

INTERNATIONAL MICROCOMPUTER SOFTWARE INC /CA/  
Form 10QSB  
May 15, 2006

**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, 2006**

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

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-15949

**INTERNATIONAL MICROCOMPUTER SOFTWARE, INC.**

(Exact name of Small business issuer in its charter)

**CALIFORNIA**

(State or other jurisdiction of incorporation or organization)

**94-2862863**

(I.R.S. Employer Identification No.)

**100 ROWLAND WAY, NOVATO, CALIFORNIA**

(Address of principal executive offices)

**94945**

(Zip code)

**(415) 878-4000**

Issuer's telephone number

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

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act). YES  NO

As of May 9, 2006, 30,947,719 shares of Issuer's common stock, no par value, were outstanding.

Transitional Small Business Disclosure Format: YES  NO

**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)

|  | <b>March 31, 2006</b> | <b>June 30, 2005</b> |
|--|-----------------------|----------------------|
|  | <b>Unaudited</b>      |                      |
| <b>ASSETS</b>  |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$9,723               | \$4,347              |
| Trading securities   | 0                     | 714                  |
| Receivables, less allowances for doubtful accounts, discounts and returns of \$493 as of March 31, 2006 and \$626 as of June 30, 2005. | 989                   | 773                  |
| Inventories, net   | 910                   | 758                  |
| Receivables, other (related to discontinued operations)  | 0                     | 2,000                |
| Receivables, other   | 0                     | 30                   |
| Other current assets   | 1,479                 | 530                  |
| Assets related to discontinued operations  | 0                     | 12,231               |
| <b>Total current assets</b>  | <b>13,101</b>         | <b>21,383</b>        |
| <b>Fixed assets, net</b>   | <b>302</b>            | <b>377</b>           |
| Intangible assets  |                       |                      |
| Capitalized software, net  | 231                   | 494                  |
| Domain names and brands, net   | 1,818                 | 1,574                |
| Distribution rights and proprietary plans, net   | 753                   | 170                  |
| Capitalized customer lists, agreements and relationships, net  | 1,227                 | 326                  |
| Goodwill   | 3,852                 | 2,090                |
| Trademarks, net  | 18                    | 1                    |
| <b>Total intangible assets</b>   | <b>7,899</b>          | <b>4,655</b>         |
| <b>Total assets</b>  | <b>\$21,302</b>       | <b>\$26,415</b>      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                       |                      |
| Current liabilities:   |                       |                      |
| Short-term debt  | 93                    | 2,764                |
| Trade accounts payable   | 1,315                 | 2,245                |
| Accrued and other liabilities  | 1,598                 | 1,871                |
| Deferred revenues  | 26                    | 38                   |
| Liabilities related to discontinued operations   | 0                     | 1,037                |
| <b>Total current liabilities</b>   | <b>3,032</b>          | <b>7,955</b>         |
| Long-term debt and other obligations   | 176                   | 230                  |
| <b>Total liabilities</b>   | <b>3,208</b>          | <b>8,185</b>         |

Shareholders' equity

Common stock, no par value; 300,000,000 authorized; 30,144,160 issued and outstanding

as of March 31, 2006 and 28,796,886 issued and outstanding as of June 30, 2005

|   |               |               |
|---|---------------|---------------|
|   | 44,854        | 43,663        |
| Accumulated deficit                           | (26,911)      | (25,331)      |
| Accumulated other comprehensive income (loss) | 151           | (102)         |
| <b>Total shareholders' equity</b>             | <b>18,094</b> | <b>18,230</b> |

|   |                 |                 |
|---|-----------------|-----------------|
| <b>Total liabilities and shareholders' equity</b> | <b>\$21,302</b> | <b>\$26,415</b> |
|---|-----------------|-----------------|

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)

|   | <b>Three months ended March 31,</b> |                 | <b>Nine months ended March 31,</b> |                 |
|---|-------------------------------------|-----------------|------------------------------------|-----------------|
|   | <b>2006</b>                         | <b>2005</b>     | <b>2006</b>                        | <b>2005</b>     |
| Net revenues  | \$4,029                             | \$3,799         | \$11,714                           | \$10,412        |
| Product costs   | 1,424                               | 1,272           | 4,207                              | 3,415           |
| <b>Gross margin</b>   | <b>2,605</b>                        | <b>2,527</b>    | <b>7,507</b>                       | <b>6,997</b>    |
| <b>Costs and expenses</b>   |                                     |                 |                                    |                 |
| Sales and marketing   | 1,669                               | 1,635           | 4,859                              | 4,523           |
| General and administrative  | 1,047                               | 932             | 3,801                              | 2,773           |
| Research and development  | 486                                 | 418             | 1,474                              | 1,255           |
| <b>Total operating expenses</b>   | <b>3,202</b>                        | <b>2,985</b>    | <b>10,134</b>                      | <b>8,551</b>    |
| <b>Operating loss</b>   | <b>(597)</b>                        | <b>(458)</b>    | <b>(2,627)</b>                     | <b>(1,554)</b>  |
| <b>Other income (expense)</b>   |                                     |                 |                                    |                 |
| Interest and other, net   | 93                                  | (61)            | 40                                 | (22)            |
| Realized / unrealized gain on securities                                      | -                                   | (276)           | 765                                | 145             |
| <b>Loss before income tax</b>   | <b>(504)</b>                        | <b>(795)</b>    | <b>(1,822)</b>                     | <b>(1,431)</b>  |
| Income tax provision  | (21)                                | (2)             | (60)                               | (9)             |
| <b>Loss from continuing operations</b>  | <b>(525)</b>                        | <b>(797)</b>    | <b>(1,882)</b>                     | <b>(1,440)</b>  |
| Income from discontinued operations,<br>net of income tax                     | -                                   | 411             | -                                  | 855             |
| Gain (loss) from the sale of<br>discontinued operations,<br>net of income tax | 776                                 | -               | 302                                | 53              |
| <b>Net income (loss)</b>  | <b>\$251</b>                        | <b>(\$386)</b>  | <b>(\$1,580)</b>                   | <b>(\$532)</b>  |
| <b>Other comprehensive income (loss)</b>                                      |                                     |                 |                                    |                 |
| Foreign currency translation<br>adjustments                                   | 62                                  | (5)             | 253                                | (38)            |
| <b>Comprehensive income (loss)</b>  | <b>\$313</b>                        | <b>(\$391)</b>  | <b>(\$1,327)</b>                   | <b>(\$570)</b>  |
| <b>Basic earnings (loss) per share:</b>                                       |                                     |                 |                                    |                 |
| Loss from continuing operations   | (\$0.01)                            | (\$0.01)        | (\$0.06)                           | (\$0.01)        |
| Income from discontinued operations,<br>net of income tax                     | \$0.00                              | \$0.00          | \$0.00                             | \$0.00          |
| Gain (loss) from the sale of<br>discontinued operations,<br>net of income tax | \$0.02                              | \$0.01          | \$0.01                             | \$0.03          |
| <b>Net income (loss)</b>  | <b>\$0.01</b>                       | <b>(\$0.01)</b> | <b>(\$0.05)</b>                    | <b>(\$0.02)</b> |
| <b>Diluted earnings (loss) per share:</b>                                     |                                     |                 |                                    |                 |

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|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Loss from continuing operations   | (\$0.01) | (\$0.01) | (\$0.06) | (\$0.01) |
| Income from discontinued operations,<br>net of income tax                     | \$0.00   | \$0.00   | \$0.00   | \$0.00   |
| Gain (loss) from the sale of<br>discontinued operations,<br>net of income tax | \$0.02   | \$0.01   | \$0.01   | \$0.03   |
| Net income (loss)   | \$0.01   | (\$0.01) | (\$0.05) | (\$0.02) |
| Shares used in computing basic<br>earnings (loss) per share                   | 30,043   | 28,051   | 29,850   | 27,623   |
| Shares used in computing diluted<br>earnings (loss) per share                 | 30,043   | 28,051   | 29,850   | 27,623   |

See Notes to Condensed Consolidated Financial Statements

**INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

Nine months ended March 31, 2006

(In thousands, except share amounts)

**(Unaudited)**

**Common Stock**

|   | <b>Shares</b>     | <b>Amount</b>   | <b>Accumulated deficit</b> | <b>Accumulated other comprehensive income (loss)</b> | <b>Total</b>    |
|---|-------------------|-----------------|----------------------------|--|-----------------|
| <b>Balance at July 1, 2005</b>          | <b>28,796,886</b> | <b>\$43,663</b> | <b>(\$25,331)</b>          | <b>(\$102)</b>                                       | <b>\$18,230</b> |
| Issuance of common stock related to:    |                   |                 |                            |  |                 |
| Stock options exercised                 | 99,291            | 80              |                            |  | -               |
| Warrants exercised and other            | 428,673           | -               |                            |  | 80              |
| Acquisitions                            | 826,583           | 1,021           |                            |  | 1,021           |
| Finder's fee related to acquisition     | 20,000            | 25              |                            |  | 25              |
| Issuance of stock options related to:   |                   |                 |                            |  |                 |
| Consulting services rendered            |                   | 21              |                            |  | 21              |
| Issuance of warrants related to:        |                   |                 |                            |  |                 |
| Acquisitions                            |                   | 6               |                            |  | 6               |
| Procurement of short-term debt          |                   | 68              |                            |  | 68              |
| Stock buy back                          | (27,273)          | (30)            |                            |  | (30)            |
| Issuance of stock options               |                   | 2               |                            |  | 2               |
| Variable accounting adjustment          |                   | (2)             |                            |  | (2)             |
| Net loss                                |                   |                 | (1,580)                    |  | (1,580)         |
| Foreign currency translation adjustment |                   |                 |                            | 253  | 253             |
| <b>Balance at March 31, 2006</b>        | <b>30,144,160</b> | <b>\$44,854</b> | <b>(\$26,911)</b>          | <b>\$151</b>   | <b>\$18,094</b> |

See Notes to Condensed Consolidated Financial Statements

**INTERNATIONAL MICROCOMPUTER SOFTWARE, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

|  | <b>Nine months ended March 31,</b> |                |
|--|------------------------------------|----------------|
|  | <b>2006</b>                        | <b>2005</b>    |
| <b>Cash flows from operating activities:</b>                       |                                    |                |
| <b>Net cash provided by (used in) operating activities</b>         | <b>(\$948)</b>                     | <b>\$237</b>   |
| <b>Cash flows from investing activities:</b>                       |                                    |                |
| Proceeds from sale of discontinued operations                      | 10,242                             | 608            |
| Proceeds from sale of product line                                 | -                                  | 258            |
| Acquisition of subsidiaries  | (1,807)                            | (1,356)        |
| Acquisition of software development, domain names and trademarks   | -                                  | (602)          |
| Purchases of equipment and software                                | (31)                               | (213)          |
| Transfer cash to escrow for Jupitermedia                           | -                                  | (499)          |
| Proceeds from the sale of marketable securities                    | 1,524                              | 1,780          |
| Other  | (8)                                | 371            |
| Cash provided by discontinued operations in investing activities   | -                                  | 470            |
| <b>Net cash provided by investing activities</b>                   | <b>9,920</b>                       | <b>817</b>     |
| <b>Cash flows from financing activities:</b>                       |                                    |                |
| Proceeds from borrowings   | 850                                | 400            |
| Repayments of notes  | (4,579)                            | (2,368)        |
| Proceeds from warrants and options exercised                       | 80                                 | 152            |
| Cash provided by discontinued operations in financing activities   | -                                  | (20)           |
| <b>Net cash used in financing activities</b>                       | <b>(3,649)</b>                     | <b>(1,836)</b> |
| <b>Effect of exchange rate change on cash and cash equivalents</b> | <b>53</b>                          | <b>(39)</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b>        | <b>5,376</b>                       | <b>(821)</b>   |
| <b>Cash and cash equivalents at beginning of period</b>            | <b>4,347</b>                       | <b>3,212</b>   |
| <b>Cash and cash equivalents at end of the period</b>              | <b>\$9,723</b>                     | <b>\$2,391</b> |

**Nine months ended March 31,**  
**2006**                      **2005**

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

|                 |    |     |
|-----------------|----|-----|
| Interest paid   | 2  | 189 |
| Income tax paid | 66 | 2   |

**SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES**

|   |       |       |
|---|-------|-------|
| Capital stock issued in conjunction with acquisitions   | 1,046 | 1,602 |
| Warrants issued in conjunction with acquisitions        | 6     | -     |
| Notes payable incurred in conjunction with acquisitions | 1,000 | 480   |
| Warrants issued in conjunction with short-term debt     | 68    | -     |

See Notes to Condensed Consolidated Financial Statements



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

**1. Basis of Presentation**

The interim condensed consolidated financial statements have been prepared from the records of International Microcomputer Software, Inc., a California corporation, and Subsidiaries ("we" or the "Company") 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, 2006 and the results of operations and cash flows for the three and nine months ended March 31, 2006 and 2005, 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, 2005. The results of operations for the three and nine months ended March 31, 2005 are not necessarily indicative of the results to be expected for any other interim period or for the full year.

