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IMAGING TECHNOLOGIES CORP/CA  
Form 10-Q  
February 19, 2003

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, 2002

or

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

Commission file No. 0-12641

[GRAPHIC OMITTED]

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.)

17075 VIA DEL CAMPO  
SAN DIEGO, CA 92127  
(Address of principal executive offices)

Registrant's Telephone Number, Including Area Code: (858) 451-6120

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 February 12, 2003 was 144,073,122.

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| CONSOLIDATED BALANCE SHEETS   |    |
| (IN THOUSANDS, EXCEPT SHARE DATA)   |    |

| ASSETS  | DEC 31, 2002<br>(unaudited) | JUN 30, 2002<br>(audited) |
|---|-----------------------------|---------------------------|
| Current assets  |                             |                           |
| Cash . . . . .  | \$ 177                      | \$ 4                      |
| Accounts receivable, net of allowance for doubtful<br>accounts of \$165 and \$280 . . . . . | 343                         | 62                        |
| Inventories, net . . . . .  | 12                          | 15                        |
| Prepaid expenses and other current assets . . . . .   | 21                          | 3                         |
| Total current assets . . . . .  | 553                         | 85                        |
| Property and Equipment, net . . . . .   | 109                         | 21                        |
| Workers' compensation deposit and other assets . . . . .                                    | 239                         | 11                        |

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|  |    |           |    |          |
|--|----|-----------|----|----------|
| Total assets. . . . .  | \$ | 901       | \$ | 1,18     |
| -----  |    |           |    |          |
| LIABILITIES AND SHAREHOLDERS' DEFICIENCY   |    |           |    |          |
| Current liabilities  |    |           |    |          |
| Borrowings under bank notes payable . . . . .  | \$ | 3,195     | \$ | 3,29     |
| Short-term notes payable, including amounts due to<br>related parties. . . . .   |    | 2,716     |    | 2,79     |
| Convertible debentures. . . . .  |    | 1,323     |    | 80       |
| Accounts payable. . . . .  |    | 6,704     |    | 7,34     |
| PEO payroll taxes and other payroll deductions. . . . .  |    | 2,016     |    | 69       |
| PEO accrued worksite employee . . . . .  |    | 260       |    | 64       |
| Other accrued expenses. . . . .  |    | 6,375     |    | 6,03     |
|  |    | -----     |    | -----    |
| Total current liabilities. . . . .   |    | 22,589    |    | 21,60    |
| -----  |    |           |    |          |
| Shareholders' deficiency   |    |           |    |          |
| Series A convertible, redeemable preferred stock,<br>\$1,000 par value, 7,500 shares authorized,<br>420.5 shares issued and outstanding. . . . .                           |    | 420       |    | 42       |
| Common stock, \$0.005 par value, 500,000,000 shares<br>authorized; 118,518,413 shares issued and outstanding<br>at December 31, 2002; 21,929,365 at June 30, 2002. . . . . |    | 592       |    | 11       |
| Common stock warrants . . . . .  |    | 475       |    | 47       |
| Paid-in capital . . . . .  |    | 80,453    |    | 79,49    |
| Accumulated deficit . . . . .  |    | (103,628) |    | (100,92) |
|  |    | -----     |    | -----    |
| Total shareholders' deficiency . . . . .   |    | (21,688)  |    | (20,42)  |
| -----  |    |           |    |          |
| Total liabilities and shareholders' deficiency. . . . .  | \$ | 901       | \$ | 1,18     |
| =====  |    |           |    |          |

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
THREE MONTHS ENDED DECEMBER 31, 2002 AND 2001  
(IN THOUSANDS, EXCEPT SHARE DATA)  
(UNAUDITED)

|  | 2002  | 2001   |
|--|-------|--------|
| Revenues   |       |        |
| Sales of products. . . . .                       | \$ 94 | \$ 891 |
| Software sales, licenses and royalties . . . . . | 41    | 145    |
| PEO services . . . . .                           | 2,139 | 7,074  |
|  | ----- | -----  |
|  | 2,274 | 8,110  |
| -----  |       |        |
| Cost of revenues                                 |       |        |
| Cost of products sold. . . . .                   | 82    | 646    |
| Cost of software sales, licenses and royalties   | 29    | 24     |
| Cost of PEO services . . . . .                   | 1,878 | 6,795  |

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|   |           |            |
|---|-----------|------------|
|   | 1,989     | 7,465      |
| Gross profit. . . . .                                       | 285       | 645        |
| Operating   |           |            |
| Selling, general, and administrative . . . . .              | 1,124     | 2,137      |
| Research and development . . . . .                          | -         | 64         |
|   | 1,124     | 2,201      |
| Loss from operations. . . . .                               | (839)     | (1,556)    |
| Other income (expense):                                     |           |            |
| Interest and financing costs, net. . . . .                  | (490)     | (298)      |
| Extinguishment of debt . . . . .                            | 656       | -          |
| Other. . . . .  | 21        | -          |
|   | 187       | (298)      |
| Loss before income taxes. . . . .                           | (652)     | (1,854)    |
| Income tax expense. . . . .                                 | -         | -          |
| Net loss. . . . .   | \$ (652)  | \$ (1,854) |
| Loss per common share                                       |           |            |
| Basic. . . . .  | \$ (0.01) | \$ (0.19)  |
| Diluted. . . . .  | \$ (0.01) | \$ (0.19)  |
| Weighted average common shares. . . . .                     | 66,284    | 9,952      |
| Weighted average common shares - assuming dilution. . . . . | 66,284    | 9,952      |

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
SIX MONTHS ENDED DECEMBER 31, 2002 AND 2001  
(IN THOUSANDS, EXCEPT SHARE DATA)  
(UNAUDITED)

|   | 2002   | 2001     |
|---|--------|----------|
| Revenues  |        |          |
| Sales of imaging products . . . . .                 | \$ 580 | \$ 1,764 |
| Sales of software, licenses and royalties . . . . . | 179    | 350      |
| PEO services. . . . .                               | 4,961  | 7,074    |

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|  |            |            |
|--|------------|------------|
|  | 5,720      | 9,188      |
| Costs and expenses                                 |            |            |
| Cost of products sold . . . . .                    | 317        | 1,214      |
| Cost of software, licenses and royalties. . . . .  | 62         | 54         |
| Cost of PEO services. . . . .                      | 4,450      | 6,795      |
|  | 4,829      | 8,063      |
| Gross profit . . . . .                             | 891        | 1,125      |
| Operating  |            |            |
| Selling, general, and administrative. . . . .      | 3,165      | 3,586      |
| Research and development. . . . .                  | -          | 136        |
|  | 3,165      | 3,722      |
| Loss from operations . . . . .                     | (2,274)    | (2,597)    |
| Other income (expense):                            |            |            |
| Interest and financing costs, net. . . . .         | (1,111)    | (1,018)    |
| Extinguishment of debt . . . . .                   | 656        | -          |
| Other . . . . .                                    | 25         | -          |
|  | (430)      | (1,018)    |
| Loss before income taxes . . . . .                 | (2,704)    | (3,615)    |
| Income tax expense . . . . .                       | -          | -          |
| Net loss . . . . .                                 | \$ (2,704) | \$ (3,615) |
| Loss per common share                              |            |            |
| Basic . . . . .                                    | \$ (0.06)  | \$ (0.39)  |
| Diluted . . . . .                                  | \$ (0.06)  | \$ (0.39)  |
| Weighted average common shares . . . . .           | 45,473     | 9,251      |
| Weighted average common shares - assuming dilution | 45,473     | 9,251      |

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
SIX MONTHS ENDED DECEMBER 31, 2002 AND 2001  
(IN THOUSANDS, EXCEPT SHARE DATA)  
(UNAUDITED)

