INTERNATIONAL MICROCOMPUTER SOFTWARE INC /CA/
Form 10QSB
February 14, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **December 31, 2004**

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from: _______ to _______

Commission File Number 0-15949

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC.
(Exact name of Small business issuer in its charter)

CALIFORNIA (State or other jurisdiction of incorporation or organization)	**94-2862863** (I.R.S. Employer Identification No.)
100 ROWLAND WAY, NOVATO, CALIFORNIA (Address of principal executive offices)	**94945** (Zip code)
(415) 878-4000 Issuer's telephone number	

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 o

As of **February 8, 2005, 28,253,507** Shares of Issuer s common stock, no par value, were outstanding.

Transitional Small Business Disclosure Format: YES o NO x

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC.
AND SUBSIDIARIES

Table of Contents

PART I - FINANCIAL INFORMATION

Item1- Condensed Consolidated Financial Statements

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	December 31, 2004 Unaudited	June 30, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,804	$ 3,212
Investment in marketable securities	2,548	2,151
Receivables, less allowances for doubtful accounts, discounts and returns of $908 and $958	2,646	2,522
Inventories, net of reserves for obsolescence of $123 and $123	1,088	1,122
Receivables, other (related to discontinued operations)	--	1,000
Note receivable from related party	325	350
Other current assets	691	552
Assets related to discontinued operations	499	828
Total current assets	**10,601**	**11,737**
Fixed assets, net	**613**	**637**
Intangible Assets		
Capitalized software, net	2,815	2,748
Domain names, net	1,964	1,566
Trademarks	710	709
Distribution rights, net	543	594
Capitalized customer lists	940	843
Goodwill	8,829	7,559
Total intangible assets	**15,801**	**14,019**
Other assets:		
Prepaid expenses	73	99
Investment in securities	--	1,771
Total other assets	**73**	**1,870**
TOTAL ASSETS	**$ 27,088**	**$ 28,263**
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short term debt	$ 2,360	$ 3,557
Trade accounts payable	2,137	2,375
Accrued and other liabilities	1,199	1,751
Liabilities related to discontinued operations	42	397
Total current liabilities	**5,738**	**8,080**
Long-term debt and other obligations	1,842	2,318
Total liabilities	**7,580**	**10,398**

Shareholders' Equity				
Common stock, no par value; 300,000,000 authorized; 28,248,507 issued and outstanding on December 31, 2004 and 26,261,829 issued and outstanding on June 30, 2004		43,335		41,512
Accumulated deficit		(23,723)		(23,577)
Accumulated other comprehensive loss		(104)		(70)
Total shareholders' equity		**19,508**		**17,865**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$**	**27,088**	**$**	**28,263**

See Notes to Condensed Consolidated Financial Statements

3

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS and COMPREHENSIVE INCOME/(LOSS)
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended December 31,				Six Months Ended December 31,			
		2004		2003		2004		2003
Net revenues	$	6,019	$	2,356	$	11,713	$	3,977
Product costs		1,604		789		3,119		1,363
Gross margin		**4,415**		**1,567**		**8,594**		**2,614**
Costs and expenses								
Sales and marketing		2,536		887		4,829		1,485
General and administrative		1,257		964		2,391		1,621
Research and development		994		452		2,033		860
Total operating expenses		**4,787**		**2,303**		**9,253**		**3,966**
Operating loss		**(372)**		**(736)**		**(659)**		**(1,352)**
Other income and (expense)								
Interest and other, net		--		60		18		142
Realized / unrealized gain on marketable securities		471		47		422		177
Gain on sale of product line		33		--		33		--
Gain (loss) on extinguishment of debt		--		(5)		--		76
Income (loss) before income tax		**132**		**(634)**		**(186)**		**(957)**
Income tax (expense) benefit		(3)		6		(8)		10
Income (loss) from Continuing Operations		**129**		**(628)**		**(194)**		**(947)**
Income (loss) from discontinued operations, net of income tax		--		30		(5)		(51)
Gain from the sale of discontinued operations, net of income tax		--		1,000		53		1,000
Net income (loss)	**$**	**129**	**$**	**402**		**($146)**	**$**	**2**
Other comprehensive loss								
Foreign currency translation adjustments		(24)		(28)		(34)		(32)
Comprehensive income (loss)	**$**	**105**	**$**	**374**		**($180)**		**($30)**
Basic income (loss) per share								
Income (loss) from continuing operations		$0.00		($0.02)		($0.01)		($0.03)
Income (loss) from discontinued operations, net of income tax		--		$0.00		($0.00)		($0.01)
		--		$0.04		$0.00		$0.04