**2. Use of Estimates**

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

**3. Reclassifications**

Reclassifications have been made to the amounts reported for the three and nine months ended March 31, 2005 to conform to the current period's presentation. The amounts reported for the three and nine months ended March 31, 2005, present the assets, liabilities and results of operations for Allume Systems, Inc. ("Allume") as discontinued operations due to the sale of Allume to Smith Micro Software Inc. ("Smith Micro") on July 1, 2005.

Also, the amounts reported for the nine months ended March 31, 2005 include the assets, liabilities and results of operations for Keynomics, Inc. ("Keynomics") as discontinued operations due to the sale of Keynomics on July 29, 2004.

**4. Discontinued Operations**

**4a Gain (loss) from the sale of discontinued operations, net of income tax**

**Three and nine months ended March 31, 2006: Sale of Allume**

On July 1, 2005, we sold all of the issued and outstanding capital stock of Allume to Smith Micro for an aggregate sales price of \$12.8 million made up as follows:

(In millions)

| Description   | Amount         |
|---|----------------|
| Cash  | \$ 11.0        |
| Fair value of 397,547 unregistered shares of our Smith Micro common stock | 1.8            |
| <b>Total</b>  | <b>\$ 12.8</b> |

The fair value of the common stock was based on the five-trading-day average price of Smith Micro's common stock surrounding the date the business combination was announced.

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At closing an indemnity escrow was established to secure certain representations and warranties included in our stock purchase agreement with Smith Micro. The following sale proceeds were deposited into the escrow.

(In millions)

| Description   | Amount          |
|---|-----------------|
| Cash  | \$ 1.25         |
| 170,398 unregistered shares of our Smith Micro common stock | 0.784           |
| <b>Total</b>  | <b>\$ 2.034</b> |

The value of the common stock was based on the date of closing.

On November 2, 2005, we replaced the shares of Smith Micro common stock in escrow with cash, as permitted by the escrow agreement.

On November 10, 2005, we sold 100% of our holdings of Smith Micro shares at a gain of \$923,000 which was shown in Other Income as Realized Gain on Securities in the December quarter.

Pursuant to the stock purchase agreement, Smith Micro released \$500,000 plus interest of \$7,000 and \$750,000 plus interest of \$26,000 of the escrowed cash to us in December 2005 and March 2006, respectively. These amounts, when released, added to our calculation of gain or loss on the sale.

As a result of this sale, we have categorized the assets, liabilities and operations of Allume as discontinued operations for the three and nine months ended March 31, 2005 and in the three months ended March 31, 2006 we recorded a gain on the sale of discontinued operations of \$776,000 representing the amount released from escrow on March 31, 2006 plus accrued interest. The gain on the sale of Allume totaled \$302,000 as of March 31, 2006. This gain calculation does not consider the remaining cash held in escrow of approximately \$0.3 million and is subject to change in future reporting periods depending upon the future release of cash from escrow.

#### **Nine months ended March 31, 2005: Sale of Keynomics**

In July 2004, we sold the assets and customer related liabilities of our wholly owned subsidiary Keynomics. The \$53,000 gain from the sale of discontinued operations for the nine months ended March 31, 2005 relates to the sale of Keynomics and represents the excess of the total consideration received over its net carrying value.

#### **4b Income from discontinued operations, net of income tax**

Income from discontinued operations totaling \$411,000 for the three months ended March 31, 2005 represents the pre-tax net income from Allume. Allume's net revenues were \$2.5 million for the three months ended March 31, 2005. Income from discontinued operations totaling \$855,000 for the nine months ended March 31, 2005 represents the pre-tax net income of Allume of \$860,000 offset by the net loss of Keynomics of \$5,000. Allume's net revenues were \$7.6 million and Keynomics net revenues were \$68,000 for the nine months ended March 31, 2005.

#### **5. Acquisition of Weinmaster Homes, Ltd.**

On July, 1, 2005, Houseplans, Inc. ("Houseplans"), our wholly owned subsidiary, consummated the acquisition of all of the issued and outstanding stock of Weinmaster Homes, Ltd. ("WHL"), pursuant to a Stock Purchase Agreement, between WHL, Bruce and Janice Weinmaster and Houseplans.

The preliminary purchase price of approximately \$4.2 million was comprised as follows:

(In millions)

| Description                                      | Amount        |
|--|---------------|
| Fair value of 826,583 shares of our common stock | \$ 1.0        |
| Cash   | 2.0           |
| Promissory note                                  | 1.0           |
| Costs incurred to consummate the acquisition     | 0.2           |
| <b>Total</b>                                     | <b>\$ 4.2</b> |

The fair value of our common stock was determined based on 826,583 shares issued to Bruce Weinmaster and priced based on the five-trading-day average price of our common stock surrounding the date the business combination was announced. The preliminary purchase price may increase if we incur additional costs related to this acquisition in future periods. The outstanding debt related to this acquisition is now paid in full, with payments of \$250,000 and \$750,000 on July 1, 2005 and January 4, 2006, respectively. Costs incurred to consummate the acquisition include legal and accounting fees and finder's fees paid in cash and through the issuance of 20,000 shares of our common stock.

The allocation of the preliminary purchase price to the assets acquired and liabilities assumed based on their preliminary estimated fair values was as follows:

(In millions)

| Description                         | Amounts<br>(unaudited) |
|-------------------------------------|------------------------|
| Cash acquired                       | \$0.3                  |
| Other tangible assets acquired      | 0.1                    |
| Amortizable intangible assets:      |                        |
| Domain names                        | 0.6                    |
| Designer agreements / relationships | 0.8                    |
| Broker agreements / relationships   | 0.3                    |
| Proprietary plans                   | 0.6                    |
| Customer lists                      | 0.1                    |
| Goodwill                            | 1.5                    |
| Liabilities assumed                 | (0.1)                  |
| <b>Total</b>                        | <b>\$4.2</b>           |

The allocation of the purchase price was determined based on a valuation of assets acquired and liabilities assumed determined with the assistance of an independent appraisal. This allocation was based on the estimated fair value of these assets determined by management using information from the independent appraisal. The fair values and the allocation may change as we gather information on the fair value of acquired assets and liabilities and its tax effect.

The assets will be amortized or depreciated over a period of years shown on the following table:

| Description                    | Estimated remaining life (years) |
|--------------------------------|----------------------------------|
| Tangible assets:               |                                  |
| Office equipment               | 3 - 5                            |
| Computer equipment             | 3                                |
| Amortizable intangible assets: |                                  |

|                                     |    |
|-------------------------------------|----|
| Domain names                        | 5  |
| Designer agreements / relationships | 5  |
| Broker agreements / relationships   | 5  |
| Proprietary plans                   | 15 |
| Customer lists                      | 3  |

Goodwill in the amount of \$1.5 million represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired, and is not deductible for tax purposes. Goodwill will not be amortized and will be tested for impairment at least annually.

This transaction was not deemed to be a material business combination; therefore, no pro forma results are required under the Statement of Financial Accounting Standards No. 141.

The following attributes of the combination of the WHL and Houseplans businesses were considered significant factors to the establishment of the purchase price, resulting in the recognition of goodwill:

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WHL is the operator of the #4 Google ranked globalHouseplans.com website as well as the Canadian focused Weinmaster.com. WHL, one of the leading marketers of stock house plans in Canada, has operated its plans business in the United States and Canada for more than twenty-five years, and is one of the leading innovators in the market. In addition to more than 16,300 plans available to customers, which includes over 500 proprietary Weinmaster plans, WHL has an impressive array of content and tools to help homeowners and their builders economically build their dream homes. Potential operating synergies are anticipated to arise and are likely to include sales growth from joint marketing programs, utilization of best practices developed in each organization, shared content and reduced common product development costs and limited reductions in administrative costs.

**6. Plan of merger with AccessMedia**

On December 16, 2005, AccessMedia Networks, Inc. (“AccessMedia”), a Delaware corporation, AccessMedia’s stockholders, ACCM Acquisition Corp., a Delaware corporation and our wholly owned subsidiary (“Merger Sub”) and we, entered into an agreement and plan of merger (“Agreement”), under which Merger Sub will be merged with and into AccessMedia, with AccessMedia continuing after the merger as the surviving corporation and our wholly-owned subsidiary. This agreement was amended and restated on March 24, 2006.

Under the Agreement, we will issue 29 million shares of our common stock to AccessMedia’s stockholders at the closing of this transaction, representing approximately 48.4% of our outstanding stock at such time. Following the closing, we may issue up to 35 million additional shares of our common stock to AccessMedia’s stockholders if AccessMedia achieves certain revenue goals prior to December 31, 2008 (subject to certain extensions as provided in the Agreement). The closing of the transaction is anticipated to occur in the second calendar quarter of 2006. Concurrent with the closing, we intend to change our name to Broadcaster, Inc.

The Agreement has been approved by both AccessMedia’s and our Boards of Directors, and the transactions contemplated thereby are subject to customary closing conditions. IMSI has scheduled a stockholder meeting for May 23, 2006 and filed a definitive proxy on May 5, 2006 containing proposals for the stockholders, one of which is the approval of this transaction by IMSI stockholders. Following an affirmative stockholder vote, the transaction would be expected to close less than a week thereafter. The shareholders will also consider authorizing the Board to execute a reverse (1:2) stock split.

Concurrently with the execution of the Agreement, we entered into a joint operating agreement, under which we agreed to loan AccessMedia up to \$3.0 million prior to the closing of the merger pursuant to a joint operating plan and an operating budget to be delivered to a joint operating committee comprised of representatives of AccessMedia and our Company. In addition, we agreed to fund up to \$7.0 million of net working capital needs of the surviving entity if certain operating milestones are achieved, as outlined in the joint operating agreement. AccessMedia has not yet requested funding under this arrangement.

**7. Fair Value of Financial Instruments**

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

As discussed in note 4 above, we currently have approximately \$0.3 million of cash in escrow. Our cash and cash equivalents do not reflect the cash that remain in escrow.

As of June 30, 2005 we had \$0.7 million classified as trading securities on our condensed consolidated balance sheets representing the market value of our investment portfolio. The fair value of trading securities is based upon quoted market prices.

**8. Intangible Assets**

**Software Development Costs and License Fees**

Costs incurred in the initial design phase of software development are expensed as incurred in research and development. Once the point of technological feasibility is reached, direct production costs are capitalized in compliance with Statement of Financial Accounting Standards (“SFAS”) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*. We cease capitalizing computer software costs when the product is available for general release to customers. Costs associated with acquired completed software are capitalized.

We amortize capitalized software development costs and visual content license fees on a product-by-product basis. The amortization for each product is the greater of the amount computed using (a) the ratio of current gross revenues to the total of current and anticipated future gross revenues for the product or (b) 18, 36, or 60 months, depending on the product. We evaluate the net realizable value of each software product at each balance sheet date and record write-downs to net realizable value for any products for which the carrying value is in excess of the estimated net realizable value.

### Other Intangible Assets

Other intangible assets other than goodwill represent Internet domain names, acquired customer lists and contracts, distribution rights and relationships, proprietary plans, trade names and trademarks. These assets are amortized using the straight-line method over the estimated useful lives, generally five to fifteen years.

### Impairment of Long Lived Assets

We review long-lived assets and identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. We assess these assets for impairment based on estimated undiscounted future cash flows from these assets. If the carrying value of the assets exceeds the estimated future undiscounted cash flows, a loss is recorded for the excess of the asset's carrying value over the fair value. We did not recognize any impairment related to long-lived assets for the three and nine months ended March 31, 2006 and 2005.

