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IMAGISTICS INTERNATIONAL INC

Form 10-K

March 10, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(MARK ONE)

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

For the fiscal year ended December 31, 2004

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

For the transition period from _____ to _____

Commission File Number 1-16449

IMAGISTICS INTERNATIONAL INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

06-1611068
(I.R.S. Employer Identification Number)

100 Oakview Drive
Trumbull, Connecticut
(Address of Principal Executive Offices)

06611
(Zip Code)

(203) 365-7000
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class -----	Name of each exchange on which registered -----
Common Stock, par value \$0.01 per share (together with associated preferred stock purchase rights)	The New York Stock Exchange

Indicate by check mark whether the registrant: (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 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 if disclosure of delinquent filers pursuant to Item 405
of Regulation S-K is not contained herein, and will not be contained, to the
best of registrant's knowledge, in definitive proxy or information statements
incorporated by reference in Part III of this Form 10-K or any amendment to this
Form 10-K.

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The aggregate market value of the common stock held by non-affiliates was \$574,474,563 as of June 30, 2004. The amount shown is based on the closing price of Imagistics International Inc. Common Stock as reported on the New York Stock Exchange composite tape on that date.

Number of shares of Imagistics International Inc. Common Stock, par value \$0.01, outstanding as of February 28, 2005: 16,260,007

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Imagistics International Inc. Proxy Statement for the 2005 Annual Meeting of Stockholders - Part III

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IMAGISTICS INTERNATIONAL INC.

Annual Report on Form 10-K
For the Year Ended December 31, 2004

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Certain statements contained in this filing with the United States Securities and Exchange Commission on Form 10-K that are not purely historical are forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, and are based on management's beliefs, certain assumptions and current expectations. These statements may be identified by their use of forward-looking terminology such as the words "expects," "projects," "anticipates," "intends" and other similar words. Such forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, general economic, business and market conditions, competitive pricing pressures, timely development and acceptance of new products, our reliance on third party suppliers, potential disruptions affecting the international shipment of goods, disruptions in implementing information technology systems, our ability to create brand recognition and currency and interest rate fluctuations. Certain of these risks and uncertainties are discussed more fully in Part II, Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors That Could Cause Results to Vary and elsewhere in this filing on Form 10-K. The forward-looking statements contained herein are made as of the date hereof and we, except as may be required by law, do not undertake any obligation to update any forward-looking statements, whether as a result of future events, new information or otherwise.

PART I

ITEM 1. BUSINESS

General

Imagistics International Inc. ("Imagistics" or the "Company"), headquartered in Trumbull, Connecticut, is an independent direct sales, service and marketing organization offering business document imaging and management solutions, including copiers, multifunctional products, often referred to as MFPs, and facsimile machines, in the United States, Canada and the United Kingdom that sources its products from various suppliers throughout the world. MFPs provide businesses with the ability to copy, print, fax, email and scan documents on a single device and eliminate costs associated with multiple devices. MFPs also allow businesses to easily move documents from paper images to digital files and back. We provide our customers with flexible, comprehensive document imaging products and services at competitive market prices.

History

Imagistics traces its origins to Pitney Bowes Inc. ("Pitney Bowes"). Pitney Bowes began marketing and distributing copiers in 1967 and started selling facsimile products in 1982. Pitney Bowes' office systems division, which combined the copier and facsimile product lines, was created in 1998. In 2000, Pitney Bowes decided to spin-off the United States and the United Kingdom operations of the office systems division to, among other things, enable the newly formed company, Imagistics, to more fully realize its potential within the dynamic office document markets. In connection with the planned spin-off, Pitney Bowes incorporated the Company as Pitney Bowes Office Systems, Inc. in February 2001 and, in August 2001, contributed substantially all of the business and

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assets of its office systems division to the Company. The name of the Company was changed to Imagistics International Inc. on October 12, 2001, and on December 3, 2001, 100% of the common stock of the Company was distributed by Pitney Bowes to the common shareholders of Pitney Bowes based on a distribution ratio of 1 share of Imagistics common stock for every 12.5 shares of Pitney Bowes common stock held at the close of business on November 19, 2001 (the "Distribution" or "Spin-off").

In connection with the Spin-off, we entered into several agreements with Pitney Bowes and Pitney Bowes subsidiaries including a transition services agreement with Pitney Bowes providing for certain essential services for a limited period following the Spin-off, including technology related services and field equipment maintenance services, agreements with Pitney Bowes Management Services and Pitney Bowes of Canada Ltd. ("Pitney Bowes of Canada"), under which they could continue to purchase and use our products and a vendor financing agreement providing for Pitney Bowes Credit Corporation ("PBCC") to continue as our primary lease vendor on a multi-year basis after the Spin-off, an intellectual property agreement with Pitney Bowes allowing us to continue using the "Pitney Bowes" brand name in the United States and the United Kingdom for a period of up to two years following the Spin-off, a tax separation agreement and certain other agreements. Substantially all of the services provided by Pitney Bowes under these agreements, other than the vendor financing agreement, which had an initial term of five years, have ceased in accordance with the terms of the agreements.

The implementation of the order to cash phase of our enterprise resource planning ("ERP") system in October 2003 permitted us to replace the remaining information technology related services that had been provided by Pitney Bowes. We reached a new agreement with Pitney Bowes of Canada in the fourth quarter of 2003 through which Pitney Bowes of Canada may purchase and resell Imagistics' products in Canada for an additional period of two years on a non-exclusive basis. In the fourth quarter of 2004, we negotiated an agreement with Pitney Bowes for the continued provision of equipment maintenance services in remote areas

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that we do not directly service. There are alternative providers for both the vendor financing and equipment maintenance services on substantially similar terms and conditions and these ongoing arms length relationships with Pitney Bowes are not considered to be material.

Available Information

Additional information about us is available on the Internet at our corporate website, www.imagistics.com, or our investor website, www.IGIinvestor.com. In addition to other information, we make available free of charge on our investor website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after electronically filing with or furnishing such material to the Securities and Exchange Commission. The Securities and Exchange Commission maintains an Internet site at www.sec.gov, which contains reports, proxy and information statements, and other information regarding us. You may also read and copy any document we file with the SEC at its Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. The SEC can be contacted at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our investor website also provides shareholders and other interested parties with access to important corporate governance information including our Corporate Governance Guidelines, Code of Ethics, and

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the Charters of our Audit, Executive Compensation and Development, and Governance Committees. These documents are also available in print to any shareholder requesting a copy from our Investor Relations department. Amendments to our Code of Ethics and any waiver related to our Chief Executive Officer, Chief Operating Officer, Chief Financial Officer or Controller will also be made available on our investor website. Currently, there are no waivers related to our Chief Executive Officer, Chief Operating Officer, Chief Financial Officer or Controller.

Industry Overview

The document imaging and management industry consists of the production and supply of various imaging products, as well as the provision of pre-sale and after-market product services and related software and professional services. We have participated in the copier business for over 35 years and have been a leader in the facsimile machine segment of this industry for 20 years. Our competitors include the distribution units of large office equipment manufacturers such as Ricoh, Canon and Xerox, and other independent distributors such as Ikon, Danka and Global Imaging as well as numerous local independent office equipment dealers and, as technologies continue to merge, traditional printer companies such as Hewlett Packard and Lexmark.

Companies in the document imaging industry sell products primarily through three channels of distribution: direct sales, independent dealer sales and retail sales. Recently, the Internet has begun to emerge as an additional channel, primarily for lower-end equipment and supplies. Direct sales involve the marketing of products by sales representatives working directly for the company whose products they offer. Independent dealer sales result from customer calls performed by independent dealer outlets that generally sell manufacturer-branded products. Retail sales include sales of low-end products, typically through national retail outlets or local retailers.

The document imaging industry is rapidly changing. The copier industry has moved from standalone analog devices to connected products that utilize digital technologies and from monochrome to color capable devices. Digital technology provides more reliability, more functionality and higher quality. All new copier/MFP placements are digital machines. Digital products can connect with computer networks and communicate with other office imaging equipment, enabling customers to more efficiently connect and utilize their document management solutions over a wide array of more useful features, such as higher quality copies, color capability, finishing capability and the multifunctional capability of copying, printing, faxing, emailing and scanning. The scanning capability allows organizations to easily move between hard copy paper documents and electronic documents. MFPs can efficiently copy, print, fax and email documents. In addition, technological advances, added features and functionality and reduced pricing have led to a trend of increased placements of color copiers and MFPs. The migration from single function digital copiers to MFPs is now seeing the emergence of universal copiers/printers that provide cost efficient output in both black and white and color.

Today's busy corporate environment demands office equipment, software and solutions that work faster and more efficiently than ever before, while providing reliable high-quality output. The expanding use of MFPs designed to address copying, printing, faxing, emailing and scanning needs in the workplace is a direct result of these demands. MFPs efficiently send, receive and print documents, thus eliminating office bottlenecks, improving employee productivity and saving valuable workspace in offices of all sizes. As workplaces increasingly rely on computer networks, document imaging providers are also developing more products that allow for shared communication and that work seamlessly with other office systems. These networked solutions offer greater speed and, by diverting print streams to more efficient output devices, can lower a company's imaging costs significantly. The cost of managing documents is

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high for most companies and increased use of the Internet for desktop research and printing has further increased the volume and cost of imaging activity for most businesses. In addition to searching for ways to minimize

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business document costs, customers continue to demand high-performance machines that produce well-finished documents. In addition, corporations struggle with the issue of how to deploy new technology and get users to embrace it.

Currently, the industry is producing a greater number of color machines to offer customers a range of options for their copying and printing needs. Color machines allow companies to increase their level of in-house document production and produce "finished" copies for meetings, presentations and mailings, often times at much lower costs than if they purchased these jobs externally.

Corporate customers are also searching for new ways to manage their document imaging needs. Corporations are continuing to outsource non-core competencies, including document imaging. This is especially true as the complexity of these solutions increases and corporations seek to avoid hiring, training and retraining personnel to use new machines. In recent years, many large document-imaging providers have developed management services capabilities to address this need. Through management services relationships, document imaging providers offer a full range of services, from installation and training of employees to complete on-site document imaging management, including selection of equipment and provision of personnel, allowing corporate customers to choose the solution that is best for them.

Vision and Strategy

Our vision is to become the leading independent direct provider of enterprise office imaging and document solutions by providing world class products and services with unparalleled customer support and satisfaction with a focus on multiple location customers, thus building value for our shareholders, customers and employees. To achieve this vision, we plan to build on our strengths and pursue the following strategies:

Maintain and Further Strengthen Major Account Relationships. We have maintained successful relationships with many large Fortune 1000 companies for 20 years. We believe that our strong relationships with many of these customers, as well as our integrated sales and service organization and the broad national reach of our organization, have been the keys to our success in acquiring new business and retaining our current customers. Our sales effort is organized to create customer-centric national account and commercial user sales organizations, each offering our full range of products to their respective customer bases. This customer-centric organization allows us to leverage our customer relationships with major accounts while also expanding our product offerings to our commercial user customers.

