IMAGING TECHNOLOGIES CORP/CA
Form 10-Q
May 20, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
QUARTERLY REPORT UNDER SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2002
or
TRANSITION REPORT UNDER SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file No. 0-12641

[GRAPHIC OMITED]

IMAGING TECHNOLOGIES CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE 33-0021693
(State or other jurisdiction of incorporation or organization) (IRS Employer ID No.)

15175 INNOVATION DRIVE
SAN DIEGO, CALIFORNIA 92128
(Address of principal executive offices)
Registrant's Telephone Number, Including Area Code: (858) 613-1300

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

The number of shares outstanding of the registrant's common stock as of May 15, 2002, was 349,032,249.

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PART I. - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

ASSETS

	MARCH 31, 2002	JUNE 30, 2001
(audited)		
Current assets		
Cash	$ 87	$ 35
Accounts receivable:		
Billed	1,158	58
Unbilled	306	-
	1,464	58
Inventories	1,045	50
Prepaid expenses and other	168	259
Total current assets	2,764	402
Property and equipment, net	177	241
Goodwill, net	1,823	569
Other	16	-
	$ 4,780	$ 1,212

LIABILITIES AND SHAREHOLDERS' EQUITY

	MARCH 31, 2002	JUNE 30, 2001
Current liabilities		
Borrowings under bank note payable	$ 3,718	$ 4,318
Short-term debt	4,562	3,379
Accounts payable	6,407	6,450
PEO payroll taxes and other payroll deductions	404	-
PEO accrued worksite employee	529	-
Other accrued expenses	5,525	3,175
Total current liabilities	21,145	17,322

Stockholders' net capital deficiency

Series A preferred stock, $1,000 par value, 7,500 shares authorized, 420.5 shares issued and outstanding. . . .	420	420
Common stock, $0.005 par value, 500,000,000 shares authorized, 276,935,848 and 170,901,065 shares issued and outstanding, respectively	1,572	864
Paid-in capital	73,122	69,472
Shareholder loans	(105)	(105)
Common stock warrants	541	475
Accumulated deficit	(91,915)	(87,236)
Total shareholders' net capital deficiency	(16,365)	(16,110)
	$ 4,780	$ 1,212

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED MARCH 31,
(in thousands, except share data)
(unaudited)

	2002	2001
Revenues		
Sales of products	$ 814	$ 1,165
Software sales, licenses and royalties.	470	30
PEO services.	8,098	-
	9,382	1,195
Costs and expenses		
Cost of products sold	614	1,050
Cost of software sales, licenses and royalties.	277	-
Cost of PEO services.	7,735	-
Selling, general, and administrative.	1,863	1,559
Research and development.	68	223
	10,557	2,832
Income (loss) from operations.	(1,175)	(1,637)
Other income (expense):		
Interest and financing costs, net	(364)	(65)
Management fees	-	-
Gain on extinguishment of debt.	411	-
Other	-	-
	47	(65)
Income (loss) before income taxes.	(1,128)	(1,702)
Income tax expense		

Net income (loss)	$ (1,128)	$ (1,702)
Earnings (loss) per common share		
Basic	$ (0.01)	$ (0.01)
Diluted	$ (0.01)	$ (0.01)
Weighted average common shares	263,320	141,148
Weighted average common shares - assuming dilution	263,320	141,148

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
NINE MONTHS ENDED MARCH 31,
(in thousands, except share data)
(unaudited)

	2002	2001
Revenues		
Sales of imaging products	$ 2,578	$ 2,381
Sales of software, licenses and royalties	820	662
PEO services	15,172	-
	18,570	3,043
Costs and expenses		
Cost of products sold	1,828	1,974
Cost of software, licenses and royalties	331	-
Cost of PEO services	14,530	-
Selling, general, and administrative	5,449	5,631
Research and development	140	679
	22,278	8,284
Income (loss) from operations	(3,708)	(5,241)
Other income (expense):		
Interest and financing costs, net	(1,382)	(787)
Gain on extinguishment of debt	411	-
Other	-	-
	(971)	(787)
Income (loss) before income taxes	(4,679)	(6,028)
Income tax expense		
Net income (loss)	$ (4,679)	$ (6,028)

Earnings (loss) per common share		
Basic	$ (0.02)	$ (0.05)
Diluted	$ (0.02)	$ (0.05)
Weighted average common shares	211,143	119,045
Weighted average common shares - assuming dilution	211,143	119,045

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED MARCH 31,
(in thousands, except share data)
(unaudited)