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|   | 2002       |    | 2001    |
|---|------------|----|---------|
| Cash flows from operating activities  |            |    |         |
| Net income (loss) . . . . .   | \$ (2,704) | \$ | (3,615) |
| Adjustments to reconcile net income (loss) to<br>net cash from operating activities |            |    |         |
| Depreciation and amortization . . . . .   | 48         |    | 51      |
| Writedown of fixed assets . . . . .   | 55         |    | -       |
| Common stock issued for services . . . . .  | 671        |    | 367     |
| Amortization of debt discount . . . . .   | 450        |    | -       |
| Value of services for exercise of warrants .  | 166        |    | -       |
| Value of warrants issued for services . . . .                                       | 70         |    | -       |
| Gain on extinguishments of debt . . . . .   | (656)      |    | -       |
| Changes in operating assets and liabilities   |            |    |         |
| Accounts receivable . . . . .   | 286        |    | (1,418) |
| Inventories . . . . .   | 139        |    | (827)   |
| Prepaid expenses and other . . . . .  | (115)      |    | (44)    |
| Accounts payable and accrued expenses . .   | 857        |    | 1,961   |
| PEO liabilities . . . . .   | 942        |    | 424     |
| Other assets . . . . .  | -          |    | 2       |
|   | -----      |    | -----   |
| Net cash from (used by)<br>operating activities . . . . .                           | 209        |    | (3,099) |
| Cash flows from investing activities  |            |    |         |
| Capital expenditures . . . . .  | -          |    | (56)    |
| Cash investment in acquisitions . . . . .   | -          |    | (250)   |
| Other . . . . .   | -          |    | -       |
|   | -----      |    | -----   |
| Net cash from investing activities . . . .  | -          |    | (91)    |
| Cash flows from financing activities  |            |    |         |
| Net borrowings under bank lines of credit . . . . .                                 | (100)      |    | (500)   |
| Issuance of short-term notes payable . . . . .                                      | -          |    | 1,922   |
| Warrant proceeds . . . . .  | -          |    | 66      |
| Net proceeds from issuance of common stock . . . .                                  | 25         |    | 1,826   |
|   | -----      |    | -----   |
| Net cash from (used by) financing<br>activities . . . . .                           | (75)       |    | 3,314   |
| Net increase (decrease) in cash . . . . .   | 134        |    | 124     |
| Cash, beginning of period . . . . .   | 43         |    | 35      |
|   | -----      |    | -----   |
| Cash, end of period . . . . .   | \$ 177     | \$ | 159     |
|   | =====      |    | =====   |

NON-CASH INVESTING AND FINANCING ACTIVITIES

During the three months ended September 30, 2002, the Company rescinded the \$70,000 conversion of convertible notes payable into common stock (See note 6)

During the three months ended December 31, 2002, the Company converted \$80,000 of debt into 8,000,000 shares of common stock.

During the three months ended December 31, 2002, the Company issued 100,000 shares of common stock in connection with its acquisition of Dream Canvas Technology, Inc.

See Notes to Consolidated Financial Statements

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## IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2002

(IN THOUSANDS, EXCEPT SHARE DATA)  
(UNAUDITED)

### NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated 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 accounting principles generally accepted in the United States of America. These consolidated 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 consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the years ended June 30, 2002, 2001 and 2000 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 consolidated financial statements have been prepared assuming that the Company will continue as a going concern. For the three months ended December 31, 2002, the Company experienced a net loss of \$652,000 and as of December 31, 2002, the Company had a negative working capital deficiency of \$22,036,000 and had a negative shareholders' deficiency of \$21,688,000. In addition, the Company is in default on certain note payable obligations and is being sued by numerous trade creditors for nonpayment of amounts due. The Company is also deficient in its payments relating to payroll tax liabilities. These conditions raise substantial doubt about its ability to continue as a going concern.

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.

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, shareholders 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

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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.

In order for the Company to continue in existence, it must obtain additional funds to provide adequate working capital to finance operations, and begin to generate positive cash flows from its operations. During the past two fiscal years the Company has raised approximately \$3 million through the issuance of convertible debentures. The Company is currently in the process of filing a registration statement to register shares underlying the convertible debentures. In order for the Company to raise additional funds through a convertible debenture, the Company must get a registration statement filed and declared effective with the SEC. However, there can be no assurance that the Company will be able to 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 including compliance with the Imperial Bank settlement agreement. Any additional equity or convertible debt financings could result in substantial dilution to the Company's shareholders. 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 Company is also looking at making strategic acquisitions of companies that have positive cash flows. Specifically, the Company has just recently acquired a controlling interest in Quik Pix, Inc., a controlling interest in Greenland Corporation. The Company has also reduced its personnel and moved its corporate office in an effort to reduce operating costs. The financial statements do not include any adjustments that might result from the outcome of this going concern 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. The following is a reconciliation of Basic EPS to Diluted EPS:



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(in thousands)

|                         | EARNINGS (LOSS)<br>(NUMERATOR) | SHARES<br>(NUMERATOR) | PER-SHARE<br>AMOUNT |
|-------------------------|--------------------------------|-----------------------|---------------------|
|                         | -----                          | -----                 | -----               |
| DECEMBER 31, 2001       |                                |                       |                     |
| Net loss . . . . .      | \$ (3,615)                     |                       |                     |
| Preferred dividends.    | (12)                           |                       |                     |
|                         | -----                          |                       |                     |
| Basic and diluted EPS . | \$ (3,617,)                    | 9,251                 | \$ (0.39)           |
|                         | =====                          | =====                 | =====               |
| DECEMBER 31, 2002       |                                |                       |                     |
| Net loss . . . . .      | \$ (2,704)                     |                       |                     |
| Preferred dividends.    | (12)                           |                       |                     |
|                         | -----                          |                       |                     |
| Basic and diluted EPS . | \$ (2,716)                     | 45,473                | \$ (0.06)           |
|                         | =====                          | =====                 | =====               |

NOTE 4. INVENTORIES

| (in thousands) . . . . .        | DEC. 31, 2002 | SEPT. 30, 2002 |
|---------------------------------|---------------|----------------|
| Inventories                     |               |                |
| Materials and suppliers.        | \$ 2          | \$ 261         |
| Finished goods . . . . .        | 10            | 165            |
|                                 | -----         | -----          |
|                                 | 12            | 426            |
| Less: inventory reserve . . . . | -             | (275)          |
|                                 | -----         | -----          |
|                                 | \$ 12         | \$ 151         |
|                                 | =====         | =====          |

NOTE 5. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the FASB issued SFAS No. 141 "Business Combinations." SFAS No. 141 supersedes Accounting Principles Board ("APB") No. 16 and requires that any business combinations initiated after June 30, 2001 be accounted for as a purchase; therefore, eliminating the pooling-of-interest method defined in APB 16. The statement is effective for any business combination initiated after June 30, 2001 and shall apply to all business combinations accounted for by the purchase method for which the date of acquisition is July 1, 2001 or later. The Company has implemented this pronouncement and has concluded that the adoption has no material impact to the financial statements.

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangibles." SFAS No. 142 addresses the initial recognition; measurement and amortization of intangible assets acquired individually or with a group of other assets (but not those acquired in a business combination) and addresses the amortization provisions for excess cost over fair value of net assets acquired or intangibles acquired in a business combination. The statement is effective for fiscal years beginning after December 15, 2001, and is effective July 1, 2001 for any intangibles acquired in a business combination initiated after June 30, 2001. The Company has implemented this pronouncement and has concluded that

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the adoption has no material impact to the financial statements.

In October 2001, the FASB recently issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires companies to record the fair value of a liability for asset retirement obligations in the period in which they are incurred. The statement applies to a company's legal obligations associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, and development or through the normal operation of a long-lived asset. When a liability is initially recorded, the company would capitalize the cost, thereby increasing the carrying amount of the related asset. The capitalized asset retirement cost is depreciated over the life of the respective asset while the liability is accreted to its present value. Upon settlement of the liability, the obligation is settled at its recorded amount or the company incurs a gain or loss. The statement is effective for fiscal years beginning after June 30, 2002. The Company has implemented this pronouncement and has concluded that the adoption has no material impact to the financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Statement 144 addresses the accounting and reporting for the impairment or disposal of long-lived assets. The statement provides a single accounting model for long-lived assets to be disposed of. New criteria must be met to classify the asset as an asset held-for-sale. This statement also focuses on reporting the effects of a disposal of a segment of a business. This statement is effective for fiscal years beginning after December 15, 2001. The Company has implemented this pronouncement and has concluded that the adoption has no material impact to the financial statements.