### Goodwill

In accordance with SFAS No. 142, *Goodwill and Intangible Assets*, goodwill is assessed for impairment annually (in our first fiscal quarter) or more frequently if circumstances indicate impairment. We had goodwill in the amount of \$3.9 million and \$2.1 million as of March 31, 2006 and June 30, 2005, respectively, mainly related to the acquisitions we made during the quarter ended September 30, 2005 and during the last two fiscal years ended June 30, 2005 and 2004. We did not recognize any impairment related to goodwill for the three and nine months ended March 31, 2006 and 2005.

## 9. Debt

The following table details our outstanding debt as of March 31, 2006:

(In thousands)

|  | As of March 31, 2006 |
|--|----------------------|
| <b>Short-term</b>                          |                      |
| Acquisition related obligations Weinmaster | \$ -                 |
| Cardiff Consultants, Ltd.                  | 91                   |
| Other obligations                          | 2                    |
| <b>Subtotal short-term</b>                 | <b>93</b>            |
| <b>Long-term</b>                           |                      |
| Acquisition related obligations            |                      |
| ULTRYX                                     | 176                  |
| Other obligations                          | -                    |
| <b>Subtotal long-term</b>                  | <b>176</b>           |
| <b>Grand total</b>                         | <b>\$269</b>         |



As discussed above in note 5, the purchase of WHL was financed by a \$1.0 million promissory note which had been paid in full as of March 31, 2006. Cardiff Consultants, Ltd. was owed non-interest bearing amounts with the final payment due September 2006, with \$91,000 fair value classified as short-term debt.

ULTRYX, Inc. was owed non-interest bearing amounts with the final payment due February 2012, shown as \$176,000 in long-term debt.

As of June 30, 2005, we owed \$2.0 million on a 4% secured promissory note to Monterey Bay Tech., Inc. ("MBYI") with the final payment during May 2007. This note arose in connection with the acquisition of Allume from MBYI in April 2004. Also in connection with this transaction, MBYI also was owed \$667,000, non-interest bearing and due in August 2005. Following the sale of Allume to Smith Micro in July 2005, we repaid the MYBI obligations. As of June 30, 2005, we recorded \$94,000 and \$61,000 in short-term and long-term debt, respectively, payable to Cardiff Consultants, Ltd. (which includes the payment of \$65,000 of principal during the nine months ended March 31, 2006), \$168,000 in long-term debt to ULTRYX and \$3,000 and \$1,000 in long-term and short-term debt for other obligations.

#### 10. Gain / (loss) on Marketable Securities

The following table details the realized and unrealized net loss on marketable securities that we recognized on our condensed consolidated statements of operations and comprehensive income/(loss) for the three and nine months ended March 31, 2006 and 2005, respectively:

(In thousands)

| Description  | Gain (loss) on marketable securities for the three months ended March 31, 2006 |  |  |            |
|--------------|--|--|--|------------|
|              | Realized   | Reversal of unrealized gain / (loss) recognized in prior periods | Unrealized gain / (loss) for the three months ended March 31, 2006 | Total      |
|              | \$-  | -  | -  | \$-        |
| <b>Total</b> | <b>\$-</b>   | <b>-</b>   | <b>-</b>   | <b>\$-</b> |

| Description | Gain (loss) on marketable securities for the three months ended March 31, 2005 |  |  |       |
|-------------|--|--|--|-------|
|             | Realized   | Reversal of unrealized gain / (loss) recognized in prior periods | Unrealized gain / (loss) for the three months ended March 31, 2005 | Total |
|             | \$-  | -  | -  | \$-   |
|             |  |  |  |       |

| Description | Gain (loss) on marketable securities for the nine months ended March 31, 2006 |  |  |       |
|-------------|---|--|--|-------|
|             | Realized  | Reversal of unrealized gain / (loss) recognized in prior periods | Unrealized gain / (loss) for the nine months ended | Total |
|             |   |  |  |       |
|             |   |  |  |       |

March 31,  
2006

|                                     |              |             |               |             |              |
|-------------------------------------|--------------|-------------|---------------|-------------|--------------|
| Smith Micro common stock            | \$923        |             |               |             | \$923        |
| Other stock in investment portfolio | (\$234)      | \$90        | (\$14)        | \$76        | (\$158)      |
| <b>Total</b>                        | <b>\$689</b> | <b>\$90</b> | <b>(\$14)</b> | <b>\$76</b> | <b>\$765</b> |

**Gain (loss) on marketable securities for the nine months ended March 31, 2005**

| Description | Realized | Unrealized   |  | Sub total<br>Unrealized<br>gain /<br>(loss) | Total |
|-------------|----------|--|--|---|-------|
|             |          | Reversal of<br>unrealized gain /<br>(loss)<br>recognized in<br>prior periods | Unrealized<br>gain /<br>(loss) for<br>the nine<br>months<br>ended<br>March 31,<br>2005 |   |       |

|                               |         |           |        |           |       |
|-------------------------------|---------|-----------|--------|-----------|-------|
| Stock in investment portfolio | \$2,239 | (\$2,067) | (\$27) | (\$2,094) | \$145 |
|-------------------------------|---------|-----------|--------|-----------|-------|

The Smith Micro shares were registered and sold by us in November 2005 resulting in a realized gain of \$923,000.

## 11. Marketable Securities Activity

(In thousands)

|  | <b>Nine Months Ended March 31</b> |                |
|--|-----------------------------------|----------------|
|  | <b>2006</b>                       | <b>2005</b>    |
| <b>Beginning balance of marketable securities July 1</b>       | \$714                             | \$2,151        |
| Net cash transferred in (out) of marketable securities account | (2,755)                           | 16             |
| Securities received from sale of subsidiary                    | 1,832                             | -              |
| Purchases of marketable securities                             | -                                 | (3,885)        |
| Realized gain  | 689                               | 2,181          |
| Unrealized loss  | 76                                | (2,061)        |
| Borrowings from (repayment of) margin account                  | (558)                             | 3,885          |
| Interest and dividends earned                                  | 2                                 | -              |
| Margin interest paid   | -                                 | (29)           |
| Wire fees  | -                                 | -              |
| Net change in marketable securities                            | (714)                             | 107            |
| <b>Ending balance of marketable securities March 31</b>        | <b>\$0</b>                        | <b>\$2,258</b> |

## 12. Segment Information

We have two reportable operating segments which are based on our product families that generate revenues and incur expenses related to the sale of our software and Internet content. All inter-company amounts are eliminated through consolidation. Certain general and administrative expenses are allocated among our different segments.

(In thousands)

|                         | <b>Three months ended March, 31 2006</b> |   |                 | <b>Three months ended March, 31 2005</b> |   |                 |
|-------------------------|--|---|-----------------|--|---|-----------------|
|                         | <b>Software<br/>Segment</b>              | <b>Internet<br/>Content<br/>Segment</b> | <b>Total</b>    | <b>Software<br/>Segment</b>              | <b>Internet<br/>Content<br/>Segment</b> | <b>Total</b>    |
| Net revenues            | \$1,814                                  | \$2,215                                 | <b>\$4,029</b>  | \$2,319                                  | \$1,480                                 | <b>\$3,799</b>  |
| Gross margin            | 1,157                                    | 1,448                                   | <b>\$2,605</b>  | 1,686                                    | 841                                     | <b>\$2,527</b>  |
| Operating Income (loss) | (985)                                    | 388                                     | (\$597)         | (459)                                    | 1                                       | (\$458)         |
| Total Assets            | \$15,883                                 | \$5,419                                 | <b>\$21,302</b> | \$22,307                                 | \$3,745                                 | <b>\$26,052</b> |

|                         | Nine months ended March, 31 2006 |                          |                  | Nine months ended March, 31 2005 |                          |                  |
|-------------------------|----------------------------------|--------------------------|------------------|----------------------------------|--------------------------|------------------|
|                         | Software Segment                 | Internet Content Segment | Total            | Software Segment                 | Internet Content Segment | Total            |
| Net revenues            | \$6,266                          | \$5,448                  | <b>\$11,714</b>  | \$7,427                          | \$2,985                  | <b>\$10,412</b>  |
| Gross margin            | 4,049                            | 3,458                    | <b>\$7,507</b>   | 5,350                            | 1,647                    | <b>\$6,997</b>   |
| Operating Income (loss) | (2,415)                          | (212)                    | <b>(\$2,627)</b> | (1,280)                          | (274)                    | <b>(\$1,554)</b> |
| Total Assets            | \$15,883                         | \$5,419                  | <b>\$21,302</b>  | \$22,307                         | \$3,745                  | <b>\$26,052</b>  |

The following table details the breakdown of our net revenues and total assets by geographical location. The International column includes revenues relating to our Canadian, German and Australian wholly-owned subsidiaries, WHL, IMSI GmbH and IMSI Australia PTY Ltd, and sales derived from international distribution and republishing agreements we have in Europe (France, England), Asia (Japan and China) and Australia. The International column also includes the total assets held by our Canadian, German and Australian wholly-owned subsidiaries.

(In thousands)

|              | Three months ended March, 31 2006 |               |                 | Three months ended March, 31 2005 |               |                 |
|--------------|-----------------------------------|---------------|-----------------|-----------------------------------|---------------|-----------------|
|              | Domestic                          | International | Total           | Domestic                          | International | Total           |
| Net revenues | \$3,064                           | \$965         | <b>\$4,029</b>  | \$3,403                           | \$396         | <b>\$3,799</b>  |
| Total Assets | \$15,847                          | \$5,455       | <b>\$21,302</b> | \$25,558                          | \$494         | <b>\$26,052</b> |
|              | Nine months ended March, 31 2006  |               |                 | Nine months ended March, 31 2005  |               |                 |
|              | Domestic                          | International | Total           | Domestic                          | International | Total           |
| Net revenues | \$8,670                           | \$3,044       | <b>\$11,714</b> | \$8,872                           | \$1,540       | <b>\$10,412</b> |
| Total Assets | \$15,847                          | \$5,455       | <b>\$21,302</b> | \$25,558                          | \$494         | <b>\$26,052</b> |

### 13. Earnings per Share - Potentially Dilutive Securities

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 on exercise of stock options and warrants (using the treasury stock method). Potentially dilutive securities are excluded from the computation if their effect is anti-dilutive. The following table summarizes the weighted average shares outstanding:

(In thousands)

|  | Three months ended March 31, |               |
|--|------------------------------|---------------|
|  | 2006                         | 2005          |
| <b>Basic weighted average shares outstanding</b>   | <b>30,043</b>                | <b>28,051</b> |
| Total stock options outstanding                    | 4,761                        | 3,761         |
| Less: anti dilutive stock options                  | (4,761)                      | (3,761)       |
| Total warrants outstanding                         | 5,814                        | 6,623         |
| Less: anti dilutive warrants                       | (5,814)                      | (6,623)       |
| <b>Diluted weighted average shares outstanding</b> | <b>30,043</b>                | <b>28,051</b> |



|  | <b>Nine months ended March 31,</b> |               |
|--|------------------------------------|---------------|
|  | <b>2006</b>                        | <b>2005</b>   |
| <b>Basic weighted average shares outstanding</b>   | <b>29,850</b>                      | <b>27,623</b> |
| Total stock options outstanding                    | 4,761                              | 3,761         |
| Less: anti dilutive stock options due to loss      | (4,761)                            | (3,761)       |
| Total warrants outstanding                         | 5,814                              | 6,623         |
| Less: anti dilutive warrants due to loss           | (5,814)                            | (6,623)       |
| <b>Diluted weighted average shares outstanding</b> | <b>29,850</b>                      | <b>27,623</b> |

#### 14. Stock Based Awards

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

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

Beginning on July 1, 2006, we will adopt the accounting treatment required by SFAS 123 (revised 2004) which will require us to measure all employee stock-based compensation awards using a fair value method and record such expense in our consolidated financial statements.

Under variable plan accounting, we recognize a charge equal to the per share change in the share value until the underlying options expire or are exercised. During the three months ended March 31, 2006 and 2005, we recognized an expense of \$2,000 and \$2,000 respectively related to variable awards. During the nine months ended March 31, 2006 and 2005, we recognized a benefit of (\$2,000) and (\$5,000) respectively related to variable awards.

