



## Quarterly Report

Second Quarter Ended June 30, 2004

Trading Symbol: **AUGR**



AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

TABLE OF CONTENTS

Financial Statements

Unaudited Consolidated Balance Sheet.....	1
Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income for the Six Months Ended June 30.....	2
Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income for the Three Months Ended June 30.....	3
Unaudited Consolidated Statements of Cash Flows for the Six Months Ended June 30.....	4
Notes to the Unaudited Consolidated Financial Statements.....	5
Management Discussion & Analysis.....	9
Certification.....	13

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

Unaudited Consolidated Balance Sheet

ASSETS	
Current assets:	
Cash	\$ 17,293
Accounts receivable, less allowance for doubtful accounts of \$15,000	291,689
Unbilled production costs	5,203
Other current assets	211,705
Total current assets	525,890
Software, net	2,821,335
Equipment, furniture and leasehold improvements, net	443,865
Other assets (Note 3)	129,410
	\$ 3,920,500
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$ 78,038
Deferred income	835,063
Accrued payroll and related liabilities	248,640
Other accrued liabilities	83,394
Total current liabilities	1,245,135
Long-term debt (Note 2)	215,000
Deferred taxes (Note 5)	68,000
Total liabilities	1,528,135
Stockholders' equity:	
Common stock, 12,000,000 shares authorized, 5,525,586 shares issued and outstanding	4,274,625
Accumulated deficit	( 1,865,659)
Other comprehensive income/(loss)	(16,601)
Total stockholders' equity	2,392,365
	\$ 3,920,500

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

Unaudited Consolidated  
Statements of Operations and Comprehensive Income  
For the Six Months Ended June 30,

	<u>2004</u>	<u>2003</u>
Net sales (See Note 4)	\$2,568,272	\$2,993,156
Costs and expenses:		
Cost of sales	1,387,262	1,686,188
Selling, general & administrative	<u>1,071,860</u>	<u>1,069,067</u>
Total costs and expenses	<u>2,459,122</u>	<u>2,755,255</u>
Income from operations	109,150	237,901
Interest income/(expense)	<u>(37,620)</u>	<u>(32,930)</u>
Income before taxes	71,530	204,971
Provision for taxes based on income (See Note 5)	<u>    --</u>	<u>    3,000</u>
Net income	71,530	201,971
Foreign currency translation adjustments	<u>16,878</u>	<u>    --</u>
Total comprehensive income	<u>\$ 88,408</u>	<u>\$ 201,971</u>
Basic earnings per share (Note 6)	\$ .02	\$ .04
Basic weighted average shares outstanding	5,525,586	5,525,486
Diluted earnings per share (Note 6)	\$ .02	\$ .04
Diluted weighted average shares outstanding	5,880,486	5,673,819

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

Unaudited Consolidated  
Statements of Operations and Comprehensive Income  
For the Three Months Ended June 30,

	<u>2004</u>	<u>2003</u>
Net sales (See Note 4)	\$1,367,297	\$1,475,111
Costs and expenses:		
Cost of sales	720,787	835,792
Selling, general & administrative	<u>600,040</u>	<u>526,442</u>
Total costs and expenses	<u>1,320,827</u>	<u>1,362,234</u>
Income from operations	46,470	112,877
Interest income/(expense)	<u>(14,145)</u>	<u>(12,236)</u>
Income before taxes	32,325	100,641
Provision for taxes based on income (See Note 5)	<u>    --</u>	<u>    --</u>
Net income	32,325	100,641
Foreign currency translation adjustments	<u>(6,240)</u>	<u>    --</u>
Total comprehensive income	<u>\$ 26,085</u>	<u>\$ 100,641</u>
Basic earnings per share (Note 6)	\$ .01	\$ .02
Basic weighted average shares outstanding	5,525,586	5,525,486
Diluted earnings per share (Note 6)	\$ .01	\$ .02
Diluted weighted average shares outstanding	5,880,486	5,822,153

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

Unaudited Consolidated Statements of Cash Flows  
For the Six Months Ended June 30,  
Increase (Decrease) in Cash

	2004	2003
Cash flows from operating activities:		
Net income	\$ 71,530	\$ 201,971
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	467,820	577,316
Changes in operating assets and liabilities:		
Accounts receivable	117,334	119,065
Unbilled production costs	(529)	2,666
Other current assets	(27,575)	(7,685)
Other assets	--	(16,093)
Accounts payable	(7,106)	(150,506)
Deferred income	(44,980)	(489,674)
Other accrued liabilities	(71,643)	(206,657)
Accrued payroll and related liabilities	(3,404)	(36,870)
Net cash provided by (used in) operating activities	501,447	(6,467)
Cash flows from investing activities:		
Capital expenditures	(272,705)	(273,717)
Cash flows from financing activities:		
Exercise of Warrants	--	12,425
Principal borrowings/(payments) under long-term debt agreements, net	(232,402)	280,284
Cash provided by (used in) financing activities	(232,402)	292,709
Net increase (decrease) in cash	(3,660)	12,525
Foreign currency effect on cash	10,419	--
Cash at beginning of period	10,534	31,877
Cash at end of period	\$ 17,293	\$ 44,402