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This Statement rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that Statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements" and FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers". This Statement amends FASB Statement No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

In October 2002, the FASB issued Statement No. 147, "Acquisitions of Certain Financial Institutions—an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9", which removes acquisitions of financial institutions from the scope of both Statement 72 and Interpretation 9 and requires that those transactions be accounted for in accordance with Statements No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets. In addition, this Statement amends SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, to include in its scope long-term customer-relationship intangible assets of financial institutions such as depositor- and borrower-relationship intangible assets and credit cardholder intangible assets. The requirements relating to acquisitions of financial institutions is effective

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for acquisitions for which the date of acquisition is on or after October 1, 2002. The provisions related to accounting for the impairment or disposal of certain long-term customer-relationship intangible assets are effective on October 1, 2002. The adoption of this Statement did not have a material impact to the Company's financial position or results of operations as the Company has not engaged in either of these activities.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure", which amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of Statement 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of this statement did not have a material impact on the Company's financial position or results of operations as the Company has not elected to change to the fair value based method of accounting for stock-based employee compensation.

In May 2000, the Emerging Issues Task Force (EITF) issued EITF Issue No. 00-14, Accounting for Certain Sales Incentives. EITF Issue No. 00-14 addresses the recognition, measurement, and income statement classification for sales incentives that a vendor voluntarily offers to customers (without charge), which the customer can use in, or exercise as a result of, a single exchange transaction. Sales incentives that fall within the scope of EITF Issue No. 00-14 include offers that a customer can use to receive a reduction in the price of a product or service at the point of sale. The EITF changed the transition date for Issue 00-14, concluding that a company should apply this consensus no later than the company's annual or interim financial statements for the periods beginning after December 15, 2001. In June 2001, the EITF issued EITF Issue No. 00-25, Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products, effective for periods beginning after December 15, 2001. EITF Issue No. 00-25 addresses whether consideration from a vendor to a reseller is (a) an adjustment of the selling prices of the vendor's products and, therefore, should be deducted from revenue when recognized in the vendor's statement of operations or (b) a cost incurred by the vendor for assets or services received from the reseller and, therefore, should be included as a cost or expense when recognized in the vendor's statement of operations. Upon application of these EITFs, financial statements for prior periods presented for comparative purposes should be reclassified to comply with the income statement display requirements under these Issues. In September of 2001, the EITF issued EITF Issue No. 01-09, Accounting for Consideration Given by Vendor to a Customer or a Reseller of the Vendor's Products, which is a codification of EITF Issues No. 00-14, No. 00-25 and No. 00-22 Accounting for Points and Certain Other Time-or Volume-Based Sales Incentive Offers and Offers for Free Products or Services to be Delivered in the Future. The Company has adopted these issues in fiscal year 2002 and during the three months ended September 30, 2002 which did not have a material impact on the Company's financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria were based on control through voting interest. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of Interpretation 46 apply immediately to variable

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interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company does not expect the adoption to have a material impact to the Company's financial position or results of operations.

### NOTE 6. 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 Company 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 Company'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. The Company has recognized interest expense of \$364,000 relating to the beneficial conversion feature of the above notes. Additionally, the Company issued a warrant to each of the purchasers to purchase 502,008 shares of the Company's common stock at an exercise price equal to \$1.50 per share. The purchasers may exercise the warrants through December 12, 2005. During fiscal 2001, notes payable of \$675,000 was converted into the Company's common stock.

On July 26, 2001, the Company entered into a convertible note purchase agreement with certain investors whereby the Company sold to the investors a convertible debenture in the aggregate principal amount of \$1,000,000 bearing interest at the rate of eight percent (8%) per annum, due July 26, 2004, convertible into shares of our common stock. Interest is payable, at the option of the investor, in cash or shares of our common stock. The note is convertible into such number of shares of our common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$1.30 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, we issued a warrant to the investor to purchase 769,231 shares of our common stock at an exercise price equal to \$1.30 per share. The investor may exercise the warrant through July 26, 2006. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$492,000 and \$508,000, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$492,000, respectively.

On September 21, 2001, the Company entered into a convertible note purchase agreement with an investor whereby we sold to the investor a convertible promissory note in the aggregate principal amount of \$300,000 bearing interest at the rate of eight percent (8%) per annum, due September 21, 2004, convertible into shares of our common stock. Interest is payable, at the option of the investor, in cash or shares of our common stock. The note is convertible into such number of shares of our common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.532 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to

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the conversion date. Additionally, we issued a warrant to the investor to purchase 565,410 shares of our common stock at an exercise price equal to \$0.76 per share. The investor may exercise the warrant through September 21, 2006. In December 2001, \$70,000 of this note was converted into 209,039 shares of common stock and in the first quarter of fiscal 2003, the debenture holder requested that the conversion be rescinded. The Company honored the request and shares have been returned and the outstanding principal balance due under the note has been increased to \$300,000. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$106,000 and \$194,000, respectively. The value of the note was then allocated between the note and the preferential conversion feature which amounted to \$0 and \$194,000, respectively.

On November 7, 2001, the Company entered into a convertible note purchase agreement with an investor whereby we sold to the investor a convertible promissory note in the aggregate principal amount of \$200,000 bearing interest at the rate of eight percent (8%) per annum, due November 7, 2004, convertible into shares of our common stock. Interest is payable, at the option of the investor, in cash or shares of our common stock. The note is convertible into such number of shares of our common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.532 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, we issued a warrant to the investor to purchase 413,534 shares of our common stock at an exercise price equal to \$0.76 per share. The investor may exercise the warrant through November 7, 2006. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$92,000 and \$108,000, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$92,000, respectively.

On January 22, 2002, the Company entered into a convertible note purchase agreement with an investor whereby we sold to the investor a convertible promissory note in the aggregate principal amount of \$500,000 bearing interest at the rate of eight percent (8%) per annum, due January 22, 2003, convertible into shares of our common stock. Interest is payable, at the option of the investor, in cash or shares of our common stock. The note is convertible into such number of shares of our common stock as is determined by dividing (a) that portion of the outstanding principal balance of the note by (b) the conversion price. The conversion price equals the lesser of (x) \$0.332 and (y) 70% of the average of the 3 lowest closing bid prices during the 30 trading days prior to the conversion date. Additionally, we issued a warrant to the investor to purchase 3,313,253 shares of our common stock at an exercise price equal to \$0.332 per share. The investor may exercise the warrant through January 22, 2009. In accordance with EITF 00-27, the Company first determined the value of the note and the fair value of the detachable warrants issued in connection with this convertible debenture. The proportionate value of the note and the warrants is \$101,000 and \$399,000, respectively. The value of the note was then allocated between the note and the preferential conversion feature, which amounted to \$0 and \$101,000, respectively.

All the convertible debentures are shown as a current liability in the accompanying consolidated balance sheets since each debenture is convertible into common stock at any time.

### NOTE 7. STOCK ISSUANCES

Amendment To The Certificate Of Incorporation.

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On September 28, 2001, the Company's shareholders authorized an amendment to the Certificate of Incorporation to: (i) effect a stock combination (reverse split) of the Company's common stock in an exchange ratio to be approved by the Board, ranging from one (1) newly issued share for each ten (10) outstanding shares of common stock to one (1) newly issued share for each twenty (20) outstanding shares of common stock (the "Reverse Split"); and (ii) provide that no fractional shares or scrip representing fractions of a share shall be issued, but in lieu thereof, each fraction of a share that any shareholder would otherwise be entitled to receive shall be rounded up to the nearest whole share. There will be no change in the number of the Company's authorized shares of common stock and no change in the par value of a share of Common Stock.

