

INTERNATIONAL MICROCOMPUTER SOFTWARE INC /CA/
Form 10QSB
May 13, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
FORM 10-QSB

Quarterly Report Pursuant to Section 13 or 15(d) of the securities
Exchange Act of 1934

For the quarterly period ended MARCH 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 94-2862863
(State or other jurisdiction (I.R.S. Employer Identification No.)
of incorporation or organization)

100 ROWLAND WAY, SUITE 300, NOVATO, CALIFORNIA 94945
(Address of principal executive offices) (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

As of APRIL 29, 2004, 23,727,953 Shares of Issuer's common stock, no par value, were outstanding.

Transitional Small Business Disclosure Format: YES ___ NO X

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INTERNATIONAL MICROCOMPUTER SOFTWARE, INC.
AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1- CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

| | (UNAUDITED) | |
|---|----------------|---------------|
| | MARCH 31, 2004 | JUNE 30, 2003 |
| | ----- | ----- |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,905 | \$ 10,399 |
| Investment in marketable securities | 1,752 | -- |
| Receivables, less allowances for doubtful accounts, discounts and returns of \$734 and \$445 | 1,187 | 734 |
| Inventories | 451 | 268 |
| Other current assets | 624 | 240 |
| | ----- | ----- |
| TOTAL CURRENT ASSETS | 8,919 | 11,641 |
| FIXED ASSETS, NET | 412 | 85 |
| Intangible assets | | |
| Capitalized software, net | 934 | 87 |

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| | | |
|---|-----------|-----------|
| Domain names, net | 1,643 | 4 |
| Distribution rights, net | -- | 36 |
| Capitalized customer lists | 262 | -- |
| Goodwill | 611 | 179 |
| | ----- | ----- |
| TOTAL INTANGIBLE ASSETS | 3,450 | 306 |
| Other assets | | |
| Note receivable from related party | 350 | -- |
| Investment in securities | 1,436 | 998 |
| Assets related to discontinued operations | 1,300 | 1,300 |
| | ----- | ----- |
| TOTAL OTHER ASSETS | 3,086 | 2,298 |
| | ===== | ===== |
| TOTAL ASSETS | \$ 15,867 | \$ 14,330 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term debt | \$ 986 | \$ 304 |
| Trade accounts payable | 1,051 | 564 |
| Income tax payable | 1 | 271 |
| Accrued and other liabilities | 633 | 1,541 |
| Deferred revenue | 268 | 305 |
| | ----- | ----- |
| TOTAL CURRENT LIABILITIES | 2,939 | 2,985 |
| Liabilities related to discontinued operations | 84 | 84 |
| Long-term debt and other obligations | 471 | -- |
| | ----- | ----- |
| TOTAL LIABILITIES | 3,494 | 3,069 |
| Shareholders' equity: | | |
| Common stock, no par value; 300,000,000 authorized; Issued and outstanding 23,653,835 and 22,818,232 shares | 36,148 | 35,546 |
| Accumulated deficit | (23,673) | (24,223) |
| Accumulated other comprehensive loss | (102) | (62) |
| | ----- | ----- |
| TOTAL SHAREHOLDERS' EQUITY | 12,373 | 11,261 |
| | ----- | ----- |
| | ===== | ===== |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 15,867 | \$ 14,330 |
| | ===== | ===== |

See Notes to Condensed Consolidated Financial Statements

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share amounts)

(Unaudited)

Net revenues
Product costs

GROSS MARGIN

Costs and expenses:
Sales and marketing
General and administrative
Research and development

TOTAL OPERATING EXPENSES

OPERATING LOSS

Other income and (expense):
Interest and other, net
Realized gain on marketable securities
Unrealized gain on marketable securities
Gain on liquidation of foreign subsidiaries
Gain on extinguishment of debt

INCOME (LOSS) BEFORE INCOME TAX

Income tax benefit (provision)

INCOME (LOSS) FROM CONTINUING OPERATIONS

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

NET INCOME (LOSS)

Other comprehensive loss, net of tax:
Foreign currency translation, net of tax

OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX

BASIC EARNINGS (LOSS) PER SHARE

Income (loss) per share from continuing operations
Gain per share from the sale of discontinued operations
Income per share from discontinued operations, net of income tax
Earnings (loss) per share

DILUTED EARNINGS (LOSS) PER SHARE

Income (loss) per share from continuing operations
Gain per share from the sale of discontinued operations
Income per share from discontinued operations, net of income tax
Earnings (loss) per share

Shares used in computing basic earnings (loss) per share information
Shares used in computing diluted earnings (loss) per share information

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| | NINE MONTH 2004 |
|--|--------------------|
| Net revenues | \$7, |
| Product costs | 2, |
| GROSS MARGIN | 4, |
| Costs and expenses: | |
| Sales and marketing | 3, |
| General and administrative | 2, |
| Research and development | 1, |
| TOTAL OPERATING EXPENSES | 7, |
| OPERATING LOSS | (2,6) |
| Other income and (expense): | |
| Interest and other, net | |
| Realized gain on marketable securities | |
| Unrealized gain on marketable securities | 1, |
| Gain on liquidation of foreign subsidiaries | |
| Gain on extinguishment of debt | |
| INCOME (LOSS) BEFORE INCOME TAX | (4) |
| Income tax benefit (provision) | (|
| INCOME (LOSS) FROM CONTINUING OPERATIONS | (4) |
| Gain from the sale of discontinued operations | 1, |
| Income from discontinued operations, net of income tax | |
| NET INCOME (LOSS) | \$ |
| Other comprehensive loss, net of tax: | |
| Foreign currency translation, net of tax | (|
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX | \$ |
| BASIC EARNINGS (LOSS) PER SHARE | |
| Income (loss) per share from continuing operations | (\$0. |
| Gain per share from the sale of discontinued operations | \$0 |
| Income per share from discontinued operations, net of income tax | |
| Earnings (loss) per share | \$0 |
| DILUTED EARNINGS (LOSS) PER SHARE | |
| Income (loss) per share from continuing operations | (\$0. |
| Gain per share from the sale of discontinued operations | \$0 |
| Income per share from discontinued operations, net of income tax | |
| Earnings (loss) per share | \$0 |
| Shares used in computing basic earnings (loss) per share information | 23, |
| Shares used in computing diluted earnings (loss) per share information | 23, |

See Notes to Condensed Consolidated Financial Statements

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INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Nine Months ended March 31, 2004

(In thousands)

(Unaudited)

| | COMMON STOCK | |
|---|--------------|----------|
| | SHARES | AMOUNT |
| BALANCE AT JUNE 30, 2003 | 22,818 | \$35,546 |
| Issuance of common stock related to: | | |
| Warrants exercised | 505 | 96 |
| Stock options exercised | 276 | 111 |
| Acquisitions | 100 | 92 |
| Issuance of warrants related to: | | |
| Consulting services rendered | | 255 |
| Acquisitions | | 76 |
| Issuance of stock options related to: | | |
| Consulting services rendered | | 10 |
| Retirement of common stock | (45) | (59) |
| Variable accounting adjustment related to stock options previously issued | | 21 |
| Net income | | |
| Comprehensive loss | | |
| BALANCE AT MARCH 31, 2004 | 23,654 | \$36,148 |

| | ACCUMULATED OTHER COMPREHENSIVE LOSS | TOTAL |
|--------------------------------------|--------------------------------------|-------|
| BALANCE AT JUNE 30, 2003 | (\$62) | \$1 |
| Issuance of common stock related to: | | |
| Warrants exercised | | |

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| | | |
|--|---------|-----|
| Stock options exercised | | |
| Acquisitions | | |
| Issuance of warrants related to: | | |
| Consulting services rendered | | |
| Acquisitions | | |
| Issuance of stock options related to: | | |
| Consulting services rendered | | |
| Retirement of common stock | | |
| Variable accounting adjustment related to stock options previously issued | | |
| Net income | | |
| Comprehensive loss | (40) | |
| BALANCE AT MARCH 31, 2004 | (\$102) | \$1 |

