COLOR IMAGING INC
Form 10QSB/A
June 21, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB/A

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

For the quarterly period ended JUNE 30, 2001

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

For the transition period from ______________ to ______________

Commission File Number: 0-18450

COLOR IMAGING, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 13-3453420 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|---|---|
| 4350 PEACHTREE INDUSTRIAL BOULEVARD, SUITE 100<br>NORCROSS, GEORGIA | 30071 |
| (Address of principal executive offices) | (Zip code) |

(770) 840-1090

(Registrant's telephone number, including area code)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the 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 /X/ No / /

As of July 22, 2001, there were 7,956,400 shares of Common Stock outstanding.

EXPLANATORY NOTE

The accompanying financial statements for the three and six months ended June 30, 2001, have been restated to reflect the business combination with Image (see Note 2 below) under the purchase method of accounting as opposed to the pooling of interests method, as previously reported.

COLOR IMAGING, INC.
QUARTERLY REPORT ON FORM 10-QSB/A
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

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PART I: FINANCIAL INFORMATION
ITEM 1 -FINANCIAL STATEMENTS

COLOR IMAGING, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | 30-June-01 (Unaudited) As restated | 31-D (Aud As re |
|---|---|---|
| CURRENT ASSETS | | |
| Cash | $ 237,597 | $ |
| Accounts receivable | 3,896,550 | 3 |
| Refundable income taxes | 19,995 | |
| Inventory | 5,172,212 | 5 |
| Deferred taxes | 102,599 | |
| Related party portion of bonds - current | 76,716 | |
| Other current assets | 454,303 | |
| TOTAL CURRENT ASSETS | 9,959,972 | 9 |
| FIXED ASSETS | | |
| Furniture & fixtures | 129,955 | |
| R&D equipment | 432,214 | |
| Machinery & equipment | 7,297,832 | 6 |

| | | |
|---|---|---|
| Leasehold improvements | 1,262,410 | 1 |
| Accumulated depreciation | (703,923) | |
| TOTAL FIXED ASSETS, NET | 8,418,488 | 8 |
| OTHER ASSETS | | |
| Patent/intellectual property | 5,000 | |
| Deferred income tax | 503,611 | |
| Related party portion of bonds | 897,412 | |
| Other assets | 449,202 | |
| OTHER ASSETS | 1,855,225 | 1 |
| | $ 20,233,685 | $ 19 |
| CURRENT LIABILITIES | | |
| Revolving credit lines | $ 1,005,965 | $ 1 |
| Accounts payable | 6,580,796 | 6 |
| Current portion notes payable | 396,605 | |
| Current portion bonds payable | 320,000 | |
| Other current liabilities | 629,483 | |
| Current income taxes payable | -- | |
| TOTAL CURRENT LIABILITIES | 8,932,849 | 9 |
| LONG TERM LIABILITIES | | |
| Notes payable | 1,509,430 | 1 |
| Bonds payable | 3,780,000 | 3 |
| Other long term liabilities | -- | |
| LONG TERM LIABILITIES | 5,289,430 | 5 |
| TOTAL LIABILITIES | 14,222,279 | 14 |
| STOCKHOLDERS' EQUITY | | |
| Common stock, $.01 par value, authorized 20,000,000 shares; 7,046,211 and 4,000,000 shares issued on September 30, 2000 and December 31, 1999, respectively. | 79,564 | |
| Additional paid-in capital | 8,160,544 | 7 |
| Accumulated deficit | (2,228,702) | (2 |
| | 6,011,406 | 5 |
| | $ 20,233,685 | $ 19 |