On August 9, 2002, the Company's board of directors approved and effected a 1 for 20 reverse stock split. All share and per share data have been retroactively restated to reflect this stock split.

During the quarter ended December 31, 2002, the Company issued a total of 89,938,400 shares of common stock. Of the shares issued, 100,000 were issued to complete the acquisition of Dream Canvas Technology, Inc. 53,000,000 were issued to convert indebtedness. 4,000,000 were issued as employee compensation. 32,838,400 remaining shares were issued to consultants for legal and business services. The shares were valued based on the fair value of the Company's stock at the date the agreements were signed with employees, consultants, and debt holders, which totaled \$956,759. The issuances of common stock have not resulted in a change of control of the Registrant.

During the quarter ended December 31, 2002, the Company issued 13,650,000 warrants to officers and directors. The Company has not recognized an expense as a result of the issuance of these warrants as the warrants were issued to officers and directors and the exercise price was equal to the fair market of the Company's common stock at the date of issuance.

During the six months ended December 31, 2002, the Company issued 2,830,000 warrants to outside consultants. The Company recognized an expense of \$70,198 for the fair value of the warrants. The Company used the Black-Scholes option pricing model to value the warrants, with the following assumptions: (i) no expected dividends; (ii) a risk-free rate of 3.5%; (iii) expected volatility of 179% and (iv) an expected life of .25 years.

### NOTE 8. SEGMENT INFORMATION

During the period ended December 31, 2002, the Company managed and internally reported the Company's business as three (3) reportable segments: (1) imaging products and accessories; (2) imaging software; and (3) professional employer organization

| (in thousands)               | PEO BUSINESS<br>2002 | IMAGING PRODUCTS<br>2001 | IMAGING SOFTWARE<br>2002 | TOTAL<br>2001 | 2002  |
|------------------------------|----------------------|--------------------------|--------------------------|---------------|-------|
|                              | -----                | -----                    | -----                    | -----         | ----- |
| <b>Three months:</b>         |                      |                          |                          |               |       |
| Revenues . . . . .           | \$ 2,139             | \$ 7,074                 | \$ 94                    | \$ 891        | \$ 41 |
| Cost of revenues . . . . .   | 1,878                | 6,795                    | 82                       | 646           | 29    |
| Operating expenses . . . . . | 253                  | 116                      | 780                      | 2,061         | 91    |
| Operating profit (loss)      | 8                    | 163                      | (768)                    | (1,816)       | (79)  |

Six months :

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|                         |    |       |    |       |    |         |    |         |    |      |
|-------------------------|----|-------|----|-------|----|---------|----|---------|----|------|
| Revenues. . . . .       | \$ | 4,961 | \$ | 7,074 | \$ | 580     | \$ | 1,764   | \$ | 179  |
| Cost of revenues. . . . |    | 4,450 |    | 6,795 |    | 317     |    | 1,214   |    | 62   |
| Operating expenses. . . |    | 1,337 |    | 116   |    | 1,625   |    | 3,546   |    | 203  |
| Operating profit (loss) |    | (826) |    | 163   |    | (1,362) |    | (2,996) |    | (86) |

As of and during the period ended December 31, 2002, no customer accounted for more than 10% of consolidated accounts receivable or total consolidated revenues.

### NOTE 9. ACQUISITION AND SALE OF SUBSIDIARY

The Company completed the acquisition of Dream Canvas Technology, Inc. (DCT) in October 2002 and paid the sum of \$40,000 with the issuance of 100,000 shares of its common stock. In December 2002 the Company sold DCT to Baseline Worldwide Limited for \$75,000 in cash. The Company reported this transaction on Form 8-K, filed on December 19, 2002, which is incorporated by reference.

### NOTE 10. EXTINGUISHMENT OF DEBT

During the period ended December 31, 2002, the Company reviewed its accounts payable and determined that an amount of \$656,000 was associated with unsecured creditors who no longer consider such amounts currently due and payable. Accordingly, management has elected to adjust its accounts payable and to classify such adjustments as extinguishment of debt.

### NOTE 11. SUBSEQUENT EVENTS

During the period from December 31, 2002 to February 7, 2003, the Company issued 25,952,568 shares of its common stock as payment for debt and payment to consultants. 8,008,565 shares were issued for the conversion of \$59,785 of debt and \$2,781 in accrued interest. Conversions of debt were made pursuant to the Company's agreements for said conversions. The stock issued to consultants was valued by multiplying the number of shares issued times the market value of the Company's stock at the date the shares were issued. 12,500,000 restricted shares were issued to certain individuals pursuant to the Share Acquisition Agreement with Quik Pix, Inc.

On January 7, 2003, the Company completed the acquisition of shares, representing controlling interest, of Greenland Corporation and Quik Pix, Inc. The terms of the acquisitions were disclosed on Form 8-K filed January 21, 2003, and incorporated by reference.

## 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 statements contained in this Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, hopes, intentions or strategies regarding the future. Forward-looking statements include statements regarding: future product or product development; future research and development spending and our product development strategies, and are generally identifiable by the use of the words "may", "should", "expect", "anticipate", "estimates", "believe", "intend", or "project" or the negative thereof or other variations thereon or comparable terminology. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements (or industry results, performance or achievements) expressed or implied by these forward-looking statements to be materially

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different from those predicted. The factors that could affect our actual results include, but are not limited to, the following: general economic and business conditions, both nationally and in the regions in which we operate; competition; changes in business strategy or development plans; our inability to retain key employees; our inability to obtain sufficient financing to continue to expand operations; and changes in demand for products by our customers.

### OVERVIEW

Imaging Technologies Corporation develops and distributes imaging software and distributes digital imaging products. The Company sells a range of imaging products for use in graphics and publishing, digital photography, and other niche business and technical markets. The Company's core technologies are related to the design and development of software products that improve the accuracy of color reproduction.

In November 2001, we embarked on an expansion program to provide more services to help with tasks that have negatively impacted the business operations of its existing and potential customers. To this end, the Company, through strategic acquisitions, became a professional employer organization ("PEO").

ITEC now provides comprehensive personnel management services through its wholly-owned SourceOne Group and EnStructure subsidiaries. Each of these subsidiaries provides a broad range of services, including benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, and employer liability management to small and medium-sized businesses.

In May 2002, ITEC entered into an agreement to acquire Dream Canvas, Inc., a Japanese corporation that has developed machines currently used for the automated printing of custom stickers, popular in the Japanese consumer market. The Company completed the acquisition of Dream Canvas Technology, Inc. (DCT) in October 2002 and paid the sum of \$40,000 with the issuance of 100,000 shares of its common stock. In December 2002 the Company sold DCT to Baseline Worldwide Limited for \$75,000 in cash. The Company reported this transaction on Form 8-K, filed on December 19, 2002, which is incorporated by reference. (Also see Note 9 to the Consolidated Financial Statements.)

In July 2002, ITEC entered into an agreement to acquire controlling interest in Quik Pix, Inc. ("QPI"). QPI shares are traded on the National Quotation Bureau Pink Sheets under the symbol QPIX. On January 7, 2003, the Company completed the acquisition of shares, representing controlling interest, of Quik Pix, Inc. The terms of the acquisitions were disclosed on Form 8-K filed January 21, 2003, and incorporated by reference.

In August 2002, ITEC entered into an agreement to acquire controlling interest in Greenland Corporation. Greenland shares are traded on the Electronic Bulletin Board under the symbol GRLC. On January 7, 2003, the Company completed the acquisition of shares, representing controlling interest, of Greenland Corporation. The terms of the acquisitions were disclosed on Form 8-K filed January 21, 2003, and incorporated by reference.