In light of competitive pressures, technological advances and changes in the corporate workplace, we must strive to meet our customers' needs in new ways. As many corporate customers seek to reduce administrative expenses through centralized purchasing and consolidation of their vendors, we believe that we are well positioned to offer a range of products and services, including technological innovations and consulting services that will provide new options, from a single source.

Expand Our Product Offerings Through Sourcing and Distribution Relationships. We believe that one of our greatest strengths is our strategy of sourcing cost-effective "families" of products from different manufacturers to

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best suit our customers' requirements. We seek to form relationships with various manufacturers, each with different specialties and different strengths. Although we source from multiple vendors, all of our products meet our demanding specifications. In addition, we supplement our product offerings with value-added software and service offerings to optimize ease of use and operation and support them with trained staff.

In January 2005, Better Buys for Business selected the Imagistics DL 850 as Editors Choice for 2005. In 2004, J.D. Power and Associates Copier Customer Satisfaction Study ranked Imagistics #1 Copier/Multifunction Product in Overall Customer Satisfaction Among Business Users, Two Years in a Row, Tied in 2003. We believe the study validates Imagistics' product sourcing strategy and direct sales and service infrastructure. In 2004, Imagistics also received the 2004 Buyers Laboratories Pick of the Year award for the im3520 in six different product categories and the ix3010 in five different product categories, as well as the Highly Recommended award for the im2020 in six different product categories and the Recommended award for six additional Imagistics products, all in more than five different product categories. In 2003, Imagistics received the 2003 Buyers Laboratories Most Outstanding Multifunctional Product Line of the Year award as well as six Pick of the Year awards in four different product categories.

We continuously evaluate various imaging products from multiple manufacturers and software developers. We believe that our supply contracts provide us access to the best products and solutions. We believe that the transition to digital monochrome, full color and universal black and white and color copier/MFPs provides an important opportunity for us to reach new customers as manufacturers develop machines with increased capabilities. We continue to launch new digital products that offer faster, more efficient multifunctional features for our high-volume corporate customers. These new digital products offer increased document imaging options and capabilities as well as overall savings. We will continue to expand our digital document imaging product offerings in order to meet the needs of our current customers and to allow us to reach a new customer base. In order to remain

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competitive in light of the many technological options that are available to our customers, we will continue to collaborate with companies that develop integrated document solutions that incorporate multifunctional capabilities. Our success will also depend on our ability to accurately gauge shifts in market demand and to anticipate potentially unforeseen changes in market dynamics that may result from new technologies.

Increase Outreach of Our Direct Sales and Service Force to the Copier/MFP Market. Our direct sales and service strategy aims to provide our customers with one point of contact for their product needs. Regardless of their location in the United States, the United Kingdom or our served markets in Canada, our customers can contact one of our representatives in their geographic area and receive consistent sales and service assistance. This allows us to control the quality of our sales and service effort and ensure a consistent positive experience for our customers. It also provides us with an opportunity to keep in regular contact with our customers, which we believe often leads to future sales. In some remote areas, however, we rely on Imagistics-trained third-party service providers for service of our products. Our marketing strategy is to offer an extensive portfolio of product offerings and diverse technology and to utilize our national direct sales and service organization to establish long-term relationships to meet customer document imaging and management needs.

We have implemented an acquisition strategy, as described below, to

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expand, on a highly selective basis, service and distribution capabilities in areas where such presence will enhance our ability to serve national accounts, while increasing our sales effort with local companies and public agencies.

Focus on Customer Needs. Since we have direct access to our end user customers through our direct sales force, we are able to monitor their changing needs and requirements and respond in an appropriate manner. Our goal is to meet all of our customers' needs and where price is particularly critical, we have offered them refurbished and remanufactured analog and refurbished digital systems as well as standalone devices. Because of our purchasing structure, we believe that we will be able to provide digital equipment and solutions as our customers require them. Because we source digital products and train our workforce on the sales, use and service of these products, and because we continue to research and source new products, we believe that we will be able to respond effectively as the industry changes in the future. However, if we fail to accurately predict changes in market demand we may lose sales or incur losses due to excess or obsolete inventories.

Pursue an Expansion Strategy. In order to remain competitive, we will continue to expand our copier, MFP, software and solutions businesses in geographic markets in the United States and abroad. Our direct sales and service strategy has been an effective method for attracting and retaining customers and we believe we can use it to further expand our document imaging business. We currently supply document imaging products and services to a variety of large corporations, many of which have an international presence and seek global sourcing of their document imaging needs. In order to serve these clients more effectively, we purchased two dealerships in 2004 to establish direct operations in Canada. We expect to use our United Kingdom operation as a platform for expansion of our business into the larger European market over time. Our United Kingdom product offerings, which were limited to facsimile products, were expanded to include a full range of MFPs in January 2003.

In March 2004, we acquired substantially all of the assets and business of Canadian Business Systems and Office Solutions Group, a combined business dealership in Mississauga, a suburb of Toronto, Canada and in August 2004, we acquired substantially all of the capital stock of Doering & Brown Corporation, an independent dealership based in London, Ontario, Canada. These acquisitions reflect our strategy to expand service and distribution capabilities internationally where such presence will enhance our ability to provide direct service to our broad base of global customers.

In June 2004, we acquired substantially all of the assets and business of Copy Systems, an independent dealership based in Little Rock, Arkansas reflecting our continued strategy to expand direct service and distribution capabilities in areas of the country where such presence will enhance our ability to serve national accounts, while increasing our sales effort with local companies and public agencies.

Business Segments

We operate in two reportable segments based on geographic area: North America and the United Kingdom. Revenues from external customers and from Pitney Bowes are attributed to geographic regions based on where the revenues are derived. Financial information by segment is set forth in Note 5, "Business Segment Information," of the "Notes to Consolidated Financial Statements" included in Item 8 herein.

Products

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We offer a broad range of office copier/MFPs, facsimile machines and related products and services. These products and services serve a wide range of customer needs from departmental to workgroup solutions. The utilization of digital technology has led to development of equipment that contains multiple capabilities and greater options for document imaging and management applications. Historically, we have used standard industry classifications to classify our equipment product offerings as part of either the copier product line or the facsimile product line based upon the primary function of the equipment.

The evolution of technology has blurred distinctions between traditional copiers and facsimiles since most new products are multifunctional. Imagistics has not introduced a single function machine in over four years. Facsimile has evolved into a feature found on machines ranging in speed from 10 pages per minute to 65 pages per minute rather than a dedicated single function machine. Some time in the future, differentiating between facsimile and copier equipment will not be meaningful.

We offer a broad range of products for departmental applications including color, universal black and white and color, black and white, digital, networked and stand-alone copiers/MFPs. Our definition of departmental machines incorporates the standard industry product segments 2 through 5, which range in speed from 20 to 90 pages per minute for black and white prints and typically produce a maximum size output consisting of ledger size copies/prints.

Our digital black and white copier/MFP departmental solutions include twelve products with speeds from 20 to 85 pages per minute. Our line of products can address application needs of workgroups with as few as several hundred to as many as 750,000 impressions per month. Most of these solutions are available as multifunctional devices and offer a range of finishing solutions from simple collating to booklet making, Z-folding, hole punching and multi-position stapling.

During 2004, we discontinued our black and white analog refurbished product line offerings and are currently concentrating on refurbished digital copier/MFP offerings and will be migrating our remanufactured copier/MFPs from analog to digital during 2005.

Our current 22 and 31 page per minute digital color copier products are positioned to provide both color capable and color centric solutions to clients, ranging in speed from 31 to 45 pages per minute in monochrome and 11 to 31 pages per minute in full color. We currently offer four color products. These multifunctional digital copiers offer copying and networking functionality and are designed to support both color and monochrome applications and offer enhanced image quality color printing and copying, a wide range of digital art functions and enhanced finishing options that include booklet making capabilities.

We also offer a broad range of lower-end workgroup products and solutions. Our definition of workgroup machines is the standard industry product Segment 1 which range in speed from 11 to 19 pages per minute for black and white prints and typically produce a maximum size output consisting of legal size copies/prints. Our workgroup products include traditional copiers, MFPs and facsimile solutions.

We have historically been a leader in workgroup facsimile systems and one of the largest suppliers of facsimile equipment to the Fortune 1000. We currently offer a full range of workgroup facsimile solutions that range from traditional new and remanufactured facsimile equipment to MFPs. We currently offer eight new MFP solutions; five remanufactured facsimile machines and one new facsimile machine.

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We also maintain alliances with leading document software solutions providers to satisfy our customers' document management requirements. Through our alliances, we provide our customers with access to software solutions providers that enable printing from host applications directly to lower cost Imagistics' networked MFPs without re-coding, that deliver documents directly to point of need whenever required and that allow our customers to build customized document management applications, from simple scan-store-retrieve, to complex enterprise systems involving automated workflows, web-access, and multi-level security. Other partners provide facsimile server solutions that increase productivity and decrease costs of traditional facsimile applications and software tools for the design, generation and delivery of all types of forms, reports and other documents.

Supplies

We offer a full complement of consumable supplies for our products, such as copier and facsimile toner and cartridges, staples and paper. Many of our copier/MFP customers enter into cost-per-copy rental and/or maintenance agreement plans that include supplies. This accounts for a constant source of copier/MFP supply revenue and helps to achieve a high level of customer retention. Demand for facsimile supplies has decreased with the use of e-mail and the availability of third-party refilled toner cartridges. In response to this decrease in demand, we introduced our own line of refilled cartridges under the "ECO" brand. Refilled ECO cartridges work with many of our own facsimile machines and also with many competitor facsimile machines and

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laser printers. With increased printing on multifunctional devices and the deployment of color solutions, we expect related supplies revenue related to these MFPs to increase, which will offset a portion of the loss in facsimile supplies revenue.

Service

Our continued commitment to our products and customers is evident in the many aftermarket service options that we provide. Our products are serviced by our nationwide service organization of approximately 1,200 Imagistics and contracted service representatives. We believe that this dedicated service force provides us with a distinct advantage over many of our competitors. These representatives are trained to service our product line and are managed through a central dispatch system to meet strict customer response time requirements. These representatives provide a full range of preventative maintenance and repair services to major account customers and commercial users.