	2002	2001
Cash flows from operating activities		
Net income (loss)	$ (4,679)	$ (6,028)
Adjustments to reconcile net income (loss) to net cash from operating activities		
Depreciation and amortization	81	252
Stock issued for services	495	871
Non-cash interest	831	364
Warrant discount expense	109	-
Gain on extinguishment of debt	(411)	-
Changes in operating assets and liabilities		
Accounts receivable	(1,406)	58
Inventories	(994)	47
Prepaid expenses and other	(91)	(43)
Accounts payable and accrued expenses	2,428	701
PEO payroll taxes and other payroll deductions payable	404	-
PEO accrued worksite employee expense	529	-
Other assets	(16)	-
Net cash from operating activities	(2,720)	(3,778)
Cash flows from investing activities		
Capital expenditures	(56)	(104)
Cash investment in acquisitions	(250)	-
Cash acquired in acquisitions	215	-
Other	-	150
Net cash from investing activities	(91)	46
Cash flows from financing activities		
Net borrowings under bank lines of credit	(600)	(1,500)
Issuance of other notes payable	1,183	850
Warrant proceeds	66	-
Net proceeds from issuance of common stock	2,214	4,366
Net cash from financing activities	2,863	3,716
Net increase (decrease) in cash	52	(16)

Cash, beginning of period	35	291
Cash, end of period	$ 87	$ 275

See Notes to Consolidated Financial Statements.

IMAGING TECHNOLOGIES CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share data)
(unaudited)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements of Imaging Technologies Corporation and Subsidiaries (the "Company" or "ITEC") have been prepared pursuant to the rules of the Securities and Exchange Commission (the "SEC") for quarterly reports on Form 10-Q and do not include all of the information and note disclosures required by generally accepted accounting principles. These financial statements and notes herein are unaudited, but in the opinion of management, include all the adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the years ended June 30, 2001, 2000, and 1999 included in the Company's annual report on Form 10-K filed with the SEC. Interim operating results are not necessarily indicative of operating results for any future interim period or for the full year.

NOTE 2. GOING CONCERN CONSIDERATIONS

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. At March 31, 2002, and for the year then ended, the Company has experienced a net loss and has deficiencies in working capital and net worth that 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, stockholders may find it more difficult to sell common stock. This lack of liquidity also may make it more difficult to raise capital in the future. Trading of the Company's common stock is now being conducted over-the-counter through the NASD Electronic Bulletin Board and covered by Rule 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 shareholders to sell our common stock in the secondary market would be limited. As a result, the market liquidity for our common stock would be severely and adversely affected. We can provide no assurance that trading in our common stock will not be subject to these or other regulations in the future, which would negatively affect the market for our common stock.

The Company must obtain additional funds to provide adequate working capital and finance operations. 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 stockholders. If adequate funds are not available, the Company may be required to delay, reduce or eliminate some or all of its planned activities, including any potential mergers or acquisitions. The Company's inability to fund its capital requirements would have a material adverse effect on the Company. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 3. EARNINGS (LOSS) PER COMMON SHARE

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

	EARNINGS (LOSS) (NUMERATOR)	SHARES (DENOMINATOR)	PER-SHARE AMOUNT
MARCH 31, 2001			
Net loss	$ (1,702)		
Preferred dividends	(6)		
Basic and diluted EPS. .	(1,708)	114,148	$ (0.01)

MARCH 31, 2002			
Net loss	$ (1,128)		
Preferred dividends	(6)		
Basic and diluted EPS. .	(1,134)	263,320	$ (0.01)

NOTE 4. INVENTORIES

	MAR. 31, 2002	JUNE 30, 2001
Inventories		
Materials and suppliers	$ 264	$ 10
Finished goods.	781	40
	$ 1,045	$ 50

NOTE 5. RECENT ACCOUNTING PRONOUNCEMENTS

SFAS 141

In July 2001, FASB issued SFAS No. 141, "Business Combinations," which is effective for business combinations initiated after June 30, 2001. SFAS No. 141 eliminates the pooling of interest method of accounting for business combinations and requires that all business combinations occurring on or after July 1, 2001 be accounted for under the purchase method. The Company does not expect SFAS No. 141 to have a material impact on its financial statements.

SFAS 142

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after December 15, 2001. Early adoption is permitted for entities with fiscal years beginning after March 15, 2001, provided that the first interim financial statements have not been previously issued. SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in the financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives. SFAS No. 142 provides specific guidance for testing goodwill and intangible assets that will not be amortized for impairment. In addition, SFAS No. 142 expands the disclosure requirements about goodwill and other intangible assets in the years subsequent to their acquisition. Impairment losses for goodwill and indefinite-life intangible assets that arise due to the initial application of SFAS No. 142 are to be reported as resulting from a change in accounting principle. However, goodwill and intangible assets acquired after June 30, 2001 will be subject immediately to the provisions of SFAS No. 142. The Company does not expect SFAS No. 142 to have a material effect on its financial statements. Previously, the Company amortized $118 thousand of goodwill and discontinued amortization of goodwill for acquisitions made prior to July 1, 2001.