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 1.** The unaudited consolidated financial statements included herein have been prepared by management and include all normal and recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position at June 30, 2004, the results of operations and the statement of cash flows for the three and six months ended June 30, 2004 and 2003 in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of Auto-Graphics, Inc. and its wholly owned subsidiary, A-G Canada Ltd. The Company has no so-called special purpose entities or off-balance sheet or derivative financing of any kind. All entities have been consolidated and all material intercompany accounts and transactions have been eliminated.

The results of operations for the subject periods are not necessarily indicative of the results for the entire year.

This Quarterly Report is qualified in its entirety by the information included in the Company's Annual Report to the SEC on Form 10-KSB for the period ending December 31, 2003 including, without limitation, the financial statements and notes therein.

**NOTE 2.** The Company was in compliance with all of its financial loan covenants as of June 30, 2004 under its bank credit agreement. In February 2004, the Company concluded a new credit agreement with a new primary bank, Pacific Mercantile Bank. The credit facility is a revolving line of credit with an initial commitment of \$750,000 declining to \$500,000 on October 1, 2004 consistent with the Company's forecasted declining requirements for financing. The credit facility matures on May 1, 2006. The interest rate on the new credit facility is the Wall Street Journal bank prime rate plus a 1.5% margin (5.75% at July 1, 2004). The credit facility is secured by all of the assets of the Company and its subsidiary, A-G Canada Ltd. and requires that the Company maintain certain minimum financial covenant ratios. At June 30, 2004, the total borrowing was \$215,000 with \$535,000 in additional credit availability under the credit facility.

**NOTE 3.** In February 2003, A-G Canada, Ltd. a wholly owned Canadian subsidiary of the Company, pledged a Guaranteed Income Certificate in the amount of \$54,000 to Toronto Dominion Bank as collateral for a four-year Letter of Credit in the amount of \$54,000.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

**Note 4.** Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for reporting information about operating segments in interim and annual financial statements.

The following table summarizes sales based on the location of the customers and assets based on the location of the asset presented on the basis of generally accepted accounting principles for the three months ended June 30, 2004, and 2003:

	<u>2004</u>	<u>2003</u>
Geographic areas		
Net sales		
United States	\$ 2,146,142	\$ 2,493,879
Foreign - Canada/Other	422,130	499,277
Long-lived assets, net		
United States	3,262,800	3,787,452
Foreign - Canada	2,400	6,359

**Note 5.** Deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been reported in the Company's financial statements or tax returns. A valuation allowance at June 30, 2004 reflects an unrecognized U.S. and foreign tax loss carryforward. At December 31, 2003, the Company had available net operating loss carryforwards for federal income tax purposes of \$3,398,000, \$2,089,000 for state income tax purposes and \$160,000 for foreign income tax purposes. These net operating loss carryforwards expire in 2022 for federal taxes, 2010 for state and 2008 for foreign taxes.

**Note 6.** Earnings Per Share

Statement of Financial Accounting Standards No. 128, "Earnings per Share" requires the presentation of basic earnings per share and diluted earnings per share. Basic and diluted earnings per share computations presented by the Company conform to the standard and are based on the weighted average number of shares of Common Stock outstanding during the year. During the six months ended June 30, 2004, no stock options or warrants were issued.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations:

<u>Three months ended June 30, 2004</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 32,325	5,525,586	\$ 0.01
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>    354,900</u>	<u>                  </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 32,325</u>	<u>5,880,486</u>	<u>\$ 0.01</u>
<u>Three months ended June 30, 2003</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 100,641	5,525,586	\$ 0.02
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>    296,567</u>	<u>                  </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 100,641</u>	<u>5,822,153</u>	<u>\$ 0.02</u>
<u>Six months ended June 30, 2004</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 71,530	5,525,586	\$ 0.02
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>    354,900</u>	<u>                  </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 71,530</u>	<u>5,880,486</u>	<u>\$ 0.02</u>
<u>Six months ended June 30, 2003</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 201,971	5,525,486	\$ 0.04
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>    148,333</u>	<u>                  </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 201,971</u>	<u>5,673,819</u>	<u>\$ 0.04</u>

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

**Note 7.** Recently Issued Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. The Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The Company believes the adoption of this Statement will have no material impact on its financial statements.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