Gain from the sale of discontinued operations, net of income tax				
Net income (loss)	$0.00	0.02	($0.01)	$0.00
Diluted income (loss) per share				
Income (loss) from continuing operations	$0.00	($0.02)	($0.01)	($0.03)
Income (loss) from discontinued operations, net of income tax	--	$0.00	($0.00)	($0.01)
Gain from the sale of discontinued operations, net of income tax	--	$0.04	$0.00	$0.04
Net income (loss)	$0.00	$0.02	($0.01)	$0.00
Shares used in computing basic earnings (loss) per share information	27,916	23,268	27,605	23,223
Shares used in computing diluted earnings (loss) per share information	29,885	23,268	27,605	23,223

See Notes to Condensed Consolidated Financial Statements

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
Six Months ended December 31, 2004
(In thousands)
(Unaudited)

	Common Stock			Accumulated	Accumulated Other Comprehensive	
	Shares		Amount	Deficit	Loss	Total
Balance at June 30, 2004	**26,262**	**$**	**41,512**	**($23,577)**	**($70)**	**$ 17,865**
Issuance of common stock related to:						
Warrants exercised	125		26			**26**
Stock options exercised	222		111			**111**
Acquisitions	1,640		1,602			**1,602**
Issuance of warrants related to:						
Consulting services rendered			13			**13**
Acquisitions			8			**8**
Issuance of stock options related to:						
Consulting services rendered			2			**2**
Acquisitions			66			**66**
Variable accounting adjustment related to stock options previously issued			(5)			**(5)**
Net loss				(146)		**(146)**
Foreign currency translation adjustment					(34)	**(34)**
Balance at December 31, 2004	**28,249**	**$**	**43,335**	**($23,723)**	**($104)**	**$ 19,508**

See Notes to Condensed Consolidated Financial Statements

5

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six months ended December 31, 2004	2003
Cash flows from operating activities:		
Net cash generated (used) by operating activities	**$ 248**	**($2,507)**
Cash flows from investing activities:		
Proceeds from sale of marketable securities	1,780	--
Cash released from escrow	650	--
Proceeds from sale of product line	258	--
Related party note receivable (DCDC)	25	(350)
Acquisition of business, net of cash acquired	(1,357)	(257)
Cash transferred to escrow	(499)	--
Purchase of trade names, software and domain names	(172)	(13)
Purchase of equipment and furniture	(126)	(167)
Acquisition of product line	--	(1,525)
Investment in marketable securities	--	(160)
Cash used by discontinued operations in investing activities	--	(7)
Net cash generated (used) by investing activities	**559**	**(2,479)**
Cash flows from financing activities:		
Settlement of note payable (Imageline)	--	(160)
Proceeds from short-term borrowings	400	--
Repayments of Contractual Liabilities	(1,718)	(109)
Warrants exercised	26	65
Options exercised	111	71
Cash used by discontinued operations in financing activities	--	--
Net cash used by financing activities	**(1,181)**	**(133)**
Effect of exchange rate change on cash and cash equivalents	(34)	(31)
Net increase (decrease) in cash and cash equivalents	**(408)**	**(5,150)**
Cash and cash equivalents at beginning of period	3,212	10,399
Cash and cash equivalents at end of the period	**$ 2,804**	**$ 5,249**

See Notes to Condensed Consolidated Financial Statements

(In thousands)	Six months ended December 31, 2004	2003
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$125	$0
SUPPLEMENTAL DISCLOSURE OF NON-CASH FINANCING ACTIVITIES		

Notes payable incurred in conjunction with acquisitions	$505	$833
Capital stock issued in conjunction with acquisitions	$1,602	$77

See Notes to Condensed Consolidated Financial Statements

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The interim condensed consolidated financial statements have been prepared from the records of International Microcomputer Software, Inc. and Subsidiaries ("IMSI") without audit. All significant inter-company balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments, which consist of only normal recurring adjustments, to present fairly the financial position at December 31, 2004 and the results of operations and cash flows for the three and six months ended December 31, 2004 and 2003, have been made. The interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in our Annual Report on Form 10-KSB as amended for the fiscal year ended June 30, 2004. The results of operations for the three and six months ended December 31, 2004 are not necessarily indicative of the results to be expected for any other interim period or for the full year.