We support all of our customers through our 24 hour-a-day, 7 day-a-week diagnostic center. Located in Melbourne, Florida, the diagnostic center is staffed with Imagistics employees who are experts in the use and servicing of our products and who help minimize any downtime or disruption to our customers. The diagnostic center usually handles over 3,500 calls from customers each day.

Financing Options

We provide our customers with flexible financing options that allow for the sale, lease or rental of our products. In the past, we have sold products to commercial users either directly to the end user or to a leasing company that, in turn, leases the product to the end user. Where leasing is involved, we sell equipment to either Pitney Bowes' wholly owned subsidiary, PBCC, or to other finance companies. Currently, PBCC is the primary source of lease financing for

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our products. We have entered into an agreement with PBCC that provides for an ongoing lease-purchase equipment-financing program for our products. In December 2004, Pitney Bowes announced their intent to spin-off PBCC to shareholders. We do not believe that this will have a material impact on our relationship with PBCC. In 2004 and 2003, approximately 15% and 14% respectively, of our revenues were derived from sales to PBCC for lease to the end user.

Historically, in offering products to our major account customers, we have used a rental strategy. Most often, we rent our facsimile machines at a flat rate and we are increasingly renting copier and MFP based solutions to our large major account customers as well. We typically rent our copiers on either a cost-per-copy basis, with minimum monthly page volumes, or at a flat rate with allowance and overage plans for certain services and other options. In the case of rentals, we seek to negotiate a master rental contract with our customers that can be revised to reflect rental of additional products and upgrades to current products or additional services. Generally, our rental contracts are for 36-month terms with renewal options that are automatic unless the customer gives prior notice of cancellation. These rental contracts also cover service and, in most cases, include supplies for use with our equipment. We believe that this approach provides the flexibility this customer base requires and many prefer compared to owning these assets.

Customers

Our primary customers are mid-to-large corporate customers and government entities. We serve major companies in the manufacturing, distribution, financial services, government and education markets as well as others. While continuing to strengthen and expand our relationships with our current customers, we have also established new initiatives geared specifically toward more efficiently serving mid-sized and regional companies or commercial users, while shifting our focus to multi-location customers. We plan to maintain our relationships with commercial users through the use of our trained team of commercial sales representatives. In an effort to expand our distribution organization and increase service coverage for multi-location customers, Imagistics has from time to time acquired independent regional office equipment dealerships. Imagistics' products are incorporated into their product mix and their sales and service teams are fully trained by Imagistics.

We market and distribute our products to the following types of customers:

- o major national accounts, including large corporate customers,
- o government and education entities and
- o commercial accounts, including mid-size and regional businesses.

National account customers include major national and international corporations. Because we began our business by serving major account customers in the facsimile market 20 years ago and have maintained steady relationships with many of these same customers, our major accounts provide us with recurring rental revenues over longer-term contracts. Our marketing strategy includes establishing long-term copier/MFP-based relationships with our customers, similar to those we have established with our

facsimile customers, by leveraging our national sales and service organization to meet their needs. In addition, because of their individual and complex needs, we are able to provide our major account customers with cutting-edge products as well as customized approaches to their specific needs. We believe customers in

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these markets have a preference for doing business with companies they have a long-term relationship with and our existing business relationships allow us to monitor customer needs and provide appropriate upgrades.

We target state governments and agencies, counties, cities, local governments and other political sub-divisions. These customers provide a long-term source of business and, because of our experience we can anticipate their document imaging needs. Government entities may source products through varied bidding processes or through negotiated agreements. Our government contracts are generally for a period of four to five years. State and local government entities typically acquire products through their own varied bidding processes. Although many of these contracts are terminable for non-appropriations of funds by our customers, we have not had a significant number of early terminations of these contracts for non-appropriation.

We also target commercial accounts, which generally have more discrete document imaging needs for one specific area or portion of their business or workplace. We customarily sell or lease equipment to these customers and, in most instances, our contracts provide ongoing supplies and service to them.

Because of our approach of providing a system of national direct sales and service, our ability to provide a range of products, system options and after-market arrangements to our major account customers and our attention to maintaining our relationships with customers through consistent product service, we believe that we can expand these markets in the future.

Due to our diversified customer base, no single customer is large enough to have a material impact on our overall business. Also, due to our diverse customer base and the recurring nature of our rental, service and supply revenues, seasonal variations do not significantly impact our business.

Sales and Marketing

We believe that our sales and marketing approach is uncommon in our industry. While many of our competitors offer either their own or other manufacturers branded products either by dealer sales or retail sales, we rely solely on distributing Imagistics' branded products through direct sales with support by direct service. Research conducted by CAP Ventures and J.D. Power and Associates indicates a preference for direct sales and service. Our direct sales and service personnel are located throughout the United States, Canada and the United Kingdom, marketing and servicing our products to our customers and potential customers. Our representatives use national sales and service standards so that our customers receive consistent and reliable assistance regardless of where they are located or which one of our locations they call.

In addition to our United States business, we currently operate in Canada and the United Kingdom. Our Canadian and U.K. businesses offer a complete product line. We plan to continue to increase the international marketing of our products. Our goal is to increase our service to our current customers as well as broaden our existing customer base. Our Canadian business is headquartered in Mississauga, Canada. Our U.K. business is headquartered in Harlow, England. Our products are also offered in Canada through Pitney Bowes of Canada, a subsidiary of Pitney Bowes.

Suppliers and Distribution

For maximum flexibility in product development and to assure our clients of the best possible business document solutions, we purchase equipment from a number of different firms throughout the world, rather than manufacture our products ourselves. We impose high quality standards on all of our equipment suppliers. We do internal testing of all products before adding them to the Imagistics family. The testing focuses on our customers' applications to ensure

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that we have the best offering to meet these needs.

We source our equipment from suppliers throughout the world including Konica Minolta, Muratec, Brother, Sharp and Toshiba. We have contractual relationships with these suppliers, although we continue to search for the best products and do not enter into exclusive relationships with any of our suppliers. We do not have minimum order quantities with any of our suppliers. Konica Minolta, Sharp, Toshiba and Brother currently supply a significant portion of our new copier/MFP equipment. If Konica Minolta, Sharp, Toshiba or Brother were unable to deliver products for a significant period of time, we would be required to find replacement products, which may not be available on a timely or cost-effective basis. This could have a material adverse effect on our business, financial condition and results of operations. We do not believe that we are materially dependent upon any other supplier of products, whether new products, parts or consumable supplies. To mitigate against disruptions to our business, we keep an adequate level of inventory on hand to meet the needs of our customers for several months.

Using third-party suppliers allows us to offer our customers products with the most current features and technologies. We believe that this sourcing strategy also offers us maximum flexibility. As we expand or upgrade our product line, we are able to

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choose from the best available products for each product range. We select products by balancing costs and availability of features with ease of customer use, service personnel training, parts availability, reliability and serviceability. Because of these benefits, in most cases, we purchase similar products from one manufacturer to cover several product levels.

We generally require manufacturers to build our products to order with 60 day or less lead times. We usually take title to the goods at the factory, or in the case of Asian factories, at the closest seaport. Finished goods are shipped by ocean freight to a United States port, primarily in California, and then trans-shipped to one of approximately nine warehouses in the United States. In the normal course of business, when a customer order is received, equipment is unpacked, set up and tested in the warehouse prior to shipping to the customer location. Supplies are stored primarily at one warehouse located in Columbus, Ohio and are shipped via ground service or overnight delivery directly to our customers or service engineers. Our Canadian and United Kingdom businesses use similar manufacturing and shipping procedures and finished goods are shipped directly to two contract warehouses in Canada and one of two contract warehouses in the United Kingdom. Our reliance on Asian manufacturing could make our business susceptible to disruptions in international transportation due to port strikes, acts of war or other factors beyond our control.

Patents, Trademarks and Copyrights

In connection with the Spin-off, we entered into a trademark license, patent license and copyright license agreement that provided us with a non-exclusive license to the Pitney Bowes trademark for a period of up to two years following the Spin-off. In addition, the agreement provides for us to license certain patents and patent applications on a non-exclusive basis in connection with our business in the United States and the United Kingdom, for the term of the relevant patents, none of which are material to our business. Finally, the agreement provides for us to license all copyrighted material used in connection with our business in the United States and the United Kingdom for the term of the relevant copyrights.

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We have registered "Imagistics" as a trademark in the United States, Canada, the European Community and other jurisdictions and we have completely transitioned to the use of the "Imagistics" brand name. In addition, as a reseller of equipment supplied to us by major manufacturers of imaging equipment, we benefit from the use of patents and patent licenses secured by our suppliers.

Employees

We employ approximately 3,600 individuals throughout the world including approximately 1,200 sales personnel. We employ approximately 100 people in Canada. We also employ approximately 100 people in the United Kingdom, almost all of whom are subject to the European Works Council regulations. None of our other employees are covered by a collective bargaining agreement. We believe that we have good relations with our employees.

Competition

We are primarily involved in the supply of document imaging equipment to corporate, governmental and commercial customers. The document imaging equipment supply industry is highly competitive. Customers rigorously evaluate suppliers on the basis of product features, functions, reliability and quality, service expertise, geographic reach and price competitiveness. Many of our competitors manufacture their own products. Although we believe that our reliance on third parties for manufacturing provides us with certain benefits, it is possible that our competitors' guaranteed access to product supply through captive manufacturing operations may provide them with a competitive advantage. In addition, our primary suppliers sell products in competition with us, either directly or through independent office equipment dealers. Some of our competitors have substantially greater financial resources than we do.

Our primary competitors are Xerox, Ikon, Danka, Canon, Ricoh, Global Imaging, Hewlett Packard and Lexmark.

Environmental Matters

We are subject to federal, state and local laws intended to protect the environment. We believe that, as a general matter, our policies, practices and procedures are properly designed to reasonably prevent the risk of environmental damage and financial liability to the Company.

Backlog

Generally, equipment sales and rental orders are shipped within 30 days and supplies orders are shipped immediately. Accordingly, our backlog is not significant.