SFAS 143

In June 2001, the FASB issued SFAS No. 143 "Accounting for Asset Retirement Obligation." SFAS No. 143 is effective for fiscal years beginning after June 15, 2002, and will require companies to record a liability for asset retirement obligations in the period in which they are incurred, which typically could be upon completion or shortly thereafter. The FASB decided to limit the scope to legal obligation and the liability will be recorded at fair value. The effect of adoption of this standard on the Company's results of operations and financial positions is being evaluated.

SFAS 144

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. It provides a single accounting model for long-lived assets to be disposed of and replaces SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of." The effect of adoption of this standard on the Company's results of operations and financial positions is being evaluated.

NOTE 6. CONVERTIBLE NOTES PAYABLE

In December 2000, the Company entered into a Convertible Note Purchase Agreement for $850,000, bearing an annual interest a of 8%, due December 2003. The Note is convertible into the Company's common stock.

In July 2001, the Company entered into a Convertible Note Purchase Agreement for $1,000,000, bearing an annual interest rate of 8%, due July 2004. The Note is convertible into the Company's common stock.

In September 2001, the Company entered into a Convertible Promissory Note for $300,000, bearing an interest rate of 8%, due September 2004. The Note is convertible into the Company's common stock.

In November 2001, the Company entered into a Convertible Promissory Note for $200,000, bearing an interest rate of 8%, due November 2004. The Note is convertible into the Company's common stock.

In January 2002, the Company entered into a Secured Convertible Debenture for $500,000, bearing an interest rate of 8%. The Debenture is convertible into the Company's common stock.

NOTE 7. STOCK ISSUANCES

During the quarter, ITEC issued 23,055,556 common shares to holders of $415,000 of convertible notes payable at an average conversion price of $0.018 per share.

ITEC issued during the quarter 4,277,778 registered common shares for legal and consulting services at an average market price of $0.03 per share pursuant to previously registrations under Form S-8. The Company recognized $128,333 in expenses.

Registered warrants, exercised during the quarter at an average price of $0.016 per share, amounted to 24,833,333 common shares. The Company received $388,000 in cash and expensed $108,667 as a warrant discount as the result of repricing the exercise price.

As the result of beneficial conversions of convertible notes payable to common stock, during the quarters ended March 31, 2002, December 31 and September 30, 2001, $165,556, $85,719 and $579,699 was charged to interest expense respectively.

During the quarter, the Company settled $1,160,221 of its debt in exchange for 35,705,190 common shares and notes payable of $40,000. This resulted in a gain on extinguishments of debt of $410,879.

NOTE 8. BUSINESS ACQUISITIONS

On March 8, 2002, ITEC acquired all of the outstanding shares of EnStructure, Inc. ("EnStructure), a Nevada corporation, for $250,000, payable in 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 attached as an to the Company's Form 8-K, dated March 28, 2002.

EnStructure is professional employer organization ("PEO") that intends to provides personnel management services, including benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, and employer liability management.

The purchase price was determined through analysis of the value of future revenues and profits of EnStructure and the value of certain insurance relationships held in California by EnStructure.

EnStructure, Inc. is operated by ITEC as a wholly-owned subsidiary. EnStructure will be the operating unit into which the Company will place new California-based PEO clients. The acquisition agreement, iprovides for the purchase price to be tied to selling PEO services of $20 million in annual value during a certain period of time.

EnStructure was incorporated in May 2001 and has had limited operations to date. It was established to market PEO services, primarily in California.

EnStructure's sole property is a qualified first-dollar-coverage workers' compensation insurance agreement with California's State Fund Insurance Company. As the acquisition price does not meet the materiality rule of Regulation S-X. Pro forma financial statements are not available as EnStructure has had limited operations since its inception. The Company disclosed the details of the EnStructure transaction on

NOTE 9. SEGMENT INFORMATION

During the three-month and nine-month period ended March 31, 2002, the Company managed and internally reported the Company's business as three reportable segments, principally, (1) imaging products and accessories, (2) imaging software, and (3) PEO services.

Segment information for the period ended March 31, 2002 is as follows:

(in thousands)

	IMAGING PRODUCTS	IMAGING SOFTWARE	PEO SERVICES
3-months			
Revenues.	$ 814	$ 470	$ 8,098
Operating income (loss)	(1,412)	154	83
9-months			
Revenues.	$ 2,578	$ 820	$ 15,172
Operating income (loss)	(4,280)	390	182

Additional information regarding revenue by products and service groups is not presented because it is currently impracticable to do so due to various reorganizations of the Company's accounting systems. A comprehensive accounting system is being implemented that should enable the Company to report such information in the future.

During the period ended March 31, 2002, no customer accounted for more than 10% of consolidated accounts receivable or total consolidated revenues.