See Notes to Condensed Consolidated Financial Statements

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INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | NINE MONTHS ENDED MARCH | |
|--|-------------------------|------------|
| | 2004 | 2003 |
| Cash flows from operating activities: | | |
| NET CASH USED BY OPERATING ACTIVITIES | (\$ 2,450) | (\$ 2,450) |
| Cash flows from investing activities: | | |
| Acquisition of product lines | (1,815) | |
| Acquisition of business | (260) | |
| Loan to related party | (350) | |
| Investment in marketable securities | (367) | |
| Proceeds from sale of marketable securities | 116 | |
| Purchase of equipment and furniture | (347) | |
| Purchase of software and domain names | (66) | |
| Cash used by discontinued operations in investing activities | -- | |
| NET CASH USED BY INVESTING ACTIVITIES | (3,089) | |
| Cash flows from financing activities: | | |

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| | | |
|--|----------|-------|
| Settlement of note payable (Imageline) | (160) | |
| Note borrowings | 350 | |
| Note repayments | (312) | |
| Warrants exercised | 96 | |
| Options exercised | 111 | |
| Proceeds from issuance of common stock | -- | |
| Repayment of capital lease obligations | -- | |
| Cash used by discontinued operations in financing activities | -- | |
| | ----- | ----- |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | 85 | |
| | ----- | ----- |
| Effect of exchange rate change on cash and cash equivalents | (40) | |
| Net decrease in cash and cash equivalents | (5,494) | |
| Cash and cash equivalents at beginning of period | 10,399 | |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD | \$ 4,905 | \$ |
| | ===== | ===== |

See Notes to Condensed Consolidated Financial Statements

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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 March 31, 2004 and the results of operations and cash flows for the three and nine months ended March 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 for the fiscal year ended June 30, 2003. The results of operations for the three and nine months ended March 31, 2004 are not necessarily indicative of the results to be expected for any other interim period or for the full year.

2. DISCONTINUED OPERATIONS

As previously disclosed in our annual report on Form 10-KSB for the fiscal year ended June 30, 2003, we sold ArtToday, Inc ("ArtToday"), our wholly-owned subsidiary based in Arizona, to Jupitermedia Corporation ("Jupiter") in June 2003. Under Generally Accepted Accounting Principles ("GAAP") in the United States, ArtToday's operating results for the three and nine months ended March 31, 2003, have been accounted for as discontinued operations.

Reclassifications have been made to the amounts reported in fiscal 2003 to conform to the current year presentation. The amounts reported for fiscal 2003 present the results of operations for ArtToday as discontinued operations due to the sale of ArtToday on June 30, 2003.

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

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of the first earn-out from the sale of ArtToday. This earn-out was contingent on ArtToday reaching certain revenue milestones. The full amount of the \$1.0 million earn-out was earned during the quarter ended December 31, 2003 and was paid per the stock purchase agreement on February 13, 2004.

As part of the sale of ArtToday, Inc., a portion of the consideration received was placed in an escrow account to offset potential indemnity claims against ArtToday, Inc. which were unknown at the close of the transaction. The escrowed amounts consisted of \$1,300,000 in cash and 250,000 shares of Jupitermedia Corporation common stock. The cash was recorded as "Assets related to discontinued operations" and was subject to claims of \$84,000 of certain minority shareholders of ArtToday which was recorded as "Liabilities related to discontinued operations". Net of any indemnity claims the cash escrow is scheduled to be released as follows; 50% at June 30, 2004 and 50% at December 31, 2004. The stock escrow, which is classified as "Investment in Securities", is scheduled to be released net of any claims on December 31, 2005. At the Company's option, we are allowed to sell the shares in escrow at any time during the escrow period but are required to maintain a \$1.0 million balance of cash or securities in the account. As part of an amended escrow agreement with Jupitermedia, 125,000 of the shares were released from the escrow account in February 2003. Those shares have been classified as "Investment in Marketable Securities". At March 31, 2004, we had sold 10,000 of the Jupitermedia shares.

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3. RECLASSIFICATIONS

Effective for the quarter ended December 31, 2003, we revised our accounting treatment with regard to fees paid to our third party E-commerce solution provider, whereby we now record them as sales and marketing expenses as compared to our prior treatment of them as an offset to revenue. The effect of this reclassification, as of March 31, 2004, was to increase revenues and sales and marketing expense by \$92,000 and \$249,000 for the three and nine months ended March 31, 2004. In order to conform our prior year's results to this revised presentation for the three and nine months ended March 31, 2003, we have increased revenues and sales and marketing expense by \$93,000 and \$248,000, respectively.

4. PRODUCT LINE AND OTHER ACQUISITIONS

The table below documents the components of consideration paid for each significant acquisition completed in the nine months ended March 31, 2004 and the allocation of that consideration to the tangible and intangible assets acquired.

| DATE TRANSACTION CLOSED: | HOUSEEPLANS.COM FEBRUARY 23, 2004 | PLANWORKS NOVEMBER 17, 2003 | CADSYMBOL NOVEMBER 6, 2003 | CADS OCTO 2 |
|--------------------------------------|---|-----------------------------------|----------------------------------|-------------------|
| CONSIDERATION | | | | |
| Cash | \$ 270 | \$ 260 | \$ 171 | \$ |
| Less: Cash on hand | -- | (16) | -- | |
| Cash paid to fund Escrow Account (s) | 30 | -- | 170 | |

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| | | | | |
|---------------------|--------|--------|--------|----|
| Stock | -- | 77 | -- | |
| Warrants | 17 | -- | 30 | |
| Notes payable | 313 | 14 | -- | |
| Liabilities assumed | -- | 23 | -- | |
| Transaction fees | 20 | 20 | 1 | |
| ----- | | | | |
| TOTAL CONSIDERATION | \$ 650 | \$ 378 | \$ 372 | \$ |
| ----- | | | | |

ASSET ALLOCATION

| | | | | |
|--------------------------------------|--------|--------|--------|----|
| Tangible Assets | | | | |
| Inventory | -- | -- | -- | |
| Marketing materials | -- | -- | -- | |
| Prepaid expenses | -- | 1 | -- | |
| Computer hardware | -- | -- | 12 | |
| Computer software | -- | -- | -- | |
| TOTAL TANGIBLE ASSETS | \$- | \$ 1 | \$ 12 | |
| Intangible Assets | | | | |
| Capitalized software / content | 200 | -- | 180 | |
| Websites and associated domain names | 300 | 315 | 180 | |
| Customer lists | 150 | 33 | -- | |
| Goodwill | -- | 29 | -- | |
| TOTAL INTANGIBLE ASSETS | \$ 650 | \$ 377 | \$ 360 | \$ |
| ----- | | | | |
| TOTAL ASSETS ACQUIRED | \$ 650 | \$ 378 | \$ 372 | \$ |
| ----- | | | | |

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HOUSEPLANS.COM

On February 23, 2004 we entered, through our wholly owned subsidiary, Homeplan, Inc., into an asset purchase and license agreement with ULTRYX, Inc ("ULTRYX") whereby we acquired certain assets of ULTRYX. The assets included the homeplans.com domain name, related web site assets including house plans images and related on-line and print content in addition to customers' profiles. The total consideration for the acquisition was \$650,000 (including fees of \$20,000). Included in the agreement was a warrant to purchase twenty thousand (20,000) shares of IMSI's common stock at any time within the three-year period following the execution of the agreement at \$1.24 per share.