See Notes to Consolidated Financial Statements



COLOR IMAGING, INC. AND SUBSIDIARIES
UNAUDITED STATEMENTS OF OPERATIONS

| | THREE MONTH PERIODS ENDED 30-June-01 As restated | THREE MONTH PERIODS ENDED 30-June-00 As restated | SIX MONTH PERIODS ENDE 30-June-01 As restated | SIX MONTH PERIODS ENDE 30-June- As restat |
|---|---|---|---|---|
| SALES | $ 8,098,154 | $ 165,024 | $ 13,626,470 | $ 440,0 |
| COST OF SALES | 7,068,627 | 96,906 | 11,582,952 | 269,5 |
| GROSS PROFIT | 1,029,527 | 68,118 | 2,043,518 | 170,4 |
| OPERATING EXPENSES | | | | |
| Administrative | 387,776 | 75,484 | 843,957 | 150,4 |
| Research & development | 184,931 | 66,410 | 401,840 | 114,6 |
| Sales & marketing | 281,712 | -- | 507,393 | |
| | 854,419 | 141,894 | 1,753,190 | 265,0 |
| OPERATING PROFIT (LOSS) | 175,108 | (73,776) | 290,328 | (94,5 |
| OTHER INCOME AND (EXPENSE) | | | | |
| Other income | 3,304 | 361 | 10,986 | 8 |
| Financing expenses | (113,360) | (4,837) | (233,934) | (9,3 |
| Non-recurring moving expense | -- | -- | (9,570) | |
| | (110,056) | (4,476) | (232,518) | (8,5 |
| INCOME BEFORE TAXES | 65,052 | (78,252) | 57,810 | (103,1 |
| PROVISION FOR INCOME TAXES | 20,210 | (31,000) | 18,310 | (41,0 |
| NET PROFIT | $ 44,842 | $ (47,252) | $ 39,500 | $ (62,1 |
| INCOME (LOSS) PER COMMON SHARE | | | | |
| Basic | $ .01 | $ (.01) | $ .01 | $ (. |
| Diluted | $ .01 | $ (.01) | $ .01 | $ (. |
| WEIGHTED AVERAGE SHARES OUTSTANDING | | | | |
| Basic | 7,705,607 | 4,000,000 | 7,624,695 | 4,000, |
| Assumed conversion | 177,946 | --* | 169,623 | |
| | 7,883,553 | 4,000,000 | 7,794,318 | 4,000, |

* Antidilutive

See Notes to Consolidated Financial Statements

COLOR IMAGING, INC. AND SUBSIDIARIES
UNAUDITED STATEMENTS OF CASH FLOWS

| | SIX MONTHS ENDED 30-June-01 As restated | SIX MONTHS 30-June- As resta |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income (loss) | $ 39,500 | $ (62, |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 300,846 | 3, |
| Deferred income taxes | 17,300 | (41, |
| Decrease (increase) in: | | |
| Accounts and other receivables | (228,235) | 381 |
| Inventories | 9,036 | (83 |
| Prepaid and other assets | (170,768) | (134 |
| Cash surrender value of life insurance | (9,483) | |
| Deposits | -- | |
| Increase (decrease) in: | | |
| Accounts payable and accrued liabilities | 174,192 | (9 |
| Income taxes payable | -- | |
| Net cash provided by (used in) operating activities | 132,388 | (2 |
| Cash flows from investing activities: | | |
| Capital expenditures | (462,904) | (19 |
| Other Assets | (178,675) | ( |
| Net cash (used in) investing activities | (641,579) | (20 |
| Cash flows from financing activities: | | |
| Net borrowings (payments) under line of credit | (393,035) | |
| Proceeds from issuance of bonds or long-term debt | -- | |
| Proceeds from sale of stock | 935,906 | |
| Principal payments of long-term debt | (135,431) | (9 |
| Net cash provided by (used in) financing activities | 407,440 | (9 |
| Net (decrease) increase in cash | (101,751) | (31 |
| Cash at beginning of year | 339,348 | 1,1 |
| Cash at end of period | $ 237,597 | $ 8 |

See Notes to Consolidated Financial Statements



COLOR IMAGING, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2001 (see Note 7 - Restatement) are not necessarily indicative of the results that may be expected for the year ended December 31, 2001.