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

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

OVERVIEW

Imaging Technologies Corporation develops and distributes imaging software and distributes high-quality digital imaging products. The Company sells a range of printer and 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. ITEC's ColorBlind software provides color management to improve the accuracy of color reproduction - especially as it relates to matching color between different devices in a network, such as monitors and printers.

In order to capitalize on its existing systems integration expertise, the Company has begun to provide more services to help with tasks that have negatively impacted the business operations of our exiting and potential customers. To this end, ITEC has begun to pursue strategic acquisitions in personnel and employment practice management. We believe that there is considerable synergy between providing office systems solutions with administrative services.

The Company provides comprehensive personnel management services through its wholly-owned SourceOne subsidiary. SourceOne is a professional employer organization ("PEO") that provides benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, and employer liability management.

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 quarters due to anticipated changes in the Company's business as these changes relate to acquisitions of new businesses, changes in product lines, and the potential for discontinuing certain components of the business.

The Company's current strategy is: (1) to commercialize its own technology, which is embodies in its ColorBlind Color Management software, (2) to market imaging products, including printers, copiers, and consumables (toner, ink, etc.) from other manufacturers to its customers, and (3) to expand its PEO related business activities.

To successfully execute its current strategy, the Company will need to improve its working capital position. 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.

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 stockholders. If adequate funds are not available, the Company may be required to delay, reduce or eliminate some or all of its planned activities, including any potential mergers or acquisitions. The Company's inability to fund its capital requirements would have a material adverse effect on the Company. Also see "Liquidity and Capital Resources." and "Item 1. Business - Risks and Uncertainties - Future Capital Needs."

Office Products and Systems

The office products and systems industry is undergoing a fundamental transformation characterized by a transition from analog to digital systems, management of publishing and printing over the Internet, reliance on outsourcing, and the rapid transition to color output.

The worldwide document/imaging market is expected to grow to $209 billion by 2003. The global office market is forecast to increase to $43 billion in 2003. In-house color document production is expected to grow at a compound annual rate of 40% over the next few years.

ITEC's office products and systems group integrates a variety of products, including printers, plotters, copiers, and software, into a seamless, networked solution for clients who are generally small to medium sized businesses. Hardware, software and supplies are bundled together as a systems solution.

ITEC's e-commerce initiatives, dealseekers.com and color.com, provide for sales and support of software products and consumables such as inks, toner, and paper.

PERSONNEL MANAGEMENT SYSTEMS - SOURCEONE AND ENSTRUCTURE

As ITEC changes its focus from development and manufacturing to providing business services, management identified the opportunity to expand into personnel and human resources management. ITEC hopes to leverage its office products and systems expertise with that of offering professional employer organization (PEO) services.

The Company's PEO business provides a broad range of services associated with staff leasing and human resources management. These include benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, employer liability management, employee recruiting and selection, performance management, and training and development services.

The PEO business is growing rapidly, but profit margins are low. Consequently, profitability depends on (1) economies of scale leading to greater operating efficiencies; and (2) value-added services such as training, education, Internet support, and office products sales.

The PEO industry collectively serves approximately 4 million work site employees in the United States. The target market for the PEO industry is represented by companies with 100 or fewer employees; a market of approximately 60 million people.

The PEO industry began in 1985 with approximately 14,000 employees collectively under management. According to the National Association of Professional Employer Organizations ("NAPEO"), there are approximately 900 PEO firms operating in the U.S., in nearly every state.

NAPEO reports that current PEO industry revenues are approximately $18 billion. The average annual growth rate of the industry, since 1985, has been 15%. According to the U.S. Small Business Administration ("SBA"), the U.S. has over 6 million small businesses, defined as those companies with 100 or fewer employees, representing over 99% of all businesses. The U.S. Census Bureau reports that small businesses represent the fastest growing segment of U.S. employment and commerce, representing an estimated annual payroll of $1.4 trillion.

A typical PEO client company has 12 work site employees and an average annual pay per work site employee of $22,517.

The PEO industry is growing due to the increased burden associated with employment practice management and human resources regulation.

Growing pressure from federal agencies such as the Department of Labor, the Immigration and Naturalization Service, and the Equal Employment Opportunity Commission, and the burdens of employment-related compliance such as COBRA, OSHA, workers' compensation, unemployment compensation, wrongful termination, ADA ("Americans with Disabilities Act"), and FMLA ("Family and Medical Leave Act") demand increasing levels of resources from small businesses.

ACQUISITION AND SALE OF BUSINESS UNITS

On March 8, 2002, ITEC acquired all of the outstanding shares of EnStructure, Inc. ("EnStructure), a Nevada corporation, for $250,000, payable in 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 professional employer organization ("PEO") that intends to provides personnel management services, including benefits and payroll administration, health and workers' compensation insurance programs, personnel records management, and employer liability management.

The purchase price was determined through analysis of the value of future revenues and profits of EnStructure and the value of certain insurance relationships held in California by EnStructure.