Had compensation cost for the stock-based compensation plans been determined based upon the fair value at grant dates for awards under those plans consistent with the method prescribed by SFAS 123, net income and net loss would have been decreased and increased, respectively, to the pro forma amounts indicated below. The pro forma consolidated financial information should be read in conjunction with the related historical information and is not necessarily indicative of actual results.

(In thousands, except per share amounts)

|  | <b>Three months ended March 31,</b> |                |
|--|-------------------------------------|----------------|
|  | <b>2006</b>                         | <b>2005</b>    |
| <b>Net income , as reported</b>                          | <b>\$251</b>                        | <b>\$(386)</b> |
| Intrinsic compensation charge recorded under APB 25      | 3                                   | 8              |
| Pro forma compensation charge under SFAS 123, net of tax | (89)                                | (90)           |
| <b>Pro forma net income (loss)</b>                       | <b>\$165</b>                        | <b>\$(468)</b> |

Earnings (loss) per share:

|                     |        |          |
|---------------------|--------|----------|
| Basic—as reported   | \$0.01 | (\$0.01) |
| Basic—pro forma     | \$0.01 | \$0.00   |
| <hr/>               |        |          |
| Diluted—as reported | \$0.01 | (\$0.01) |
| Diluted—pro forma   | \$0.01 | \$0.00   |



|  | <b>Nine months ended March 31,</b> |                  |
|--|------------------------------------|------------------|
|  | <b>2006</b>                        | <b>2005</b>      |
| <b>Net loss, as reported</b>                             | <b>\$(1,580)</b>                   | <b>\$(532)</b>   |
| Intrinsic compensation charge recorded under APB 25      | 21                                 | 23               |
| Pro forma compensation charge under SFAS 123, net of tax | (249)                              | (507)            |
| <b>Pro forma net loss</b>                                | <b>\$(1,808)</b>                   | <b>\$(1,016)</b> |
| Loss per share:  |                                    |                  |
| Basic—as reported  | (\$0.05)                           | (\$0.02)         |
| Basic—pro forma  | (\$0.06)                           | (\$0.04)         |
| Diluted—as reported                                      | (\$0.05)                           | (\$0.02)         |
| Diluted—pro forma  | (\$0.06)                           | (\$0.04)         |

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

|                                 | <b>Nine months ended March 31,</b> |               |
|---------------------------------|------------------------------------|---------------|
|                                 | <b>2006</b>                        | <b>2005</b>   |
| Risk-free interest rates        | 4.9% - 4.2%                        | 4.5% - 4.1%   |
| Expected dividend yields        | -                                  | -             |
| Expected volatility             | 75.0% - 69.2%                      | 66.2% - 55.0% |
| Expected option life (in years) | 10                                 | 10            |

The weighted average fair values as of the grant date for grants made during the three and nine months ended March 31, 2006 were \$0.69 and \$0.84, respectively.

The weighted average fair values per option as of the grant date for grants made during the three and nine months ended March 31, 2005 were \$0.85 and \$0.74, respectively.

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

### Overview

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to provide readers with an understanding of the Company. The following are included in our MD&A:

- Overview;
- Significant Trends and Developments in Our Business;
- How We Generate Revenue;
- Recent Events;
- Forward Looking Statements;
- Results of Operations;
- Liquidity and Capital Resources;
- Critical Accounting Policies; and
- Factors That May Impact Future Operating Results.

We are a leading provider of stock house plans over the Internet with the largest selection of plans for consumers and builders. We also sell a variety of related content and services over the Internet. In addition, we are a developer and publisher of software solutions which we market and sell to individuals and small business users through an array of distribution channels. We are committed to being a leading provider of these applications and services to businesses and consumers.

### Significant Trends and Developments in Our Business

Since the beginning of July 2004, we have acquired two house plans businesses: Abbisoft House Plans Inc. ("Abbisoft") and Weinmaster Homes Ltd. ("WHL") to add to Houseplans. We sold subsidiaries Keynomics and Allume, which are software and productivity enhancement businesses now shown as discontinued operations. We show stronger growth, both organic and acquired, in the Houseplans business line. Our software businesses present a higher gross margin but show slower growth and negative growth comparisons in some periods. Both businesses have seasonality. Software is affected by the annual release cycle and Houseplans is correlated with the building season. We expect growth trends to continue, with the impact of any housing slowdown cushioned by our consumer-friendly business model. Expense levels are expected to continue near current dollar levels and increasing at less than the rate of revenue growth. Additional cost savings are expected to be implemented by management as opportunities arise.

As combined, the businesses have not yet achieved breakeven with economies of scale. In order to achieve profitability, we will need to generate significantly higher revenue and continue to manage our expenses. Our ability to generate higher revenues and achieve profitability depends on many factors, including the demand for our products and services, the level of product and price competition, market acceptance of our new products, general economic conditions and the successful integration of Abbisoft and WHL. In this regard, we continue to invest in areas that we believe can accelerate revenue growth and to manage expenses to align our operations and cost structure with market conditions.

Over the past twelve months we have completed several acquisitions aimed at growing our revenues and strengthening our financial results. Management believes that good value target companies, presenting a strategic fit with our current operations, are still present in the marketplace and that potential business combinations with these entities, such as our planned merger with AccessMedia, would help us increase shareholder value. If the AccessMedia transaction were not to occur, significant non-contingent transaction costs would appear as general and administrative expense in the period.

### How We Generate Revenue

We lead the market for house plans sold over the Internet with the largest selection of plans for consumers and builders. We also sell a variety of related content and services over the Internet. Additionally, we develop, publish, market and sell a variety of software titles and services that are targeted to a wide array of users primarily for individuals and small businesses. To efficiently serve our customers and maximize our revenue opportunities, we have aligned our business along two segments as described below:

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| <b>Business Segment</b> | <b>Product Family</b>                    | <b>Product Group</b>       | <b>Selected Product Brand</b>  |   |
|-------------------------|--|----------------------------|--|---|
| <b>Software</b>         | Precision Design Software                | Professional CAD Solutions | <i>TurboCAD Professional</i><br><i>TurboCADCAM</i><br><i>CADsymbols</i><br><i>TurboCAD Deluxe</i>  |   |
|                         |  | Consumer CAD Solutions     | <i>DesignCAD</i><br><i>Instant Series</i><br><i>FloorPlan</i><br><i>FlowCharts &amp; More</i><br><i>FormTool</i><br><i>QuickStart</i><br><i>TurboProject</i><br><i>Animations &amp; More</i> |   |
|                         | Business Applications and Other Software | Business Solutions         | <i>ClipArt &amp; More</i><br><i>HiJaak</i><br><i>EazyLanguage</i><br><i>Legacy Family Tree</i><br><i>TurboTyping</i>   |   |
|                         |  | Graphics Solutions         |  |   |
|                         | <b>Internet Content</b>                  | Home Design                | Consumer Solutions   | <i>Houseplans.com</i><br><i>Houseplanguys.com</i><br><i>Homeplanfinder.com</i><br><i>Globalhouseplans.com</i> |
|                         |  |                            | Houseplans   |   |

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

Our market-leading house plans are physically delivered either by our organization or by our designer partners.

Our software products are sold either as electronic software download (“ESD”) or as physical products. Our physical distribution network includes leading distributors and retailers in North America and worldwide.

Our distribution methods are comprised of the following three major channels:

***Direct Marketing:***

We conduct postal and email direct mail campaigns to businesses and end users for our existing and new products in addition to upgrades of existing products, as well as third-party offers. These mailings generally offer a specially priced product, as well as complementary or enhanced products for additional fees. We also maintain e-commerce websites and employ a sales force internally and through strategic partnerships.

***Retail / Distribution:***

We are present in the retail software market through selected distributors and partners for a number of our products in order to reach a wider range of end users. Intense price competition along with the intermittent unfavorable retail conditions, including erosion of margins from competitive marketing and high rates of product returns, make this distribution channel increasingly challenging.

***Republishing / Original Equipment Manufacturers (“OEM”):***

We have republishing agreements domestically and internationally which typically include minimum guaranteed royalty payments.

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**Recent Events****The Weinmaster Homes, Ltd. (“WHL”) Acquisition**

On July 1, 2005, Houseplans, Inc, our wholly owned subsidiary, consummated the acquisition of all the stock of WHL, pursuant to a stock purchase agreement between WHL, Bruce and Janice Weinmaster and Houseplans, Inc. The purchase price of approximately \$4.2 million consisted of \$2.0 million in cash, \$1.0 million in a promissory note, transaction costs of \$0.2 million and \$1.0 million (based on the five-trading-day average price of our common stock surrounding the date the business combination was announced) in our unregistered common stock, which we have committed to register with the SEC within sixty days of the completion of the AccessMedia transaction pursuant to an amended registration rights agreement dated October 28, 2005.

**The Sale of Allume**

On July 1, 2005, we sold all of the issued and outstanding capital stock of Allume to Smith Micro for an aggregate sales price of \$12.8 million made up as follows:

(In millions)

| Description   | Amount         |
|---|----------------|
| Cash  | \$ 11.0        |
| Fair value of 397,547 unregistered shares of our Smith Micro common stock | 1.8            |
| <b>Total</b>  | <b>\$ 12.8</b> |

The fair value of the common stock was based on the five-trading-day average price of Smith Micro’s common stock surrounding the date the business combination was announced.

At closing an indemnity escrow was established to secure certain representations and warranties included in our stock purchase agreement with Smith Micro. The following sale proceeds were deposited into the escrow.

(In millions)

| Description   | Amount          |
|---|-----------------|
| Cash  | \$ 1.25         |
| 170,398 unregistered shares of our Smith Micro common stock | 0.784           |
| <b>Total</b>  | <b>\$ 2.034</b> |

The value of the common stock was based on the date of closing.

On November 2, 2005, we replaced the shares of Smith Micro common stock in escrow with cash, as permitted by the escrow agreement.

On November 10, 2005, we sold 100% of our holdings of Smith Micro shares at a gain of \$923,000 which was shown in Other Income as Realized Gain on Securities in the December quarter.

Pursuant to the stock purchase agreement, Smith Micro released \$500,000 plus interest of \$7,000 and \$750,000 plus interest of \$26,000 of the escrowed cash to us in December 2005 and March 2006, respectively. These amounts, when released, added to our calculation of gain or loss on the sale.

As a result of this sale, we have categorized the assets, liabilities and operations of Allume as discontinued operations for the three and nine months ended March 31, 2005 and in the three months ended March 31, 2006 we recorded a

gain on the sale of discontinued operations of \$776,000 representing the amount released from escrow on March 31, 2006 plus accrued interest. The gain on the sale of Allume totaled \$302,000 as of March 31, 2006. This gain calculation does not consider the remaining cash held in escrow of approximately \$0.3 million and is subject to change in future reporting periods depending upon the future release of cash from escrow.

## **Plan of Merger with AccessMedia**

On December 16, 2005, AccessMedia Networks, Inc. (“AccessMedia”), a Delaware corporation and the stockholders of AccessMedia, ACCM Acquisition Corp., a Delaware corporation and our wholly owned subsidiary (also referred to as Merger Sub), and we entered into an Agreement and Plan of Merger (“Agreement”), under which Merger Sub will be merged with and into AccessMedia, with AccessMedia continuing after the merger as the surviving corporation and our wholly-owned subsidiary. This agreement was amended and restated on March 24, 2006.

Under the agreement, we will issue 29 million shares of our common stock to AccessMedia’s stockholders at the closing, representing approximately 48.4% of our outstanding stock at such time. Following the closing, we may issue up to 35 million additional shares to AccessMedia’s stockholders if AccessMedia achieves certain revenue goals prior to December 31, 2008 (subject to certain extensions as provided in the Agreement). The closing of the transaction is anticipated to occur in the second calendar quarter of 2006. Concurrent with the closing, we intend to change our name to Broadcaster, Inc. The shareholders will also consider authorizing the Board to execute a reverse (1:2) stock split.

The Agreement has been approved by both AccessMedia’s and our Boards of Directors, and the transactions contemplated thereby are subject to customary closing conditions. IMSI has scheduled a stockholder meeting for May 23, 2006 and filed a definitive proxy on May 5, 2006 containing proposals for the stockholders, one of which is the approval of this transaction by IMSI stockholders. Following an affirmative stockholder vote, the transaction would be expected to close less than a week thereafter.