**CRITICAL ACCOUNTING POLICIES**

The Company maintains its accounting books and records in accordance with accounting principles generally accepted in the United States of America. The preparation of the financial statements of the Company in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and sales and expenses during the reporting period. These estimates are based on information available as of the date of the financial statements. Actual results may materially differ from those estimated. The Company's critical accounting policies include the following:

- + Capitalized software development costs
- + Amortization of software development costs
- + Revenue Recognition

The Company accounts for internally developed software in accordance with Statement of Financial Accounting Standard (SFAS) No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed." After technical feasibility has been established, the Company capitalizes the average cost per billable hour of its software development process including payroll and payroll benefits, training and recruiting costs. The Company collects and records the programming labor hours invested in software development projects. Annually, the Company evaluates these accumulated costs for recoverability against estimated future revenues and determines the amount, which will be capitalized. Of the annual software development project costs eligible for capitalization, the Company generally capitalizes about 60% and expenses the remainder. To the extent that more development costs are capitalized, the Company's net income will increase, and, to the extent that more software development costs are expensed instead of capitalized, the Company's net income will decline. Because of the direct effect on earnings, the Company endeavors to capitalize and expense a relatively consistent amount year-to-year to minimize the fluctuation in earnings.

The Company amortizes its software development costs in accordance with the estimated economic life of the software, which generally is seven years. The Company's typical product lifecycle has been about 15 years, which was true for its prior film/fiche product line, CD-ROM product line and current Internet/Web product line, which has now been deployed for ten years and is still growing. To the extent the average actual useful life varies significantly from the estimated useful life, amortization expense may be understated or overstated. Generally, amortization expense averages approximately 14% of the revenue stream.

Revenue recognition policies vary according to the nature of the revenue. The Company's primary revenue stream is outsourced web hosting services which are sold on a subscription basis. Generally, these large contract services are billed in advance on an annual, semi-annual or quarterly basis. Revenue is then

AUTO-GRAPHS, INC.  
Quarterly Report  
June 30, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

recognized monthly as services are rendered. Revenues which have been billed and payment collected in advance are booked as deferred revenue until the services are provided and revenues earned. For certain small annual subscriptions, one-fourth of the annual revenue is recognized in the quarter the annual subscription is billed and the balance is deferred and recognized evenly over the next three quarters in accordance with SOP 97-2, "Software Revenue Recognition," as amended by SOP 98-4 and 98-9. Certain contract job processing services are progress billed and revenues recognized as the processing services are performed on a monthly basis. Certain software and hardware sales are billed when the product is shipped or access rights are provided to the customer.

**LIQUIDITY AND CAPITAL RESOURCES**

The working capital deficit improved by \$840,000 to a negative \$719,000 for the six months ended June 30, 2004 up from a negative \$1,560,000 for the same period in 2003 due primarily to an decrease of \$85,000 in current assets and a reduction in current liabilities of approximately \$755,000.

The Company's primary AGent™ product is sold on an annual subscription basis with fees for services billed to the customer and paid annually or quarterly in advance. These cash payments are received and booked to deferred revenue on the balance sheet to be applied as the monthly sales revenues are earned and recognized on a pro-rata basis. As the actual cash is received, it is used to pay down the line of credit or for working capital needs. A growing percentage of sales (currently over 65%) of the Company's sales revenues are now being paid through customer advances without ever flowing through accounts receivable. Therefore, the average accounts receivable balance is approximately one-third of what it would otherwise historically be and there is a substantial deferred revenue balance in current liabilities representing revenues to be earned from future services to customers who have paid in advance.

At December 31, 2003, the Company's principal financial commitments, other than its bank line of credit and equipment financing, involved the lease of corporate facilities in Pomona, California and in Toronto, Canada. Total commitments over next four years total approximately \$734,000.

The Company's principal use of cash for investing activities in 2004 and 2003 was directed towards continuing development of the Company's AGent™ and VERSO™ software and ASP (Application Service Provider) services. The amount invested in capitalized software was \$217,000 for the six months ended June 30, 2004 and \$250,000 for the same period in 2003. The remainder of investing activities was to acquire hardware and software used to expand and enhance online services to the Company's current and prospective ASP customers. Total capital expenditures were unchanged at \$273,000 for the six months ended June 30, 2004 compared to \$274,000 for the same period in 2003.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management believes that liquidity and capital resources should be adequate to fund operations and expected reductions in bank debt in 2004. Based on the Company's 2004 Plan, management expects that the Company will have no bank debt by December 31, 2004 and will only require occasional working capital financing in the future. The Company has no current plans to enter the equity market to raise additional capital.

The Company has refocused its resources on its core business of library services. The Company's strategy is to offer ASP (Application Service Provider) services through outsourced web hosting to its library customers sold on an annual subscription basis. This is very attractive to our customers because it eliminates the large upfront capital investment, and ongoing technical management and technical staff requirements that the library would otherwise require and also provides an affordable and predictable monthly budget for the library. With a core of highly competent technical personnel, computer equipment and the Internet/Web, the Company can offer an efficient and very cost effective solution for the library. The majority (now approximately 85%) of this subscription business also forms an ongoing stream of recurring business each year under multiple year contracts.

