3.7 million for the nine-month period ended March 31, 2001, a decrease of $3.6 million or 49%. 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 March 31, 2001, 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 Consolidated Financial Statements.)

RISKS AND UNCERTAINTIES

THE COMPANY NEEDS ADDITIONAL 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 ITEC's 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 ITEC'S 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 our 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 of future performance for any particular period.

ITEC IS IN A 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.

OUR MARKET IS CHARACTERIZED BY 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.

Furthermore, 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.

WE ARE HIGHLY DEPENDENT UPON OUTSIDE 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 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 our business, the Company has been active in acquiring businesses that management believes are complementary. We continue to pursue other strategic acquisitions. 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."

THE COMPANY IS DEPENDENT 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.

COMPONENTS AVAILABILITY AND COST; DEPENDENCE ON SINGLE SOURCES

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 ITEC PRODUCTS OR OUR 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 some product hardware designs, the Company has developed 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 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.

14

ITEC IS HIGHLY DEPENDENT 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 United States represented a significant amount 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."

ITEC RELIES HEAVILY 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 March 31, 2001, 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 private-label arrangements that allow it to address specific market segments or geographic areas. To prevent inventory write-downs in the event that these customers do not purchase products as anticipated, the Company may need to convert such products to make them salable to other customers.

ITEC'S STOCK PRICE IS VOLATILE

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

ITEC HAS NOT PAID ANY 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 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 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 15g-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.

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 us 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 us. A motion to dismiss the lawsuit was granted on February 16, 2001 on our behalf and those individual defendants that have been served. However, on or about March 19, 2001, an amended complaint was filed on behalf of Nahid Nazarian Behfarin, Peter Cook, Stephen Domagala and Michael S. Taylor, on behalf of themselves and others similarly situated. On or about March 20, 2001, we once again filed a motion to dismiss the case along with certain other individual defendants. The motion is pending. We believe these claims are without merit and we intend to vigorously defend against them on our behalf as well as on behalf of the other defendants. The defense of this action has been tendered to our insurance carriers.

Throughout fiscal 1999, 2000 and 2001, and through the date of this filing, approximately 50 trade creditors have made claims and/or filed actions alleging the failure of us to pay our obligations to them in a total amount exceeding $3 million. These actions are in various stages of litigation, with many resulting in judgments being entered against us. Several of those who have obtained judgments have filed judgment liens on our assets. These claims range in value from less than one thousand dollars to just over one million dollars, with the great majority being less than twenty thousand dollars. Should we be required to pay the full amount demanded in each of these claims and lawsuits, we may have to cease our operations. However, to date, the superior security interest held by Imperial Bank has prevented nearly all of these trade 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

(a) Exhibits:

(b) Reports on Form 8-K:

On January 19, 2001, the Company filed a report on Form 8-K related to a Convertible Note Purchase Agreement with Amro International, et.al. (Also see Note 5 to the Consolidated Financial Statements in this report on Form 10-Q.

17

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: May 15, 2001

IMAGING TECHNOLOGIES CORPORATION (Registrant)

By: /s/ BRIAN BONAR

Brian Bonar
Chief Executive Officer

By: /S/ CHRISTOPHER W. MCKEE

Acting Principal Accounting Officer