Concurrently with the execution of the Agreement, we entered into a joint operating agreement, under which we agreed to loan AccessMedia up to \$3.0 million prior to the closing of the merger pursuant to a joint operating plan and an operating budget to be delivered to a joint operating committee comprised of representatives of our Company and AccessMedia. In addition, we agreed to fund up to \$7.0 million of net working capital needs of the surviving entity if certain operating milestones are achieved. AccessMedia has not yet requested funding under this arrangement.

## **Forward Looking Statements**

The following information should be read in conjunction with our consolidated financial statements and the notes thereto and in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our June 30, 2005 Annual Report on Form 10-KSB, as amended. This quarterly report on Form 10-QSB, and in particular this “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” may contain forward-looking statements regarding future events or our future performance. These future events and future performance involve certain risks and uncertainties including those discussed in the “Factors That May Impact Future Operating Results” section of this Form 10-QSB, as well as in our Fiscal 2005 Form 10-KSB, as amended, as filed with the U.S. 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.

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



available alternative would not produce a materially different result.

**Results of Operations**

The following tables sets forth our results of operations for the three and nine months ended March 31, 2006 and 2005 in absolute dollars and as a percentage of net revenues. It also details the changes from the prior fiscal year in absolute dollars and in percentages.

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(In Thousands)

|  | Three months ended March 31, |               |                |               |                              |              |
|--|------------------------------|---------------|----------------|---------------|------------------------------|--------------|
|  | 2006                         |               | 2005           |               | \$ Change from previous year |              |
|  | \$                           | As % of sales | \$             | As % of sales | Variance                     | %            |
| Net revenues   | \$4,029                      | 100%          | \$3,799        | 100%          | \$230                        | 6%           |
| Product cost   | 1,424                        | 35%           | 1,272          | 33%           | 152                          | 12%          |
| <b>Gross margin</b>  | <b>2,605</b>                 | <b>65%</b>    | <b>2,527</b>   | <b>67%</b>    | <b>78</b>                    | <b>3%</b>    |
| Operating expenses   |                              |               |                |               |                              |              |
| Sales & marketing  | 1,669                        | 41%           | 1,635          | 43%           | 34                           | 2%           |
| General & administrative   | 1,047                        | 26%           | 932            | 25%           | 115                          | 12%          |
| Research & development   | 486                          | 12%           | 418            | 11%           | 68                           | 16%          |
| <b>Total operating expenses</b>                                  | <b>3,202</b>                 | <b>79%</b>    | <b>2,985</b>   | <b>79%</b>    | <b>217</b>                   | <b>7%</b>    |
| <b>Operating loss</b>  | <b>(597)</b>                 | <b>-15%</b>   | <b>(458)</b>   | <b>-12%</b>   | <b>(139)</b>                 | <b>30%</b>   |
| Other income (expenses)  |                              |               |                |               |                              |              |
| Interest expense   | 26                           | 1%            | (64)           | -2%           | 90                           | -141%        |
| Interest income  | 56                           | 1%            | 22             | 1%            | 34                           | 155%         |
| Gain (loss) sale of product line                                 | -                            | 0%            | -              | 0%            | -                            | 0%           |
| Gain (loss) on disposal of subsidiaries                          | -                            | 0%            | -              | 0%            | -                            | 0%           |
| Realized gain (loss) - Securities                                | -                            | 0%            | 100            | 3%            | (100)                        | -100%        |
| UnRealized gain (loss) - Securities                              | -                            | 0%            | (376)          | -10%          | 376                          | 100%         |
| Foreign exchange gain/loss                                       | 11                           | 0%            | (19)           | -1%           | 30                           | -158%        |
| <b>Total other income</b>  | <b>93</b>                    | <b>2%</b>     | <b>(337)</b>   | <b>-9%</b>    | <b>430</b>                   | <b>-128%</b> |
| <b>Income (loss) before income tax</b>                           | <b>(504)</b>                 | <b>-13%</b>   | <b>(795)</b>   | <b>-21%</b>   | <b>291</b>                   | <b>-37%</b>  |
| Income tax benefit (provision)                                   | (21)                         | -1%           | (2)            | 0%            | (19)                         | 950%         |
| <b>Income loss from continuing operations</b>                    | <b>(525)</b>                 | <b>-13%</b>   | <b>(797)</b>   | <b>-21%</b>   | <b>272</b>                   | <b>-34%</b>  |
| Income (loss) from discontinued operations, net of income tax    |                              |               |                |               |                              |              |
| Gain from the sale of discontinued operations, net of income tax | 776                          | 19%           | 860            | 23%           | (84)                         | -10%         |
| <b>Net income (loss)</b>   | <b>\$251</b>                 | <b>6%</b>     | <b>(\$386)</b> | <b>-10%</b>   | <b>\$637</b>                 | <b>-165%</b> |

(In Thousands)

|  | Nine months ended March 31, |               |                |               |                              |             |
|--|-----------------------------|---------------|----------------|---------------|------------------------------|-------------|
|  | 2006                        |               | 2005           |               | \$ Change from previous year |             |
|  | \$                          | As % of sales | \$             | As % of sales | Variance                     | %           |
| Net revenues   | \$11,714                    | 100%          | \$10,412       | 100%          | \$1,302                      | 13%         |
| Product cost   | 4,207                       | 36%           | 3,415          | 33%           | 792                          | 23%         |
| <b>Gross margin</b>  | <b>7,507</b>                | <b>64%</b>    | <b>6,997</b>   | <b>67%</b>    | <b>510</b>                   | <b>7%</b>   |
| Operating expenses   |                             |               |                |               |                              |             |
| Sales & marketing  | 4,859                       | 41%           | 4,523          | 43%           | 336                          | 7%          |
| General & administrative   | 3,801                       | 32%           | 2,773          | 27%           | 1,028                        | 37%         |
| Research & development   | 1,474                       | 13%           | 1,255          | 12%           | 219                          | 17%         |
| <b>Total operating expenses</b>                                  | <b>10,134</b>               | <b>87%</b>    | <b>8,551</b>   | <b>82%</b>    | <b>1,583</b>                 | <b>19%</b>  |
| <b>Operating loss</b>  | <b>(2,627)</b>              | <b>-22%</b>   | <b>(1,554)</b> | <b>-15%</b>   | <b>(1,073)</b>               | <b>69%</b>  |
| Other income (expenses)  |                             |               |                |               |                              |             |
| Interest expense   | (118)                       | -1%           | (189)          | -2%           | 71                           | -38%        |
| Interest income  | 161                         | 1%            | 91             | 1%            | 70                           | 77%         |
| Gain (loss) sale of product line                                 | (1)                         | 0%            | 33             | 0%            | (34)                         | -103%       |
| Gain (loss) on disposal of subsidiaries                          | -                           | 0%            | -              | 0%            | -                            | 0%          |
| Realized gain (loss) - Securities                                | 689                         | 6%            | 2,239          | 22%           | (1,550)                      | -69%        |
| UnRealized gain (loss) - Securities                              | 76                          | 1%            | (2,094)        | -20%          | 2,170                        | 100%        |
| Foreign exchange gain/loss                                       | (2)                         | 0%            | 43             | 0%            | (45)                         | -105%       |
| <b>Total other income</b>  | <b>805</b>                  | <b>7%</b>     | <b>123</b>     | <b>1%</b>     | <b>682</b>                   | <b>554%</b> |
| <b>Income (loss) before income tax</b>                           | <b>(1,822)</b>              | <b>-16%</b>   | <b>(1,431)</b> | <b>-14%</b>   | <b>(391)</b>                 | <b>27%</b>  |
| Income tax benefit (provision)                                   | (60)                        | -1%           | (9)            | 0%            | (51)                         | 567%        |
| <b>Income loss from continuing operations</b>                    | <b>(1,882)</b>              | <b>-16%</b>   | <b>(1,440)</b> | <b>-14%</b>   | <b>(442)</b>                 | <b>31%</b>  |
| Income (loss) from discontinued operations, net of income tax    |                             |               |                |               |                              |             |
|  | -                           | 0%            | (5)            | 0%            | 5                            | -100%       |
| Gain from the sale of discontinued operations, net of income tax |                             |               |                |               |                              |             |
|  | 302                         | 3%            | 913            | 9%            | (611)                        | -67%        |
| <b>Net income (loss)</b>   | <b>(\$1,580)</b>            | <b>-13%</b>   | <b>(\$532)</b> | <b>-5%</b>    | <b>(\$1,048)</b>             | <b>197%</b> |

**Net Revenues**

The following illustrations of our net revenue reflect the allocation of our products across our business segments and across the distribution channels as well as the breakdown of our net sales domestically and internationally for the three and nine months ended March 31, 2006 and 2005.

(In thousands)

|                        | Three months ended March 31,<br>2006 |                                |                |                        | Nine months ended March 31,<br>2006 |                                |                 |
|------------------------|--------------------------------------|--------------------------------|----------------|------------------------|-------------------------------------|--------------------------------|-----------------|
|                        | Software<br>Segment                  | Internet<br>Content<br>Segment | Total          |                        | Software<br>Segment                 | Internet<br>Content<br>Segment | Total           |
| Net Revenues           | \$1,814                              | \$2,215                        | <b>\$4,029</b> | Net Revenues           | \$6,266                             | \$5,448                        | <b>\$11,714</b> |
| Channel Revenues       |                                      |                                |                | Channel Revenues       |                                     |                                |                 |
| Direct Marketing       | 885                                  | 2,215                          | <b>3,100</b>   | Direct Marketing       | 2,974                               | 5,448                          | <b>8,422</b>    |
| Retail / Distribution  | 172                                  | 0                              | <b>172</b>     | Retail / Distribution  | 627                                 | 0                              | <b>627</b>      |
| Republishing / OEM     | 757                                  | 0                              | <b>757</b>     | Republishing / OEM     | 2,665                               | 0                              | <b>2,665</b>    |
| <b>Subtotal</b>        | <b>1,814</b>                         | <b>2,215</b>                   | <b>4,029</b>   | <b>Subtotal</b>        | <b>6,266</b>                        | <b>5,448</b>                   | <b>11,714</b>   |
| Domestic Revenues      | 1,494                                | 1,570                          | <b>3,064</b>   | Domestic Revenues      | 4,895                               | 3,775                          | <b>8,670</b>    |
| International Revenues | 319                                  | 646                            | <b>965</b>     | International Revenues | 1,371                               | 1,673                          | <b>3,044</b>    |
| <b>Subtotal</b>        | <b>\$1,813</b>                       | <b>\$2,216</b>                 | <b>\$4,029</b> | <b>Subtotal</b>        | <b>\$6,266</b>                      | <b>\$5,448</b>                 | <b>\$11,714</b> |

|                       | Three months ended March 31,<br>2005 |                                |                |                       | Nine months ended March 31,<br>2005 |                                |                 |
|-----------------------|--------------------------------------|--------------------------------|----------------|-----------------------|-------------------------------------|--------------------------------|-----------------|
|                       | Software<br>Segment                  | Internet<br>Content<br>Segment | Sub<br>Total   |                       | Software<br>Segment                 | Internet<br>Content<br>Segment | Sub<br>Total    |
| Net Revenues          | \$2,319                              | \$1,480                        | <b>\$3,799</b> | Net Revenues          | \$7,428                             | \$2,984                        | <b>\$10,412</b> |
| Channel Revenues      |                                      |                                |                | Channel Revenues      |                                     |                                |                 |
| Direct Marketing      | 1,305                                | 1,480                          | <b>2,785</b>   | Direct Marketing      | 3,862                               | 2,984                          | <b>6,846</b>    |
| Retail / Distribution | 308                                  | 0                              | <b>308</b>     | Retail / Distribution | 1,056                               | 0                              | <b>1,056</b>    |
| Republishing / OEM    | 706                                  | 0                              | <b>706</b>     | Republishing / OEM    | 2,510                               | 0                              | <b>2,510</b>    |
| <b>Subtotal</b>       | <b>2,319</b>                         | <b>1,480</b>                   | <b>3,799</b>   | <b>Subtotal</b>       | <b>7,428</b>                        | <b>2,984</b>                   | <b>10,412</b>   |
| Domestic Revenues     | 1,923                                | 1,480                          | <b>3,403</b>   | Domestic Revenues     | 5,888                               | 2,984                          | <b>8,872</b>    |
|                       | 396                                  | 0                              | <b>396</b>     |                       | 1,540                               | 0                              | <b>1,540</b>    |

|                        |                |                |                |                        |                |                |                 |
|------------------------|----------------|----------------|----------------|------------------------|----------------|----------------|-----------------|
| International Revenues |                |                |                | International Revenues |                |                |                 |
| <b>Subtotal</b>        | <b>\$2,319</b> | <b>\$1,480</b> | <b>\$3,799</b> | <b>Subtotal</b>        | <b>\$7,428</b> | <b>\$2,984</b> | <b>\$10,412</b> |

**Revenues by Business Segment**

We have two business segments: Internet Content Segment and the Software Segment.