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ITEM 2. PROPERTIES

The following table provides information regarding our primary owned and leased properties:

Location	Own/ Lease	Square Footage	Expiration Date
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North America:

United States:

Columbus, Ohio	Lease	217,864	2009	Warehouse and d
Trumbull, Connecticut	Own	74,000	N/A	Corporate headq
Beacon Falls, Connecticut	Lease	66,050	2006	Warehouse and e
Milford, Connecticut	Own	41,000	N/A	Warehouse and e
Denver, Colorado	Lease	29,178	2008	Administration
Melbourne, Florida	Lease	17,103	2008	Diagnostic call
Shelton, Connecticut	Lease	14,509	2009	Diagnostic and
Shelton, Connecticut	Lease	11,439	2005	Administrative

Canada:

Mississauga, Ontario	Lease	11,675	2009	Headquarters an
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United Kingdom:

Harlow	Lease	18,800	2009	Warehouse
Harlow	Lease	11,866	2007	Headquarters an

We also lease space in approximately 174 sales and service locations throughout North America. In the United States, we lease space in approximately 167 sales and service locations totaling approximately 717,000 square feet. Leases relating to approximately 32 of our sales and service locations totaling approximately 119,000 square feet expire in 2005. We plan to renew or replace these leases to the extent they are for stand-alone facilities, and for certain other facilities, we plan to relocate and enter into new leases with less square footage. In Canada, we also lease seven locations throughout Ontario, Canada, consisting of one warehouse and six sales and service locations. The seven leases aggregate approximately 22,500 square feet. In the United Kingdom, we also lease two sales offices near London and Birmingham on one-year leases and one sales office in Newbury on a five-year lease. These three leases aggregate approximately 2,700 square feet.

ITEM 3. LEGAL PROCEEDINGS

In connection with the Distribution, we agreed to assume all liabilities associated with our business, and to indemnify Pitney Bowes for all claims relating to our business. In the normal course of business, we are party to litigation relating to our business. These may involve claims by or against Pitney Bowes or Imagistics relating to, among other things, contractual rights under vendor, insurance or other contracts, trademark, patent and other intellectual property matters, equipment, service or payment disputes with customers, bankruptcy preference claims and disputes with employees.

We have not recorded liabilities for loss contingencies since the ultimate resolutions of the legal matters cannot be determined and a minimum cost or amount of loss cannot be reasonably estimated. In our opinion, none of these proceedings, individually or in the aggregate, should have a material adverse effect on our consolidated financial position, results of operations or cash flows.

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

There were no matters submitted to a vote of our security holders during the fourth quarter ended December 31, 2004.

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Information concerning the executive officers of Imagistics is set forth below:

Name ----	Age ---	Position -----
Marc C. Breslawsky.....	62	Chairman and Chief Executive Off
Joseph D. Skrzypczak.....	49	President and Chief Operating Of
Christine B. Allen.....	55	Chief Human Resources Officer
John C. Chillock.....	48	Vice President, Customer Service
George E. Clark.....	58	Vice President and General Manag
Timothy E. Coyne.....	50	Chief Financial Officer
Chris C. Dewart.....	50	Vice President, Sales
Mark S. Flynn.....	50	Vice President, General Counsel
Nathaniel M. Gifford.....	52	Vice President, Product Developm
William H. Midgley.....	55	Chief Administrative Officer
John R. Reilly.....	38	Vice President, Marketing

Marc C. Breslawsky. Mr. Breslawsky has served as Chairman and Chief Executive Officer of Imagistics since February 2001. In connection with the Spin-off, Mr. Breslawsky was elected to our board of directors as Chairman. From 1996 to 2001, Mr. Breslawsky was President and Chief Operating Officer of Pitney Bowes. From 1994 to 1996, Mr. Breslawsky was Vice Chairman of Pitney Bowes. Mr. Breslawsky is a director of C. R. Bard, Inc., The Brink's Company and UIL Holdings Corporation.

Joseph D. Skrzypczak. In May 2004, Mr. Skrzypczak was appointed to the role of President and Chief Operating Officer. Prior to this appointment, Mr. Skrzypczak served as our Chief Financial Officer since February 2001. Mr. Skrzypczak was the Chief Operating Officer and acting Chief Financial Officer at Dictaphone Corporation from October 1998 until December 2000. Prior to being elected Chief Operating Officer, Mr. Skrzypczak served as Senior Vice President and Chief Financial Officer from October 1997 to October 1998 and served as Vice President and Chief Financial Officer from May 1994 to October 1997 at Dictaphone. After being acquired by Lernout & Hauspie in May 2000, Dictaphone declared bankruptcy in November 2000, as part of Lernout & Hauspie's overall bankruptcy filing. Mr. Skrzypczak initially joined Pitney Bowes in 1981 and held various management positions until May 1994. Prior to working for Dictaphone Corporation, Mr. Skrzypczak served as Vice President of Finance for Pitney Bowes' office systems division, and was directly responsible for all financial and administrative activities. Prior to initially joining Pitney Bowes in 1981, Mr. Skrzypczak worked for Price Waterhouse. He is a certified public accountant.

Christine B. Allen. Ms. Allen became our Chief Human Resources Officer in January 2002. From 1995 to 2001, she was with The Hartford Financial Services Group, Inc.; she joined The Hartford as Director, Human Resources, Commercial Market and subsequently assumed responsibilities as Vice President, Human Resources, Commercial Lines. Ms. Allen served as Vice President of Human Resources for The Walden Book Company from 1988 until 1994. She began her career with Macy's New York in 1973 and served in a variety of human resources related capacities for large retailing companies, such as Caldor and Abraham & Straus prior to joining Waldenbooks.

John C. Chillock. In October 2000, Mr. Chillock assumed the role of our Vice President, Customer Service Operations. Mr. Chillock joined Pitney Bowes' office systems division in 1998 as Vice President, Field Operations. Prior to joining office systems, Mr. Chillock served in various management positions at Dictaphone Corporation from 1977 to 1998. Prior to joining Dictaphone Corporation, Mr. Chillock was a Director of Operations for Intellisys Electronic

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Commerce, a division of the Chase Manhattan Bank.

George E. Clark. In October 2000, Mr. Clark assumed the role of Vice President and General Manager, Business Product Centers. Prior to the Spin-off, Mr. Clark was employed by Pitney Bowes for over 25 years in varying capacities pertaining to the sales and marketing of imaging equipment at Pitney Bowes. Mr. Clark served as Vice President of Copier Systems for the Northeast Region from 1988 to 1990, Vice President of Marketing for Copier Systems from 1990 to 1997 and Vice President of Business Products Centers East Region from 1997 to 2000. Prior to joining Pitney Bowes, Mr. Clark was employed by Regenesys, Inc., a financial reorganization firm in Boston, Massachusetts.

Timothy E. Coyne. In May 2004, Mr. Coyne was appointed to the role of Chief Financial Officer. Mr. Coyne joined Imagistics in 2001 as the Vice President and Corporate Controller. Prior to joining Imagistics, Mr. Coyne was employed by TransPro, Inc. as the Chief Financial Officer from 1998 to 2001 and Vice President and Corporate Controller from 1996 to 1998. From 1990 to 1996, Mr. Coyne served as the Vice President of Finance and Administration for Keene Corporation. Mr. Coyne was the Vice President, Finance and Administration, Treasurer and Secretary of Kasco Corp, a subsidiary of Bairnco Corp. from

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1986 to 1990. Mr. Coyne held a variety of positions with The Coca-Cola Bottling Company of New York, including Vice President and Corporate Controller from 1984 to 1986. Mr. Coyne began his career at Peat Marwick Mitchell & Co. in New York.

Chris C. Dewart. In August 2004, Mr. Dewart was appointed to the role of Vice President, Sales. Prior to this appointment, Mr. Dewart held the title of Vice President, Commercial Sales. Prior to the Spin-off he was employed by Pitney Bowes in the office systems division since 1983, and served as Vice President since 1990. Mr. Dewart served as Vice President of European Operations--facsimile systems division from 1990 to 1991, Vice President and General Manager of Canadian Operations from 1991 to 1998 and Vice President of U.S. Sales for Facsimile Systems from 1998 to August 2000. In August 2000, he assumed the position of Vice President of Sales for Commercial Markets. Prior to joining office systems, Mr. Dewart held various positions at General Electric Corporation and Monroe/Litton.

Mark S. Flynn. Mr. Flynn became our Vice President, General Counsel and Secretary in April 2001. Most recently, he was a partner in the corporate department of the law firm Wiggin & Dana LLP from 1999 to 2001. From 1997 to 1999, Mr. Flynn served as Senior Deputy General Counsel to Olin Corporation. Mr. Flynn held the position of Executive Vice President, General Counsel and Secretary at ServiceMaster Diversified Health Services, a subsidiary of the ServiceMaster Company, from 1993 to 1997 and Vice President, General Counsel and Secretary at Arcadian Corporation/Arcadian Partners, L.P. from 1989 to 1993. Prior to those positions, Mr. Flynn served in various counsel positions at Olin Corporation from 1986 to 1989, as an attorney at Intercontinental Hotels Corporation from 1983 to 1986 and as an associate at the law firm of Hughes Hubbard & Reed from 1980 to 1983. Mr. Flynn serves on the advisory board of Integra Ventures, a Seattle-based venture fund specializing in life sciences and health care services.

Nathaniel M. Gifford. Mr. Gifford is currently our Vice President, Product Development and Marketing. Prior to the Spin-off he was employed in the Pitney Bowes office products business for over 20 years in varying capacities pertaining to product management, planning and marketing. Prior to joining Pitney Bowes, Mr. Gifford worked at Travelers Insurance Company and Cititrust Bank in the area of securities analysis and investments.

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William H. Midgley. In December 2004, Mr. Midgley was appointed to the role of Chief Administrative Officer. Mr. Midgley joined Imagistics in 2003 as the Vice President, Global Supply Chain. Prior to joining Imagistics, Mr. Midgley was the Vice President, Supply Chain for PSS World Medical, Inc. Mr. Midgley began his career at Sony Electronics where he held a variety of financial, operations and business process positions with responsibilities in order management, inventory control, billing, collections and accounts receivable, logistics and supply chain.

John R. Reilly. In April 2004, Mr. Reilly was appointed to the role Vice President, Marketing. Prior to joining Imagistics, Mr. Reilly held the position of Vice President, Strategic Planning with Konica Minolta Business Solutions, U.S.A. from 2003 to 2004, where he was responsible for the integration of Konica's and Minolta's distribution channels due to their merger. From 1994 to 2003, Mr. Reilly managed Minolta's marketing department with responsibilities for both the dealer and direct channels. During his career at Minolta, Mr. Reilly led all aspects of marketing, including product planning and management, field marketing, sales training, marketing communications, advertising and lead generation. From 1990 to 1994, Mr. Reilly worked for MCS/Canon Business Solutions, with varying roles in sales management. Mr. Reilly began his career as a business development manager for PC Concepts in Wayne, PA.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Imagistics common stock (trading symbol "IGI") is listed for trading on the New York Stock Exchange ("NYSE"). On June 3, 2004, our Chief Executive Officer submitted to the NYSE a written certification pursuant to Section 303A.12(a) of the NYSE Listed Company Manual certifying that he was not aware of any violation by Imagistics of applicable NYSE listing standards. Information on the high and low sales prices for Imagistics common stock during the two most recent fiscal years is included in Note 16, "Quarterly Financial Data," of the "Notes to Consolidated Financial Statements" included in Item 8 herein. At February 28, 2005 there were approximately 16,260,007 shares outstanding and approximately 16,698 stockholders of record. Imagistics has not declared or paid any cash dividends on its common stock.