EnStructure, Inc. is operated by ITEC as a wholly-owned subsidiary. EnStructure will be the operating unit into which the Company will place new California-based PEO clients. The acquisition agreement, iprovides for the purchase price to be tied to selling PEO services of $20 million in annual value during a certain period of time.

EnStructure was incorporated in May 2001 and has had limited operations to date. It was established to market PEO services, primarily in California. EnStructure's sole property is a qualified first-dollar-coverage workers' compensation insurance agreement with California's State Fund Insurance Company.

RESULTS OF OPERATIONS NET REVENUES

Revenues were $9.4 million and $1.2 million for the three-month period ended March 31, 2002 and 2001, respectively, as increase of 683%. For the nine-month period ended March 31, 2002 and 2001, respectively, revenues were $18.6 million and $3.04 million, an increase of 512%. The increase in total revenues for the three and nine month periods as compared with the prior year was due primarily to revenues associated with the Company's PEO operations.

IMAGING PRODUCTS

Sales of imaging products were $814 thousand and $1.2 million for the three month period ended March 31, 2002 and 2001, respectively, a decrease of $351 thousand or 43%. For the nine-month period ended March 31, 2002 and 2001, sales of imaging products were $2.6 million and $2.4 million, respectively; an increase $197 thousand, or 8%. Increase and decreases in product sales from the reported periods of 2002 as compared to 2001 were due to variances on the Company's ability to finance inventory purchases. The Company's lack of sufficient working capital has had, and may continue to have, a negative adverse effect on imaging products sales.

Revenue from software sales, licensing fees and royalties were $470 thousand and $30 thousand for the three-month period ended March 31, 2002 and 2001 respectively, an increase of $440 thousand, or 1,467%. For the nine-month period ended March 31, 2002 and 2001, respectively, software sales, licensing fees and royalties were $820 thousand and $662 thousand, respectively, an increase of $158 thousand, or 24%. The increase is primarily due to increased sales of ColorBlind software.

Royalties and licensing fees vary from quarter to quarter and are dependent on the sales of products sold by OEM customers using ITEC technologies. These revenues, however, continue to decline, and are expected to decline in the future due to the Company's focus on imaging product sales and the Company's PEO operations as opposed to technology licensing activities.

PEO SERVICES

PEO revenues for the three-month period ended March 31, 2002 were $8.1 million. PEO revenues for the nine-month period ended March 31, 2002 were $15.1 million. The Company entered this business segment through acquisitions in November 2001. Consequently, there were no reported PEO revenues in the prior year.

COST OF PRODUCTS SOLD

Cost of products sold were $614 thousand (75% of product sales) and $1.05 million (90% of product sales) for the three-month period ended March 31, 2002 and 2002, respectively. For the nine-month period ended March 31, 2002 and 2001, cost of products sold were $1.83 million (71% of product sales) and $1.97 million (83% of product sales), respectively. The increase in margins is primarily due to changes in product mix. In the prior year, ITEC continued to sell branded printer products, developed in-jous and manufactured by contractors. ITEC now integrates a wide variety of imaging products, which are acquired from other manufacturers and integrated for customers by ITEC's sales and support staff.

Cost of software, licenses and royalties were $277 thousand (59% of associated revenues) for the three-month period ended March 31, 2002. For the nine-month period ended March 31, 2002, cost of software, licenses and royalties were $331 thousand (40% of associated revenues). Comparative results for the year-earlier period is not presented because it is currently impracticable to do so due to various reorganizations of the Company's accounting systems. A comprehensive accounting system is being implemented that should enable the Company to report such information in the future.

Cost of PEO services were $7.7 million (96% of PEO revenues) for the three-month period ended March 31, 2002; and $14.5 million (96% of PEO revenues) for the nine-month period ended March 31, 2002. The Company began providing these services pursuant to acquisitions in the current fiscal year. Accordingly, there are no comparative results for the prior year periods.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses have consisted primarily of salaries and commissions of sales and marketing personnel, salaries and related costs for general corporate functions, including finance, accounting, facilities and legal, advertising and other marketing related expenses, and fees for professional services.

Selling, general and administrative expenses for the three-month period ended March 31, 2002 and 2001, respectively, were $1.86 million and $1.6 million. In the current three-month period, selling, general, and administrative expenses increased $304 thousand (16%) from the year-earlier quarter. The increase was due primarily to the costs associated with consulting expenses and the issuance of stock.

Selling, general and administrative expenses for the nine-month period ended March 31, 2002 and 2001, respectively, were $5.5 million and $5.6 million. In the current nine-month period, the Company reduced selling, general, and administrative expenses $182 thousand (3%) due primarily to staff reductions, which were offset, in part, by consulting expenses.