PLANWORKS

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On November 17, 2003, we acquired Planworks L.L.C. ("Planworks"), a leading online provider of house plans. Planworks operates the houseplanguys.com website that contains an extensive library of over 11,000 unique house plans and has more than 25,000 members. We also acquired ten other domain names which are used to assist individuals and designers looking for house plans and related products, further strengthening the IMSI network of online design and content commerce sites. The total consideration for the acquisition was \$378,000.

CADSYMBOL ACQUISITION

On November 6, 2003, we entered into an asset purchase agreement with Assisto GmbH ("Assisto"), a German company, whereby we acquired title and interest in certain tangible and intangible assets of Assisto. The assets included certain CAD symbol content, custom developed software and all related assets including inventory, web sites and domain names. The total purchase price was approximately \$372,000 including warrants which were granted to Ane Gylholm and Michael Heckmann, principals of Assisto, to each purchase twenty thousand (20,000) shares of IMSI's common stock at any time within the three year period following the closing at an exercise price of \$1.21, which was the price of IMSI's common stock on the closing date.

CADSYMBOLS ACQUISITION

On October 27, 2003, we entered into an asset license and purchase agreement with Cardiff Consultants, Limited, a New York corporation ("Cardiff"), whereby we acquired from Cardiff the exclusive, non-transferable right to use the cadsymbols.com and cadsymbols.net domain names and trademarks until December 31, 2006, when Cardiff is to assign the domain names and trademark to us subject to our payment of all amounts due Cardiff. The total consideration for the acquisition was \$830,000. As part of the agreement, we granted to Cardiff a warrant to purchase twenty-five thousand (25,000) shares of IMSI's common stock at any time within the three-year period following the execution of the agreement at \$1.14 per share.

Upon the execution of the agreement, Cardiff deposited in an escrow account the assignment agreement of each domain name, and the assignment agreement of the trademark. The escrow agreement calls for release of the assignment documents to us on September 30, 2006 subject to the cumulative payment to Cardiff of all amounts due.

CADALOG

On September 12, 2003, we acquired from CADalog, Inc, CADalog.com, a network of websites that offers one of the largest mechanical parts symbols libraries on-line and allows members access to over 8 million 2D and 3D hardware component symbols. The acquisition also included the purchase of CADalog, Inc.'s Partsx1.com, Partswork.com and 3DModelsharing.com websites. This acquisition gives us the opportunity to sell additional CAD content and software plug-ins. The total consideration for the acquisition was \$295,000.

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DESIGNCAD

On July 28, 2003, we entered into an agreement to purchase the tangible and intangible assets of Upperspace Corporation ("Upperspace"), an Oklahoma corporation, constituting its DesignCAD line of products, several learning aids, and various smaller design programs.

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In addition to the purchase price of \$1,000,000, the agreement calls for an earn-out based on net revenue that could result in an additional \$300,000 to be paid to Upperspace during the next three fiscal years and a license pursuant to which Upperspace shall act for a period as the exclusive distributor of the purchased products to retail outlets, and a non-exclusive reseller of the product through direct sales channels such as the internet, email, telephone and fax.

CADKEY ACQUISITION TERMINATION

As previously disclosed, on August 22, 2003, we entered into an agreement with CADKEY Corporation ("CADKEY") a Massachusetts corporation to purchase substantially all of its assets. The proposed purchase price was \$2,500,000 and the assumption of CADKEY customer obligations. The acquisition was conditioned upon court approval pursuant to Section 363 of the U.S. Bankruptcy Code after CADKEY filed a voluntary petition under Chapter 11 of the Bankruptcy Code on August 22, 2003 in the U.S. Bankruptcy Court in Worcester, Massachusetts.

On October 27, 2003, we terminated our bid to acquire substantially all of the assets of CADKEY through an auction sale. As a result of the termination, we received a break up fee of \$45,000 which was recorded as a reduction of legal expense and were reimbursed for \$225,000 of professional fees advanced to CADKEY in addition to the \$250,000 that was initially held in escrow. These amounts were initially recorded as short-term assets in the "Other current assets" account.

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") whereby we extended a loan to DCDC in the amount of \$350,000. The note is due, with interest, on September 18, 2004. The note is secured by 400,000 shares of IMSI's stock held by DCDC. The agreement also called for DCDC not to sell any IMSI common stock which it held, with the exception of private sales of IMSI common stock prior to February 15, 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. This 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 quarter ended September 30, 2003.

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6. DEBT

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

| | DEBT AS OF MARCH 31, 2004 |
|--|------------------------------|
| ----- | |
| SHORT-TERM | |
| Short-term financing (secured by selected accounts receivable) | \$322 |
| CADsymbol Escrow | 141 |
| Acquisition related notes | |
| DesignCAD Acquisition | 300 |

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| | |
|--|---------|
| CADsymbols.com Acquisition | 142 |
| Planworks Acquisition | 14 |
| Houseplans.com Acquisition | 62 |
| Other | 6 |
| ----- | |
| SUBTOTAL SHORT-TERM | 986 |
| ----- | |
| LONG-TERM | |
| Liabilities related to discontinued operations | 84 |
| Acquisition related notes | |
| Houseplans.com Acquisition | 281 |
| CADsymbols.com Acquisition | 187 |
| Other | 3 |
| ----- | |
| SUBTOTAL LONG TERM | 555 |
| ----- | |
| GRAND TOTAL | \$1,541 |
| ----- | |

7. REALIZED GAIN ON MARKETABLE SECURITIES

During the quarter ended March 31, 2004, we realized a \$76,000 gain on marketable securities as we sold 10,000 shares of Jupitermedia common stock that we received as part of the consideration related to the sale of ArtToday on June 30, 2003.

8. UNREALIZED GAIN ON MARKETABLE SECURITIES

We recorded a \$1.7 million and a \$1.9 million gain on marketable securities during the three and nine months ended March 31, 2004, respectively reflecting the increase in market value of our equity portfolio. The following table summarizes the net gain on marketable securities:

| DESCRIPTION | THREE MONTHS ENDED MARCH 31, 2004 | NINE MONTHS ENDED MARCH 31, 2004 |
|--|-----------------------------------|----------------------------------|
| Gain on Jupitermedia common stock | \$ 1,660,000 | \$ 1,660,000 |
| Gain on professionally managed portfolio | 27,681 | 27,681 |
| ----- | | |
| TOTAL | \$ 1,687,681 | \$ 1,687,681 |
| ----- | | |

9. SEGMENT INFORMATION

We have three reportable operating segments based on the sales market. Two of these are geographic segments and generate revenues and incur expenses related to the sale of our PC productivity software. The third segment comprises the revenues and expenses related to Keynomics, our business applications subsidiary

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which provides ergonomic and keyboard training for worker-enhanced safety, productivity and ergonomic compliance improvements through its proprietary software system, "The KeySoft Performance System".

The following table details segment information (in thousands). The foreign segment refers to the operations of our German and Australian wholly owned subsidiaries, IMSI GmbH and IMSI Australia PTY Ltd.

| | KEYNOMICS | NORTH AMERICA | OTHER FOREIGN |
|----------------------------------|-----------|---------------|---------------|
| ----- | | | |
| QUARTER ENDED MARCH 31, 2004 | | | |
| Net Revenues | \$71 | \$2,582 | \$131 |
| Operating loss | (225) | (925) | (90) |
| Identifiable assets | 136 | 15,591 | 360 |
| ----- | | | |
| QUARTER ENDED MARCH 31, 2003 | | | |
| Net Revenues | 442 | 1903 | 280 |
| Operating loss | 65 | (547) | (24) |
| Identifiable assets | 232 | 2,374 | 350 |
| ----- | | | |
| NINE MONTHS ENDED MARCH 31, 2004 | | | |
| Net Revenues | 549 | 6,267 | 423 |
| Operating loss | (426) | (2,142) | (73) |
| Identifiable assets | 136 | 15,591 | 360 |
| ----- | | | |
| NINE MONTHS ENDED MARCH 31, 2003 | | | |
| Net Revenues | 1,066 | 5,545 | 557 |
| Operating loss | 57 | (1,359) | (52) |
| Identifiable assets | \$232 | \$2,374 | \$350 |
| ----- | | | |

10. EARNINGS (LOSS) PER SHARE

Basic earnings per share are 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.