We anticipate that future earnings will be used principally to support operations and finance the growth of our business. Thus, we do not intend to pay cash dividends on our common stock in the foreseeable future. We have entered into a senior secured credit facility providing for both term and revolving credit borrowings, which allows us to borrow funds for general corporate purposes, including the repayment of other debt, working capital and acquisitions. The credit facility contains affirmative and negative covenants that, among other things, require us to satisfy certain financial tests and maintain certain financial ratios. The credit facility also limits our ability to declare and pay dividends on our shares. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources." If our lenders permit us to declare dividends, the dividend amounts, if any, will be determined by our board after considering a number of factors, including our financial condition, capital requirements, funds generated from operations, future business prospects, applicable contractual restrictions and any other factors our board may deem relevant.

Issuer Purchases of Equity Securities

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In March 2002, the Board of Directors approved a \$30.0 million stock buy back program. In October 2002, the Board of Directors authorized the repurchase of an additional \$28.0 million of our stock, raising the total authorization to \$58.0 million. In July 2003, the Board of Directors authorized the repurchase of an additional \$20.0 million of our stock, raising the total authorization to \$78.0 million. In May 2004, the Board of Directors authorized the repurchase of an additional \$30.0 million of our stock, raising the total authorization to \$108.0 million and, as of December 31, 2004, we have accumulated approximately 3.9 million shares of treasury stock at a cost of approximately \$88.8 million. The stock buy back program has no fixed termination date.

The following table provides information with respect to the purchase of shares of our common stock under the stock buy back program during each month in the fourth quarter of 2004:

(Dollars in thousands, except per share amounts)

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan
October 1, 2004 - October 31, 2004	52,500	\$ 34.73	52,500
November 1, 2004 - November 30, 2004	12,500	\$ 35.23	12,500
December 1, 2004 - December 31, 2004	32,700	\$ 34.44	32,700
	-----		-----
Total	97,700	\$ 34.70	97,700
	=====		=====

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ITEM 6. SELECTED FINANCIAL DATA

The following table presents our selected financial data. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and notes thereto included in Items 7 and 8 herein.

(Dollars in thousands, except per share amounts)

	2004	Year ended December 31,			2000
	2004	2003	2002	2001	2000
Consolidated Statement of Operations Data					
Sales	\$310,530	\$316,002	\$314,899	\$307,929	\$323,6
Rentals	209,501	222,183	232,228	237,449	232,1
Support services	89,022	84,011	82,803	80,698	86,9
	-----	-----	-----	-----	-----
Total revenue	609,053	622,196	629,930	626,076	642,7
	-----	-----	-----	-----	-----
Cost of sales (1)	171,344	192,772	198,437	197,300	184,2

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Cost of rentals	59,102	72,254	84,114	92,191	88,5
Selling, service and administrative expenses	331,460	312,759	311,924	305,799	252,7
	-----	-----	-----	-----	-----
Operating income	47,147	44,411	35,455	30,786	117,1
Interest expense	3,693	8,437	8,106	9,825	11,2
	-----	-----	-----	-----	-----
Income before income taxes	43,454	35,974	27,349	20,961	105,9
Provision for income taxes	18,511	15,515	10,906	8,402	41,9
	-----	-----	-----	-----	-----
Net income	\$ 24,943	\$ 20,459	\$ 16,443	\$ 12,559	\$ 64,0
	=====	=====	=====	=====	=====
Basic earnings per share (2)	\$ 1.54	\$ 1.22	\$ 0.88	\$ 0.65	\$ 3.
Diluted earnings per share (2)	\$ 1.48	\$ 1.19	\$ 0.86	\$ 0.65	\$ 3.
Consolidated Balance Sheet Data					
Total current assets	\$273,636	\$266,621	\$264,153	\$283,575	\$297,0
Total assets	\$467,536	\$446,732	\$461,238	\$494,009	\$499,4
Current portion of long-term debt	\$ 545	\$ 545	\$ 749	\$ 1,000	\$
Due to Pitney Bowes	\$ --	\$ --	\$ --	\$ --	\$122,1
Total current liabilities, including amounts due to Pitney Bowes	\$ 95,693	\$ 96,159	\$101,914	\$ 81,479	\$178,1
Long-term debt	\$ 70,359	\$ 62,903	\$ 73,399	\$116,000	\$
Total long-term liabilities	\$ 94,800	\$ 83,172	\$ 95,077	\$127,091	\$ 11,2
Stockholders' equity	\$277,043	\$267,401	\$264,247	\$285,439	\$310,0
Other Data					
Net cash provided by operating activities	\$ 79,398	\$ 83,042	\$158,451	\$147,813	\$137,7
Depreciation and amortization	\$ 65,780	\$ 74,513	\$ 81,593	\$ 82,725	\$ 73,7
Capital expenditures	\$ 63,374	\$ 50,954	\$ 66,599	\$ 84,347	\$ 83,6

Certain previously reported amounts have been reclassified to conform to the current year presentation.

(1) On December 31, 2001 the Company changed its method of accounting for the cost of inventory from the last-in, first-out (LIFO) method to the first-in, first-out (FIFO) method. In accordance with Accounting Principles Board Opinion No. 20, "Accounting Changes," this change in accounting method has been applied retroactively by restating the prior year's financial statements for all periods presented.

(2) The basic and diluted earnings per share amounts for the year ended December 31, 2000 are for comparative purposes only as common shares were not issued until December 2001. Outstanding shares for 2000 is based on actual shares issued plus assumed conversions, at Spin-off.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Imagistics International Inc. ("Imagistics" or the "Company") is an independent direct sales, service and marketing organization offering business document imaging and management solutions, including copiers, multifunctional products, often referred to as MFPs, and facsimile machines in the United States, Canada and the United Kingdom. Our primary customers include large corporate customers known as national accounts, government entities and mid-size and regional businesses known as commercial accounts. Multifunctional products

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offer the multiple functionality of copying, printing, faxing, emailing and scanning in a single unit. In addition, we offer a range of document imaging options including digital, analog, color and/or networked products and systems.

Our strategic vision is to become the leading independent direct provider of enterprise office imaging and document solutions by providing world-class products and services with unparalleled customer support and satisfaction with a focus on multiple location customers, thus building value for our shareholders, customers and employees. Our strategic initiatives include:

- o Maintaining and further strengthening major account relationships,
- o Expanding our product offerings through our sourcing and distribution relationships,
- o Increasing outreach of our direct sales and service force to the copier/MFP market,
- o Focusing on customer needs and
- o Pursuing opportunistic expansion and investments.

Our revenue is generated from three lines of business: copier/MFP, facsimile and sales to Pitney Bowes of Canada. We report sales to Pitney Bowes of Canada separately as it operates under a separate reseller agreement. The principal evolution in our industry and business has been the transition to networked digital copiers/MFPs, away from single-function standalone facsimile machines and analog copiers. This transition has resulted in decreased demand for and usage of single function facsimile equipment in the marketplace. We have responded to this market development by focusing our efforts on the growth opportunities existing in our digital copier/MFP product line. As a result, the increase in our copier/MFP product line revenues has offset the decrease in facsimile product line revenues.

Imagistics Spin-off from Pitney Bowes

On December 11, 2000, the board of directors of Pitney Bowes Inc. ("Pitney Bowes") approved the spin-off of the U.S. and U.K. operations of its office systems business to its common stockholders as an independent, publicly traded company. On December 3, 2001, Imagistics was spun-off from Pitney Bowes pursuant to a contribution by Pitney Bowes of substantially all of Pitney Bowes' U.S. and U.K. office systems businesses to us and a distribution of our common stock to common stockholders of Pitney Bowes based on a distribution ratio of 1 share of our common stock for every 12.5 shares of Pitney Bowes common stock held at the close of business on November 19, 2001 (the "Distribution" or "Spin-off").

Pitney Bowes no longer has a financial investment in our business. We entered into a transition services agreement with Pitney Bowes providing for certain essential services to us for a limited period following the Distribution. These services were provided at cost and included information technology, computing, telecommunications, certain accounting, field service of equipment and dispatch call center services. We and Pitney Bowes had agreed to an extension until December 31, 2003, of the transition services agreement as it related to information technology and related services. Services provided under this extension were at negotiated market rates. Except for field service of equipment, all of the services provided by Pitney Bowes under these agreements have ceased in accordance with the terms of the agreements.

Effective July 1, 2003, we and Pitney Bowes entered into a one-year service agreement on an arms-length basis relating to field service of equipment in certain remote geographic locations not covered by our direct service organization. This agreement, the initial term of which expired on July 1, 2004,

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had been extended under the same terms and conditions, through September 30, 2004. Effective October 1, 2004, we and Pitney Bowes entered into a three-year service agreement under similar terms and conditions. This agreement expires on September 30, 2007. Services provided under this agreement are at negotiated prices.

For 2004, we paid Pitney Bowes \$5.1 million in connection with the field service of equipment agreement. In 2003, we paid Pitney Bowes \$16.1 million in connection with the transition services agreement, including field service of equipment and other administrative expenses. For 2002, we paid Pitney Bowes \$20.4 million in connection with these agreements and certain shared corporate and administrative services.

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We also entered into certain other agreements covering intellectual property, commercial relationships, leases and licensing arrangements and tax separation matters. The pricing terms of the products and services covered by the other commercial agreements reflect negotiated prices.

Critical Accounting Policies and Significant Estimates

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates include usage of equipment for rental assets billed in arrears, sales returns, usage adjustments and other allowances for equipment sales, equipment rentals and service contract billings, the collectibility of accounts receivable, the use and recoverability of inventory, the useful lives of tangible assets, the realization of deferred taxes and an evaluation of the potential impairment, if any, of goodwill and other long-lived assets, among others. The markets for our products are characterized by intense competition, rapid technological development and pricing pressures, all of which could affect the future realizability of our assets. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Actual results could differ from these estimates. We have identified certain accounting policies that are critical to the understanding of our results of operations due to the judgment management must make in their application. These significant accounting policies are outlined below.

Revenue recognition

Revenue on equipment and supplies sales is recognized when contractual obligations have been satisfied, title and risk of loss have been transferred to the customer and collection of the resulting receivable is reasonably assured. For copier/MFP equipment, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the installation of the equipment at the customer location. For facsimile equipment and facsimile supplies, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the delivery of the facsimile equipment and the facsimile supplies to the customer location. We record a provision for estimated sales returns and other allowances based upon historical experience.