Information Relating To Forward-Looking Statements

The Company wants to provide stockholders and investors with meaningful and useful information. Therefore, this report may contain forward-looking information, describing the Company's belief concerning future events or business conditions, and the outlook of the Company based on currently available information. These forward looking statements are subject to risks and uncertainties which could cause actual events or the Company's actual results or performance to differ materially from those expressed in these statements. Readers are encouraged to read the Company's Annual Report on Form 10-KSB and its other reports filed with the Securities and Exchange Commission for a more complete description of these factors. The Company assumes no obligation to update the information contained in this quarterly report.

**RESULTS OF OPERATIONS**

Six Months Ended June 30, 2004 as Compared to Six Months Ended June 30, 2003

Net sales decreased \$425,000 or 14% from \$2,993,000 in 2003 to \$2,568,000 in 2004 due to lower sales from its TEA contract and delays in major contract bids.

Cost of sales decreased \$299,000 in 2004 or 18% as a result of cost reductions in payroll and production costs in 2003. Gross margins improved to 46% in 2004 from 44% in 2003 as the Company has continued to focus on its core library ASP services business. As the Company has transitioned from labor intensive businesses to outsourced web hosting (ASP) businesses most of the direct costs in cost of sales have been replaced largely by fixed indirect period costs.

AUTO-Graphics, INC.  
Quarterly Report  
June 30, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Selling, general and administrative expenses were virtually unchanged in 2004 from 2003.

Income from operations declined \$129,000 or 54% from \$238,000 in 2003 to \$109,000 in 2004 due the decline in net sales.

Interest/other expense was \$38,000 in 2004 up from \$33,000 in 2003 due to an increase in accrued interest on loans against the cash surrender value of life insurance.

Net income was \$72,000 in 2004 compared to \$202,000 in 2003, a decline of \$130,000 due the significant decline in net sales. Both basic and diluted earnings per share were \$0.02 in 2004 compared to basic and diluted earnings per share of \$0.04 in 2003.

Second Quarter 2004 as Compared to Second Quarter 2003

Net sales decreased \$108,000 or 7% from \$1,475,000 in 2003 to \$1,367,000 in 2004 due to lower sales from its TEA contract and delays in major contract bids.

Cost of sales decreased \$115,000 in 2004 or 14% as a result of cost reductions in payroll and production costs in 2003. Gross margins improved to 47% in 2004 from 43% in 2003 as the Company has continued to focus on its core library ASP services business.

Selling, general and administrative expenses increased \$74,000 or 14% to \$600,000 in 2004 from \$526,000 in 2003 primarily due to additional trade show expenses and recruiting costs associated with hiring a new Chief Executive Officer.

Income from operations declined \$67,000 or 58% from \$113,000 in 2003 to \$46,000 in 2004 due the decline in net sales and higher selling, general and administrative expenses.

Interest expense was \$14,000 in 2004 up from \$12,000 in 2003 due to an increase in accrued interest on loans against the cash surrender value of life insurance.

Net income was \$32,000 in 2004 compared to \$101,000 in 2003, a decline of \$68,000 or 68% due the decline in net sales and higher selling, general and administrative expenses. Both basic and diluted earnings per share were \$0.01 in 2004 compared to basic and diluted earnings per share of \$0.02 in 2003.

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

CERTIFICATION

I, Patrick T. Bergamasco and Daniel E. Luebben, certify that we have reviewed this quarterly report of Auto-Graphics, Inc. Based on our knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report. Based on our knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: August 15, 2004

/s/ Patrick T. Bergamasco  
Patrick T. Bergamasco  
Chief Executive Officer

/s/ Daniel E. Luebben  
Daniel E. Luebben  
Chief Financial Officer  
and Secretary

AUTO-GRAPHICS, INC.  
Quarterly Report  
June 30, 2004

Additional documents available from Auto-Graphics, Inc.

The Company's Annual Report and Code of Ethical Conduct may be viewed and printed on the Company's website at <http://www.auto-graphics.com> and click on the "company" hyperlink and then on the "Investor Relations" hyperlink. If you would like to receive a printed copy of the Company's Annual Report on Form 10-KSB and/or a copy of the Company's Code of Ethical Conduct at no charge, please mail your request to Attention: Secretary, Auto-Graphics, Inc., 3201 Temple Avenue, Pomona, California 91768, or send an e-mail to [del@auto-graphics.com](mailto:del@auto-graphics.com) with your return address or call Daniel E. Luebben, the Secretary of the Company, at 1-800-776-6939 extension 1504.