2. Use of Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. Our financial statements would be affected to the extent there are material differences between these estimates and actual results. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management s judgment in its application. There are also areas in which management s judgment in selecting any available alternative would not produce a materially different result.

3. Discontinued Operations

Gain from the sale of discontinued operations, net of income tax

As previously disclosed in our annual report on Form 10-KSB, as amended, for the fiscal year ended June 30, 2004, we sold the assets and customer related liabilities of our wholly owned subsidiary Keynomics, Inc. in July 2004. We evaluated the Keynomics business segment and its long term prospects during the fourth quarter of fiscal 2004 and with our focus on direct marketing and the on-line distribution of utilities and precision design content, we determined that Keynomics no longer represented a strategic fit for our company. The $53,000 gain from the sale of discontinued operations for the six months ended December 31, 2004 relate to the sale of Keynomics during the quarter ended September 30, 2004 and represent the excess of the total consideration received over its net carrying value.

During the quarter ended December 31, 2003, we recorded a gain of $1.0 Million from the sale of discontinued operations representing the successful achievement of the first earn-out from the sale of ArtToday to Jupitermedia Corporation in June 2003.

Income (loss) from discontinued operations, net of income tax

The amounts reported for the three and six months ended December 31, 2004 and 2003 as discontinued operations represent the pre-tax results of operations for Keynomics. This segment had pre-tax net gain of $30,000 for the quarter ended December 31, 2003 and pre-tax losses of $5,000 and $51,000 for the six months ended December 31, 2004 and

2003 respectively. These losses were derived from net revenues of $319,000 for the quarter ended December 31, 2003 and $68,000 and $478,000 for the six months ended December 31, 2004 and 2003 respectively.

4. **Acquisitions**

The table below details the consideration paid for acquisitions and amendments to prior acquisitions, completed during the six month period ended December 31, 2004 and the allocation of that consideration to the tangible and intangible assets acquired.

Table I-1-4

	Precision Design Solutions Segment Aggregated Non Material Transactions	Consumer and Business Software Solutions Segment Aggregated Non Material Transactions	
Consideration			
Cash	$ 1,318	$ 50	
Escrowed cash	75	0	
Notes	300	205	
Common stock	503	65	
Derivative securities	0	65	
Less: Cash on hand	(104)	0	
Legal & escrow fees	33	0	
Broker fees (cash & warrants)	43	0	
Total Consideration	**2,168**	**385**	
			Estimated Useful Life
Purchase Price Allocation			
Assumed liabilities	**(125)**	**0**	
Tangible Assets			
Inventory	1	0	
Prepaid expenses	12	0	
Accounts receivable	8	0	
Total Tangible Assets	**21**	**0**	
Intangible Assets			
Identifiable Assets			
Customer list	220	0	3 years
Domain names	603	0	5 years
Software development costs	0	0	5 years
Total Identifiable Assets	**823**	**385**	
Unidentifiable Assets			
Goodwill	1,449	0	Indefinite
Total Unidentifiable Assets	**1,449**	**0**	
Total Intangible Assets	**2,229**	**385**	
Total	**$ 2,168**	**$ 385**	

<u>Acquisition of Abbisoft House Plans, Inc.</u>

As previously disclosed in our quarterly report on Form 10-QSB for the quarter ended September 30, 2004, we completed a stock purchase agreement on September 28, 2004 whereby we acquired all the outstanding stock of Abbisoft House Plans, Inc. (Abbisoft), an on-line provider of stock house plans which operates the www.Homeplanfinder.com website. The consideration for the acquisition was paid in a combination of cash, notes payable (secured by the acquired business) and 500,000 unregistered IMSI common shares valued at $1.0067 per share.