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

THREE MONTHS ENDED

MARCH 31, 2004 MARCH 31, 2003 MARC

| NUMERATOR: | | |
|--|------------|------------|
| Net income (loss) | \$548 | (\$103) |
| Numerator for basic earnings (loss) per share - income (loss) available to common stockholders | 548 | (103) |
| Numerator for diluted earnings (loss) per share - income (loss) available to common stockholders after assumed conversions | 548 | (103) |
| DENOMINATOR: | | |
| Denominator for basic earnings (loss) per share - weighted average shares outstanding | 23,475,424 | 22,806,882 |
| Effect of dilutive securities using the treasury stock method as at March 31, 2004: | | |
| 7,163,244 Warrants Outstanding | -- | -- |
| 2,101,198 Stock Options Outstanding | -- | -- |
| Effect of dilutive securities using the treasury stock method as at March 31, 2003: | | |
| 5,254,077 Warrants Outstanding | 2,867,241 | -- |
| 2,223,321 Stock Options Outstanding | 981,647 | -- |
| Dilutive potential common shares | -- | -- |
| Denominator for diluted earnings (loss) per share - adjusted weighted average shares and assumed conversion | 27,324,312 | 22,806,882 |
| BASIC EARNINGS (LOSS) PER SHARE | \$0.02 | \$0.00 |
| DILUTED EARNINGS (LOSS) PER SHARE | \$0.02 | \$0.00 |

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 warrants and options when grants are made at an exercise price equal to the fair market value of the Company's stock. We have adopted the disclosure only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation".

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.

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During the three and nine months ended March 31, 2004 we recognized charges of \$10,000 and \$21,000 respectively related to variable awards. This compares to charges of \$0 and (\$5,000), respectively for the three and nine months ended March 31, 2003.

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:

| (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | THREE MONTHS ENDED MARCH 31, | |
|---|------------------------------|----------|
| | 2004 | 2003 |
| NET INCOME (LOSS), AS REPORTED | \$548 | (\$103) |
| Intrinsic compensation charge recorded under APB 25 | 11 | 72 |
| Pro Forma compensation charge under SAS 123 | (404) | (467) |
| PRO FORMA NET INCOME (LOSS) | \$155 | (\$498) |
| Pro Forma net income (loss) per share: | | |
| Basic--as reported | \$0.02 | \$0.00 |
| Basic--pro forma | \$0.01 | (\$0.02) |
| Diluted--as reported | \$0.02 | \$0.00 |
| Diluted--pro forma | \$0.01 | (\$0.02) |

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The fair value of each option granted was estimated on the date of the grant using the Black-Scholes option-pricing model using the following weighted average assumptions:

| | THREE MONTHS ENDED MARCH 31, | |
|---------------------------------|------------------------------|--------|
| | 2004 | 2003 |
| Risk-free interest rates | 2.21% - 2.80% | 1.17% |
| Expected dividend yields | -- | -- |
| Expected volatility | 98.47% | 101.1% |
| Expected option life (in years) | 5 | 5 |

The weighted average fair value per option as of the grant date for grants made during the three and nine months ended March 31, 2004 were \$1.08 and \$1.08, respectively. This compares to \$0.43 and \$0.63, respectively for the three and nine months ended December 31, 2002.

12. NEW ACCOUNTING STANDARDS

ACCOUNTING FOR REVENUE ARRANGEMENTS WITH MULTIPLE DELIVERABLES In November 2002, the EITF reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Issue 00-21 provides guidance on how to account for

arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of Issue 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of Issue 00-21 did not have a material effect on our consolidated financial position, results of operations or cash flows.

AMENDMENT OF STATEMENT 133 ON DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES On April 30, 2003, the FASB issued Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Statement 149 is intended to result in more consistent reporting of contracts as either freestanding derivative instruments subject to Statement 133 in its entirety, or as hybrid instruments with debt host contracts and embedded derivative features. In addition, Statement 149 clarifies the definition of a derivative by providing guidance on the meaning of initial net investments related to derivatives. Statement 149 is effective for contracts entered into or modified after June 30, 2003. At March 31, 2004, we do not hold any derivative instruments. The adoption of Statement 149 did not have an effect on our consolidated financial position, results of operations or cash flows.

FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF BOTH LIABILITIES AND EQUITY On May 15, 2003, the FASB issued Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. Statement 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. Statement 150 represents a significant change in practice in the accounting for a number of financial instruments, including mandatory redeemable equity instruments and certain equity derivatives that frequently are used in connection with share repurchase programs. Statement 150 is effective for all financial instruments created or modified after May 31, 2003, and to other instruments as of July 1, 2003. We adopted Statement 150 on July 1, 2003 and the effect of adopting this statement did not have an impact on our financial position, results of operations or cash flows.

13. SUBSEQUENT EVENT: ACQUISITION OF ALADDIN SYSTEMS, INC.

On April 19, 2004 (the "Closing Date"), we consummated the acquisition of all the stock of Aladdin Systems, Inc. ("Aladdin"), pursuant to a Stock Purchase Agreement (the "Stock Purchase Agreement"), dated January 20, 2004, between Aladdin Systems Holdings, Inc, the parent company of Aladdin, and IMSI.

Aladdin is a developer and publisher of utility software solutions in the areas of information access, removal, recovery, security and distribution of information and data for the Windows(R), Linux and Macintosh(R) platforms.

The consideration paid in the Acquisition (which was determined as a result of arms'-length negotiations and which was based upon an in depth analysis of Aladdin's current and projected business activity in addition to comparable companies and transactions) consists of a combination of cash in the amount of \$1,500,000, subject to a 10% escrow, 2,317,881 unregistered shares of IMSI common stock (which are required to be registered within 90 days of the Closing Date) and two three-year convertible notes in the aggregate amount of \$3,000,000. Additional cash earn-out payments may be 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. Additionally,

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eligible employees of Aladdin will be given the opportunity to convert their existing Aladdin Systems Holdings Inc. stock options into IMSI stock options priced at market as of the date of the closing. The newly granted options will be subject to vesting as set forth in our 2004 Incentive Stock Option Plan. The conversion ratio was calculated using the Black-Scholes valuation methodology.

We relied on our available cash balances to honor the payment related to the cash component of this transaction.

We are in the process of obtaining a third party valuation of certain intangible assets and as a result the allocation of the purchase price relating to the Aladdin Acquisition is not available at the time of this filing. On April 21, 2004, we filed a current report on Form 8-K disclosing the details of this acquisition. The audited annual financial statements of Aladdin Systems, Inc., the unaudited interim financial statements and the pro forma financial statements required in accordance with item 310 (c) and 310 (d) of regulation S-B and the purchase price allocation will be filed by an amendment to the above referenced current report on Form 8-K as soon as practicable but not later than July 5, 2004.

ITEM 2- MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND PLAN OF OPERATIONS

OVERVIEW

IMSI is a developer and publisher of consumer software in the precision design and business applications and other categories. We offer a wide variety of application software that we market through an array of distribution channels including retail, direct to consumer and online. We are committed to being a leading provider of these applications and services to the Architectural, Engineering and Construction (AEC) and Mechanical market.

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.

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 or Plan of Operations in our Fiscal 2003 Form 10-KSB. This quarterly report on Form 10-QSB, and in particular this "Management's Discussion and Analysis or Plan 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 2003 Form 10-KSB, as filed with the Securities and Exchange Commission ("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.

RESULTS OF OPERATIONS

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

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thousands of dollars and in percentages.