The Company's business continues to experience operational and liquidity challenges. Accordingly, year-to-year financial comparisons may be of limited usefulness now and for the next several periods due to anticipated changes in the Company's business as these changes relate to potential acquisitions of new businesses, changes in product lines, and the potential for suspending or discontinuing certain components of the business.

The Company's current strategy is: to expand its PEO business and to commercialize its own technology, which is embodied in its ColorBlind Color



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Management software and other products obtained through strategic acquisitions.

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, 2002 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. The Company plans to overcome the circumstances that impact our ability to remain a going concern through a combination of achieving profitability, raising additional debt and equity financing, and renegotiating existing obligations.

Since the removal of the court appointed operational receiver in June 2000, the Company has been able to reestablish relationships with some past customers and distributors and to establish relationships with new customers. Additionally, the Company has been working to reduce costs through the reduction in staff, the suspension of certain research and development programs, such as the design and manufacture of controller boards and printers, and the suspension of product sales and marketing programs related to office equipment and services in favor of a greater concentration on its PEO and imaging software businesses. The Company began a program to reduce its debt through debt to equity conversions. Management continues to pursue the acquisition of businesses that will grow the Company's business.

There can be no assurance, however, that the Company will be able to 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 shareholders. 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. Also see "Liquidity and Capital Resources." and "Risks and Uncertainties - Future Capital Needs."

### RESTRUCTURING AND NEW BUSINESS UNITS

From August 20, 1999 until June 21, 2000, the Company had been under the control of an operational receiver appointed by the Court pursuant to litigation between the Company and Imperial Bank. The litigation has been dismissed, and Company management has reassumed control. Accordingly, Company management did not have operational control for nearly all of fiscal 2000.

In July 2001, the Company suspended its printer controller development and manufacturing operations in favor of selling products from other companies to its customers.

In October 2002, the Company suspended its sales and marketing activities associated with the distribution of office products, including printers, scanners, plotters, and computer networking devices.

### ACQUISITION AND SALE OF BUSINESS UNITS

In December 2000, the Company acquired all of the shares of EduAdvantage.com, Inc., an internet sales organization that sells computer hardware and software products to educational institutions and other customers via its websites: [www.eduadvantage.com](http://www.eduadvantage.com) and [www.soft4u.com](http://www.soft4u.com). During fiscal 2001, the Company began integrating EduAdvantage operations. However, these operations have not been profitable and management is evaluating the future of this business unit.

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In October 2001, the Company acquired certain assets, for stock, related to the Company's office products and services business activities, representing \$250,000 of inventories, fixed assets, and accounts receivable. Management has since suspended these operations in favor of concentrating on its software and PEO businesses and the products and services offered by its recent acquisitions.

In November 2001, the Company acquired SourceOne Group, Inc. and operates it as a wholly-owned subsidiary. SourceOne provides PEO services, including benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, and employer liability management to small and medium-sized businesses.

In March 2002, ITEC acquired all of the outstanding shares of EnStructure, Inc. ("EnStructure"), a PEO company, for restricted common stock of the Company. The purchase price may be increased or decreased based upon EnStructure's representations of projected revenues and profits, which are defined in the acquisition agreement, which was exhibited as part of the Company's Form 8-K, dated March 28, 2002. EnStructure is operated as a wholly-owned subsidiary.

In May 2002, ITEC entered into an agreement to acquire Dream Canvas, Inc., a Japanese corporation that has developed machines currently used for the automated printing of custom stickers, popular in the Japanese consumer market. The Company completed the acquisition of Dream Canvas Technology, Inc. (DCT) in October 2002 and paid the sum of \$40,000 with the issuance of 100,000 shares of its common stock. In December 2002 the Company sold DCT to Baseline Worldwide Limited for \$75,000 in cash. The Company reported this transaction on Form 8-K, filed on December 19, 2002,. (Also see Note 9 to the Consolidated Financial Statements.)

In July 2002, ITEC entered into an agreement to acquire controlling interest in Quik Pix, Inc. ("QPI"). QPI shares are traded on the National Quotation Bureau Pink Sheets under the symbol QPIX. On January 7, 2003, the Company completed the acquisition of shares, representing controlling interest, of Quik Pix, Inc. The terms of the acquisitions were disclosed on Form 8-K filed January 21, 2003.

In August 2002, ITEC entered into an agreement to acquire controlling interest in Greenland Corporation. Greenland shares are traded on the Electronic Bulletin Board under the symbol GRLC. On January 7, 2003, the Company completed the acquisition of shares, representing controlling interest, of Greenland Corporation. The terms of the acquisitions were disclosed on Form 8-K filed January 21, 2003

### SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to allowance for doubtful accounts, value of intangible assets and valuation of non-cash compensation. Management bases its estimates and judgments on historical experiences and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant accounting estimates inherent in the preparation of the Company's financial statements include estimates as to the appropriate carrying value of certain

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assets and liabilities which are not readily apparent from other sources, primarily allowance for doubtful accounts and estimated fair value of equity instruments used for compensation. These accounting policies are described at relevant sections in this discussion and analysis and in the notes to the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2002.

### RESULTS OF OPERATIONS NET REVENUES

Revenues were \$2.3 million and \$8.1 million for the three-month period ended December 31, 2002 and 2001, respectively, a decrease of \$5.8 million or 72%. Revenues were \$5.7 million and \$9.2 million for the six-month period ended December 31, 2002 and 2001, respectively, a decrease of \$3.5 million or 38%. The decrease in revenues was due primarily to changes in the customer structure of the Company's PEO activities in SourceOne Group (SOG). Since the acquisition of SOG, the Company has lost several customers due to changes in rates for services, particularly workers' compensation insurance. Additionally, management elected to terminate certain customers due to profitability concerns. New customers are anticipated pursuant to signed agreements, which will begin to produce revenues in the third quarter of the current fiscal year. Additional PEO contracts are being negotiated by ExpertHR, a wholly-owned subsidiary of Greenland Corporation, controlling interest of which was acquired by the Company in January 2003.

Sales of imaging products were \$94 thousand and \$891 thousand for the three-month period ended December 31, 2002 and 2001, respectively, a decrease of \$797 thousand or 90%. Sales of imaging products were \$580 thousand and \$1.8 million for the six-month period ended December 31, 2002 and 2001, respectively, a decrease of \$1.2 million or 68%. The decrease in product sales from the reported periods of 2002 to 2001 was due to the suspension of sales and marketing activities associated with the resale of office products, including copiers, printers, and network solutions. In October 2002, the Company laid-off most of the employees associated with these activities in order to reduce costs. The Company's lack of sufficient working capital has had, and may continue to have, a negative adverse effect on product sales.

The Company had sales software sales, licensing fees, and royalties for the three-month period ended December 31, 2002 and 2001 of \$41 thousand and \$145 thousand, respectively. Software revenues fell by \$104 thousand (72%). For the six-month period ended December 31, 2002 and 2001, software sales, licensing fees, and royalties were \$179 thousand and \$350 thousand, respectively, a decrease of \$171 thousand (49%). The reduction in software revenues was due to the Company's lack of sufficient working capital to support sales and marketing activities. Royalties from the licensing of ColorBlind source code are insignificant and are reported as part of software sales.

### COST OF PRODUCTS SOLD

Cost of products sold were \$82 (87% of product sales) and \$646 thousand (73% of product sales) for the three-month period ended December 31, 2002 and 2001, respectively. For the six-month period ended December 31, 2002 and 2001, cost of products sold were \$317 thousand (55% of product sales) and \$1.2 million (67% of product sales), respectively.

The decrease in margins is primarily due to price reductions to customers on products sold by the Company in the periods reported. The Company has concentrated on sales of its ColorBlind software rather than on office products. The Company suspended its sales and marketing efforts on behalf of office products and services in October 2002 due to shortages of working capital.