NOTE 2. DESCRIPTION OF COMPANY

On May 16, 2000, Color Imaging, Inc., formerly known as Advatex Associates, Inc. (Advatex), Logical Acquisition Corp. (LAC), Color Acquisition Corp. (CAC), Logical Imaging Solutions, Inc. (Logical) and Color Image, Inc. (Image) entered into a Merger Agreement and Plan of Reorganization, as amended (Merger Agreement), pursuant to which LAC merged with and into Logical and CAC merged with and into Image (the Merger) and Logical and Image became wholly-owned subsidiaries of Advatex. Pursuant to the Merger Agreement, stockholders of Logical and Image exchanged their common stock for shares of common stock of Advatex. A reverse stock split of one share of common stock for 6.0779 shares of common stock was simultaneously approved for the then existing Advatex common stock. Subsequently, the equity interests in Logical were converted by virtue of the Logical Merger into approximately 3,000,000 newly issued shares of Advatex common stock, on the basis of 1.84843 Advatex Common Shares for each one share of common stock of Logical. The equity interests in Image were converted by virtue of the Image Merger into approximately 3,000,000 newly issued shares of Advatex common stock on the basis of 15 Advatex common shares for each one share of common stock of Image. The above transactions were consummated on June 28, 2000.

Prior to the completion of the above referenced transaction, Advatex was a non-operating, fully reporting, public shell, and both Logical and Image were privately owned operating enterprises. By the terms of the Merger Agreement and Plan of Reorganization, the combination was contingent upon the agreement of all of the enterprises, and it was, therefore considered a single business combination.

Image and Logical each received the same number of shares and both the board of directors and executive officers of the Company were equally divided between the managements of Logical and Image. However, since the majority of the voting stock was held by directors coming from Logical or including former Logical directors, Logical was determined to be the accounting acquirer in the reverse merger with Advatex, based upon guidance provided by Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) Topic 2A and APB 16, regarding Business Combinations.

The fair market value of the shares being issued in the reverse acquisition transaction could not be determined and accordingly, the transaction was valued at the fair market value of the issuer's net assets, which approximated their carrying value. As a result, and consistent with treatment of a merger between a non-operating public shell and privately held entity, no goodwill was recognized.

NOTE 2. DESCRIPTION OF COMPANY (CONTINUED)

Concurrently with the above transaction, Advatex, the legal acquirer, issued 3,000,000 shares of common stock (with a per share value of $1.00 as determined in the aforementioned reverse acquisition by Logical of Advatex) in exchange for the outstanding shares of Image. This transaction was accounted for under the purchase method of accounting (see Note 7 -- Restatement). The fair value of the Image's assets was reviewed to determine the allocation of the cost of the purchase to tangible and intangible assets, including goodwill. Management determined that no adjustment to the financial statements of Image was necessary, and that the fair value of the tangible and intangible assets of Image was equivalent to their respective book values and no goodwill was recognized in this transaction. The historical financial statements are those of Logical, and the assets, liabilities and operating results of Image are only included in the consolidated financial statements of the Company from the date of acquisition, June 28, 2000.

The following unaudited pro forma results of operations were developed assuming the acquisition had occurred at the beginning of the earliest period presented.

| | THREE MONTH PERIODS ENDED | | SIX MONTH PER |
|---|---|---|---|
| | JUNE 30, 2001 | JUNE 30, 2000 | JUNE 30, 2001 |
| | | (Unaudited Proforma Data) | |
| Net sales | $ 8,098,154 | $ 5,807,984 | $ 13,626,470 |
| Net income | $ 44,842 | 29,887 | 39,500 |
| Income per share | $ .01 | $ -- | .01 |

On July 7, 2000, by a vote of the majority of stockholders, Advatex Associates, Inc. (Advatex), changed its name to Color Imaging, Inc. (the Company or Color) and approved the reverse stock split.

Color develops, manufactures and markets products used in electronic printing and photocopying. Color designs, manufactures and delivers black text toners, specialty toners, including color and MICR (magnetic ink characters used on checks and other financial documents). Color also supplies other consumable products used in electronic printing and photocopying, including toner cartridges, cartridge components, photoreceptors and imaging drums.

Logical's development efforts have focused on creating a digital variable printing process that provides high-speed, color printing systems for commercial applications. Logical designs, manufactures and delivers complete printing systems, including software, control units and print engines to its customers.

NOTE 3. STOCK OPTIONS

Prior to the Merger, the Company granted options to acquire 500,000 shares of the common stock of the Company to senior members of the Company's management. The option price is $2.00 per share. The options will vest over a two to four year period.