On June 30, 2003, we sold ArtToday, our wholly owned subsidiary based in Arizona to Jupitermedia Corporation. Under Generally Accepted Accounting Principles in the United States, ArtToday's operating results for all periods presented have been accounted for as discontinued operations.

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| | THREE MONTHS ENDED MARCH 31, | | | |
|--|------------------------------|---------------------|---------|---------------------|
| | 2004 | | 2003 | |
| | \$ | AS % OF SALES | \$ | AS % OF SALES |
| Net revenues | \$2,784 | 100% | \$2,625 | 100% |
| Product costs | 1,045 | 38% | 1,096 | 42% |
| ----- | | | | |
| GROSS MARGIN | 1,739 | 62% | 1,529 | 58% |
| Operating expenses | | | | |
| Sales & marketing | 1,467 | 53% | 874 | 33% |
| General & administrative | 864 | 31% | 803 | 31% |
| Research & development | 648 | 23% | 358 | 14% |
| ----- | | | | |
| TOTAL OPERATING EXPENSES | 2,979 | 107% | 2,035 | 78% |
| ----- | | | | |
| OPERATING LOSS | (1,240) | -45% | (506) | -19% |
| ----- | | | | |
| Other Income (expenses) | | | | |
| Interest and other, net | 58 | 2% | (199) | -8% |
| Realized gain on marketable securities | 76 | 3% | - | 0% |
| Unrealized gain on marketable securities | 1,688 | 61% | - | 0% |
| Gain on liquidation of foreign subsidiaries | - | 0% | 4 | 0% |
| Gain on extinguishment of debt | - | 0% | 134 | 5% |
| ----- | | | | |
| TOTAL OTHER INCOME (EXPENSES) | 1,822 | 66% | (61) | -2% |
| ----- | | | | |
| INCOME (LOSS) BEFORE INCOME TAX | 582 | 21% | (567) | -22% |
| ----- | | | | |
| Income tax benefit (provision) | (34) | -1% | 45 | 2% |
| ----- | | | | |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | 548 | 20% | (522) | -20% |
| ----- | | | | |
| Gain from the sale of discontinued operations | - | 0% | - | 0% |
| Income from discontinued operations, net of income tax | - | 0% | 419 | 16% |
| ----- | | | | |
| NET INCOME (LOSS) | \$548 | 20% | (\$103) | -4% |
| ===== | | | | |

| | NINE MONTHS ENDED MARCH 31, | | | |
|--|-----------------------------|---------------------|---------|---------------------|
| | 2004 | | 2003 | |
| | \$ | AS % OF SALES | \$ | AS % OF SALES |
| Net revenues | \$7,239 | 100% | \$7,168 | 100% |
| Product costs | 2,417 | 33% | 2,678 | 37% |
| ----- | | | | |
| GROSS MARGIN | 4,822 | 67% | 4,490 | 63% |
| Operating expenses | | | | |
| Sales & marketing | 3,270 | 45% | 2,478 | 35% |
| General & administrative | 2,538 | 35% | 2,185 | 30% |
| Research & development | 1,655 | 23% | 1,181 | 16% |
| ----- | | | | |
| TOTAL OPERATING EXPENSES | 7,463 | 103% | 5,844 | 82% |
| ----- | | | | |
| OPERATING LOSS | (2,641) | -36% | (1,354) | -19% |
| ----- | | | | |
| Other Income (expenses) | | | | |
| Interest and other, net | 198 | 2% | (381) | -5% |
| Realized gain on marketable securities | 76 | 1% | - | 0% |
| Unrealized gain on marketable securities | 1,865 | 26% | - | 0% |
| Gain on liquidation of foreign subsidiaries | - | 0% | 46 | 1% |
| Gain on extinguishment of debt | 76 | 1% | 569 | 8% |
| ----- | | | | |
| TOTAL OTHER INCOME (EXPENSES) | 2,215 | 30% | 234 | 3% |
| ----- | | | | |
| INCOME (LOSS) BEFORE INCOME TAX | (426) | -6% | (1,120) | -16% |
| ----- | | | | |
| Income tax benefit (provision) | (24) | 0% | 45 | 1% |
| ----- | | | | |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | (450) | -5% | (1,075) | -15% |
| ----- | | | | |
| Gain from the sale of discontinued operations | 1,000 | 14% | - | 0% |
| Income from discontinued operations, net of income tax | - | 0% | 785 | 11% |
| ----- | | | | |
| NET INCOME (LOSS) | \$550 | 8% | (\$290) | -4% |
| ===== | | | | |

NET REVENUES

Net revenues of each of our principal product categories in dollars and as a percentage of total net revenues for the three and nine months ended March 31, 2004 and 2003 are summarized in the following table (in thousands except for percentage amounts):

| | THREE MONTHS ENDED MARCH | | | |
|---------------------------------|--------------------------|------|---------|------|
| | 2004 | | 2003 | |
| | \$ | % | \$ | % |
| Precision Design | \$1,823 | 65% | \$1,233 | 47% |
| Business Applications and Other | 961 | 35% | 1,392 | 53% |
| NET REVENUES | \$2,784 | 100% | \$2,625 | 100% |

| | NINE MONTHS ENDED MARCH 3 | | | |
|---------------------------------|---------------------------|------|---------|------|
| | 2004 | | 2003 | |
| | \$ | % | \$ | % |
| Precision Design | \$3,873 | 54% | \$2,985 | 42% |
| Business Applications and Other | 3,366 | 46% | 4,183 | 58% |
| NET REVENUES | \$7,239 | 100% | \$7,168 | 100% |

Concurrent with the introduction our the newest release of our flagship product, TurboCAD(R) 10.0 in March 2004 and the full quarter effect of our wholly owned subsidiary Homeplan, Inc, sales of precision design products and services increased in the three and nine months ended March 31, 2004 as compared to the same reporting periods in the previous fiscal year. Additionally the introduction of the "DesignCAD" and the "Instant Series" line of products during the first quarter of fiscal 2004 contributed to the increase in sales of the precision design products as compared to the same period from the previous fiscal year. Revenues from Planworks amounted to \$467,000 and \$579,000 during the quarter and the nine months ended March 31, 2004. As we completed the acquisition of Planworks, LLC on November 18, 2003, we did not have similar revenues to report for the comparable period from the previous fiscal year.

Despite the introduction of new titles (PhotoObject) and the release of newer version of our existing products (EasyLanguage and Net Accelerator), the decline in sales of our historically strong selling products in the "Business Applications and Other" products like MasterClips and OrgPlus, and the decline in revenues from Keynomics, our productivity software subsidiary, resulted into an overall decrease in this segment during the three and nine months ended March 31, 2004 as compared to the same periods of the previous fiscal year. Revenues from Keynomics amounted to \$71,000 and \$549,000 during the three and nine months ended March 31, 2004, respectively as compared to \$441,000 and \$1,066,000, respectively in the comparable periods from the previous fiscal year. Keynomics produces ergonomic and keyboard training applications for worker-enhanced safety, productivity and ergonomic compliance improvements. Keynomics markets its applications mainly to call and data processing centers that have seen their activities increasingly outsourced to foreign competitors and therefore negatively affecting the Company's revenues.

