



Quarterly Report

First Quarter Ended June 30, 2005

Trading Symbol: **AUGR**



AUTO-GRAPHICS, INC.
Quarterly Report
June 30, 2005

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Unaudited Consolidated Balance Sheet

ASSETS	
Current assets:	
Cash	\$ 608,411
Accounts receivable, less allowance for doubtful accounts of \$30,000	286,103
Unbilled production costs	3,779
Other current assets	162,204
Total current assets	1,060,497
Software, net	2,575,500
Equipment, furniture and leasehold improvements, net	259,285
Other assets (Note 3)	61,366
	\$ 3,956,648
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	
Current liabilities:	
Accounts payable	\$ 65,145
Deferred income	899,568
Accrued payroll and related liabilities	240,766
Other accrued liabilities	94,087
Total current liabilities	1,299,566
Deferred taxes (Note 5)	57,000
Total liabilities	1,356,566
Stockholders' equity:	
Common stock, 12,000,000 shares authorized, 5,525,586 shares issued and outstanding	4,274,625
Accumulated deficit	(1,633,943)
Other comprehensive income/(loss)	(40,600)
Total stockholders' equity	2,600,082
	\$ 3,956,648

See Notes to Unaudited Consolidated Financial Statements.

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

	2005	2004
Net sales (See Note 4)		
Subscriptions		
and maintenance	\$2,257,060	\$2,176,238
License and services	289,475	392,034
	2,546,535	2,568,272
Costs and expenses (See Note 1)		
Cost of sales	633,807	683,269
Research and development	255,054	261,983
Sales, marketing		
and customer service	1,050,827	1,070,728
General and		
administrative	514,285	439,846
Total costs and expenses	2,453,973	2,455,826
Income from operations	92,562	112,446
Interest/Other expense	(2,960)	(40,916)
Income before taxes	89,602	71,530
Income tax expense (Note 5)	--	--
Net income	\$ 89,602	\$ 71,530
 <u>Earnings per share (Note 6):</u>		
Basic income		
per share	\$.02	\$.01
Weighted average shares		
outstanding	5,525,586	5,525,586
Diluted income		
per share	\$.02	\$.01
Weighted average shares		
outstanding	5,935,486	5,880,486

See Notes to Unaudited Consolidated Financial Statements.

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

	2005	2004
Net sales (See Note 4)		
Subscriptions and maintenance	\$1,131,440	\$1,017,166
License and services	208,594	350,131
	1,340,034	1,367,297
Costs and expenses (See Note 1)		
Cost of sales	321,305	347,772
Research and development	135,324	152,382
Sales, marketing and customer service	531,906	577,036
General and administrative	298,660	243,637
Total costs and expenses	1,287,195	1,320,827
Income from operations	52,839	46,470
Interest/Other expense	(1,597)	(14,145)
Income before taxes	51,242	32,325
Income tax expense (Note 5)	--	--
Net income	\$ 51,242	\$ 32,325
 <u>Earnings per share (Note 6):</u>		
Basic income per share	\$.01	\$.01
Weighted average shares outstanding	5,525,586	5,525,586
Diluted income per share	\$.01	\$.01
Weighted average shares outstanding	5,935,486	5,880,486

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
 Unaudited Consolidated Statement Of Stockholders' Equity
 And Comprehensive Income
 For the Six Months Ended June 30,

	<u>Common Stock</u>		Retained	Other	Total
	<u>Shares</u>	<u>Amount</u>	<u>(Accumulated Deficit)</u>	<u>Comprehensive Income/(Loss)</u>	<u>Stockholders' Equity</u>
Balances at December 31, 2004	5,525,586	\$4,274,625	\$(1,723,545)	\$ (40,495)	\$ 2,510,585
Net Income	--	--	89,602	--	89,602
Foreign Currency Translation Adjustments	--	--	--	(105)	<u>(105)</u>
Comprehensive Income	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>89,497</u>
Balances at June 30, 2005	<u>5,525,586</u>	<u>\$4,274,625</u>	<u>\$(1,633,943)</u>	<u>\$ (40,600)</u>	<u>\$ 2,600,082</u>

See Notes To Consolidated Financial Statements.

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

	2005	2004
Cash flows from operating activities:		
Net income	\$ 89,602	\$ 71,530
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	409,816	467,820
Allowance for Doubtful Accounts	15,000	
Changes in operating assets and liabilities		
Accounts receivable	218,667	117,334
Unbilled production costs	(2,249)	(529)
Other current assets	25,446	(27,575)
Other assets	1,216	--
Accounts payable	(20,095)	(7,106)
Deferred revenue	73,492	(44,980)
Accrued payroll and related liabilities	(12,378)	(3,404)
Other accrued liabilities	(60,628)	(71,643)
Net cash provided by operating activities	737,891	501,447
Cash flows from investing activities:		
Capital expenditures	(29,440)	(22,705)
Capitalized software development	(250,000)	(250,000)
Net cash used in investing activities	(279,440)	(272,705)
Cash flows from financing activities (Note 2):		
Surrender of Key-man Life Insurance Policies, Net Payments under long-term debt	100,665	
	--	(232,402)
Net cash provided by (used in) financing activities	100,665	(232,402)
Net increase (decrease) in cash	559,116	(3,660)
Foreign currency effect on cash	(9,285)	10,419
Cash at beginning of year	58,580	10,534
Cash at end of year	\$ 608,411	\$ 17,293

See Notes to Unaudited Consolidated Financial Statements.