Cost of software, licenses and royalties were \$29 thousand (71%) and \$24 thousand (17%) for the three-month period ended December 31, 2002 and 2001,

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respectively. Such costs were \$62 thousand (35%) and \$54 thousand (16%) for the six-month period ended December 31, 2002 and 2001, respectively. The decrease in margin was due primarily to production and manufacturing costs associated with new versions of ColorBlind software that have been released since the beginning of the current fiscal year.

Cost of PEO services were \$1.9 million (91%) and \$6.8 million (96%) for the period ended December 31, 2002 and 2001, respectively. The increase in margin is primarily due to the cancellation of several unprofitable clients.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the three-month period ended December 31, 2002 and 2001, respectively, were \$1.1 million and \$2.1 million. Selling, general and administrative expenses for the six-month period ended December 31, 2002 and 2001, respectively, were \$3.2 million and \$3.6 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, 2002, the selling, general, and administrative expenses decreased \$1 million (48%) from the year-earlier period due to reductions in staff, suspension of certain operations that have been unprofitable due to limited working capital, and a move to smaller facilities to house corporate offices. For the six-month period ended December 31, 2002 and 2001, the Company reduced selling, general, and administrative expenses \$400 thousand (11%) due primarily to reductions in personnel, which were associated with the Company's sales and marketing of office products and services, which have been suspended.

### RESEARCH AND DEVELOPMENT

There were no research and development costs for the three-month and six-month periods ended December 31, 2002. Research and development costs were \$64 thousand for the prior year three-month period. For the six-month period ended December 31, 2001, research and development costs were \$136 thousand.

The Company had been reducing its research and development costs during the past several quarters. It has suspended most of its engineering and licensing activities associated with OEM printer products and has re-directed its research and development costs toward the support of its ColorBlind software products. The Company released the latest versions of its ColorBlind software in the first quarter of fiscal 2003.

### 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. Additionally, in order to facilitate its growth and future liquidity, the Company has made some strategic acquisitions.

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 2002, the Company issued an additional 87.9 million shares. During the six-month period ended December 31, 2002, the Company issued an additional 95.7 million shares. These shares of common stock were issued primarily for raising capital, for corporate expenses in lieu of cash, and for acquisitions.

During the quarter ended December 31, 2002, ITEC issued 8,000,000 common

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shares to holders of notes payable at an average conversion price of \$0.01 per share. In addition, ITEC also converted \$500,000 of indebtedness into 45,000,000 common shares.

As of December 31, 2002, the Company had negative working capital of \$22.0 million, a decrease of approximately \$1.3 million (6%) in working capital as compared to June 30, 2002. This decrease was due primarily to (1) reduced current assets, including accounts receivable and inventories, which were associated with the Company's suspended office products sales and distribution activities; and (2) increased accrued expenses, which are associated with the Company's PEO business.

Net cash provided by operating activities was \$209 thousand for the six-month period ended December 31, 2002 compared to net cash used by operating activities of \$3.1 million for the year-earlier period, a decrease of \$3.3 million, due primarily to reduced overall operating expenditures.

No cash was used in investing activities during the six-month period ended December 31, 2002. Net cash used in investing activities was \$91 thousand during the six-month period ended December 31, 2001. The change was due primarily to the Company's cash investment for the SourceOne Group acquisition in the prior year.

Net cash used by financing activities was \$75 thousand for the six-month period ended December 31, 2002 compared to net cash from financing activities of \$3.3 million in the year-earlier period, a decrease of \$3.4 million (103%). The decrease is related primarily to the issuance of notes payable and common stock, which have been used to finance continuing operations.

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, 2002, was approximately \$342 thousand.

The Company's capital requirements depend on numerous factors, including market acceptance of the Company's products and services, the resources the Company devotes to marketing and selling its products and services, and other factors. The report of the Company's independent auditors accompanying the Company's June 30, 2002 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

IF WE ARE UNABLE TO SECURE FUTURE CAPITAL, WE WILL BE UNABLE TO CONTINUE OUR OPERATIONS.

Our business has not been profitable in the past and it may not be profitable in the future. We may incur losses on a quarterly or annual basis for a number of reasons, some within and others outside our control. See "Potential Fluctuation in Our Quarterly Performance." The growth of our business will require the commitment of substantial capital resources. If funds are not available from operations, we will need additional funds. We 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 we need them. Even if funds are available, the terms under which the funds are available to us may not be acceptable to us. Insufficient funds may require us to delay, reduce or eliminate some or all of our planned activities.

To successfully execute our current strategy, we will need to improve our

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working capital position. The report of our independent auditors accompanying the Company's June 30, 2002 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 our working capital and net worth. The Company plans to overcome the circumstances that impact our ability to remain a going concern through a combination of increased revenues and decreased costs, with interim cash flow deficiencies being addressed through additional equity financing.

IF OUR QUARTERLY PERFORMANCE CONTINUES TO FLUCTUATE, IT MAY HAVE A NEGATIVE IMPACT ON OUR BUSINESS.

Our quarterly operating results can fluctuate significantly depending on a number of factors, any one of which could have a negative impact on our results of operations. The factors include: the timing of product announcements and subsequent introductions of new or enhanced products by us and by our competitors, the availability and cost of products and/or components, the timing and mix of shipments of our products, the market acceptance of our new products and services, seasonality, changes in our prices and in our competitors' prices, 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.

We may experience significant quarterly fluctuations in revenues and operating expenses as we introduce new products and services. Accordingly, any inaccuracy in our forecasts could adversely affect our financial condition and results of operations. Demand for our products and services could be adversely affected by a slowdown in the overall demand for imaging products and/or PEO services. Our failure to complete shipments during a quarter could have a material adverse effect on our results of operations for that quarter. Quarterly results are not necessarily indicative of future performance for any particular period.

THE MARKET PRICE OF OUR COMMON STOCK HISTORICALLY HAS FLUCTUATED SIGNIFICANTLY.

Our 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 our business, fluctuations in our operating results, a shortfall in our revenues or earnings compared to the estimates of securities analysts, announcements of technological innovations, new products or enhancements by us or our competitors, general conditions in the markets we serve, general conditions in the worldwide economy, developments in patents or other intellectual property rights, and developments in our relationships with our customers and suppliers.

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

SINCE OUR COMPETITORS HAVE GREATER FINANCIAL AND MARKETING RESOURCES THAN WE DO, WE MAY EXPERIENCE A REDUCTION IN MARKET SHARE AND REVENUES.

The markets for our products and services are highly competitive and rapidly changing. Some of our current and prospective competitors have significantly greater financial, technical, manufacturing and marketing resources than we do. Our ability to compete in our markets depends on a number of factors, some within and others outside our control. These factors include: the frequency and success of product and services introductions by us and by our

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competitors, the selling prices of our products and services and of our competitors' products and services, the performance of our products and of our competitors' products, product distribution by us and by our competitors, our marketing ability and the marketing ability of our competitors, and the quality of customer support offered by us and by our competitors.

A key element of our strategy is to provide competitively priced, quality products and services. We cannot be certain that our products and services will continue to be competitively priced. We have reduced prices on certain of our 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 our gross margins and may adversely affect our financial condition and results of operations.

The PEO industry is highly fragmented. While many of our competitors have limited operations, there are several PEO companies equal or substantially greater in size than ours. We also encounter competition from "fee-for-service" companies such as payroll processing firms, insurance companies, and human resources consultants. The large PEO companies have substantially more resources than us and provide a broader range of resources than we do.

IF WE ACQUIRE COMPLEMENTARY BUSINESSES, WE MAY NOT BE ABLE TO EFFECTIVELY INTEGRATE THEM INTO OUR CURRENT OPERATIONS, WHICH WOULD ADVERSELY AFFECT OUR OVERALL FINANCIAL PERFORMANCE.