NOTE 4. WARRANTS TO PURCHASE COMMON STOCK

As part of the Merger, the Company granted warrants (the "New Warrant") to purchase up to 100,000 shares of the common stock of the Company to professional advisors to the Merger. The New Warrant entitles the warrant holder to purchase, at any time and for a five-year period, a share of common stock of the Registrant for $2.00 per share. In addition, current shareholders own 272,000 similar warrants (the "Old Warrant"). The Old Warrant entitles the warrant holder to purchase, at any time until September 15, 2001, a share of common stock of the Registrant for $2.70 per share.

NOTE 5. EARNINGS PER SHARE

Basic and diluted earnings per share have been computed in accordance with the adoption of SFAS No. 128.



NOTE 6. INVENTORIES

Inventories consisted of the following components as of June 30, 2001 and December 31, 2000:

| | June 30, 2001 | December 31, 2000 (As restated) |
|---|---|---|
| Raw materials ............ | $ 1,624,938 | $ 794,128 |
| Work-in-process........... | 1,637,465 | 1,275,545 |
| Finished goods............ | 2,032,464 | 3,234,230 |
| Obsolescence allowance..... | (122,655) | (122,655) |
| Total........................ | $ 5,172,212 | $ 5,181,248 |

NOTE 7. RESTATEMENT OF SIX MONTHS YEAR 2001 FINANCIAL STATEMENTS:

The accompanying financial statements for the six months ended June 30, 2001, have been restated to reflect the business combination with Image (see Note 2 under the purchase method of accounting as opposed to the pooling of interests method, as previously reported. Accordingly, Image's financial statements are only consolidated beginning with the date of acquisition, June 28, 2000. In addition, the Company reclassified certain tangible assets that were erroneously classified as Patent/Intellectual Property. The following tables present the impact of the restatement.

| | As Previously Reported | As Restated |
|---|---|---|
| As of June 30, 2001: | | |
| Balance Sheet: | | |
| Related party portion bonds current | $ 76,032 | $ 76,716 |
| Property, plant and equipment, net | 7,282,588 | 8,418,488 |

| | | |
|---|---|---|
| Patent/intellectual property | 1,140,900 | 5,000 |
| Related party portion bonds, non-current | 898,096 | 897,412 |
| Additional paid-in capital | 7,917,254 | 8,160,544 |
| Accumulated deficit | (1,985,412) | (2,228,702) |

See also Note 2 -- Unaudited Proforma Data



ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our Consolidated Condensed Financial Statements and related Notes included in this report.

FACTORS THAT MAY AFFECT FUTURE RESULTS AND INFORMATION CONCERNING FORWARD-LOOKING STATEMENTS

Statements contained in this report which are not statements of historical fact are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements may be identified by the use of forward-looking terms such as "believes," "expects," "may", "will," "should" or "anticipates" or by discussions of strategy that involve risks and uncertainties. From time to time, we have made or may make forward-looking statements, orally or in writing. These forward-looking statements include statements regarding our ability to borrow funds from financial institutions or affiliates and/or engage in sales of our securities, our intention to repay certain borrowings from future sales of our securities, the ability to expand capacity by placing in service additional manufacturing equipment, the ability to commercialize our electron beam imaging technologies and products, our expected acquisition of business or technologies, our expectation that shipments to international customers will continue to account for a material portion of net sales, anticipated future revenues, sales, operations, demand, technology, products, business ventures, major customers, major suppliers, competition, capital expenditures, credit arrangements, and other statements regarding matters that are not historical facts, involve predictions which are based upon a number of future conditions that ultimately may prove to be inaccurate. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects upon our business. We cannot predict whether future developments affecting us will be those anticipated by management, and there are a number of factors that could adversely affect our future operating results or cause our actual results to differ materially from the estimates or expectations reflected in such forward-looking statements, including without limitation, those discussed in the sections titled "The Company" and "Management's Discussion and Analysis."

The information referred to above should be considered by investors when reviewing any forward-looking statements contained in this report, in any of our public filings or press releases or in any oral statements made by us or any of our officers or other persons acting on our behalf. The important factors that could affect forward-looking statements are subject to change, and we disclaim any obligation or duty to update or modify these forward-looking statements.