This transaction was not deemed to be a material business combination, therefore, no pro forma results are required under the Statement of Financial Accounting Standards No. 141. We do not expect the goodwill associated with this acquisition to be deductible for tax purposes.

Amendment to the Allume Acquisition

In September 2004, IMSI and Aladdin Systems Holdings, Inc (Aladdin Holdings) amended the portion of the purchase agreement which called for earn-outs to be paid based on the achievement of certain revenue targets (under the terms of the original purchase agreement between us and Aladdin Holdings signed on April 18, 2004, cash earn-out payments could have been earned, up to an aggregate of $2,000,000, based on net revenues derived from Aladdin for the three consecutive twelve-month periods following the Closing Date). With the amendment, the earn-out payments were converted from contingent obligations to fixed obligations as follows:

- The first earn out payment of $666,667 which could have been due on April 19, 2005 became fully earned as of the amendment date and will be payable on June 2, 2005.

- The second and third earn-out payments were terminated in consideration of the issuance of shares of the common stock of IMSI priced as of the closing bid price on the date of the amendment. As a result, during the first quarter of Fiscal Year 2005, we issued to Aladdin Holdings an additional 1,065,807 shares of our common stock, with a value of $1,033,867, pursuant to a transaction exempt from registration under Section 4(2) of the Securities Act.

Consequently, as of June 30, 2004, we amended the purchase price of the Allume acquisition to include the $1.7 million value of the fixed obligations described above. This additional amount was allocated to goodwill. We do not expect the goodwill associated with this acquisition to be deductible for tax purposes.

As part of the same agreement, Aladdin Holdings agreed to modify the date by which we were required to file the registration statement on Form SB- 2 to register the common stock that Aladdin Holdings received from us as part of the original agreement from ninety (90) days from the Closing Date to September 30, 2004. Additionally, Aladdin Holdings agreed to modify the date by which the registration statement was required to be declared effective by the SEC from one hundred and eighty (180) days from the Closing Date to March 31, 2005. We filed the registration statement with the SEC on September 29, 2004 and it was declared effective on November 4, 2004, fulfilling our obligations under this agreement.

5. Note Receivable from Related Party - DCDC 15% Note

On September 18, 2003, we received a 15% one-year note from Digital Creative Development Corporation (DCDC) upon extending a loan to DCDC in the amount of $350,000 secured by 400,000 shares of IMSI s stock held by DCDC and due on September 18, 2004. Concurrent with this note, DCDC repaid the entire principal portion of a $50,000 note, made in favor of IMSI on February 25, 2003. That note, due on February 25, 2004, was unsecured and carried a 4% interest rate. The note had been previously recorded as a fully reserved receivable as it was unsecured. The reversal of the reserve upon the repayment of this note was consequently accounted for as other income during the first quarter of fiscal 2004.

On September 18, 2004, we amended the terms of the $350,000 promissory note with DCDC extending the maturity of the note to May 31, 2005. The accrued interest which was earned through September 18, 2004 was paid in full on October 1, 2004 in addition to a principal payment in the amount of $25,000. Additionally, DCDC agreed to increase the collateral attached to the note by assigning to IMSI its interest in a private equity investment.

On January 31, 2005, we sold the above referenced promissory note to Mag Multi Corp (Mag Multi), a New York corporation for $343,000, representing the principal balance and all accrued interest as of the date of the transfer.

9

6. Debt

The following table details our outstanding debt as of December 31, 2004:

Table I-1-6

		As of December 31, 2004
Short-Term		
Acquisition related notes		
Aladdin Systems Holdings, Inc	$	1,666
All other acquisition related obligations		423
Subtotal		***2,089***
Short term financing (secured by selected accounts receivable)		261
Other Short term obligation		10
Subtotal Short Term		**2,360**
Long-Term		
Acquisition related notes		
Aladdin Systems Holdings, Inc		1,500
All other acquisition related obligations		342
Subtotal Long Term		**1,842**
Grand Total	**$**	**4,202**

7. Fair Value of Financial Instruments

The fair value of cash and cash equivalents, trade receivables, trade payables and debt approximates carrying value due to the short maturity of such instruments.