In order to grow our business, we may acquire businesses that we believe are complementary. To successfully implement this strategy, we must identify suitable acquisition candidates, acquire these candidates on acceptable terms, integrate their operations and technology successfully with ours, retain existing customers and maintain the goodwill of the acquired business. We may fail in our efforts to implement one or more of these tasks. Moreover, in pursuing acquisition opportunities, we 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 we do. Competition for these acquisition targets likely could also result in increased prices of acquisition targets and a diminished pool of companies available for acquisition. Our overall financial performance will be materially and adversely affected if we are 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 our business, managing geographically-dispersed operations, reductions in our 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, our 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 our reputation, and any acquired business could significantly under perform relative to our expectations. We cannot be certain that we will be able to integrate acquired businesses, products or technologies successfully or in a timely manner in accordance with our strategic objectives, which could have a material adverse effect on our overall financial performance.

In addition, if we issue 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 our common stock.

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IF WE ARE UNABLE TO DEVELOP AND/OR ACQUIRE NEW PRODUCTS IN A TIMELY MANNER, WE MAY EXPERIENCE A SIGNIFICANT DECLINE IN SALES AND REVENUES, WHICH MAY HURT OUR ABILITY TO CONTINUE OPERATIONS.

The markets for our 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. Our future success will depend on our ability to continue to develop new versions of our ColorBlind software, and to acquire competitive products from other manufacturers. We monitor new technology developments and coordinate with suppliers, distributors and dealers to enhance our products and to lower costs. If we are unable to develop and acquire new, competitive products in a timely manner, our financial condition and results of operations will be adversely affected.

IF THE MARKET'S ACCEPTANCE OF OUR PRODUCTS CEASES TO GROW, WE MAY NOT GENERATE SUFFICIENT REVENUES TO CONTINUE OUR OPERATIONS.

The markets for our products are relatively new and are still developing. We believe that there has been growing market acceptance for color printers, color management software and supplies. We cannot be certain, however, that these markets will continue to grow. Other technologies are constantly evolving and improving. We cannot be certain that products based on these other technologies will not have a material adverse effect on the demand for our products. If our products are not accepted by the market, we will not generate sufficient revenues to continue our operations.

IF WE ARE FOUND TO BE INFRINGING ON A COMPETITOR'S INTELLECTUAL PROPERTY RIGHTS OR IF WE ARE REQUIRED TO DEFEND AGAINST A CLAIM OF INFRINGEMENT, WE MAY BE REQUIRED TO REDESIGN OUR PRODUCTS OR DEFEND A LEGAL ACTION AT SUBSTANTIAL COSTS TO US.

We currently hold no patents. Our 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 our software, hardware designs or the integration of the two. We protect our software source code as trade secrets and make our proprietary source code available to OEM customers only under limited circumstances and specific security and confidentiality constraints.

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

IF OUR DISTRIBUTORS REDUCE OR DISCONTINUE SALES OF OUR PRODUCTS, OUR BUSINESS MAY BE MATERIALLY AND ADVERSELY AFFECTED.

Our products are marketed and sold through a distribution channel of value added resellers, manufacturers' representatives, retail vendors, and systems integrators. We have 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. We support our worldwide distribution network and end-user customers through operations headquartered in San Diego. As of February 7, 2002, we directly employed 6 individuals involved in marketing and sales activities.



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A portion of our sales are made through distributors, which may carry competing product lines. These distributors could reduce or discontinue sales of our products, which could adversely affect us. These independent distributors may not devote the resources necessary to provide effective sales and marketing support of our products. In addition, we are 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 our markets.

INCREASES IN HEALTH INSURANCE PREMIUMS, UNEMPLOYMENT TAXES, AND WORKERS' COMPENSATION RATES WILL HAVE A SIGNIFICANT EFFECT ON OUR FUTURE FINANCIAL PERFORMANCE.

Health insurance premiums, state unemployment taxes, and workers' compensation rates are, in part, determined by our SourceOne subsidiary's claims experience, and comprise a significant portion of SourceOne's direct costs. We employ risk management procedures in an attempt to control claims incidence and structure our benefits contracts to provide as much cost stability as possible. However, should we experience a large increase in claims activity, the unemployment taxes, health insurance premiums, or workers' compensation insurance rates we pay could increase. Our ability to incorporate such increases into service fees to clients is generally constrained by contractual agreements with our clients. Consequently, we could experience a delay before such increases could be reflected in the service fees we charge. As a result, such increases could have a material adverse effect on our financial condition or results of operations.

WE CARRY SUBSTANTIAL LIABILITY FOR WORKSITE EMPLOYEE PAYROLL AND BENEFITS COSTS.

Under our client service agreements, we become a co-employer of worksite employees and we assume the obligations to pay the salaries, wages, and related benefits costs and payroll taxes of such worksite employees. We assume such obligations as a principal, not merely as an agent of the client company. Our obligations include responsibility for (a) payment of the salaries and wages for work performed by worksite employees, regardless of whether the client company makes timely payment to SourceOne of the associated service fee; and (2) providing benefits to worksite employees even if the costs incurred by the SourceOne to provide such benefits exceed the fees paid by the client company. If a client company does not pay us, or if the costs of benefits provided to worksite employees exceed the fees paid by a client company, our ultimate liability for worksite employee payroll and benefits costs could have a material adverse effect on the Company's financial condition or results of operations.

AS A MAJOR EMPLOYER, OUR OPERATIONS ARE AFFECTED BY NUMEROUS FEDERAL, STATE, AND LOCAL LAWS RELATED TO LABOR, TAX, AND EMPLOYMENT MATTERS.

By entering into a co-employer relationship with employees assigned to work at client company locations, we assume certain obligations and responsibilities or an employer under these laws. However, many of these laws (such as the Employee Retirement Income Security Act ("ERISA") and federal and state employment tax laws) do not specifically address the obligations and responsibilities of non-traditional employers such as PEOs; and the definition of "employer" under these laws is not uniform. Additionally, some of the states in which we operate have not addressed the PEO relationship for purposes of compliance with applicable state laws governing the employer/employee relationship. If these other federal or state laws are ultimately applied to our PEO relationship with our worksite employees in a manner adverse to the Company, such an application could have a material adverse effect on the Company's financial condition or results of operations.

While many states do not explicitly regulate PEOs, 21 states have passed laws

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that have licensing or registration requirements for PEOs, and several other states are considering such regulation. Such laws vary from state to state, but generally provide for monitoring the fiscal responsibility of PEOs and, in some cases, codify and clarify the co-employment relationship for unemployment, workers' compensation, and other purposes under state law. There can be no assurance that we will be able to satisfy licensing requirements of other applicable relations for all states. Additionally, there can be no assurance that we will be able to renew our licenses in all states.

THE MAINTENANCE OF HEALTH AND WORKERS' COMPENSATION INSURANCE PLANS THAT COVER WORKSITE EMPLOYEES IS A SIGNIFICANT PART OF OUR BUSINESS.

The current health and workers' compensation contracts are provided by vendors with whom we have an established relationship, and on terms that we believe to be favorable. While we believe that replacement contracts could be secured on competitive terms without causing significant disruption to our business, there can be no assurance in this regard.

OUR STANDARD AGREEMENTS WITH PEO CLIENTS ARE SUBJECT TO CANCELLATION ON 60-DAYS WRITTEN NOTICE BY EITHER THE COMPANY OR THE CLIENT.

Accordingly, the short-term nature of these agreements make us vulnerable to potential cancellations by existing clients, which could materially and adversely affect our financial condition and results of operations. Additionally, our results of operations are dependent, in part, upon our ability to retain or replace client companies upon the termination or cancellation of our agreements.

A NUMBER OF LEGAL ISSUES REMAIN UNRESOLVED WITH RESPECT TO THE CO-EMPLOYMENT AGREEMENT BETWEEN A PEO AND ITS WORKSITE EMPLOYEES, INCLUDING QUESTIONS CONCERNING THE ULTIMATE LIABILITY FOR VIOLATIONS OF EMPLOYMENT AND DISCRIMINATION LAWS.