BACKGROUND

Color Imaging, Inc., formerly known as Advatex Associates, Inc., was incorporated in Delaware in 1987. On May 16, 2000, Advatex, Logical Acquisition Corp., Color Acquisition Corp., Logical Imaging Solutions, Inc. ("Logical") and Color Image, Inc. ("Image") entered into a Merger Agreement and Plan of Reorganization, as amended ("Merger Agreement") pursuant to which Logical Acquisition Corp. merged with and into Logical and Color Acquisition Corp. merged with and into Image (the "Merger"), whereby Logical and Image became our wholly-owned subsidiaries. Pursuant to the Merger Agreement, shareholders of Logical and Image exchanged their shares for shares of common stock of Advatex Associates, Inc.. Logical shareholders converted their shares into shares of common stock of Advatex Associates, Inc. at the ratio of 1.84843 shares of common stock of Advatex Associates, Inc. for each one share of Logical. Image shareholders converted their shares into shares of common stock of Advatex Associates, Inc. at the ratio of 15 shares of common stock of Advatex Associates, Inc. for each one share of Image. Following the conversion of shares by Logical and Image shareholders, shareholders of Logical and Image owned approximately 85% of the outstanding shares of common stock of Advatex Associates, Inc. and shareholders of Advatex Associates, Inc. after the Merger owned approximately 15%.

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The purpose of the Merger was to combine Image's toner and consumable expertise and manufacturing plant with Logical's advanced printing system capabilities to offer a wider product range and ensure product supply for Logical's print system. On July 7, 2000, pursuant to a vote of our stockholders, we changed our name from Advatex Associates, Inc. to Color Imaging, Inc, and on December 31, 2000, Color Image, Inc. was merged with and into Color Imaging, Inc. (the "Company" or "Color").

OVERVIEW

The Company, Color Imaging, Inc. (OTCBB: CIMG), develops, manufactures and markets products used in electronic printing, analog and digital copiers and high-speed digital printing. These high-speed digital printing systems print in real-time directly on offset presses. Offset presses are presses that utilize plates and ink to print on paper and other materials. We conduct our business through two separate operating units, Color Imaging, Inc. ("Color") and Logical Imaging Solutions, Inc. ("Logical"). Color develops, purchases from others and markets electronic printing products, including black text, color, magnetic ink character recognition and specialty toners, and provides other parts and accessories for laser printers and analog and digital copiers. Logical designs, manufactures and integrates components made by third parties into a complete printing system and offers technical support and supplies in connection therewith. Logical's printing system allows commercial printers to digitally process and print data that may change from page to page, also known as variable data, and images at very high speeds directly on commercial offset web presses. This capability saves time and money for both the printer and its customer.

Color

Since 1989, Color has developed, manufactured and marketed products used in electronic printing and photocopying. Image formulates and produces black text and specialty toners, including color and magnetic character recognition toners for numerous laser printers and a number of facsimile machines and photocopiers. Color's toners permit the printing of a wide range of user-selected colors and also the full process color printing of cyan, yellow, magenta and black. Magnetic character recognition toners enable the printing of magnetic characters that are required for the high-speed processing of checks and other financial documents. Color also supplies other consumable products used in electronic printing and photocopying, including toner cartridges, cartridge components, photoreceptors and imaging drums.

Color has continually expanded its product line and manufacturing capabilities. This expansion has led to the creation of more than 130 different black text, color, magnetic ink character recognition and specialty toner formulations, including aftermarket toners and imaging products for printers and facsimile machines manufactured by Brother(TM), Canon(TM), Delphax(TM), Hewlett Packard(TM), IBM(TM), Lexmark(TM), Sharp(TM), Xerox(TM), Minolta(TM), Mita(TM), Panafax(TM), Pentax(TM), Pitney Bowes(TM), Epson(TM), Fuji-Xerox(TM), Toshiba(TM), Kyocera(TM), Okidata(TM), Panasonic(TM), and printing systems developed by Logical. Color also manufacturers and or markets toners for use in Ricoh(TM), Sharp(TM), Xerox(TM), Canon(TM), Lanier(TM) and Toshiba(TM) copiers. Color also offers product enhancements, including imaging supplies, that enable standard laser printers to print magnetic character recognition data. Color markets branded products directly to OEMs and aftermarket products worldwide to distributors. In addition, aftermarket products for laser printers and digital and analog copiers are also marketed to remanufacturers and to dealers, respectively.