As of December 31, 2004 we had $2.5 million classified under investments in marketable securities on our balance sheet representing the market value of our investment portfolio.

The total consideration related the sale of ArtToday to Jupitermedia in June 2003 included 250,000 shares of Jupitermedia common stock. The ArtToday purchase agreement originally called for these shares to be held in escrow until December 30, 2005. However, at our discretion, we had the ability to replace all, or a portion of, the common stock held in escrow with cash in an amount equal to the closing market value, at June 30, 2003, of the common stock to be replaced.

In February 2004, pursuant to an amended escrow agreement, Jupitermedia agreed to release from the escrow account, without additional cash consideration, 125,000 of the original 250,000 shares that were tendered as part of the consideration in the sale of ArtToday.

During the quarter ended September 30, 2004, we substituted approximately $500,000 (recorded as Assets from Discontinued Operations) in cash for the remaining 125,000 shares of Jupitermedia. This amount will be released to us, net of any claims, on December 30, 2005.

After their release from the escrow account the Jupitermedia shares stock were deposited into our marketable securities account and were sold as market conditions allowed. We did not hold any shares of Jupitermedia common stock as of December 31, 2004.

In addition to the shares referenced above, the escrow account also included $1.3 million in cash to be released in two equal installments in June 2004 and December 2004. On December 30, 2004, we received the second payment of $650,000 that was held in escrow in connection to the ArtToday sale to Jupitermedia.

The first payment of $650,000 was released to us on June 30, 2004 of which approximately $42,000 was paid to the former minority shareholders of ArtToday.

The remaining $650,000 escrow balance was released to us on December 30, 2004 in addition to accrued interest. Approximately $42,000 of the remaining cash in escrow was due to the former minority shareholders of ArtToday and was paid to them in January 2005.

8. Gain / (loss) on marketable securities

The following table details the net gain on marketable securities that we recognized during the three and six months ended December 31, 2004:

Table I-1-8

	Gain (loss) on marketable securities for the three months ended December 31, 2004				
	Realized		**Unrealized**		**Total**
Description		Reversal of unrealized gain / (loss) recognized in prior periods	Unrealized gain / (loss) for the quarter ended December 31, 2004	Sub total Unrealized gain / (loss)	
Jupitermedia common stock	$ 1,050	($1,050)	$ 0	**($1,050)**	**$ 0**
Other Stock in investment portfolio	111	9	351	**360**	**471**
Total	**$ 1,161**	**($1,041)**	**$ 351**	**($690)**	**$ 471**

	Gain (loss) on marketable securities for the six months ended December 31, 2004				
	Realized		**Unrealized**		**Total**
Description		Reversal of unrealized gain / (loss) recognized in prior periods	Unrealized gain / (loss) for the six months ended December 31, 2004	Sub total Unrealized gain / (loss)	
Jupitermedia common stock	$ 2,094	($2,097)	$ 163	**($1,934)**	**$ 160**
Other Stock in investment portfolio	64	92	106	**198**	**262**
Total	**$ 2,158**	**($2,005)**	**$ 269**	**($1,736)**	**$ 422**

9. Segment Information

We have two reportable operating segments which serve businesses and individuals in the design and consumer markets. The segments are classified in accordance to our product families and generate revenues and incur expenses related to the sale of our software and services. All inter-company amounts are eliminated through consolidation. Certain general and administrative expenses are allocated among our different segments based on each segment contribution to total revenue.

Table I-1-9

	Three months ended December 31, 2004			Three months ended December 31, 2003		
	Precision Design	**Consumer & Business**	**Total**	**Precision Design**	**Consumer & Business**	**Total**

	Solutions	Software Solutions		Solutions	Software Solutions	
Net revenues	$ 2,682	$ 3,337	**$ 6,019**	$ 1,375	$ 981	**$ 2,356**
Gross margin	1,671	2,744	**4,415**	861	706	**1,567**
Operating Loss	($109)	($263)	**($372)**	($461)	($275)	**($736)**

	Six months ended December 31, 2004			Six months ended December 31, 2003		
	Precision Design Solutions	Consumer Software Solutions	Total	Precision Design Solutions	Consumer Software Solutions	Total
Net revenues	$ 4,757	$ 6,956	**$ 11,713**	$ 2,032	$ 1,945	**$ 3,977**
Gross margin	3,087	5,507	**8,594**	1,299	1,315	**2,614**
Operating Loss	($244)	($415)	**($659)**	($729)	($623)	**($1,352)**

The following table details the geographical breakdown in our net revenues (in thousands). The International sales refer to the revenues from our German and Australian wholly owned subsidiaries, IMSI GmbH and IMSI Australia PTY Ltd, and sales derived from international distribution and republishing agreement we have in Europe (France, England), Asia (Japan and China) and Australia.