Rental contracts, which often include supplies, are generally for an initial term of three years with automatic renewals unless we receive prior

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notice of cancellation. Under the terms of rental contracts, we bill our customers a flat periodic charge and/or a usage-based fee. Revenues related to these contracts are recognized each month as earned, either using the straight-line method or based upon usage, as applicable. We record a provision for estimated usage adjustments on rental contracts based upon historical experience.

Support services contracts, which often include supplies, are generally for an initial term of one year with automatic renewals unless we receive prior notice of cancellation. Under the terms of support services contracts, we bill our customers either a flat periodic charge or a usage-based fee. Revenues related to these contracts are recognized each month as earned, either using the straight-line method or based upon usage, as applicable. We record a provision for estimated usage adjustments on service contracts based upon historical experience.

Certain rental and support services contracts provide for invoicing in advance, generally quarterly. Revenue on contracts billed in advance is deferred and recognized as earned revenue over the billed period. Certain rental and support services contracts provide for invoicing in arrears, generally quarterly. Revenue on contracts billed in arrears is accrued and recognized in the period in which it is earned.

We enter into arrangements that include multiple deliverables, which typically consist of the sale of equipment with a support services contract. We account for each element within an arrangement with multiple deliverables as separate units of accounting. Revenue is allocated to each unit of accounting based on the residual method, which requires the allocation of the revenue based on the fair value of the undelivered items. Fair value of support services is primarily determined by reference to renewal pricing of support services contracts when sold on a stand-alone basis.

Accounts receivable

Accounts receivable are stated at net realizable value by recording allowances for those accounts receivable amounts that we believe are uncollectible. Our estimate of losses is based on prior product returns and invoice adjustment experience as well as prior collection experience and includes evaluating the credit worthiness of each of our customers, analyzing historical bad debt write-offs and reviewing the aging of the receivables. Our allowance for doubtful accounts includes amounts for specific accounts that we believe are uncollectible, as well as amounts that have been computed by applying certain percentages based on historic

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loss trends, to certain accounts receivable aging categories and estimated amounts relating to delinquencies associated with the changes in our billing practices with the implementation of our enterprise resource planning ("ERP") system.

Inventory valuation

Inventories are valued at the lower of cost or market. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values. Inventory provisions are calculated using management's best estimates of inventory value based on the age of the inventory, quantities on hand compared with historical and projected usage and current and anticipated demand.

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Rental equipment

Rental equipment is comprised of equipment on rent to customers and is depreciated using the straight-line method over the estimated useful life of the equipment. Copier/MFP equipment is depreciated over three years and facsimile equipment placed in service on or after October 1, 2003 is depreciated over three years. Facsimile equipment placed in service before October 1, 2003 is depreciated over five years.

Capitalized computer software costs

We capitalize certain costs of internally developed software. Capitalized internal costs include purchased materials and services and payroll and payroll related costs. Costs for general administration, overhead, maintenance and training, as well as the cost of software that does not add functionality to the existing system, are expensed as incurred. The cost of internally developed software is amortized on a straight-line basis over appropriate periods, principally three to seven years. The unamortized balance of internally developed software is included in property, plant and equipment in the consolidated balance sheets.

Goodwill

We evaluate goodwill for impairment annually in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142. SFAS No. 142 requires the use of a nonamortization approach to account for purchased goodwill and certain intangibles. Under a nonamortization approach, goodwill and certain intangibles are not amortized into results of operations, but instead are reviewed periodically for impairment with any resulting impairment charged to results of operations only in the periods in which the recorded value of goodwill and intangibles is more than their fair value. SFAS No.142 prescribes a two-step method for determining goodwill impairment. In the first step, the implied fair value of the reporting unit's goodwill is compared to the carrying amount of goodwill. If the carrying amount of goodwill is greater than the implied fair value of goodwill, the second step of the impairment test is required and the fair value of the reporting unit's goodwill is determined by allocating the reporting unit's fair value to all of the assets and liabilities in the same manner performed in a purchase price allocation. The fair value of the goodwill is then compared to its carrying amount to determine if there is goodwill impairment. We completed our review of goodwill in accordance with SFAS No. 142 effective October 1, 2004 and have determined that our recorded goodwill is not impaired.

Deferred taxes on income

Income taxes are accounted for under the asset and liability method, which requires the recognition of deferred tax assets and liabilities based on the estimated future tax consequences of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the periods the temporary differences are expected to be settled. A valuation allowance is established, as needed, to reduce net deferred tax assets to realizable value. A valuation allowance has not been established for our deferred tax assets as we believe it is more likely than not, they will be realized.

Financial instruments

We recognize all derivative financial instruments as assets and liabilities and measure them at fair value. All derivative financial instruments were designated and qualified as cash flow hedges and, accordingly, the effective portions of changes in fair value of the derivative were recorded in

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other comprehensive income and were recognized in the income statement when the hedged item affected earnings.

Historically, we used interest rate swap agreements to manage and reduce risk related to interest payments on our debt instruments. During the third quarter of 2003, we revised our cash flow estimates, disposed of our two interest rate swap agreements and reclassified the cumulative change in the fair market value of the interest rate swap agreements from other comprehensive income into interest expense.

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Overview of 2004 Financial Results

Total revenue for 2004 decreased 2% to \$609 million from 2003 revenue of \$622 million. Net income in 2004 was \$25 million, or \$1.48 per diluted common share, compared with net income of \$20 million, or \$1.19 per diluted common share in 2003.

Revenue

The following table shows our revenue by geographic segment for the periods indicated.

Dollars in millions

	Year ended December 31, 2004	2003	2002
	-----	-----	-----
North America	\$ 588	\$ 602	\$ 608
United Kingdom	21	20	22
	-----	-----	-----
Total revenue	\$ 609	\$ 622	\$ 630
	=====	=====	=====

Our revenue is generated from three lines of business: copier/MFP, facsimile and sales to Pitney Bowes of Canada. The following table shows our revenue and growth rates versus the prior year by revenue type for our three business lines, for the periods indicated. Sales to Pitney Bowes of Canada are presented separately as it operates under a reseller agreement. There is no rental or support service revenue associated with Pitney Bowes of Canada.

Dollars in millions

	Year ended December 31,					
	2004		2003		2002	
	Revenue	Growth rate	Revenue	Growth rate	Revenue	Growth rate
	-----	-----	-----	-----	-----	-----
Sales						
Copier/MFP products	\$ 223	9%	\$ 204	7%	\$ 190	(3%)
Facsimile products	73	(13%)	83	(14%)	97	(10%)

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Pitney Bowes of Canada	15	(46%)	29	4%	28	380%
	-----		-----		-----	
Total sales	311	(2%)	316	--	315	2%
Rentals						
Copier/MFP products	110	9%	101	7%	94	7%
Facsimile products	99	(18%)	121	(12%)	138	(8%)
	-----		-----		-----	
Total rentals	209	(6%)	222	(4%)	232	(2%)
Support services						
Copier/MFP products	82	7%	76	4%	74	3%
Facsimile products	7	(6%)	8	(16%)	9	2%
	-----		-----		-----	
Total support services	89	6%	84	1%	83	3%
	-----		-----		-----	
Total revenue	\$ 609	(2%)	\$ 622	(1%)	\$ 630	1%
	=====		=====		=====	

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The following table shows our revenue and growth rates versus the prior year for our three business lines, for the periods indicated. Sales to Pitney Bowes of Canada are presented separately as it operates under a reseller agreement.

Dollars in millions

	Year ended December 31,					
	2004		2003		2002	
	Revenue	Growth rate	Revenue	Growth rate	Revenue	Growth rate
	-----	-----	-----	-----	-----	-----
Revenue						
Copier/MFP products	\$ 415	9%	\$ 381	6%	\$ 358	1%
Facsimile products	179	(16%)	212	(13%)	244	(8%)
	-----		-----		-----	
Revenue excluding						
Pitney Bowes of Canada	594	--	593	(1%)	602	(3%)
Pitney Bowes of Canada	15	(46%)	29	4%	28	380%
	-----		-----		-----	
Total revenue	\$ 609	(2%)	\$ 622	(1%)	\$ 630	1%
	=====		=====		=====	

Sales to Pitney Bowes of Canada are pursuant to a reseller agreement and are at margins significantly below the typical margins on sales to our direct customers. We expect to maintain a reseller agreement with Pitney Bowes of Canada, however, we are unable to predict the future level of sales to Pitney Bowes of Canada. Although revenue, excluding sales to Pitney Bowes of Canada represents a non-GAAP financial measure, we believe it is useful to analyze revenue excluding sales to Pitney Bowes of Canada in order to better evaluate

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the effectiveness of our direct sales and marketing initiatives, including the transition of our business from facsimile to copier/MFP products, and our pricing policies.

Results of Operations

The following table shows our income statement data, expressed as a percentage of total revenue, for the periods indicated. The table also shows cost of sales as a percentage of sales revenue, cost of rentals as a percentage of rental revenue and our effective income tax rate.

	As a % of total revenue, except as noted		
	Year ended December 31,		
	2004	2003	2002
	----	----	----
Equipment sales	28%	27%	25%
Supplies sales	23%	24%	25%
	----	----	----
Total sales	51%	51%	50%
Equipment rentals	34%	36%	37%
Support services	15%	13%	13%
	----	----	----
Total revenue	100%	100%	100%
Cost of sales	28%	31%	32%
Cost of rentals	10%	12%	13%
Selling, service and administrative expenses	54%	50%	50%
	----	----	----
Operating income	8%	7%	5%
Interest expense	1%	1%	1%
	----	----	----
Income before income taxes	7%	6%	4%
Provision for income taxes	3%	3%	2%
	----	----	----
Net income	4%	3%	2%
	====	====	====
Cost of sales as a percentage of sales revenue	55.2%	61.0%	63.0%
	====	====	====
Cost of rentals as a percentage of rental revenue	28.2%	32.5%	36.2%
	====	====	====
Effective tax rate	42.6%	43.1%	39.9%
	====	====	====

We consider revenue from equipment rentals, supplies sales and support services to be recurring because they typically are derived from equipment rentals subject to multi-year contracts and from supplies sales and support services, which are a natural consequence of the use of our installed base of equipment. Although the initial term of our rental contracts are generally three years, they typically provide a continuing stream of revenue resulting from automatic renewal options or new rental contracts for replacement equipment. Historically, our recurring revenue has consistently been in the range of approximately 72% - 75% of total revenue. However, we cannot provide any

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assurance that our recurring revenue will continue at these rates. We believe this information is useful because it indicates our ability to generate a consistent revenue base.