Logical

Logical designs, assembles and markets a complete printing system, SOLUTION2000, to commercial printers. When installed directly on an offset printing press, the SOLUTION2000 expands printing capabilities to include the printing of variable data and images, including bar codes, magnetic ink character recognition and unlimited alphanumeric sequencing. These functions allow commercial printers to digitally process and print variable data at extremely high speeds where previously they were able to only print fixed images from printing plates or cylinders installed on their offset printing presses. Since its founding in 1993, Logical's development efforts have focused on creating a high-speed digital variable data printing system for commercial printing applications that combines software, hardware and consumable products. Logical also offers a full line of consumable products, including toners, print cartridges and toner fusing assemblies. Logical's strategy is to continually build an installed base of printer systems that will generate a recurring demand for these consumable products.

Logical is developing the DigitalColorPress, a Solution series of printing systems incorporating color printing capabilities. The DigitalColorPress will print variable data in color at rates exceeding 250 pages-per-minute. This is in contrast to other products that do not print directly on the press and print at speeds of approximately 85 pages per minute. Logical believes that this represents an attractive alternative for high-speed offset printing applications because it reduces steps and labor in the print process. Logical intends to market the DigitalColorPress color printing system as an enhancement to existing Solution series installations and as an upgrade for other printing systems.

OVERVIEW (RESTATEMENT OF FINANCIAL STATEMENTS)

The Company has revised its accounting treatment for the merger completed in June 2000 from a pooling-of-interests to the purchase method in accordance with guidance provided by the Securities and Exchange Commission Staff Accounting Bulletin Topic 2A and APB 16, regarding business combinations. The financial information contained in this amended report is in conformity with the purchase method of accounting for the merger. Accordingly, the accompanying financial statements for the six months ended June 30, 2000, have been restated to reflect the business combination with Image under the purchase method of accounting as opposed to the pooling of interests method, as previously reported. As the result, Image's financial statements are only consolidated beginning with the date of acquisition, June 28, 2000.

Net sales, for the three and six month periods that ended on June 30, 2001, were primarily generated from the sale of consumable products, including toner. Revenue is recognized from the sale of products when the goods are shipped to the customer. In the three and six month periods ended June 30, 2001, net sales increased $7,933,000 and $13,186,000, respectively. The large increase in net revenues for both the three and six month periods ended June 30, 2001 compared to the same period of 2000 was primarily the result of consolidation of Image's financial statements.

Cost of goods sold includes direct material and labor and manufacturing and service overhead. Inventories are stated at the lower of cost (first-in, first-out) or market. Equipment is depreciated using the straight-line method over the estimated useful life of the equipment. Improvements to leased property are amortized over the lesser of the life of the lease or the life of the improvements.

Selling, general and administrative expenses include marketing and customer support staffs, other marketing expenses, management and administrative personnel costs, professional services, legal and accounting fees and administrative operating costs. Selling, general and administrative costs are expensed when the costs are incurred.

Research and development expenses include costs associated with the development of new products and significant enhancements of existing products, and consist primarily of employee salaries, benefits, consulting expenses and depreciation of laboratory equipment.



RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain information derived from the Company's consolidated statements of operations and expressed as a percentage of net sales:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 20 |
| | (Percentage of Net Sales) | | | |
| Net sales .............................. | 100 | 100 | 100 | 1 |
| Cost of goods sold ...................... | 87 | 59 | 85 | |
| Gross Profit ........................... | 13 | 41 | 15 | |
| Administrative expenses.................. | 5 | 46 | 6 | |

| | | | | |
|---|---|---|---|---|
| Research and Development................. | 3 | 40 | 3 | |
| Sales and Marketing...................... | 3 | 0 | 4 | |
| Operating income......................... | 2 | -45 | 2 | - |
| Interest expense......................... | 1 | 3 | 2 | |
| Depreciation and Amortization............ | 2 | 1 | 2 | |
| Income before income taxes............... | 1 | -47 | 0 | - |
| Provision for income taxes (credit) ...... | 0 | -18 | 0 | |
| Net income (Loss) ....................... | 1 | -29 | 0 | - |