COSTS OF RESEARCH AND DEVELOPMENT

Costs of research and development were $68 thousand and $223 thousand for the period ended March 31, 2002 and 2001, respectively; a decrease of $155 thousand (70%). For the nine-month period ended March 31, 2002 and 2001, respectively, research and development costs were $140 thousand and $679 thousand, a decrease of $539 thousand (79%). Over the past year, the Company had been reducing its engineering and licensing activities and has re-directed research and development costs toward the development and support of the Company's ColorBlind software products.

OTHER INCOME AND EXPENSE

Interest and financing costs were $364 thousand for the period ended March 31, 2002 as compared to $65 thousand in the prior year period. For the nine-months ended March 31, 2002, interest and financing costs totaled $1.4 million; these costs were $787 in the prior year period. The increases are due primarily to the addition of beneficial conversions on the Company's convertible debt.

During the three-month period ended March 31, 2002, the Company settled $1.2 of its debt in exchange for approximately 36 million common shares and notes payable of $40 thousand. This resulted in a gain on extinguishments of debt of $411 thousand.

LIQUIDITY AND CAPITAL RESOURCES

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

As a result of some of the Company's financing activities, there has been a significant increase in the number of issued and outstanding shares. During the three-month period ended March 31, 2002, the Company issued an additional 87.8 million shares. During the nine-month period ended March 31, 2002, the Company issued 143.5 million shares. These shares of common stock were issued for raising capital due to private placements and for corporate expenses in lieu of cash, and for the exercise of warrants. (Also see Note 7 to the Consolidated Financial Statements.)

As of March 31, 2002, the Company had negative working capital of $18.7 million, an increase of approximately $1.8 million (11%) in working capital as compared to June 30, 2001, due primarily to the Company's net loss in each successive quarterly period since the year ended June 30, 2001.

Net cash used in operating activities decreased $1.1 million (28%) to $2.7 million during the nine-month period ended March 31, 2002, due primarily to a $1.3 million (22%) decrease in the Company's net loss from the prior year period.

Net cash used by investing activities was $91 thousand during the nine-month period ended March 31, 2002. The Company had cash from investing activities of $46 thousand in the prior year period. The difference was due primarily to cash used for acquisitions in the current fiscal year.
Net cash from financing activities was $2.9 million for the nine-month period ended March 31, 2002, a decrease of $853 thousand, or 23%. The decrease is due primarily to a reduction in proceeds from the sale of common stock, because the trading price of the Company's common stock fell substantially during the period.

The Company has no material commitments for capital expenditures. The Company's 5% convertible preferred stock (which ranks prior to the Company's common stock), carries cumulative dividends, when and as declared, at an annual rate of $50.00 per share. The aggregate amount of such dividends in arrears at March 31, 2002, was approximately $315 thousand.

The Company's capital requirements depend on numerous factors, including market acceptance of the Company's products, the scope and success of the Company's product development efforts, the resources the Company devotes to marketing and selling its products, and other factors. The report of the Company's independent auditors accompanying the Company's June 30, 2001 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.

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.

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 the results of our 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 inventory; the timing and mix of shipments of our products; the market acceptance of our new products; our ability to retain our existing PEO customers and to recruit new PEO customers; seasonality; currency fluctuations; 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. In addition, our inventory purchases and spending levels are based upon our forecast of future demand for our products. Accordingly, any inaccuracy in our forecasts could adversely affect our financial condition and results of operations. Demand for our products could be adversely affected by a slowdown in the overall demand for computer systems, printer products or digitally printed images. 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. Our PEO business is dependent upon the staffing levels of our clients. Reductions of our clients' staff could have a negative impact on our future financial 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 the products we sell 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 introductions by us and by our competitors; the variety of PEO related services offered by us and by our competitors; the selling prices of our products and of our competitors' products; 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. We cannot be certain that our products 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.

IF WE ARE UNABLE TO OFFER OUR CUSTOMERS 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 offer competitive products and achieve cost reductions for the products we sell. In addition, we monitor new technology developments and coordinate with suppliers, distributors and dealers to enhance our existing products and lower costs. Advances in technology will require increased investment in ColorBlind product development to maintain our market position. If we are unable to develop 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 AND SERVICES 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 imaging products, color management software, supplies and PEO services. 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 and services. If our products are not accepted by the market, we will not generate sufficient revenues to continue our operations.

IF OUR SUPPLIERS CEASE LICENSING THEIR PRODUCTS TO US, WE MAY HAVE TO REDUCE OUR WORK FORCE OR CEASE OPERATIONS.

At present, many of our products use technology licensed from outside suppliers. We rely heavily on these suppliers for upgrades and support. In the case of our font products, we license the fonts from outside suppliers, who also own the intellectual property rights to the fonts. Our reliance on third-party suppliers involves many risks, including our limited control over potential hardware and software incompatibilities among the products we sell. Furthermore, we cannot be certain that all of the suppliers of products we market will continue to license their products to us, or that these suppliers will not license their products to other companies simultaneously.