Internationally, we distribute our products through our wholly owned German and Australian subsidiaries and republishing partners in Europe and Asia. International revenues during the quarter ended March 31, 2004 decreased slightly despite increased European business. This was the result of the decrease in the revenues recognized from our Australian subsidiary after we licensed the distribution rights of some of our products in Australia to a third party publisher in exchange for royalty payments. The increase in international sales during the nine months ended March 31, 2004, is primarily due to our reentry into the European market by re-activating our German subsidiary during the previous fiscal year. Total net sales from our German subsidiary accounted for \$104,000 and \$354,000, respectively during the three and nine months ended March 31, 2004. The following table details the revenue breakdown between the domestic and international markets for the periods indicated.

| | THREE MONTHS ENDED MARCH 31, | | | | | |
|---------------------|------------------------------|------|---------|------|-----------|----------|
| | 2004 | | 2003 | | \$ CHANGE | % CHANGE |
| | \$ | % | \$ | % | | |
| Domestic sales | \$2,300 | 83% | \$2,125 | 81% | \$175 | 8% |
| International sales | 484 | 17% | 500 | 19% | (16) | -3% |
| NET REVENUES | \$2,784 | 100% | \$2,625 | 100% | \$159 | 6% |

| | NINE MONTHS ENDED MARCH 31, | | | | | |
|---------------------|-----------------------------|------|---------|------|-----------|----------|
| | 2004 | | 2003 | | \$ CHANGE | % CHANGE |
| | \$ | % | \$ | % | | |
| Domestic sales | \$5,969 | 82% | \$6,074 | 85% | (\$105) | -2% |
| International sales | 1,270 | 18% | 1,094 | 15% | 176 | 16% |
| NET REVENUES | \$7,239 | 100% | \$7,168 | 100% | \$71 | 1% |

We are currently serving the domestic and international retail markets using a combination of direct sales and republishing agreements. Low barriers to entry, intense price competition, and business consolidations continue to characterize the consumer software industry. Each of these factors along with the intermittent unfavorable retail conditions, including erosion of margins from competitive marketing and high rates of product returns, may adversely affect our revenues in the future.

Our international revenues may be affected by the risks customarily associated with international operations, including fluctuations of the U.S. dollar, increases in duty rates, exchange or price controls, longer collection cycles, government regulations, political instability and changes in international tax laws.

PRODUCT COSTS AND GROSS MARGIN

Our product costs include license fees, royalties that we pay to third parties based on sales of published software, amortization of capitalized software acquisition and development costs, the costs of CD-ROM duplication, printing of manuals, packaging and fulfillment, and freight. Costs associated with the return of products, such as refurbishment and the write down in value of returned goods are also included in product costs.

Our gross margin improved to 62% from 58% and to 67% from 63%, respectively during the three and nine months ended March 31, 2004. This improvement was due to our increased direct marketing emphasis on the higher margin precision design products. These products carry a lower cost as compared to others in our product mix as we own the majority of their underlying technology. In addition, we have experienced a significant reduction in amortization expenses for software products as a result of the products being fully amortized. Future business and product line acquisitions, however, will increase our basis in certain intangible assets (i.e. capitalized software development costs), the amortization of which may negatively affect our gross margin in the future.

Given the uncertain product lifecycle for some of our historically high margin products and depending on the success of the release of newer software versions, we may see our gross margin decline in future reporting periods.

SALES AND MARKETING

Our sales and marketing expenses consist primarily of salaries and benefits of sales and marketing personnel, commissions, advertising, printing and direct mail expenses. The increase in sales and marketing expenses during the three and nine months ended March 31, 2004 was mainly attributable to the following:

- o The additional sales and marketing expenses we incurred relating to the Planworks business that we acquired during the second quarter of fiscal 2004.
- o Increased payroll and related wage expenses due to increases in headcount in order to strengthen our direct marketing presence.
- o Increased direct mail expenses relative to our growing efforts to focus on direct targeting of our customers via marketing campaigns.
- o Increased commissions paid to outside service providers that help us with their sales forces and E-commerce systems.

GENERAL AND ADMINISTRATIVE

Our general and administrative expenses consist primarily of salaries and benefits for employees in the legal, finance, accounting, human resources, information systems and operations departments, fees to our professional advisors, rent and other general operating costs.

Our general and administrative expenses slightly increased during the quarter ended March 31, 2004 as compared to the same quarter from the previous year.

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This increase is primarily due to additional IT and investors relation expenses in part offset by a decrease in legal costs.

The increase in general and administrative expenses during the nine months ended March 31, 2004 as compared to the same reporting period from the previous fiscal year was primarily due to amortization expense of \$237,000 from the issuance of warrants to outside consultants mainly providing services in the area of investor relations. The comparable period from the previous fiscal year also included the reversal of the intrinsic value of warrants issued to Mr. Martin Wade III, our CEO, as part of his initial employment agreement. During the second quarter of fiscal 2003, we amended Mr. Wade's employment agreement whereby IMSI and Mr. Wade agreed to the full and complete cancellation of all outstanding warrants granted to Mr. Wade. Consequently, we reversed, during the nine months ended March 31, 2003, \$432,000 of already incurred amortization expense of the intrinsic value of warrants issued to Mr. Wade which were unvested.

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Excluding the effect of the two transactions above, general and administrative expenses would have declined by approximately \$316,000 during the nine months ended March 31, 2004 as compared to the same period from the previous fiscal year. This decrease is mainly attributable to the decline of general and administrative expenses related to our Australian subsidiary as we switch their business model to a licensing mode and to a substantial decline in our legal fees as a result of the settlement of all outstanding legal actions from previous periods.

RESEARCH AND DEVELOPMENT

Our research and development expenses consist primarily of salaries and benefits for research and development employees and payments to independent contractors. Our management believes that investment in research and development is essential to respond to ever-evolving customers demands. The increased ratio of research and development expenses as a percentage of sales reflects our commitment to investing in and developing our core products. We continue to maintain a strong partnership with our third party development team in Russia at competitive costs.

The increase in research and development expenses in the three and nine months ended March 31, 2004 as compared to the same period from the previous fiscal year resulted mainly from increased personnel and consulting costs. These costs related to the development of our web properties including houseplans.com and the development of new versions of our software products including the recently released TurboCAD Professional Version 10 and OrgChart Professional.

INTEREST AND OTHER, NET

Interest and other expenses, net, include interest and penalties on debt instruments, foreign currency transaction gains and losses, and other non-recurring items. The following table summarizes the components of interest and other, net for the three and nine months ended March 31, 2004 and 2003:

THREE MONTHS ENDED MARCH 31,

NINE MO

\$ CHANGE FROM

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| | 2004 | 2003 | PREVIOUS YEAR | | 2004 |
|--|-------------|----------------|-----------------------------|--------------|--------------|
| | | | \$ INCREASE / (DECREASE) | % | |
| Interest & Other, net | | | | | |
| Interest (expense) | (\$23) | (\$128) | \$105 | -82% | (\$26) |
| Interest income | 24 | 1 | 23 | 2300% | 69 |
| Foreign exchange gain (loss) | (1) | 37 | (38) | -103% | 47 |
| Other income (Expenses) | 58 | (109) | 167 | -153% | 108 |
| TOTAL INTEREST & OTHER, NET | \$58 | (\$199) | \$257 | -129% | \$198 |

As previously disclosed in our annual report for the fiscal year ended June 30, 2003, in September 2001 we undertook an intensive reassessment of the current costs and future potential financial benefits of the Design.NET project, an online design and visualization tool allowing users to design homes and offices on the Internet. We concluded it would be in our best interest to spin off the Design.NET project. Consequently, we entered into an agreement with Michael Gariepy (a former Vice president of IMSI) to transfer the majority of the ownership of the project (80.01%) to employees (including Mr. Gariepy) who were key to its continued development while we retained a 19.99% ownership interest in the new venture. Based on our understanding of the project and the risks associated with its technical feasibility, we recorded the value of our ownership with a zero book value. Pursuant to that agreement, the employees resigned from IMSI and established Plan3D, Inc. to pursue the development of the technology. During the quarter ended March 31, 2004, we sold our ownership in Plan3D to Mr. Gariepy in exchange for 45,000 shares of IMSI common stock that he held. As a result, of this transaction, we recognized a gain of \$58,000.

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REALIZED GAIN ON MARKETABLE SECURITIES

During the quarter ended March 31, 2004 we realized a \$76,000 gain on marketable securities as we sold 10,000 shares of Jupitermedia common stock that we received as part of the consideration related to the sale of ArtToday on June 30, 2003.