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THREE MONTHS ENDED JUNE 30, 2000

NET SALES. Net sales were $8,098,000 for the three months ended June 30, 2001, or an increase of $7,933,000, or 4808% compared to $165,000 for the three month period ended June 30, 2000. The large increase in net sales during the three month period ended June 30, 2001 compared to the same period of 2000 was primarily the result of consolidation of Image's financial statements for the second quarter 2001.

COST OF GOODS SOLD. Cost of goods sold increased by $6,971,000 or 7194% to $7,069,000 in the three months ended June 30, 2001 from $97,000 in the three months ended June 30, 2000. This increase was primarily due to increased net sales. Cost of goods sold as a percentage of net sales increased to 87% in the second quarter of 2001 from 59% in the second quarter of 2000. This decrease was due to the higher level of sales at lower profit margins.

GROSS PROFIT. As a result of the above factors, gross profit increased to $1,030,000 in the three months ended June 30, 2001 from $68,000 in the three months ended June 30, 2000. Gross profit as a percentage of net sales decreased to 13% in the second quarter of 2001 from 41% in the second quarter of 2000. This decrease was also due to the higher level of sales at lower margins.

GENERAL AND ADMINISTRATIVE, R&D AND SELLING EXPENSES. General and administrative, selling and R&D expenses increased $713,000 or 502% to $854,000 in the three months ended June 30, 2001 from $142,000 in the three months ended June 30, 2000. General and administrative, R&D and selling expenses decreased, as a percentage of net sales, to 11% in the second quarter of 2001 from 86% in the second quarter of 2000. General and administrative expenses increased by $312,000 or 414% to $388,000 in the three months ended June 30, 2001 from $75,000 in the three months ended June 30, 2000. R&D expenses increased by $119,000 or 178% to $185,000 in the three months ended June 30, 2001 from $66,000 in the three months ended June 30, 2000. Selling expenses increased by $282,000 in the three months ended June 30, 2001 compared to no selling expenses for the three months ended June 30, 2000. The large increase in operating expenses for the three month period ended June 30, 2001 compared to the same period of 2000 was primarily the result of consolidation of Image's financial statements for the second quarter 2000.

OPERATING INCOME. As a result of the above factors the operating profit increased by $249,000 to a profit of $175,000 in the three months ended June 30, 2001 from a loss of $74,000 in the three months ended June 30, 2000.

INTEREST EXPENSE. Interest expense was $113,000 in the three months ended June 30, 2001 compared to $5,000 for the three months ended June 30, 2000.

OTHER INCOME. An increase in miscellaneous income, reduced by small currency exchange losses, resulted in other income increasing to $3,300 from income of $400 for the three months ended June 30, 2001 compared to the same period of 2000.

INCOME TAXES. Income tax provisions increased to $20,000 in the three months ended June 30, 2001 from a tax benefit of $31,000 for the comparable period in 2000.

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO SIX MONTHS ENDED JUNE 30, 2000.

NET SALES. Net sales were $13,626,000 for the six months ended June 30, 2001, or an increase of 2997% compared to $440,000 for the six month period ended June 30, 2000, with the increase primarily attributable to toner and consumable sales. The large increase in net revenues for both the six month period ended June 30, 2001 compared to the same period of 2000 was primarily the result of consolidation of Image's financial statements for the second quarter 2001.

COST OF GOODS SOLD. Cost of goods sold increased by $11,313,000 or 4190% to $11,583,000 in the six months ended June 30, 2001 from $270,000 in the six months ended June 30, 2000. This increase was primarily due to increased net sales. Cost of goods sold as a percentage of net sales increased to 85% in the six months ended June 30, 2001 from 61% in the first six month period of 2000. This increase in cost of sales is attributable to toner sales at a lower profit margin.