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 are currently facing all of these challenges and our ability to meet them over the long term has not been established. As a result, 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. See "Future Capital Needs."

IF OUR VENDORS ARE NOT ABLE TO CONTINUE TO SUPPLY GOODS AND SERVICES AT APPROPRIATE PRICES TO MEET THE PROJECTED MARKET DEMAND FOR OUR PRODUCTS, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR FINANCIAL PERFORMANCE.

The terms of our supply contracts for goods and services are negotiated separately in each instance. Any significant increase in prices or decrease in availability of products we purchase for resale could have a material adverse effect on our business and overall financial performance.

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 are copyrighted. However, copyright protection does not prevent other companies from emulating the features and benefits provided by our software. 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 FOREIGN ACCOUNTS RECEIVABLE ARE NOT COLLECTIBLE, A NEGATIVE IMPACT ON OUR CONTINUED OPERATIONS AND OVERALL FINANCIAL PERFORMANCE COULD RESULT.

We conduct business globally. Accordingly, our future results could be adversely affected by a variety of uncontrollable and changing factors including: foreign currency exchange fluctuations; regulatory, political or economic conditions in a specific country or region; the imposition of governmental controls; export license requirements; restrictions on the export of critical technology; trade restrictions; changes in tariffs; government spending patterns; natural disasters; difficulties in staffing and managing international operations; and difficulties in collecting accounts receivable.

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

We intend to pursue international markets as key avenues for growth and to increase the percentage of sales generated in international markets. In our 2001, 2000 and 1999 fiscal years, sales outside the United States represented approximately 22%, 2% and 56% of our net sales, respectively. We expect sales outside the United States to continue to represent a significant portion of our sales. As we continue to expand our international sales and operations, our business and overall financial performance may be adversely affected by the factors stated above.

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

Throughout fiscal 1999, 2000 and 2001, and through the date of this filing, approximately 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 fiscal quarter ended December 31, 2001, 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 product sales and contract 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 discontinued 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 OUR WORLDWIDE 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 centralized distribution and support operations headquartered in San Diego. As of April 19, 2002, we directly employed 14 individuals involved in marketing and sales activities.

A large percentage of our sales are made through distributors who may carry competing product lines. These distributors could reduce or discontinue sales of our products which could materially and 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. We believe that our future growth and success will continue to depend in large part upon our distribution channels. Our business could be materially and adversely affected if our distributors fail to pay amounts to us that exceed reserves we have established.

IF HEALTH INSURANCE PREMIUMS, UNEMPLOYMENT TAXES AND WORKERS' COMPENSATION RATES INCREASE, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR FINANCIAL PERFORMANCE.

Health insurance premiums, state unemployment taxes, and workers' compensation rates are, in part, determined by our claims experience, and comprise a significant portion of our PEO operations' 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 PEO operations' 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 us of the associated service fee; and (2) providing benefits to worksite employees even if the costs incurred by us 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 our financial condition or results of operations.

IF CERTAIN FEDERAL, STATE AND LOCAL LAWS RELATED TO LABOR, TAX AND EMPLOYMENT MATTERS ARE CHANGED, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR CONTINUED PEO OPERATIONS AND ON OUR OVERALL FINANCIAL PERFORMANCE.

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 us, such an application could have a material adverse effect on our financial condition or results of operations. While many states do not explicitly regulate PEOs, twenty-one states have passed laws 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. Our client service agreement establishes a contractual division of responsibilities between us 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 us 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 our agents, subjecting us to liability for the actions of such worksite employees.

IF WE ARE UNABLE TO RETAIN HEALTH AND WORKERS' COMPENSATION INSURANCE PLANS THAT COVER WORKSITE EMPLOYEES ON FAVORABLE TERMS, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR CONTINUED PEO OPERATIONS AND ON OUR OVERALL FINANCIAL PERFORMANCE.

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.

IF WE ARE UNABLE TO RETAIN OR REPLACE OUR EXISTING PEO CUSTOMERS, IT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR OVERALL FINANCIAL PERFORMANCE.

Our standard agreements with PEO clients are subject to cancellation on sixty days written notice by either us 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.

AS A COMPANY IN THE TECHNOLOGY INDUSTRY AND DUE TO THE VOLATILITY OF THE STOCK MARKETS GENERALLY, OUR STOCK PRICE COULD FLUCTUATE SIGNIFICANTLY IN THE FUTURE.

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 computer peripheral market and the imaging 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 stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. Similarly, the market price of our common stock may fluctuate significantly based upon factors unrelated to our operating performance.