**Internet Content Segment:** We introduced this segment upon the acquisition of Houseplans, Inc. completed during the quarter ended December 31, 2003. During the nine months ended March 31, 2005, we completed the acquisition of Abbisoft House Plans, Inc. We continued to grow this segment to build a leading position in the sale of stock house plans online. During the nine months ended March 31, 2006, we completed the acquisition of Weinmaster Homes, Ltd., operator of globalHouseplans.com website as well as the Canadian-focused Weinmaster website.

The Internet Content Segment is primarily comprised of a network of highly ranked websites hosting an extensive library of unique stock house plans and marketed under the Houseplans, homeplanfinder, houseplanguys, globalHouseplans and Weinmaster websites. These websites are targeted to general contractors, consumers and designers.

Revenues generated by this segment grew substantially during the three and nine months ended March 31, 2006 as compared to the same period in the previous fiscal year. In addition to the revenues generated from our new acquisition in this segment, Weinmaster Homes, Ltd., which amounted to \$645,589 and \$1,673,169 for the three and nine months ended March 31, 2006, the revenue increase (6.1% and 26.5% year over year without WHL) for the Internet Content Segment highlights the organic growth of the underlying business. During the past few months, we were able to focus our direct marketing message, improve our websites, introduce new services and increase the number of units sold and the average selling price of our house plans.

This increase in revenues should continue during future reporting periods as we focus on improving the branding and marketing of our main websites and as we continue to successfully integrate the businesses we acquired. We expect some impact from the macroeconomics of the housing market but cannot predict the slowdown, if any, for our business. The prime building season ends in the fall and we expect our sales will then move to a lower, off-season level until early in 2007.

**Software Segment:** The software segment is comprised of the precision design software, the business applications and other software product families.

Within this business segment, revenues from the sale of the precision design software product family slightly decreased with the anticipation of the new version of our TurboCad products which was released at the end of March 2006, thus resulting in a pre-release decline in the sale of the business applications and other software product family resulting in an overall 21.8% and 15.7% decrease in the revenues derived from the software business during the three and nine months ended March 31, 2006 as compared to the same period from the previous fiscal year.

**Precision design software product family:** This product family which includes our flagship product, TurboCAD as well as other widely recognized brand names such FloorPlan, DesignCAD and the Instant Series had decreased revenues during the three and nine months ended March 31, 2006 as compared to the same period from the previous fiscal year. The anticipation of the new version of our TurboCad products released at the end of March 2006 accounted for the majority of the revenue decline in this product family.

**Business applications and other software product family:** This product family mainly includes third party product brands that we license from other software publishers and market to our client base along with certain software titles that we develop internally.

The decline in sales in this product family during the three and nine months ended March 31, 2006 was mainly the result of the decline in the revenues generated from the sale of third party products (including titles published by Allume that we were able to cross sell to our customers during previous quarters prior to our divestiture of Allume on July 1, 2005). The decline in revenues from the sale of FormTool and Hijaak (two internally developed products whose current versions are nearing the end of their life cycles) also contributed to the decline in revenues in this product family for fiscal 2006 as compared to the previous fiscal year.

### **Revenues by Distribution Channel**

Direct marketing accounted for the majority of our sales by distribution channel (77%). Revenues derived from the Internet Content Segment are exclusively sold through the direct marketing channel, therefore, the substantial increase in sales of the Internet Content Segment during the three and nine months ended March 31, 2006 accounted for the substantial boost in sales through the direct marketing channel for the same period as compared to the same period

from the previous fiscal year. Additionally, a substantial amount of our software segment sales were also fulfilled through our direct marketing channel where the more profitable Electronic Software Distribution (ESD) is the delivery method of choice.

We are reducing our focus on the retail / distribution channel as the retail consumer software market involves publishing competition, promotional expense and product returns relative to direct distribution. The decline in revenues from the retail / distribution and from the republishing / OEM channels \$136,000 and \$429,000 during the three and nine months ended March 31, 2006 as compared to the same period from the previous fiscal year reflects our increased focus on the direct marketing distribution channel. Revenues from republishing / OEM channel are mainly revenues derived from minimum guaranteed royalty agreements we have with domestic and international republishing partners.

### **Domestic and International Revenues**

We distribute our products through our wholly owned Canadian, Australian and German subsidiaries and republishing partners in Europe and Asia. Historically, our international activities relate mainly to the software segment but, with the acquisition of Weinmaster Homes, Ltd. in July 2005, we are increasing our presence on the international markets for the Internet Content Segment. The sharp increase in our international revenues for the quarter ended March 31, 2006, both in absolute dollars and as a percentage of total sales, is mainly attributable to the revenues generated from our newly acquired Canadian subsidiary.

Revenues from our German subsidiary declined slightly to \$153,000 for the quarter ended March 31, 2006, but increased to \$731,000 for the nine months ended March 31, 2006 from \$161,000 and \$639,000 for the same periods in the previous fiscal year. Introduction of new versions and updates of our software titles, better acceptance of our products in the European markets and improved focus on the retail and direct marketing channels were mainly the reasons for the revenues derived from our German subsidiary.

Revenues from our Australian subsidiary are primarily derived from royalty payments from a third party publisher after we licensed the distribution rights of certain products in Australia during fiscal 2003. Revenue from our Australian subsidiary amounted to approximately \$20,000 and \$84,000 for the three and nine months ended March 31, 2006 from \$25,000 and \$120,000 for the same period in the previous year.

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 consolidated gross margins decreased to 64.7% and 64.1% for the three months and nine months ended March 31, 2006 from 66.5% and 67.2% during the comparable period of the previous fiscal year. The growing share (“mix”) of the lower margin Internet Content Segment as a percentage of our total revenues was the primary reason for the decrease in our consolidated gross margins.

We were able to significantly improve the gross margin of our Internet Content Segment as we negotiated more competitive royalty rates with our vendors, increased our collection of proprietary royalty-free content and worked to integrate the acquisition we made in this segment. We believe that gross margins in the Internet Content Segment will modestly improve in the near-term as we continue our integration of WHL and as we leverage our leading position in the marketplace.

Despite a consolidation in sales of the more profitable precision design software product family, gross margin of the Software Segment decreased 31.4% and 24.3% during the three and nine months ended March 31, 2006 as compared to the same period from the previous fiscal year. The products in the precision design software product family carry a lower cost as compared to products in the business applications and other software family as we own the majority of their underlying technology. The decrease in the Software Segment margins was mainly due to obsolete inventory write offs, increases in shipping costs and the effect of fixed costs. The margins achieved during the three and nine months ended March 31, 2006 in this segment may fluctuate during future reporting periods 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. However, as we are able to shift sales mix by distribution channel toward the more profitable direct marketing channel, we should witness improvement in on our overall profit margin.

In addition to the costs of CD-ROM duplication, printing of manuals, packaging and fulfillment, and royalties and license fees that we pay to third parties based on sales of published software and content, our product costs include costs associated with the return of products, such as refurbishment and the write down in value of returned goods.

Our product costs also include the amortization of capitalized software, a component of our overall product costs. These amortization expenses amounted to \$91,000 and \$107,000 for the three months ended March 31, 2006 and 2005, respectively. As we continue to acquire businesses and product lines, we are likely to increase our basis in certain intangible assets, the amortization of which may negatively affect our gross margin in the future.

### **Sales and Marketing**



Sales and marketing expenses for the Internet Content Segment increased during the three and nine months ended March 31, 2006 as compared to the same period from the previous fiscal year. This increase was mainly the result of the additional sales and marketing expenses related to our newly acquired business (WHL), the increased direct marketing expenses, especially relating to advertising necessary to increase the traffic to our websites and to the increased payroll and related expenses from additional headcount. Despite the increase in sales and marketing expenses for this segment during the quarter ended March 31, 2006 as compared to the same period from the previous fiscal year, we continue to integrate the acquisitions and we continue to implement savings and identify synergies among our business units.

The increase in sales and marketing expenses for the Internet Content Segment was in part offset by a decrease in sales and marketing expenses for the Software Segment during the three and nine months ended March 31, 2006 as compared to the same periods from the previous fiscal year. The decrease in the sales and marketing expenses for the Software Segment was mainly the result of decreased consulting expenses, commissions paid to outside E-commerce partners and advertising expenses relating to the retail distribution channel.

Sales and marketing expenses consist primarily of salaries and benefits of sales and marketing personnel, commissions, advertising, printing and direct mail expenses. We continue to improve our focus on the direct marketing distribution channel and the ESD delivery method by improving our internal sales force and partnering with outside service providers of 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, amortization expenses, fees to our professional advisors, rent and other general operating costs.

The increase in our general and administrative expenses for the three and nine months ended March 31, 2006 as compared to the same period from the previous fiscal year is mainly attributable to severance pay accrued for an executive, increased payroll and related benefit expenses due to additional headcount, increased accounting fees, and real estate lease termination expenses relating to the Allume business we sold in July 2005. A significant portion of lease expenses related to the Allume business was accrued as of our year ended June 30, 2005. The accrual as of June 30, 2005 was based upon our decision to sublease the Allume facility. During the quarter ended September 30, 2005, we decided against subleasing the property and chose to incur a lease buy out option increasing our liability by about \$25,000.

The additional general and administrative expenses we incurred as a result of the WHL acquisition also accounted for the increase in general and administrative expenses relating to Internet Content Segment. During the three and nine months ended March 31, 2006, the Internet Content Segment assumed a larger share of common general and administrative expenses than for the previous comparable periods. If the growth of this business continues to outpace Software, this shift will continue.

### **Research and Development**

Our research and development expenses consist primarily of salaries and benefits for research and development employees and payments to independent contractors, mainly our third party contract development teams in Russia with whom we continue to maintain a strong partnership at competitive costs.

Research and development expenses for the three and nine months ended March 31, 2006 increased as compared to the same period from the previous fiscal year. The increase was related to the development cost associated to the new releases in the Software Segment, TurboCAD version 12 which was released at the end of March 2006. We continue a steady investment in research and development in the Software Segment. This is a reflection of our commitment to improving our existing core products and developing new titles, features and functionalities. Our management believes that product innovation and new technology integration is essential to proactively respond to the ever-evolving customer demands.