Table I-2-4

	Three months ended December 31, 2004		Three months ended December 31, 2003			
	$	% of total	$	% of total	**$ Change**	**% change**
Domestic sales	$ 5,059	84%	$ 2,046	87%	$ 3,013	147%
International sales	960	16%	310	13%	650	210%
Total Net Sales	**$ 6,019**	**100%**	**$ 2,356**	**100%**	**$ 3,663**	**155%**

	Six months ended December 31, 2004		Six months ended December 31, 2003			
	$	% of total	$	% of total	**$ Change**	**% change**
Domestic sales	$ 10,051	86%	$ 3,274	82%	$ 6,777	207%
International sales	1,662	14%	703	18%	959	136%
Total Net Sales	**$ 11,713**	**100%**	**$ 3,977**	**100%**	**$ 7,736**	**195%**

10. Earnings/ (Loss) per Share

Basic earnings/ (loss) per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted average number of common and potentially dilutive securities outstanding during the period. Potentially dilutive securities consist of the incremental common shares issuable upon exercise of stock options and warrants (using the treasury stock method). Potentially dilutive securities are excluded from the computation if their effect is anti-dilutive.

The following table sets forth the computation of basic and diluted earnings/(loss) per share:

Table I-1-10

	Three months ended December 31, 2004	Three months ended December 31, 2003	Six months ended December 31, 2004	Six months ended December 31, 2003
Numerator:				
Net income (loss)	$ 129	$ 402	($146)	$ 2
Numerator for basic earnings (loss) per share - income (loss) available to common stockholders	129	$ 402	($146)	$ 2
Numerator for diluted earnings (loss) per share - income (loss) available to common stockholders after assumed conversions	$ 129	$ 402	($146)	$ 2
Denominator:				
	27,916,479	23,268,099	27,605,356	23,223,488

Denominator for basic loss per share - weighted average shares outstanding						
Effect of dilutive securities using the treasury stock method as at December 31, 2004:						
Total Warrants Outstanding - 6,633,244		1,486,527		--	--	--
Total Stock Options Outstanding - 3,247,777		481,741		--	--	--
Effect of dilutive securities using the treasury stock method as at December 31, 2003:						
Total Warrants Outstanding - 7,363,244		--		--	--	--
Total Stock Options Outstanding - 2,058,664		--		--	--	--
Dilutive potential common shares		--		--	--	--
Denominator for diluted loss per share - adjusted weighted average shares and assumed conversion		29,884,747		23,268,099	27,605,356	23,223,488
Basic earnings/(loss) per share	$	0.00	$	0.02	($0.01)	$ 0.00
Diluted earnings/(loss) per share	$	0.00	$	0.02	($0.01)	$ 0.00

12

11. Stock Based Awards

Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, an Amendment of FASB Statement No. 123, amends the disclosure requirements of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), to require more prominent disclosures in both annual and interim financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

We account for stock-based compensation plans in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, under which no compensation cost is recognized in the financial statements for employee stock arrangements when grants are made at fair market value. The Company has adopted the disclosure only provisions of SFAS No. 123, Accounting for Stock Based Compensation .

Beginning on January 1, 2006, the Company will adopt the accounting treatment required by FASB Statement No. 123 (revised 2004) which will require the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in the Company's consolidated financial statements.

Under variable plan accounting, we recognize a charge equal to the per share change in the share value until the underlying options expire or are exercised. During the three months ended December 31, 2004 and 2003, we recognized an expense of $1,737 and a benefit of ($2,069) respectively related to variable awards. During the six months ended December 31, 2004 and 2003, we recognized a benefit of ($4,963) and an expense of $12,735 respectively related to variable awards.