Years ended December 31, 2004 and December 31, 2003

Revenue. In 2004, total revenue of \$609 million declined 2% from the prior year total revenue of \$622 million, reflecting lower facsimile revenue and lower sales to Pitney Bowes of Canada, partially offset by higher copier/MFP revenue. Excluding the impact of revenue attributable to Pitney Bowes of Canada, which operates under a reseller agreement, total revenue increased slightly versus the prior year.

Equipment and supplies sales revenue of \$311 million decreased 2% in 2004 from \$316 million in 2003, reflecting lower sales to Pitney Bowes of Canada and lower facsimile sales, partially offset by higher copier/MFP sales. Excluding the impact of sales to Pitney Bowes of Canada, total sales revenue increased 3% compared with the prior year. Copier/MFP sales increased 9% primarily due to growth in both low and high end digital and color multifunctional product segments, our geographic expansion as described in Note 15 of our "Notes to Consolidated Financial Statements" and increased supplies sales related to the growth in equipment sales. Facsimile equipment and supplies sales declined 13% compared with the prior year reflecting lower sales of supplies primarily due to the expected continuing industry-wide reduction in facsimile usage, partially offset by higher sales of facsimile equipment reflecting rental to sale conversions.

Equipment rental revenue of \$209 million declined 6% in 2004 from \$222 million in 2003, reflecting the continued expected decline in facsimile rental revenues, partially offset by an increase in copier/MFP rental revenues resulting from our continuing copier/MFP marketing focus. Rental revenue derived from our copier/MFP product line increased 9% reflecting increased page volumes as well as growth in the overall installed rental population resulting from awards of new state rental contracts and equipment placements at our national accounts, which prefer a rental placement strategy similar to that of our historic facsimile product placement strategy. Rental revenue from our facsimile product line declined 18% versus the prior year reflecting the expected continuing decline in the installed base and lower pricing on new placements and renewals compared to expiring contracts.

Support services revenue, primarily derived from stand-alone service contracts, increased 6% to \$89 million in 2004 from \$84 million in 2003, resulting primarily from higher copier/MFP page volumes as well as growth in the installed base of copier/MFP equipment and our geographic expansion of sales as described in Note 15 of our "Notes to Consolidated Financial Statements," partially offset by lower facsimile service revenue.

Cost of sales. Cost of sales was \$171 million in 2004 compared with \$193 million in 2003 and as a percentage of sales revenue declined to 55.2% in 2004 from 61.0% in 2003. This decline was due to lower copier/MFP product cost, lower inventory obsolescence charges and a lower proportion of sales to Pitney Bowes of Canada, which are at substantially lower gross margins than direct sales, partially offset by the continuing shift in product mix toward copier/MFP products, which have a higher cost as a percentage of sales revenue than the facsimile product line.

Cost of rentals. Cost of rentals was \$59 million in 2004 compared with \$72 million in 2003 and as a percentage of rental revenue declined to 28.2% in 2004 from 32.5% in 2003. This decline resulted from product cost improvements coupled with the impact of our disciplined focus on improving profit margins, partially offset by an increase in the continuing mix of copier/MFP product rentals, which have a higher cost as a percentage of rental revenue than facsimile machines.

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Selling, service and administrative expenses. Selling, service and administrative expenses of \$331 million were 54.4% of total revenue in 2004 compared with \$313 million or 50.3% of total revenue in 2003. Selling, service and administrative expenses increased 6% over the prior year primarily resulting from higher compensation and benefit expenses relating to higher copier/MFP revenue coupled with increased sales headcount, higher operating expenses associated with direct distribution expansion, higher administrative costs related to the implementation and stabilization of our ERP system and increased bad debt expense. This was partially offset by reduced advertising expenses, reduced 2004 bonus and certain employee benefit accruals, lower costs resulting from the absence of payments to Pitney Bowes for information technology charges and the absence of service charges from Pitney Bowes, which were included under the transition services agreement. The impact of the employee benefit accrual reduction was \$2.6 million and the impact of the reduction in the 2004 bonus accrual was \$2.7 million.

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Purchasing and receiving costs, inspection costs, warehousing costs and other distribution costs are included in selling, service and administrative costs because no meaningful allocation of these expenses to cost of sales or cost of rentals is practicable. These costs amounted to \$19 million and \$17 million for the years ended December 31, 2004 and 2003, respectively.

Field sales and service operating expenses are included in selling, service and administrative expenses because no meaningful allocation of these expenses to cost of sales, cost of rentals or cost of support services is practicable.

Interest expense. Interest expense decreased to \$4 million in 2004 from \$8 million in 2003. Interest expense in 2003 included a loss of \$2.8 million reclassified from accumulated other comprehensive loss related to the revision of our cash flow estimates and subsequent disposition of our two interest rate swap agreements. Excluding the impact of this loss, interest expense decreased as a result of lower interest rates, partially offset by higher average debt levels. The weighted average interest rate was 3.0% for 2004 versus 5.8% for 2003. As of December 31, 2004 we had no interest rate swap agreements outstanding.

Effective tax rate. Our effective tax rate was 42.6% in 2004 compared with 43.1% in 2003, which reflects the tax on a foreign dividend net of foreign tax credits. Our future effective tax rate will depend on our structure and tax strategies as well as any future jurisdictional rate changes and could vary from our historical effective tax rates.

Years ended December 31, 2003 and December 31, 2002

Revenue. In 2003, total revenue of \$622 million declined 1% from the prior year total revenue of \$630 million, primarily reflecting lower rental revenue, partially offset by higher support services revenue.

Equipment and supplies sales revenue of \$316 million increased slightly in 2003 from \$315 million in 2002. Excluding the impact of sales to Pitney Bowes of Canada, total sales revenue was essentially flat compared to prior year. Copier/MFP sales revenue increased 7% resulting from increased placements in our mid-market digital black and white and color copiers/MFPs as well as higher supplies sales. Facsimile sales revenue declined 14% due to lower equipment and supplies sales resulting from the anticipated lower industry-wide facsimile usage.

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Equipment rental revenue of \$222 million declined 4% in 2003 from \$232 million in 2002, reflecting the continued expected decline in facsimile rental revenues, partially offset by an increase in copier/MFP rental revenues. Rental revenue derived from our copier/MFP product line increased 7% reflecting increases in page volumes and new placements in our mid-level digital black and white and color product categories as well as growth in the overall installed rental population resulting from a continuing copier/MFP marketing focus on national accounts, which prefer a rental placement strategy similar to that of our historic facsimile product placement strategy. Rental revenue from our facsimile product line declined 12% versus the prior year reflecting a lower installed base and lower pricing on new placements and renewals compared to expiring contracts.

Support services revenue, primarily derived from stand-alone service contracts, increased 1% to \$84 million in 2003 from \$83 million in 2002, reflecting a product mix shift toward higher-end copiers/MFPs, offset by lower facsimile service revenue due to lower pricing.

Cost of sales. Cost of sales was \$193 million in 2003 compared with \$198 million in 2002 and as a percentage of sales revenue declined to 61.0% in 2003 from 63.0% in 2002. This decline was due to lower obsolete inventory provisions, the impact of our disciplined focus on improving profit margins and lower product cost, partially offset by an increase in the mix of copier/MFP product sales, which have a higher cost of sales percentage than facsimile sales. The provision to write our inventory down to net realizable value declined \$8 million to \$7 million in 2003 from \$15 million in 2002.

Cost of rentals. Cost of rentals was \$72 million in 2003 compared with \$84 million in 2002 and as a percentage of rental revenue declined to 32.5% in 2003 from 36.2% in 2002. This decline resulted from product cost improvements coupled with the impact of our disciplined focus on improving profit margins, partially offset by an increase in the mix of copier/MFP product rentals, which have a higher cost as a percentage of rental revenue than facsimile machines.

Selling, service and administrative expenses. Selling, service and administrative expenses of \$313 million were 50.3% of total revenue in 2003 compared with \$312 million or 49.5% of total revenue in 2002. Selling, service and administrative expenses increased slightly over the prior year primarily resulting from higher information technology and associated administrative expenses related to maintaining legacy systems while incurring costs relating to our enterprise resource planning ("ERP") project, partially offset by lower employee compensation and benefit expenses and lower advertising.

Purchasing and receiving costs, inspection costs, warehousing costs and other distribution costs are included in selling, service and administrative costs because no meaningful allocation of these expenses to cost of sales or cost of rentals is practicable. These costs amounted to \$17 million and \$16 million for the years ended December 31, 2003 and 2002, respectively.

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Field sales and service operating expenses are included in selling, service and administrative expenses because no meaningful allocation of these expenses to cost of sales, cost of rentals or cost of support services is practicable.

Interest expense. Interest expense was \$8 million in 2003 and 2002. Interest expense in 2003 included a loss of \$2.8 million resulting from the reclassification from accumulated other comprehensive loss related to the

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disposition of our two interest rate swap agreements. Interest expense for 2002 included a loss of \$0.4 million resulting from the prepayment of \$8 million of the Term Loan and associated unwinding of a portion of one of the interest rate swap agreements. Excluding the impact of these losses, interest expense decreased as a result of lower debt levels coupled with lower interest rates. The weighted average interest rate was 5.8% for 2003 versus 7.1% for 2002. As of December 31, 2003 we had no interest rate swap agreements outstanding.

Effective tax rate. Our effective tax rate was 43.1 % in 2003 compared with 39.9% in 2002 due to an increase in state and local income taxes, a change in the estimate of the deductibility for tax purposes of certain expenses, and the tax on a foreign dividend net of foreign tax credits. Our future effective tax rate will depend on our structure and tax strategies as well as any future jurisdictional rate changes and could vary from our historical effective tax rates.

Expansion of Sales and Service Capabilities

During 2004, we acquired substantially all of the assets and business of two independent dealers of copier and multifunctional equipment and related support services and all of the capital stock of one independent dealer of copier and multifunctional equipment and related support services to expand our geographic sales and service capabilities. During 2003, we acquired substantially all of the assets and business of one independent dealer of copier and multifunctional equipment and related support services, to expand our geographic sales and service capabilities. These acquisitions, individually or in the aggregate, were not significant to our financial position or results of operations. These acquisitions were accounted for using the purchase method of accounting. The purchase price, including direct costs of the acquisitions, was allocated to acquired assets and assumed liabilities. The excess of the purchase price over the net tangible assets acquired was recorded as goodwill. The operating results of these acquisitions are included in our financial statements from the dates of the respective acquisitions.

Liquidity and Capital Resources

On November 9, 2001 we entered into a Credit Agreement with a group of lenders (the "Credit Agreement") that provided for secured borrowings or the issuance of letters of credit in an aggregate amount not to exceed \$225 million, comprised of a \$125 million Revolving Credit Facility (the "Revolving Credit Facility") and a \$100 million Term Loan (the "Term Loan"). The term of the Revolving Credit Facility is five years and the term of the Term Loan is six years.