### **Interest and Other, Net**

Interest and other, net, include interest earned on cash and cash equivalents, interest expense on debt instruments, foreign currency transaction gains and losses, and other non-recurring items. A positive interest expense for the quarter ended March 31, 2006 is the result of the waiving of accrued interest on an obligation of an acquisition. The

following table summarizes the components of interest and other, net for the three and nine months ended March 31, 2006 and 2005:

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(In thousands)

|  | Three months ended March 31, |               |                              |              | Nine months ended March 31, |               |                              |              |  |
|--|------------------------------|---------------|------------------------------|--------------|-----------------------------|---------------|------------------------------|--------------|--|
|  | 2006                         | 2005          | \$ Change from previous year |              | 2006                        | 2005          | \$ Change from previous year |              |  |
|  |                              |               | \$ Increase / (Decrease)     | %            |                             |               | \$ Increase / (Decrease)     | %            |  |
|  | \$                           | \$            |                              |              | \$                          | \$            |                              |              |  |
| Interest & Other, net                  |                              |               |                              |              |                             |               |                              |              |  |
| Interest expense                       | \$27                         | (\$64)        | \$90                         | -142%        | (\$118)                     | (\$189)       | \$71                         | -38%         |  |
| Interest income                        | 56                           | 22            | 35                           | 155%         | 161                         | 91            | 70                           | 77%          |  |
| Gain on Sale of Product Line           | -                            | -             | -                            |              | (1)                         | 33            | (34)                         | -103%        |  |
| Foreign exchange gain                  | 10                           | (19)          | 29                           | -153%        | (2)                         | 43            | (45)                         | -105%        |  |
|  |                              |               | -                            |              |                             |               | -                            |              |  |
| <b>Total Interest &amp; Other, Net</b> | <b>\$93</b>                  | <b>(\$61)</b> | <b>\$154</b>                 | <b>-252%</b> | <b>\$40</b>                 | <b>(\$22)</b> | <b>\$62</b>                  | <b>-282%</b> |  |

**Gain / (Loss) on Marketable Securities**

The following table details the realized and unrealized net loss on marketable securities that we recognized on our condensed consolidated statements of operations and comprehensive income/(loss) for the three and nine months ended March 31, 2006 and 2005, respectively:

(In thousands)

| Description  | Gain (loss) on marketable securities for the three months ended March 31, 2006 |  |  |                                    |     |
|--------------|--|--|--|------------------------------------|-----|
|              | Realized   | Unrealized   |  | Total                              |     |
|              |  | Reversal of unrealized gain / (loss) recognized in prior periods | Unrealized gain / (loss) for the three months ended March 31, 2006 | Sub total Unrealized gain / (loss) |     |
| <b>Total</b> | \$-  | -  | -  | -                                  | \$0 |
|              | \$-  | -  | -  | -                                  | \$0 |

**Gain (loss) on marketable securities for the three months ended March 31, 2005**

| Description | Gain (loss) on marketable securities for the three months ended March 31, 2005 |  |  |                                    |  |
|-------------|--|--|--|------------------------------------|--|
|             | Realized   | Unrealized   |  | Total                              |  |
|             |  | Reversal of unrealized gain / (loss) recognized in prior periods | Unrealized gain / (loss) for the three months ended March 31, 2005 | Sub total Unrealized gain / (loss) |  |
|             |  |  |  |                                    |  |

|              |            |          |          |          |          |
|--------------|------------|----------|----------|----------|----------|
|              | \$-        | -        | -        | -        | -        |
| <b>Total</b> | <b>\$-</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>-</b> |

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**Gain (loss) on marketable securities for the nine months ended March 31, 2006**

| Description                         | Realized     | Unrealized   |  | Sub total<br>Unrealized<br>gain /<br>(loss) | Total        |
|-------------------------------------|--------------|--|--|---|--------------|
|                                     |              | Reversal of<br>unrealized gain /<br>(loss) recognized<br>in<br>prior periods | Unrealized<br>gain /<br>(loss) for<br>the nine<br>months<br>ended<br>March 31,<br>2006 |   |              |
| Smith Micro common stock            | \$923        |  |  |   | \$923        |
| Other stock in investment portfolio | (\$234)      | \$90   | (\$14)   | \$76  | (\$158)      |
| <b>Total</b>                        | <b>\$689</b> | <b>\$90</b>  | <b>(\$14)</b>  | <b>\$76</b>                                 | <b>\$765</b> |

**Gain (loss) on marketable securities for the nine months ended March 31, 2005**

| Description                   | Realized       | Unrealized   |  | Sub total<br>Unrealized<br>gain /<br>(loss) | Total        |
|-------------------------------|----------------|--|--|---|--------------|
|                               |                | Reversal of<br>unrealized gain /<br>(loss) recognized<br>in<br>prior periods | Unrealized<br>gain /<br>(loss) for<br>the nine<br>months<br>ended<br>March 31,<br>2005 |   |              |
| Stock in investment portfolio | \$2,239        | (\$2,067)  | (\$27)   | (\$2,094)                                   | \$145        |
| <b>Total</b>                  | <b>\$2,239</b> | <b>(\$2,067)</b>   | <b>(\$27)</b>  | <b>(\$2,094)</b>                            | <b>\$145</b> |

The Smith Micro shares were registered and sold by us in November 2005 resulting in a realized gain of \$923,000 for the three months ended December 31, 2005.

### Provision for State and Federal Income Taxes

We recorded income tax expense of \$21,000 and \$2,000 for the three months ended March 31, 2006 and 2005, respectively. The tax expense for the three and nine months ended March 31, 2006 primarily represented accrued Canadian income taxes. The tax expense for the three and nine months ended March 31, 2005 represented state income taxes accrued where we have operations.

We have not recorded a tax benefit for domestic tax losses because of the uncertainty of realization. We adhere to SFAS 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. Consistent with our past practice, we have recorded a full valuation allowance at March 31, 2006 as the realizeability of our net operating loss carry-forwards is not determinable.

### Gain (loss) from Discontinued Operations

**Three and nine months ended March 31, 2006: Sale of Allume**

On July 1, 2005, we sold all of the issued and outstanding capital stock of Allume to Smith Micro for an aggregate sales price of \$12.8 million consisting of \$11.0 million cash and 397,547 unregistered shares of Smith Micro's common stock, having a market value (based on the five-trading-day average price of Smith Micro's common stock surrounding the date the business combination was announced) of \$1.8 million. At closing, a portion of the proceeds from the sale was deposited in an indemnity escrow, which included \$1.25 million in cash and 170,378 shares of Smith Micro's common stock having a closing date market value of \$784,000, to secure certain representations and warranties included in our stock purchase agreement with Smith Micro. In November 2005, we replaced the shares of Smith Micro common stock in escrow with cash, as permitted by the escrow agreement and sold 100% of our holdings of Smith Micro shares at a gain of \$923,000. Smith Micro released \$500,000 and \$750,000 of the escrowed cash to us in December 2005 and March 2006, respectively.

As a result of this sale, we have categorized the assets, liabilities and operations of Allume as discontinued operations for the three and nine months ended March 31, 2005 and in the three months ended March 31, 2006 we recorded a gain on the sale of discontinued operations of \$776,000 primarily representing the amount released from escrow on March 31, 2006 plus accrued interest. The gain on the sale of Allume for the nine months ended March 31, 2006 totaled \$302,000. This gain calculation does not include the remaining cash held in escrow of approximately \$0.3 million and is subject to change in future reporting periods depending upon the future release of cash from escrow.

#### **Nine months ended March 31, 2005: Sale of Keynomics**

In July 2004, we sold the assets and customer related liabilities of our wholly owned subsidiary Keynomics, Inc. The \$53,000 gain from the sale of discontinued operations for the nine months ended March 31, 2005 relates to the sale of Keynomics and represents the excess of the total consideration received over its net carrying value.

#### **Income from discontinued operations, net of income tax**

Income from discontinued operations totaling \$411,000 for the three months ended March 31, 2005 represents the pre-tax net income of Allume. Allume's net revenues were \$1.7 million for the three months ended March 31, 2005.

Income from discontinued operations totaling \$913,000 for the nine months ended March 31, 2005 represents the pre-tax net incomes of Allume of \$860,000 offset by the net loss of Keynomics of \$5,000. Allume's net revenues were \$7.6 million and Keynomics net revenues were \$68,000 for the nine months ended March 31, 2005.

#### **Liquidity and Capital Resources**

As of March 31, 2006, we had \$9,723,000 in cash and cash equivalents. This represents a \$164,000 decrease from the \$9,887,000 balance as of December 31, 2005 and a \$5,376,000 increase from the \$4,347,000 balance as of June 30, 2005. Working capital at March 31, 2006 was \$10,129,000. This represents an increase of \$604,000 over the working capital at December 31, 2005 of \$9,525,000 and a decrease of \$3,299,000 over working capital at June 30, 2005 of \$13,428,000.

Our operating activities used net cash of \$948,000 following a net loss of \$1,580,000 for the nine months ended March 31, 2006. This compares to net cash generated from operations of \$237,000 for the nine months ended March 31, 2005. A non-cash loss on the sale of Allume in the amount of \$474,000 during the nine months ended March 31, 2006 and a realized and unrealized gain on securities of \$765,000 were the major items that helped reconcile the net loss to cash used by our operating activities.

Our investing activities provided net cash of \$9,920,000 during the nine months ended March 31, 2006, as compared to net cash provided of \$817,000 during the comparable period from the previous fiscal year. The sale of Allume to Smith Micro on July 1, 2005 accounted for the majority of the cash we generated during the nine months ended March 31, 2006. The cash we generated from the sale of Allume was partially used to finance the acquisition of Weinmaster Homes which we consummated in July 2005. The divestiture and acquisition we completed in the nine months ended March 31, 2006 are consistent with our strategy to grow our Internet Content Segment with a focus on products and services that complement our direct marketing and online distribution strengths.

Our financing activities consumed net cash of \$3,649,000 for the nine months ended March 31, 2006. This compares to \$1,836,000 of net cash used by financing activities during the comparable period from the previous fiscal year. The cash used by our financing activities for the nine months ended March 31, 2006 was primarily related to payments we made on notes relating to the acquisitions of Allume that we repaid in full after we sold Allume on July 1, 2005. This repayment of debt was in part offset by a short-term borrowing in the amount of \$850,000 utilizing a 15% revolving note to a lender. The balance of this short-term financing including all accrued interest was due on September 30, 2005. We repaid all amounts due under this note on October 3, 2005.



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 and the sale of Allume to Smith Micro in July 2005 provided us with additional sources of funds to support our growth strategy.

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 planned merger with AccessMedia is consistent with our growth strategy.

We may seek, in the future, 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, equity sources and borrowing capacity. We believe that we will be able to obtain any additional financing required on competitive terms particularly if we are successful in improving our financial performance. 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.

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.

Pursuant to a joint operating agreement with AccessMedia, we have committed to fund development expenses for AccessMedia pending the completion of our merger in an amount up to \$3 million. The funding is subject to various conditions, including mutual agreement on an operating budget with AccessMedia. In addition, our merger agreement with AccessMedia provides that we will commit up to \$7 million to fund AccessMedia's working capital after the closing so long as AccessMedia achieves certain milestones. AccessMedia has not yet requested funding under this arrangement.

### **Critical Accounting Policies**

In accordance with SEC guidance, those material 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 or service has been delivered, the fee is fixed and determinable, and collection of the resulting account is probable.

- Revenue from packaged product sales to resellers and end users is recorded at the time of the sale net of estimated returns.
- Revenue from sales to distributors is recognized when the product sells through to retailers or end users. Sales to distributors permit limited rights of return according to the terms of the contract.
- For software and content delivered via the Internet, revenue is recorded when the customer downloads the software, activates the subscription account or is shipped the content.
  - Revenue from post contract customer support ("PCS") is recognized ratably over the contract period.
  - Subscription revenue is recognized ratably over the contract period.
- We use the residual method to recognize revenue when a license agreement includes one or more elements to be delivered at a future date. If there is an undelivered element under the license arrangement, we defer revenue based on vendor-specific objective evidence ("VSOE") of the fair value of the undelivered element, as determined by the

price charged when the element is sold separately. If VSOE of fair value does not exist for all undelivered elements, we defer all revenue until sufficient evidence exists or all elements have been delivered.

- Non-refundable advanced payments received under license agreements with no defined terms are recognized as revenue when the customer accepts the delivered software.
- 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.
- 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.
- 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 condensed consolidated 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.

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 value. As of March 31, 2006, approximately \$356,000 of our inventory was held by certain of our distributors under consignment arrangements.

### **Software Development Costs and License Fees**

Costs incurred in the initial design phase of software development are expensed as incurred in research and development. Once the point of technological feasibility is reached, direct production costs are capitalized in compliance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*. We cease capitalizing computer software costs when the product is available for general release to customers. Costs associated with acquired completed software are capitalized.

We amortize capitalized software development costs and visual content license fees on a product-by-product basis. The amortization for each product is the greater of the amount computed using (a) the ratio of current gross revenues to the total of current and anticipated future gross revenues for the product or (b) 18, 36, or 60 months, depending on the product. We evaluate the net realizable value of each software product at each balance sheet date and record write-downs to net realizable value for any products for which the carrying value is in excess of the estimated net realizable value.

### **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. We account for the impairment and disposition of long-lived assets in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. In accordance with SFAS 144, long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

In accordance with SFAS No. 142, *Goodwill and Intangible Assets*, goodwill is being assessed for impairment annually or more frequently if circumstances indicate impairment.