Had compensation cost for the stock-based compensation plans been determined based upon the fair value at grant dates for awards under those plans consistent with the method prescribed by SFAS 123, net income would have been reduced to the pro forma amounts indicated below:

Table I-1-11

(in thousands, except per share amounts)	**Three months Ended December 31,**				**Six months Ended December 31,**			
		2004		**2003**		**2004**		**2003**
Net income (loss), as reported	**$**	**129**	**$**	**402**		**($146)**	**$**	**2**
Intrinsic compensation charge recorded under APB 25		7		247		15		254
Pro Forma compensation charge under SFAS 123		(205)		(614)		(417)		(866)
Pro Forma net income (loss)		**($69)**	**$**	**35**		**($548)**		**($610)**
Pro Forma net income (loss) per share:								
Basic as reported	$	0.00	$	0.02		($0.01)	$	0.00
Basic pro forma		($0.00)	$	0.00		($0.02)		($0.03)
Diluted as reported	$	0.00	$	0.02		($0.01)	$	0.00
Diluted pro forma		($0.00)	$	0.00		($0.02)		($0.03)

The weighted average fair values per option as of the grant date for grants made for both the three and six months ended December 31, 2004 were $0.68 and $0.74. This compares to $0.85 and $0.85, respectively for the three and six months ended December 31, 2003.

13

12. Goodwill

Total goodwill at December 31, 2004 was $8.8 million and relates to the acquisitions we consummated during fiscal 2004 and 2005. During the quarter ended September 30, 2004, we eliminated $179,000 of goodwill related to Keynomics against the gain on the sale of discontinued operations.

In accordance with SFAS No. 142, *Goodwill and Intangible Assets* goodwill is being assessed for impairment annually or more frequently if circumstances indicate impairment. We have not recognized any impairment charges related to goodwill during the six months ended December 31, 2004.

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

Overview

IMSI is a developer and publisher of software in the precision design, utilities and business applications categories. We offer a wide variety of application software that we market through an array of distribution methods including:

- Direct marketing to consumers and businesses,
- Retail/ Distribution agreements.
- Republishing & OEM agreements.

We are committed to being a leading provider of these applications and services to businesses and consumers.

We believe that consistent growth of both the revenues and operating earnings can be achieved through internally developed products and services and through acquisition. Management believes that good value target companies are present in the marketplace and that business combinations with these entities would help us achieve our growth potential in addition to providing synergies that would improve profitability.

How We Generate Revenue

We develop, publish, market and sell a variety of software titles and services that are targeted to for a wide array of uses primarily for individuals and small businesses. To efficiently serve our customers and maximize our revenue opportunities, we have aligned our business along two segments as described below:

Table I-2-1

Business Segment	Product Family	Product Group	Selected Product Brand
Precision Design Solutions	Precision Design Software	Professional CAD Solutions	*TurboCAD Professional* *TurboCADCAM* *CADsymbol CD*
		Consumer CAD Solutions	*TurboCAD Deluxe* *DesignCAD* *Instant Series* *FloorPlan*
	Precision Design Services	Content	*Houseplans.com* *Houseplanguys.com* *Homeplanfinder.com*

			CADsymbols.com
Consumer and Business Software Solutions	Utilities	Compression, Access and Transmission (CAT)	*StuffIt Deluxe & Standard*
		Security and Internet	*iClean* *Internet Cleanup* *SpamCatcher* *Spring Cleaning*
	Business Applications and Other	Software Compilations	*DragStrip* *Ten for X* *Creative Essentials* *The Big Mix*
		Business Solutions	*FlowCharts & More* *FormTool* *OrgChart Professional* *QuickStart* *TurboProject*
		Graphics Solutions	*Animations & More* *ClipArt & More* *HiJaak*
		Consumer Solutions	*Easy Language* *Legacy Family Tree* *TurboTyping*

14

Depending on the product and the customer, we deliver our products either through Electronic Software Downloads (ESD) or as physical products. Our distribution methods are comprised of the following three major channels:

· **Direct Marketing:**

- ***Direct to Consumer-*** We maintain e-commerce websites and employ a sales force internally and through strategic partnerships to directly sell products to our customers. We conduct direct mail campaigns, both postal and email, for our existing and new products in addition to upgrades of existing products, as well as third-party offers. These mailings generally offer a specially priced product, as well as complementary or enhanced products for a further charge.