We have pledged substantially all of our assets plus 65% of the stock of our direct wholly-owned subsidiaries as security for our obligations under the Credit Agreement. Available borrowings and letter of credit issuance under the Revolving Credit Facility are determined by a borrowing base consisting of a percentage of our eligible accounts receivable, inventory, rental assets and accrued and advance billings, less outstanding borrowings under the Term Loan.

The Credit Agreement contains financial covenants that require the maintenance of minimum earnings before interest, taxes, depreciation and amortization ("EBITDA") and a maximum leverage ratio (total debt to EBITDA), as well as other covenants, which, among other things, place limits on dividend payments and capital expenditures. The Credit Agreement allowed us to originally repurchase up to \$20 million of our stock and to make acquisitions up to an aggregate consideration of \$30 million. At December 31, 2004 and 2003, we were in compliance with all of the financial covenants.

Originally, amounts borrowed under the Revolving Credit Facility bore interest at variable rates based, at our option, on either the LIBOR rate plus a

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margin of from 2.25% to 3.00%, depending on our leverage ratio, or the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on our leverage ratio. Amounts borrowed under the Term Loan bore interest at variable rates based, at our option, on either the LIBOR rate plus a margin of 3.50% or 3.75%, depending on our leverage ratio, or the Fleet Bank base lending rate plus a margin of 2.50% or 2.75%, depending on our leverage ratio. A commitment fee of from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility was payable quarterly, in arrears, depending on our leverage ratio.

The Credit Agreement required us to manage our interest rate risk with respect to at least 50% of the aggregate principal amount of the Term Loan for a period of at least 36 months. Accordingly, we entered into two interest rate swap agreements in the notional amounts of \$50.0 million and \$30.0 million to convert the variable interest rate payable on the Term Loan to a fixed interest rate in order to hedge the exposure to variability in expected future cash flows. These interest rate swap agreements had been designated as cash flow hedges. The counterparties to the interest rate swap agreements were major international financial institutions. Under the terms of the swap agreements, we received payments based upon the 90-day LIBOR rate and remitted

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payments based upon a fixed rate. The fixed interest rates were 4.17% and 4.32% for the \$50.0 million and the \$30.0 million swap agreements, respectively.

Our initial borrowings of \$150 million under the Credit Agreement, consisting of \$100 million under the Term Loan and \$50 million under the Revolving Credit Facility, were used to repay amounts due to Pitney Bowes and to pay a dividend to Pitney Bowes.

On March 19, 2002, the Credit Agreement was amended to increase the total amount of our stock permitted to be repurchased from \$20.0 million to \$30.0 million. On July 19, 2002, the Credit Agreement was amended to increase the total amount of our stock permitted to be repurchased from \$30.0 million to \$58.0 million and to reduce the Term Loan interest rates to LIBOR plus a margin of from 2.75% to 3.75%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, depending on our leverage ratio. On March 5, 2003, the Credit Agreement was amended to increase the total amount of stock permitted to be repurchased from \$58.0 million to \$78.0 million, to reduce the minimum EBITDA covenant to \$100.0 million for the remainder of the term of the Credit Agreement and to revise the limitation on capital expenditures. On May 16, 2003, the Credit Agreement was amended (the "Fourth Amendment") to reduce the aggregate amount of the Revolving Credit Facility from \$125.0 million to \$95.0 million, to delete the requirement that we maintain interest rate protection with respect to at least 50% of the aggregate principal amount of the Term Loan, to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 2.25%, from LIBOR plus a margin of from 2.75% to 3.75%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of 1.25%, from the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, depending on our leverage ratio, to reduce and fix the Revolving Credit Facility interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of from 2.25% to 3.00%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of 0.25%, from the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on our leverage ratio and to fix our commitment fee at 0.375% on the average daily unused portion of the Revolving Credit Facility from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility, depending on our leverage ratio. On May 7, 2004, the Credit Agreement was amended (the "Fifth Amendment") to increase the amount of our stock permitted to be repurchased from

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\$78.0 million to \$108.0 million, to increase the aggregate amount of consideration payable for acquisitions from \$30.0 million to \$60.0 million and to remove the requirement for annual borrowing base audits so long as \$50.0 million or more of borrowings are available under the Credit Agreement and the fixed charge ratio, as defined in the Fifth Amendment, is 2.0 or higher. Effective June 1, 2004, the Credit Agreement was further amended (the "Sixth Amendment") to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of 2.25%, or to the Bank of America (formerly Fleet Bank) base lending rate plus a margin of 0.25%, from the Bank of America base lending rate plus a margin of 1.25%. On April 1, 2004, Bank of America Corporation acquired 100% of the outstanding common stock of FleetBoston Financial Corporation, the parent of Fleet Bank and our Credit Agreement was assigned to Bank of America.

During the third quarter of 2002, we revised our cash flow estimates and prepaid \$8.0 million of the amount outstanding under the Term Loan. This prepayment was covered by a portion of the \$30.0 million interest rate swap agreement that had been designated as a cash flow hedge. Since it was no longer probable that the hedged forecasted transactions related to the \$8.0 million Term Loan prepayment would occur, we recognized a loss related to that portion of the swap agreement underlying the amount of the prepayment by reclassifying \$0.4 million from accumulated other comprehensive income (loss) into interest expense. We also unwound \$8.0 million of the \$30.0 million interest rate swap agreement.

During the third quarter of 2003, we revised our cash flow estimates and prepaid \$20.0 million of the amount outstanding under the Term Loan. In light of this revision, the deletion of the interest rate protection requirement resulting from the Fourth Amendment and our consistent historical positive cash flow and near term estimated operating and capital expenditure requirements, we disposed of our two interest rate swap agreements in the notional amounts of \$50.0 million and \$22.0 million. Accordingly, we reclassified \$2.8 million from accumulated other comprehensive income (loss) into interest expense because it was no longer probable that the hedged forecasted transactions would occur.

For the years ended December 31, 2004 and 2003, our average debt outstanding was \$75.8 million and \$69.2 million, respectively.

At December 31, 2004, \$71 million of borrowings were outstanding under the Credit Agreement, consisting of \$18 million of borrowings under the Revolving Credit Facility and \$53 million of borrowings under the Term Loan, and the borrowing base amounted to approximately \$122 million. At December 31, 2004, the weighted average interest rate was 3.99% on borrowings under the Revolving Credit Facility and the interest rate was 3.81% on borrowings under the Term Loan. As of January 31, 2005, \$83 million of borrowings were outstanding under the Credit Agreement, consisting of \$31 million of borrowings under the Revolving Credit Facility and \$52 million of borrowings under the Term Loan. Approximately \$76 million of the Revolving Credit Facility was available for borrowing at December 31, 2004 and approximately \$64 million of the Revolving Credit Facility was available for borrowing at January 31, 2005. The Term Loan is payable in 8 consecutive equal quarterly installments of

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\$0.1 million due March 31, 2005 through December 31, 2006, three consecutive equal quarterly installments of \$12.9 million due March 31, 2007 through September 30, 2007 and a final payment of \$12.9 million due at maturity.

At December 31, 2004 and 2003, one irrevocable standby letter of credit in the amount of \$1.4 million and \$0.9 million, respectively was outstanding as

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security for our casualty insurance program. There were no letters of credit outstanding at December 31, 2002.

The ratio of current assets to current liabilities was 2.9 to 1 at December 31, 2004 compared to 2.8 to 1 at December 31, 2003 due to an increase in accrued billings and inventories, partially offset by a decrease in cash. At December 31, 2004, our total debt as a percentage of total capitalization increased to 20.4% from 19.2% at December 31, 2003 due to an increase in our debt coupled with stock repurchases under our stock buy back program.

In October 2003, we implemented Phase II of our ERP system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation. During the initial stages of the implementation and throughout our subsequent stabilization efforts, we experienced certain processing inefficiencies affecting billings, which impacted accounts receivable levels. We have provided for collection losses on the increase in accounts receivable at rates higher than our historical experience. However, if collection losses related to accounts receivable are higher than the amounts provided, we would recognize an additional increase in our provision for bad debt.

We began implementing Phase III of our ERP system during the fourth quarter of 2004, primarily comprised of certain automated tools to assist in invoice dispute resolution and collection activities. While we encountered performance issues in the implementation of these automated tools, these issues have been substantially remedied and these automated tools have begun to assist in our progress in collecting our accounts receivable. During 2005, we expect to complete the implementation of Phase III of our ERP implementation, which will further enhance our efficiencies with respect to our collection activities.

We remain engaged in a period of stabilization, as is typical of a large ERP system implementation. During October 2004, we experienced certain unforeseen system performance issues, which resulted in delays in invoicing our customers. We identified the causes of these performance issues and implemented appropriate remedies, however, as a result of the delayed October invoicing, we experienced delays in customer cash receipts negatively impacting accounts receivable during the fourth quarter.

Our cash flows from operations, together with borrowings under the Credit Agreement, are expected to adequately finance our ordinary operating cash requirements and capital expenditures for the foreseeable future. We expect to fund further expansion and long-term growth primarily with cash flows from operations, together with borrowings under the Credit Agreement and possible future sales of additional equity or debt securities.

Net cash provided by operating activities was \$79 million, \$83 million and \$158 million for the years ended December 31, 2004, 2003 and 2002, respectively. Net income was \$25 million, \$20 million and \$16 million in 2004, 2003 and 2002, respectively. Non-cash charges for depreciation and amortization and provisions for bad debt and inventory obsolescence in the aggregate provided cash of \$81 million, \$89 million and \$102 million for 2004, 2003 and 2002, respectively. In 2004 and 2003, the provision to write down excess and obsolete inventory amounted to \$2 million and \$7 million, respectively. In 2002 the provision to write down excess and obsolete inventory amounted to \$15 million to recognize the impact of the continuing market shift from analog to digital equipment on the market value of our inventory. Changes in the principal components of working capital required cash of \$29 million in 2004 and \$30 million in 2003, and provided cash of \$38 million in 2002. Of the \$29 million increase in our working capital requirements in 2004, \$9 million resulted from an increase in net accounts receivable, primarily due to increased delinquencies, \$8 million resulted from an increase in accrued billings and \$2 million resulted from a decrease in advance billings. The change in accrued billings and advance

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billings was related to timing of invoicing to customers. Inventory levels increased \$9 million resulting from our geographic expansion of sales and service capabilities (See Note 15 of our "Notes to Consolidated Financial Statements") as well as purchases in the fourth quarter in support of scheduled new product introductions. Of the \$30 million increase in