UNREALIZED GAIN ON MARKETABLE SECURITIES

We recorded a \$1.7 million and a \$1.9 million gain on marketable securities during the three and nine months ended March 31, 2004, reflecting the increase in the market value of our equity portfolio. The following table summarizes the net gain on marketable securities:

| DESCRIPTION | THREE MONTHS ENDED MARCH 31, 2004 | NINE MO |
|--|-----------------------------------|---------|
| Gain on Jupitermedia common stock | \$ 1,660,000 | \$ |
| Gain on professionally managed portfolio | 27,681 | |

| | | | |
|-------|----|-----------|----|
| TOTAL | \$ | 1,687,681 | \$ |
|-------|----|-----------|----|

GAIN ON EXTINGUISHMENT OF DEBT

During the nine months ended March 31, 2004, we recognized a gain of \$76,000 from the extinguishment of debt primarily relating to the settlement of liabilities related to assets under a capital lease.

During the nine months ended March 31, 2003, we recognized a gain of \$569,000 from the extinguishment of debt representing the difference between the carrying balances and the settlement amounts payable to a variety of unsecured creditors.

PROVISION FOR STATE AND FEDERAL INCOME TAXES

In the three months ended March 31, 2004, we recorded tax expense of \$34,000 arising from state income tax incurred from the prior fiscal year.

We have not recorded a tax benefit for current domestic tax losses because of the uncertainty of realization. We adhere to Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes," which requires an asset and liability approach to financial accounting and reporting for income taxes. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

INCOME FROM DISCONTINUED OPERATIONS

In June 2003, we sold ArtToday, our wholly owned subsidiary based in Arizona, to Jupitermedia. Under Generally Accepted Accounting Principles ("GAAP") in the United States, ArtToday's operating results for the three and nine months ended March 31, 2003, totaling \$419,000 and \$785,000, respectively, have been accounted for as discontinued operations.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2004, we had \$4,905,000 in cash and cash equivalents. This represents a \$344,000 decline from the \$5,249,000 balance at December 31, 2003 and a \$5,494,000 decline from the \$10,399,000 balance at June 30, 2003. Working capital at March 31, 2004 was \$6,032,000. This represents a decline of \$24,000 from the working capital at December 31, 2003 and a decline of \$2,624,000 from the working capital at June 30, 2003 of \$8,656,000.

Our operating activities used net cash of \$2,450,000 during the nine months ended March 31, 2004. This compares to net cash used in operations of \$395,000 during the nine months ended March 31, 2003. Our increased operating loss, combined with payments we made relating to accrued taxes and other accrued expenses and the increase in our receivables and inventories contributed to the increased usage of cash in the nine months ended March 31, 2004 as compared to the same period from the previous fiscal year. Receivables and inventories increased during the nine months ended March 31, 2004 primarily due to a change in the method of distribution for some of our products, including TurboCAD(R), from licensing arrangements to selling directly to resellers and distributors. 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

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of the first earn-out from the sale of ArtToday. This earn-out was contingent on ArtToday reaching certain revenue milestones. The full amount of the \$1.0 Million earn-out was earned during the second quarter of fiscal 2004 and was paid per the stock purchase agreement on February 13, 2004.

Our investing activities consumed net cash of \$3,089,000 during the nine months ended March 31, 2004, as compared to net cash used of \$233,000 during the comparable period from the previous fiscal year. The cash was mainly used to acquire Planworks and several new product lines and assets. The following table details the cash outlays for the significant acquisitions we made during the nine months ended March 31, 2004 (including transaction fees).

| | ACQUIRED IN | CASH SPENT |
|--|----------------------------|------------|
| ----- | | |
| WEBSITES, CONTENT AND NEW PRODUCT LINES: | | |
| Homeplans.com | 3rd quarter of Fiscal 2004 | |
| CADsymbols | 2nd quarter of Fiscal 2004 | |
| CADsymbol | 2nd quarter of Fiscal 2004 | |
| DesignCAD | 1st quarter of Fiscal 2004 | |
| Cadalog | 1st quarter of Fiscal 2004 | |
| Other | 2nd quarter of Fiscal 2004 | |
| BUSINESS | | |
| Planworks | 2nd quarter of Fiscal 2004 | |
| ----- | | |
| TOTAL | | |
| ----- | | |

These acquisitions are consistent with our strategy to grow our software and services businesses with a focus on products and services that complement our direct marketing and online distribution strengths. We expect to continue to identify and acquire products and launch services that satisfy real customer needs and have the combination of high growth potential and positive EBITDA. These acquisitions, including the Aladdin Systems, Inc. acquisition that we consummated subsequent to this fiscal quarter end, will be funded through a combination of cash on hand, debt and the issuance of our common stock. The divestiture of ArtToday provided us with sufficient liquidity to continue to strengthen our product portfolio and distribution channels.

Our investing activities also included investment in marketable securities in the amount of \$367,000 during the nine months ended March 30, 2004 in part offset by proceeds of \$116,000 we collected from the sale of marketable securities.

Also, during the first quarter of fiscal 2004, we received a 15% one-year note from DCDC when we extended a loan to them in the amount of \$350,000. The note is due, with interest, on September 18, 2004. The note is secured by 400,000 shares of IMSI's stock held by DCDC. The agreement also called for DCDC not to sell any IMSI common stock that it held with the exception of private sales of IMSI common stock, prior to February 15, 2004.

Our financing activities provided net cash of \$85,000 during the nine months ended March 31, 2004. This compares to \$761,000 of net cash used by financing activities during the comparable periods from the previous fiscal year. During the quarter ended March 31, 2004 we issued a short term note secured by selected accounts receivable in the amount of \$350,000 to one of our financing partners and paid off \$28,000 prior to period end. We also received cash from the

exercise of warrants and options in the amounts of \$96,000 and \$111,000, respectively in the nine months ended March 31, 2004. As previously disclosed, we paid \$160,000 to Imageline on July 7, 2003, which represents the final payment in connection with our mutual settlement of previous infringement claims. In addition, we partially repaid notes related to the businesses we acquired in the aggregate amount of \$220,000 during the nine months ended March 31, 2004.

Historically, we have financed our working capital and capital expenditure requirements primarily from short-term and long-term notes and bank borrowings, capitalized leases and sales of common stock. The sale of ArtToday to Jupitermedia in June 2003 provided us with additional sources of funds to support future growth. We may also seek additional equity and/or debt financing to sustain our growth strategy. However, we believe that we have sufficient funds to support our operations at least for the next twelve months, based on our current cash position and equity sources. If we are successful in continuing to improve our financial performance, we believe that we will be able to obtain any additional financing required on competitive terms. In addition, we will continue to seek opportunities and discussions with third parties concerning the sale or license of certain product lines and/or the sale or license of a portion of our assets.

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To achieve our growth objectives, we are considering different strategies, including growth through mergers and/or acquisitions. As a result, we are evaluating and we will continue to evaluate other companies and businesses for potential synergies that would add value to our existing operations.

The forecast period of time through which our financial resources will be adequate to support working capital and capital expenditure requirements is a forward-looking statement that involves risks and uncertainties, and actual results could vary. Furthermore, any additional equity financing may be dilutive to shareholders, and debt financing may involve restrictive covenants.

CRITICAL ACCOUNTING POLICIES

In accordance with recent Securities and Exchange Commission guidance, those accounting policies that we believe are the most critical to an investor's understanding of our financial results and condition have been expanded and are discussed below. Certain of these policies are particularly important to the portrayal of our financial position and results of operations and require the application of significant judgment by our management to determine the appropriate assumptions to be used in the determination of certain estimates.

REVENUE RECOGNITION

Revenue is recognized in accordance with American Institute of Certified Public Accountants Statement of Position ("SOP") 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, With Respect to Certain Transactions. Revenue is recognized when persuasive evidence of an arrangement exists (generally a purchase order), product has been delivered, the fee is fixed and determinable, and collection of the resulting account is probable.