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 (now Comerica 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. Through further equity infusion, primarily in the form of the exercise of warrants to purchase our common stock, operations have continued, and 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. The monthly payments have been reduced to $50,000 for the balance of calendar year 2002. of Operational Receiver

WE MAY SEEK ADDITIONAL FINANCING, WHICH WOULD RESULT IN THE ISSUANCE OF ADDITIONAL SHARES OF OUR CAPITAL STOCK AND/OR RIGHTS TO ACQUIRE ADDITIONAL SHARES OF OUR CAPITAL STOCK.

Additional issuances of capital stock would result in a reduction of current stockholders' percentage interest in ITEC. Furthermore, if the exercise price of any outstanding or issuable options or warrants or the conversion ratio of any preferred stock is lower than the price per share of common stock at the time of the exercise or conversion, then the price per share of common stock would decrease because the number of shares of common stock outstanding would increase without a corresponding increase in the dollar amount assigned to stockholders' equity.

The addition of a substantial number of shares of common stock into the market or by the registration of any other of our securities under the Securities Act may significantly and negatively affect the prevailing market price for our common stock. Furthermore, future sales of shares of common stock issuable upon the exercise of outstanding warrants and options may have a depressive effect on the market price of the common stock, as these warrants and options would be more likely to be exercised at a time when the price of the common stock is in excess of the applicable exercise price.

The sale or issuance of any shares of preferred stock having rights superior to those of the common stock may result in a decrease in the value or market price of the common stock. The issuance of preferred stock could have the effect of delaying, deferring or preventing a change of ownership without further vote or action by the stockholders and may adversely affect the voting and other rights of the holders of common stock.

Our board of directors currently is authorized to issue up to 100,000 shares of preferred stock. The board has the power to establish the dividend rates, preferential payments on our liquidation, voting rights, redemption and conversion terms and privileges for any series of preferred stock.

SINCE OUR COMMON STOCK IS NO LONGER LISTED ON THE NASDAQ SMALLCAP MARKET, IT HAS BEEN MORE DIFFICULT TO RAISE FINANCING.

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. Since we do not qualify to be listed on 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. A motion to dismiss the lawsuit was granted on February 16, 2001 on our behalf and those individual defendants that have been served. However, on or about March 19, 2001, an amended complaint was filed by Nahid Nazarian Behfarin, Peter Cook, Stephen Domagala and Michael S. Taylor, on behalf of themselves and others similarly situated. On or about March 20, 2001, we once again filed a motion to dismiss the case along with certain other individual defendants. The motion was denied and an answer to the complaint has been filed on behalf of the company and certain individual defendants. We believe these claims are without merit and we intend to vigorously defend against them on our behalf as well as on behalf of the other defendants. The defense of this action has been tendered to our insurance carriers.

Throughout fiscal 1999, 2000 and 2001, and through the date of this filing, approximately 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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None

ITEM 5. OTHER INFORMATION

The PEO industry has been experiencing a changing business environment. Regulatory agencies throughout the United States are involved in establishing new regulations related to the PEO industry. Additionally, insurance carriers are re-evaluating plans provided to employers in general and PEO companies in particular.

In April 2002, our SourceOne Group PEO subsidiary ("SOG") was ordered by the Bureau of Insurance of the State of Virginia to declare itself a Multi-Employer Welfare Arrangement ("MEWA") pursuance to Virginia law that became effective on October 1, 2001 (approximately six weeks prior to ITEC's acquisition of SOG). The Virginia Bureau of Insurance promulgated the resultant regulations during the quarter. The MEWA designation requires SOG to obtain proper licensing in order to continue as a multiple employer provider of health benefits to its worksite employees and co-employer clients, and to avoid possible fines, which, if imposed, are not expected to have a material effect upon SOG should they be imposed. Accordingly, we have submitted a licensing application to the Virginia Bureau of Insurance. Furthermore, it is our intention to replace all health benefit coverage for SOG worksite employees with brokered benefit plans directly, which will be sold to each employer client with each client being the named insured. However, there can be no assurance that all of our co-employer clients will accept this change and that they will continue to be our clients. Additionally, SOG's workers' compensation carrier declined to renew coverage as of May 1, 2002. SOG has made application to other insurance carrier programs and we expect to replace the expired policy before the end of May 2002. Prospective carriers have indicated that such a new policy would become effective May 1, 2002, which would circumvent any lapse in coverage. SOG's co-employer clients have been notified of the non-renewal of our current policy. Nevertheless, there can be no assurance that SOG will be able to retain all of its co-employer clients as a result of a change in the workers' compensation plan we provide or the higher manual premium rates anticipated under such a plan.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None.

(b) Reports on Form 8-K:

On March 28, 2002, the Company filed Form 8-K related to the acquisition of EnStructure, Inc.

On May 2, 2002, the Company filed Form 8-K related to the change of its auditors.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: May 20, 2002

IMAGING TECHNOLOGIES CORPORATION (Registrant)

By: /s/ BRIAN BONAR

Brian Bonar
Chief Executive Officer
and Principal Financial and Accounting Officer