- ***Direct to Businesses-*** We sell certain products and site licenses to businesses including large Fortune 100 companies. We market to these corporations through a combination of telemarketing, direct mail, and e-mailing. We believe that certain of our products and services, particularly TurboCAD, StuffIt, TurboProject, OrgChart Professional and HiJaak, are well suited for use within large corporations.

· **Retail / Distribution-** We are increasing our presence in the retail software market utilizing selected distributors and partners for a number of our products in order to reach a wider range of end users. However, intense price competition along with the intermittent unfavorable retail conditions, including erosion of margins from competitive marketing and high rates of product returns, make this distribution channel increasingly challenging.

· **Republishing / OEM-** We have republishing agreements domestically and internationally which typically include minimum guaranteed royalty payments.

Our ability to develop and distribute products and services and determine the optimum distribution channel for their maximum exposure is a competitive advantage that differentiates us from other players in the industry.

Forward Looking Statement

The following information should be read in conjunction with the consolidated financial statements and the notes thereto and in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations in our Fiscal 2004 Form 10-KSB, as amended. This quarterly report on Form 10-QSB, and in particular this Management s Discussion and Analysis of Financial Condition and Results of Operations, may contain forward-looking statements regarding future events or our future performance. These future events and future performance involve certain risks and uncertainties including those discussed in the Other Factors That May Affect Future Operating Results section of this Form 10-QSB, as well as in our Fiscal 2004 Form 10-KSB, as amended, as filed with SEC. Actual events or our actual future results may differ materially from any forward-looking statements due to such risks and uncertainties. We assume no obligation to update these forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements. This analysis is not intended to serve as a basis for projection of future events.

Our consolidated financial statements are prepared in accordance with GAAP. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. Our financial statements would be affected to the extent there are material differences between these estimates and actual results. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management s judgment in its application. There are also areas in which management s judgment in selecting any available alternative would not produce a materially different result.

Results of Operations

The following table sets forth our results of operations for the three and six months ended December 31, 2004 and 2003 in absolute dollars and as a percentage of net revenues. It also details the changes from the prior fiscal year in absolute dollars and in percentages.

Table I-2-2

	Three months ended December 31,						**Six months ended December 31,**					
	2004		**2003**		**$ Change from previous year**		**2004**		**2003**		**$ Change from previous year**	
	$	As % of sales	$	As % of sales	$ Increase / (Decrease)	%	$	As % of sales	$	As % of sales	$ Increase / (Decrease)	%
Net revenues	$ 6,019	100%	$ 2,356	100%	$ 3,663	155%	$ 11,713	100%	$ 3,977	100%	$ 7,736	195%
Product cost	1,604	27%	789	33%	815	103%	3,119	27%	1,363	34%	1,756	129%
Gross margin	**4,415**	**73%**	**1,567**	**67%**	**2,848**	**182%**	**8,594**	**73%**	**2,614**	**66%**	**5,980**	**229%**
Operating expenses												
Sales & marketing	2,536	42%	887	38%	1,649	186%	4,829	41%	1,485	37%	3,344	225%
General & administrative	1,257	21%	964	41%	293	30%	2,391	20%	1,621	41%	770	48%
Research & development	994	17%	452	19%	542	120%	2,033	17%	860	22%	1,173	136%
Total operating expenses	**4,787**	**80%**	**2,303**	**98%**	**2,484**	**108%**	**9,253**	**79%**	**3,966**	**100%**	**5,287**	**133%**
Operating loss	**(372)**	**-6%**	**(736)**	**-31%**	**364**	**-49%**	**(659)**	**-6%**	**(1,352)**	**-34%**	**693**	**-51%**
Other Income (expenses)												
Interest and other, net	--	0%	60	3%	(60)	-100%	18	0%	142	4%	(124)	-87%
Realized / unrealized gain on marketable securities	471	8%	47	2%	424	904%	422	4%	177	4%	245	138%
Gain on sale of product line	33	1%	--	0%	33	100%						