GROSS PROFIT. As a result of the above factors, gross profit increased by $1,873,000 to $2,043,000 in the six months ended June 30, 2001 from $170,000 in the six months ended June 30, 2000. Gross profit as a percentage of net sales decreased to 15% for the six months of 2001, from 39% for the similar period in 2000. This decrease in gross margin is primarily due to the toner sales at lower profit margins.

GENERAL AND ADMINISTRATIVE, SELLING, AND R&D EXPENSES. General and administrative, R&D and selling expenses increased $1,488,000 or 561% to $1,753,000 in the six months ended June 30, 2001 from $265,000 in the six months ended June 30, 2000. General and administrative, R&D and selling expenses decreased, as a percentage of net sales, to 13% in the first six months of 2001 from 60% in the similar six month period of 2000. This change was the result of increased sales and operations of the merged companies. General and administrative expenses increased by $694,000, or 461%, to $844,000 from $150,000 in the six month period ended June 30, 2001 compared to the six month period ended June 30, 2000. R&D expenses increased by $287,000 or 251% to $402,000 in the six months ended June 30, 2001 from $115,000 in the six months ended June 30, 2000. Selling expenses increased by $507,000 to $507,000 in the six months ended June 30, 2001. The large increase in operating expenses the six month period ended June 30, 2001 compared to the same period of 2000 was primarily the result of consolidation of Image's financial statements for the second quarter 2001.

OPERATING INCOME. As a result of the above factors, operating income increased by $384,000 to a profit of $290,000 for the six months ended June 30, 2001, compared with a loss of $95,000 in the six months ended June 30, 2000.

INTEREST EXPENSE. Interest expense increased by $225,000 to $234,000 in the six months ended June 30, 2001from $9000 in the six months ended June 30, 2000.

OTHER INCOME. As the result of increased miscellaneous income, other income increased to $11,000 in the six months ended June 30, 2001 from $1,000 in the comparable six months ended June 30, 2000.

INCOME TAXES. As the result of the increased profit for the six months ended

June 30, 2001 compared to the same period in 2000, the tax provision increased to $18,000 for the six months ended June 30, 2001 compared to a $41,000 tax benefit for the comparable period in 2000.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows provided by operating activities were $132,000 in the six months ended June 30, 2001, compared to $23,000 used by operating activities in the six months ended June 30, 2000. The cash flows provided by operating activities in the six months ended June 30, 2001 were comparatively greater than in the six months ended June 30, 2000 due primarily to increases in accounts payable. The payable increase resulted primarily from higher sales and purchasing in 2001.



Cash flows used in investing activities were $642,000 in the six months ended June 30, 2001 compared to $202,000 in the six months ended June 30, 2000. Included in cash flows used in investing activities in the six months ended June 30, 2001 was $254,000 invested in test equipment for furthering the Company's patented toner and digital color printing systems technologies.

The Company has a $1.5 million revolving line of credit with an outstanding balance as of June 30, 2001 of $506,000, and bears interest at the Bank's prime interest rate less .25 percent. The revolving line of credit has a December 31, 2001 expiration date. Under the line of credit, the Company is permitted to borrow 85 percent of eligible accounts receivable and 50 percent of eligible inventories (up to a maximum of $1.1 million).

The Bank has made available an additional line of credit of $500,000. The outstanding balance as of June 30, 2001 was $500,000. The additional line of credit has an expiration date of December 31, 2001, and bears an interest rate of the Bank's prime interest rate plus .5 percent. The Company has granted the Bank a security interest in all of the Company's assets as security for the payment of the lines of credit.

The Company believes that cash generated by operating activities, the net proceeds of $950,000 from the recent Merger and funds available under credit facilities will be insufficient to finance its operating and investing activities for the next 12 months after June 30, 2001. To the extent that the funds generated from these sources were insufficient to finance the operating activities, the Company raised additional funds through public or private financing. On August 29, 2000, the Board of Directors authorized the raising of up to $3 million of additional capital on terms and conditions acceptable to the Company.



SIGNATURES

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

COLOR IMAGING, INC.

June 18, 2002

/s/ MORRIS E. VAN ASPEREN
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Morris E. Van Asperen
Executive Vice President and Chief Financial Officer