Our client service agreement establishes a contractual division of responsibilities between the Company and our clients for various personnel management matters, including compliance with and liability under various government regulations. However, because we act as a co-employer, we may be subject to liability for violations of these or other laws despite these contractual provisions, even if we do not participate in such violations. Although our agreement provides that the client is to indemnify the Company for any liability attributable to the conduct of the client, we may not be able to collect on such a contractual indemnification claim, and thus may be responsible for satisfying such liabilities. Additionally, worksite employees may be deemed to be agents of the Company, subjecting us to liability for the actions of such worksite employees.

IF ALL OF THE LAWSUITS CURRENTLY FILED WERE DECIDED AGAINST US AND/OR ALL THE JUDGMENTS CURRENTLY OBTAINED AGAINST US WERE TO BE IMMEDIATELY COLLECTED, WE WOULD HAVE TO CEASE OUR OPERATIONS.

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. On January 31, 2003, we executed a Stipulation of Settlement, and the matter will be closed pending the distribution of the settlement to the plaintiffs. The defense of this action was tendered to our insurance carriers.

Throughout fiscal 2000, 2001, and 2002, and through the date of this

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filing, approximately fifty 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.

IF OUR OPERATIONS CONTINUE TO RESULT IN A NET LOSS, NEGATIVE WORKING CAPITAL AND A DECLINE IN NET WORTH, AND WE ARE UNABLE TO OBTAIN NEEDED FUNDING, WE MAY BE FORCED TO DISCONTINUE OPERATIONS.

For several recent periods, up through the present, we had a net loss, negative working capital and a decline in net worth, which raises substantial doubt about our ability to continue as a going concern. Our losses have resulted primarily from an inability to achieve revenue targets due to insufficient working capital. Our ability to continue operations will depend on positive cash flow, if any, from future operations and on our ability to raise additional funds through equity or debt financing. Although we have reduced our work force and suspended some of our operations, if we are unable to achieve the necessary product sales or raise or obtain needed funding, we may be forced to discontinue operations.

IF AN OPERATIONAL RECEIVER IS REINSTATED TO CONTROL OUR OPERATIONS, WE MAY NOT BE ABLE TO CARRY OUT OUR BUSINESS PLAN.

On August 20, 1999, at the request of Imperial Bank, our primary lender, the Superior Court, San Diego appointed an operational receiver to us. On August 23, 1999, the operational receiver took control of our day-to-day operations. On June 21, 2000, the Superior Court, San Diego issued an order dismissing the operational receiver as a part of a settlement of litigation with Imperial Bank pursuant to the Settlement Agreement effective as of June 20, 2000. The Settlement Agreement requires that we make monthly payments of \$150,000 to Imperial Bank until the indebtedness is paid in full. However, in the future, without additional funding sufficient to satisfy Imperial Bank and our other creditors, as well as providing for our working capital, there can be no assurances that an operational receiver may not be reinstated. If an operational receiver is reinstated, we will not be able to expand our products nor will we have complete control over sales policies or the allocation of funds.

The penalty for noncompliance of the Settlement Agreement is a stipulated judgment that allows Imperial Bank to immediately reinstate the operational receiver and begin liquidation proceedings against us. We are currently meeting the monthly amount of \$150,000 as stipulated by the Settlement Agreement with Imperial Bank. However, the monthly payments have been reduced to \$100,000 through January of 2002.

THE DELISTING OF OUR COMMON STOCK FROM THE NASDAQ SMALLCAP MARKET HAS MADE IT MORE DIFFICULT TO RAISE FINANCING, AND THERE IS LESS LIQUIDITY FOR OUR COMMON STOCK AS A RESULT.

The Nasdaq SmallCap 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 us that we 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,

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1999, a Nasdaq Listing Qualifications Panel also raised public interest concerns relating to our financial viability. While the Panel acknowledged that we were in technical compliance with the bid price and market capitalization requirements, the Panel was of the opinion that the continued listing of our common stock on The Nasdaq Stock Market was no longer appropriate. This conclusion was based on the Panel's concerns regarding our future viability. Our 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 our common stock. This lack of liquidity also may make it more difficult for us to raise capital in the future.

Trading of our 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 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 stockholders 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.

### 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. On January 31, 2003, we entered into a Stipulation of Settlement with the plaintiffs. We agreed to pay the plaintiffs 5,000,000 shares of common stock and a \$200,000 cash payment (to be paid by our insurance carriers). The defense of this action has been tendered to our insurance carriers.

On August 22, 2002, the Company was sued by its former landlord, Carmel

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Mountain #8 Associates, L.P. or past due rent on its former facilities at 15175 Innovation Drive, San Diego, CA 92127.

The Company is also a party to a lawsuit filed by Symphony Partners, L.P. related to its acquisition of SourceOne Group, LLC. We have hired counsel to represent us in this action and believe that the claims against the Company are without merit.

The Company is one of dozens of companies sued by The Massachusetts Institute of Technology, et.al, related to a patent held by the plaintiffs that may be related to part of the Company's ColorBlind software. We believe that any amounts due in royalties or otherwise to the plaintiffs by the Company, should the Company be in violation of said patent, would not be material.

Throughout fiscal 2000, 2001, and 2002, and through the date of this filing, approximately fifty 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.

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

#### Common Stock Warrants -----

The Company, from time-to-time, grants warrants to employees, directors, outside consultants and other key persons, to purchase shares of the Company's common stock, at an exercise price equal to no less than the fair market value of such stock on the date of grant.

In the first quarter ended December 31, 2002, the Company issued warrants to directors and certain officers to purchase up to 13,650,000 shares of its common stock at an exercise price equal to \$0.015 per share. The value of these warrants is estimated at \$204,750.

There were no exercises of warrants during the period ended December 31, 2002.

#### Stock Split -----

On August 9, 2002, the Company's board of directors approved and effected a 1 for 20 reverse stock split. All share and per share data have been retroactively restated to reflect this stock split.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

### ITEM 5. OTHER INFORMATION

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None

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

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10(a) Acquisition Agreement, dated December 13, 2002, between the Company and Baseline Worldwide, Ltd., incorporated by reference to Exhibit 99.3 of Form 8-K, dated December 19, 2002.

10(b) Secured Promissory Note in the amount of \$2,250,000 issued by the Company to Greenland Corporation, dated January 7, 2003, incorporated by reference to Exhibit 99.1 of Form 8-K dated January 21, 2003.

10(c) Security Agreement, dated January 7, 2003 between the Company and Greenland Corporation, incorporated by reference to Exhibit 99.2 of Form 8-K dated January 21, 2003.

10(d) Agreement to Acquire Shares, dated August 9, 2002 between the Company and Greenland Corporation, incorporated by reference to Exhibit 99.3 of Form 8-K dated January 21, 2003.

10(e) Closing Agreement, dated January 7, 2003, between the Company and Greenland Corporation, incorporated by reference to Exhibit 99.4 of Form 8-K dated January 21, 2003.

10(f) Share Acquisition Agreement, dated June 12, 2002, between the Company and Quik Pix, Inc., incorporated by reference to Exhibit 99.5 of Form 8-K dated January 21, 2003.

10(g) Closing Agreement, dated July 23, 2002 between the Company and Quik Pix, Inc., incorporated by reference to Exhibit 99.6 of Form 8-K dated January 21, 2003.

99.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), included in this filing.

(b) Reports on Form 8-K

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Form 8-K filed on December 19, 2002 related to the sale of Dream Canvas, Inc.

Form 8-K filed on January 21, 2003 related to the acquisition of shares of Greenland Corporation and Quik Pix, Inc.

SIGNATURES

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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 19, 2002

IMAGING TECHNOLOGIES CORPORATION (Registrant)

By: /S/ Brian Bonar

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Brian Bonar  
Chairman and Chief Executive Officer  
Principal Accounting Officer

CERTIFICATION  
-----

I, Brian Bonar, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Imaging Technologies Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's certifying officers are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's certifying officers have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's certifying officers have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: February 19, 2003

/s/ Brian Bonar

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Brian Bonar  
Chief Executive Officer  
Principal Accounting Officer