- o Revenue from packaged product sales to resellers and end users is recorded at the time of the sale net of estimated returns.
- o Revenue from sales to distributors is recognized when the product sells through to retailers and end users. Sales to distributors permit limited

rights of return according to the terms of the contract.

- o For software delivered via the Internet, revenue is recorded when the customer downloads the software.
- o Revenue from post contract customer support (PCS) is recognized ratably over the contract period.
- o Training fees are recognized when the service is performed.
- o Subscription revenue is recognized ratably over the contract period.
- o Revenue from hybrid products is allocated to the underlying components based on the ratio of the value of each component to the total price and each portion is recognized accordingly.
- o Non-refundable advanced payments received under license agreements with no defined terms are recognized as revenue when the customer accepts the delivered software.
- o Revenue from software licensed to developers, including amounts in excess of non-refundable advanced payments, is recorded as the developers ship products containing the licensed software.
- o Revenue from minimum guaranteed royalties in republishing agreements is recognized ratably over the term of the agreement. Royalties in excess of the guaranteed minimums are recognized when collected.
- o Revenue from Original Equipment Manufacturer (OEM) contracts is recognized upon completion of our contractual obligations.

RESERVE FOR RETURNS, PRICE DISCOUNTS AND REBATES

Reserves for returns, price discounts and rebates are estimated using historical averages, open return requests, channel inventories, recent product sell-through activity and market conditions. Our allowances for returns, price discounts and rebates are based upon management's best judgment and estimates at the time of preparing the financial statements. Reserves are subjective estimates of future activity that are subject to risks and uncertainties, which could cause actual results to differ materially from estimates.

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Our return policy generally allows our distributors to return purchased products primarily in exchange for new products or for credit towards future purchases as part of stock balancing programs. These returns are subject to certain limitations that may exist in the contract with an individual distributor, governing, for example, aggregate return amounts, and the age, condition and packaging of returned product. Under certain circumstances, such as terminations or when a product is defective, distributors could receive a cash refund if returns exceed amounts owed.

INVENTORIES

Inventories are valued at the lower of cost or market and are accounted for on the first-in, first-out basis. Management performs periodic assessments to determine the existence of obsolete, slow moving and non-salable inventories, and records necessary provisions to reduce such inventories to net realizable

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value. As of March 31, 2004, distributors held approximately \$18,000 of our inventory under consignment arrangements.

IMPAIRMENT

Property, equipment, intangible and certain other long-lived assets are amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenues. Long-lived assets are written down to fair value whenever events or changes indicate that the carrying amount of an asset may not be recoverable. Our policy is to review the recoverability of all long-lived assets at a minimum of once per year and record an impairment loss when the fair value of the assets does not exceed the carrying amount of the asset.

In accordance with SFAS No. 142, Goodwill and Intangible Assets, we will assess the underlying goodwill for impairment annually or more frequently if circumstances indicate impairment.

OTHER FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

Factors that may affect operating results in the future include, but are not limited to:

- o Market acceptance of our products or those of our competitors
- o Timing of introductions of new products and new versions of existing products
- o Expenses relating to the development and promotion of such new products and new version introductions
- o Intense price competition and numerous end-user rebates
- o Projected and actual changes in platforms and technologies
- o Accuracy of forecasts of, and fluctuations in, consumer demand
- o Extent of third party royalty payments
- o Rate of growth of the consumer software and Internet markets
- o Timing of orders or order cancellation from major customers
- o Changes or disruptions in the consumer software distribution channels
- o Economic conditions, both generally and within the software or Internet industries
- o Achievement of future earn-outs related to the sale of ArtToday, Inc.
- o Market value fluctuations related to our investments.

ITEM 3- CONTROLS AND PROCEDURES

(a) Under the supervision and with the participation of IMSI's management, including IMSI's principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), within 90 days of the filing date of this

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report. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective.

(b) We have evaluated our accounting procedures and control processes related to material transactions to ensure they are recorded timely and accurately in the financial statements. There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced in paragraph (a) above.

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PART II - OTHER INFORMATION

ITEM 1- LEGAL PROCEEDINGS

Not Applicable

ITEM 2- CHANGES IN SECURITIES

Not Applicable

ITEM 3- DEFAULTS UPON SENIOR SECURITIES

Not Applicable

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

On February 23, 2004, we filed with the Securities and Exchange Commission a Definitive Proxy Statement on Schedule 14-A pursuant to section 14(A) of the Securities Exchange Act of 1934 in connection with the solicitation of proxies by the board of directors of IMSI for use at the annual meeting of the shareholders.

The annual meeting of the shareholders of IMSI was held on March 17, 2004 and the following proposals were approved by the shareholders:

- o The election of seven directors for a term of one year:

| NAME | AGE | OCCUPATION | DIRECTOR SINCE | VOTES |
|-------------------|-----|------------------------------------|----------------|-------|
| Bruce Galloway | 45 | Chairman of the Board of Directors | 2001 | 1 |
| Martin Wade, III | 54 | Chief Executive Officer | 2001 | 1 |
| Evan Binn | 64 | Director | 2001 | 1 |
| Donald Perlyn | 60 | Director | 2001 | 1 |
| Robert Mayer | 49 | Executive Vice President | 2000 | 1 |
| Robert S. Falcone | 57 | Director | 2002 | 1 |
| Richard J. Berman | 61 | Director | 2002 | 1 |

- o The approval of the 2004 Incentive Stock Option Plan. This proposal was approved according to the votes as cast below:
 - o For: 17,980,913
 - o Against: 197,951
 - o Abstain: 279,966

- o The authorization of the issuance of options aggregating up to 49.0% of the outstanding capitalization. This proposal was approved according to the votes as cast below:
 - o For: 17,877,261
 - o Against: 321,777
 - o Abstain: 259,792

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- o The ratification of the appointment of Grant Thornton LLP as IMSI's independent auditors for the fiscal year ending June 30, 2004. This proposal was approved according to the votes as cast below:
 - o For: 18,329,509
 - o Against: 5,266
 - o Abstain: 124,055

ITEM 5- OTHER INFORMATION

Not Applicable

ITEM 6- EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS AND FINANCIAL STATEMENTS:

The following documents are filed as a part of this Report:

FINANCIAL STATEMENTS

The following consolidated financial statements of International Microcomputer Software, Inc., and Subsidiaries are incorporated by reference in Part I, Item 1:

Condensed Consolidated Balance Sheet at March 31, 2004 and June 30, 2003

Condensed Consolidated Statements of Operations for the interim periods ended March 31, 2004 and 2003

Condensed Consolidated Statements of Shareholders' Equity for the interim period ended March 31, 2004

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Condensed Consolidated Statements of Cash Flows for the interim periods ended March 31, 2004 and 2003

Notes to Condensed Consolidated Financial Statements

EXHIBITS

The following exhibits are filed as part of, or incorporated by reference into this Report:

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(B) REPORTS ON FORM 8-K

- o On February 11, 2004 we furnished a report on Form 8-K to announce our financial results for the fiscal quarter ended December 31, 2003.
- o On January 23, 2004 we filed a Form 8-K to announce that we had entered into a definitive agreement with Aladdin Systems Holding, Inc. to acquire its wholly owned subsidiary, Aladdin Systems, Inc.

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.

INTERNATIONAL MICROCOMPUTER SOFTWARE, INC.

DATE: MAY 13, 2004

/S/ MARTIN WADE, III

Martin Wade, III
Director & Chief Executive Officer

/S/ WILLIAM J. BUSH

William J. Bush
Chief Financial Officer (Principal Accounting Officer)

INDEX TO EXHIBITS:

NUMBER EXHIBIT TITLE

| | |
|------|--|
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