## **Factors That May Impact Future Operating Results**

Set forth below and elsewhere in this report and in other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this report.

### **OUR OPERATING RESULTS MAY FLUCTUATE IN FUTURE PERIODS, WHICH MAY ADVERSELY AFFECT OUR STOCK PRICE**

Our operating results have been in the past, and will continue to be, subject to quarterly and annual fluctuations as a result of numerous factors. These factors include:

- Fluctuations in demand for our products and services, especially with respect to software and Internet businesses
  - Our ability to maintain appropriate inventory levels and purchase commitments
  - Price and product competition in the software and Internet house plans businesses
    - Overall movement toward industry consolidation
    - Variations in sales channels, product costs, or mix of products sold
    - The timing, size, and mix of orders from customers
    - Fluctuations in our gross margins
    - Our ability to achieve targeted cost reductions
- Actual events, circumstances, outcomes, and amounts differing from judgments, assumptions, and estimates used in determining the values of certain assets (including the amounts of related valuation allowances), liabilities, and other items reflected in our condensed consolidated financial statements
  - How well we execute on our strategy and operating plans
- Changes in accounting rules, such as recording expenses for employee stock option grants and changes in tax accounting principles
- Compliance expense including the costs of procedures required for Sarbanes-Oxley Section 404 reporting and the costs of procedure remediation, if any
  - Merger and acquisition activity

As a consequence, operating results for a particular future period are difficult to predict, and, therefore, prior results are not necessarily indicative of results to be expected in future periods. Any of the foregoing factors, or any other factors discussed elsewhere herein, could have a material adverse effect on our business, results of operations, and financial condition that could adversely affect our stock price.

### **OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED BY UNFAVORABLE ECONOMIC AND MARKET CONDITIONS**

Our products are associated with demand for software products and building starts and negative trends in those and other areas could harm our business, operating results, or financial condition.

### **OUR REVENUE FOR A PARTICULAR PERIOD IS DIFFICULT TO PREDICT, AND A SHORTFALL IN REVENUE MAY HARM OUR OPERATING RESULTS**

As a result of a variety of factors discussed in this report, our revenue for a particular quarter is difficult to predict. Our net sales may grow at a slower rate than in past periods, or may decline. Our ability to meet financial expectations could also be adversely affected by the timing and mix of individual sales.

We plan our operating expense levels based primarily on forecasted revenue levels. These expenses and the impact of long-term commitments are relatively fixed in the short term. A shortfall in revenue could lead to operating results

being below expectations because we may not be able to quickly reduce these fixed expenses in response to short-term business changes.

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**WE EXPECT GROSS MARGIN TO VARY OVER TIME, AND OUR RECENT LEVEL OF PRODUCT GROSS MARGIN MAY NOT BE SUSTAINABLE**

Our product gross margins may not be sustainable and may be adversely affected by numerous factors, including:

- Changes in customer, geographic, or product mix
- Introduction of new products
- Sales discounts and other promotional factors in retail channels
- Increases in material or labor input costs
- Obsolescence charges
- Changes in shipment volume
- Inventory costs resulting from forecasting variances
- Increased price competition
- Changes in distribution channels
- How well we execute on our strategy and operating plans
- Inability to achieve targeted cost reductions

**DISRUPTION OF OR CHANGES IN OUR DISTRIBUTION MODEL COULD HARM OUR SALES AND MARGINS**

If we fail to manage distribution of our products and services properly, or if the economics of our distribution channels change, our revenue and gross margins could be adversely affected.

A substantial portion of our software products are sold through our channel partners and the remainder is sold through direct sales. Our stock house plans and services are sold primarily with Internet marketing and distribution and the remainder are sold through call center or indirect sales. Changes in the effectiveness of these channels or the costs associated with these distribution methods could harm our business, operating results, or financial condition.

**OUR BUSINESS SUBSTANTIALLY DEPENDS UPON THE CONTINUED GROWTH OF THE INTERNET AND INTERNET-BASED SYSTEMS**

A substantial portion of our business and revenue depends on growth of the Internet and on the use of that as a sales and distribution mechanism. To the extent that the Internet does not support this activity whether through changes in its use, lowered reliability or other factors, we could experience material harm to our business, operating results, and financial condition.

**CHANGES IN INDUSTRY STRUCTURE AND MARKET CONDITIONS COULD LEAD TO CHARGES RELATED TO DISCONTINUANCES OF CERTAIN OF OUR PRODUCTS OR BUSINESSES AND ASSET IMPAIRMENTS**

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Additionally, we are required to perform goodwill impairment tests on an annual basis and between annual tests in certain circumstances, and future goodwill impairment tests may result in a charge to earnings.



**WE HAVE MADE AND EXPECT TO CONTINUE TO MAKE ACQUISITIONS THAT COULD DISRUPT OUR OPERATIONS AND HARM OUR OPERATING RESULTS**

Our growth depends upon market growth, our ability to enhance our existing products, and our ability to introduce new products on a timely basis. We intend to continue to address the need to develop new products and enhance existing products through acquisitions of other companies, product lines, technologies, and personnel. Acquisitions involve numerous risks, including the following:

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- Difficulties in integrating the operations, technologies, products, and personnel of the acquired companies
  - Diversion of management's attention from normal daily operations of the business
  - Potential difficulties in completing projects associated with in-process research and development
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions
  - Initial dependence on unfamiliar supply chains or relatively small supply partners
  - Insufficient revenue to offset increased expenses associated with acquisitions
  - The potential loss of key employees of the acquired companies

Acquisitions may also cause us to:

- Issue common stock that would dilute our current shareholders' percentage ownership
- Assume liabilities
- Record goodwill and non-amortizable intangible assets that will be subject to impairment testing on a regular basis and potential periodic impairment charges
  - Incur amortization expenses related to certain intangible assets
  - Incur large and immediate write-offs and restructuring and other related expenses
  - Become subject to intellectual property or other litigation

Mergers and acquisitions of high-technology companies are inherently risky, and no assurance can be given that our previous or future acquisitions will be successful and will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could materially harm our business, operating results, or financial condition.

#### **OUR OPERATING RESULTS AND FUTURE PROSPECTS COULD BE MATERIALLY HARMED BY UNCERTAINTIES OR REGULATION OF THE INTERNET**

Currently, few laws or regulations apply directly to access or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as sales taxes on Internet product sales, and access charges for Internet service providers. The adoption of regulation of the Internet and Internet commerce could decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material adverse effect on our business, operating results, and financial condition.

While we do not anticipate regulation affecting software or stock house plans as products, this regulation could also harm our business, operating results, or financial condition.

#### **FAILURE TO RETAIN AND RECRUIT KEY PERSONNEL WOULD HARM OUR ABILITY TO MEET KEY OBJECTIVES**

Our success has always depended in large part on our ability to attract and retain highly skilled technical, managerial, sales, and marketing personnel. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future, or delays in hiring required personnel could make it difficult to meet key objectives and harm our business, operating results, or financial condition.

#### **ADVERSE RESOLUTION OF LITIGATION MAY HARM OUR OPERATING RESULTS OR FINANCIAL CONDITION**

We are a party to lawsuits in the normal course of our business. Litigation can be expensive, lengthy, and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results,

or financial condition. For additional information regarding certain of the lawsuits in which we are involved, see Item 1, "Legal Proceedings," contained in Part II of this report.

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**OUR BUSINESS AND OPERATIONS ARE ESPECIALLY SUBJECT TO THE RISKS OF EARTHQUAKES, FLOODS, AND OTHER NATURAL CATASTROPHIC EVENTS**

Our corporate headquarters is located Northern California, a region known for seismic activity. A significant natural disaster, such as an earthquake or a flood, could have a material adverse impact on our business, operating results, and financial condition.

**OUR STOCK PRICE MAY BE VOLATILE**

Our common stock may experience price volatility. This can be prompted by reported results, market conditions and/or general economic and political conditions, and these factors may materially adversely affect the market price of our common stock in the future.

**Item 3- Controls and Procedures**

(a) Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures (“Disclosure Controls”), as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of March 31, 2006, the end of the period covered by this quarterly 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 in place as of March 31, 2006 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.

**PART II - OTHER INFORMATION**

**Item 1 - Legal Proceedings**

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business.

We were named as one of a number of co-defendants in a suit filed in the State of New York by Xand Corporation who has asserted a claim in the amount of \$270,000 arising out of a contract with Allume Systems, Inc. which would apply to periods during our fiscal years 2004 through 2007. We believe under some circumstances, we may be contractually indemnified against some or all of the claim. We believe the claim is without merit and intend to defend the actions vigorously, if required. While we believe there is no legal basis for liability, due to the uncertainty surrounding the litigation process, we are unable to reasonably estimate a range of loss, if any, at this time.

In addition, we are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial shareholder, is an adverse party or has a material interest adverse to our interest.

**Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds**

During the quarter ended March 31, 2006, we sold no securities in transactions not registered under the Securities Act of 1933.

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**Item 3 - Defaults upon Senior Securities**

Not Applicable

**Item 4 - Submission of Matters to a Vote of Security Holders**

Not Applicable

**Item 5 - Other Information**

Not Applicable

**Item 6 - Exhibits**

**Financial Statements**

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

- Condensed Consolidated Balance Sheets at March 31, 2006 and June 30, 2005
- Condensed Consolidated Statements of Operations for the Three and Nine Month Ended March 31, 2006 and 2005
- Condensed Consolidated Statements of Shareholders' Equity for the Nine Months Ended March 31, 2006
- Condensed Consolidated Statements of Cash Flows for the Nine Months Ended March 31, 2006 and 2005
- Notes to Condensed Consolidated Financial Statements

**Exhibits**

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

| <b>Number</b> | <b>Exhibit Title</b>   | <b>Note</b> | <b>Page</b>    |
|---------------|--|-------------|----------------|
| <b>2.1</b>    | Agreement and Plan of Merger dated as of March 24, 2006, by and among International Microcomputer Software, Inc., ACCM Acquisition Corp., AccessMedia Networks, Inc., and the stockholders of AccessMedia Networks, Inc. | <b>(1)</b>  |                |
| <b>2.2</b>    | Joint Operating Agreement dated as of August 8, 2005, between International Microcomputer Software, Inc. and AccessMedia Networks, Inc., including the form of Certificate of Designation attached as Exhibit B thereto. | <b>(2)</b>  |                |
| <b>2.3</b>    | Stock Purchase Agreement between International Microcomputer Software, Inc. (the Seller) and Smith Micro Software, Inc.  | <b>(3)</b>  |                |
| <b>2.4</b>    | Weinmaster Homes, Ltd. Stock Purchase Agreement, dated July 1, 2005, between Weinmaster Homes, Ltd., Bruce Weinmaster & Janice Weinmaster and International Microcomputer Software, Inc                                  | <b>(3)</b>  |                |
| <b>3.01</b>   | Amended and Restated Articles of Incorporation   | <b>(4)</b>  |                |
| <b>3.02</b>   | Amended and Restated Bylaws  | <b>(5)</b>  |                |
| <b>31.1</b>   | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |             | <b>Page 39</b> |
| <b>31.2</b>   | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |             | <b>Page 40</b> |
| <b>32.1</b>   | Certification of Chief Executive Officer & Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |             | <b>Page 41</b> |

**Notes**

- (1) Incorporated by reference to exhibits to the Company's Current report on Form 8-K filed on March 29, 2006
- (2) Incorporated by reference to exhibits to the Company's Current report on Form 8-K filed on August 9, 2005
- (3) Incorporated by reference to exhibits to the Company's Current report on Form 8-K filed on July 7, 2005
- (4) Incorporated by reference to exhibits to the Company's registration statement on Form S-3 filed on September 22, 1993
- (5) Incorporated by reference to exhibits to the Company's Current report on Form 8-K filed on January 18, 2005

**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 15, 2006**

**By: /s/ Martin Wade, III**

Martin Wade, III

Director & Chief Executive Officer

**By: /s/ Robert O'Callahan**

Robert O'Callahan

Chief Financial Officer (Principal Accounting Officer)



**INDEX TO EXHIBITS:**

| <b>Number</b> | <b>Exhibit Title</b>   | <b>Note</b> | <b>Page</b>    |
|---------------|--|-------------|----------------|
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