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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, 2005, the results of operations for the three and six months ended June 30, 2005 and 2004 and the statement of cash flows for the six months ended June 30, 2005 and 2004 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 for the period ending December 31, 2004 including, without limitation, the financial statements and notes therein.

Statement of Income

The Statement of Income has been changed to provide additional disclosure in 2005, and 2004 has been reclassified to provide comparative information. Sales have been presented in two categories: (1) Subscriptions and Maintenance (recurring revenues) and License and Services (non-recurring revenues). Costs and expenses have been separated into Cost of Sales (including depreciation and amortization), Research and Development (net of capitalized software), Sales, Marketing and Customer Service and General and Administrative expenses.

NOTE 2. The Company was in compliance with all of its financial loan covenants as of June 30, 2005 under its bank credit agreement. The credit facility is a revolving line of credit with a commitment of \$500,000. The interest rate on the line of credit is the bank prime rate plus 1.5% margin (7.5% at June 30, 2005). The credit facility matures on May 1, 2006. 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, 2005, there were no outstanding borrowings under the line of credit and there was \$500,000 in available credit under the 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 \$40,000 to Toronto Dominion Bank as collateral for a four-year Letter of Credit in the amount of \$40,000.

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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 six months ended June 30, 2005, and 2004:

	2005	2004
Geographic areas		
Net sales		
United States	\$ 2,090,128	\$ 2,146,142
Foreign - Canada/Other	456,407	422,130
Long-lived assets, net		
United States	2,834,785	3,262,800
Foreign - Canada	--	2,400

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. The valuation allowance at December 31, 2005 and 2004 reflects an unrecognized U.S. and foreign tax loss carryforward. At December 31, 2004, the Company had available net operating loss carryforwards of \$3,065,000 for federal income tax purposes, \$2,030,000 for state income tax purposes and \$129,000 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, 2005, stock options for 30,000 shares were granted and no warrants were issued.

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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>Six months ended June 30, 2005</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 89,602	5,525,586	\$ 0.02
Effect of dilutive securities			
Stock options	<u> --</u>	<u> 409,900</u>	<u> </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 89,602</u>	<u>5,935,486</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	\$ 0.01
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>\$ 71,530</u>	<u>5,880,486</u>	<u>\$ 0.01</u>
<u>Three months ended June 30, 2005</u>	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
Basic earnings per share			
Net income available to common stockholders	\$ 51,242	5,525,586	\$ 0.01
Effect of dilutive securities			
Stock options	<u> --</u>	<u> 409,900</u>	<u> </u>
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 51,242</u>	<u>5,935,486</u>	<u>\$ 0.01</u>
<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>

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Note 7. Recently Issued Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") reissued SFAS No. 123, "Share-Based Payment." This Statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements effective as of the beginning of the first interim or annual reporting period after December 15, 2005. The Company will adopt this Standard when it becomes effective in 2006. Adoption of the Standard will result in a charge to earnings of approximately \$46,000 in 2006.

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Management 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. To the extent that more development costs are capitalized, the Company's net income will improve, and, to the extent that more software development costs are expensed instead of capitalized, the Company's net income will decline.

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 eleven years and is still growing. To the extent the actual useful life varies significantly from the estimated useful life, amortization expense may be understated or overstated. Generally, amortization expense averages approximately 14% of total sales.

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 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 or renews and the balance is deferred and

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recognized evenly over the next three quarters in accordance with Statement of Position ("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 license and hardware sales are billed when the product is shipped or access rights are provided to the customer.

LIQUIDITY AND CAPITAL RESOURCES

Management believes that liquidity and capital resources should be adequate to fund operations in 2005. The Company was in compliance with all of its financial loan covenants as of June 30, 2005 under its bank credit agreement. The credit facility is a revolving line of credit with a commitment of \$500,000. The interest rate on the line of credit is the bank prime rate plus 1.5% margin (7.5% at June 30, 2005). The credit facility matures on May 1, 2006. 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, 2005, there were no outstanding borrowings and there was \$500,000 in available credit under the facility. The working capital deficit continued to improve by \$480,000 to \$239,000 for the six months ended June 30, 2005 up from a deficit of \$719,000 for the same period in 2004 due primarily to an increase in cash of \$591,000.

The Company's primary software product, AGent™, is sold on an annual subscription basis with fees 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 (approximately 63%) 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 lower than 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, 2004, the Company's principal financial commitments, other than its bank line of credit involved the lease of corporate facilities in Pomona, California and in Toronto, Canada. Total commitments over next four years total approximately \$737,000.

The Company's principal use of cash for investing activities in 2005 and 2004 was directed towards continuing development of the Company's AGent™ and VERSO™ software and ASP (Application Service Provider) services. The amount invested

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in capitalized software was \$250,000 for the six months ended June 30, 2005 and \$93,000 for the same period in 2004. 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 up \$7,000 to \$279,000 for the six months ended June 30, 2005 compared to \$272,000 for the same period in 2004.

The Company has focused its resources on its core business of library services and is not soliciting new publishing customers. The Company's strategy is to offer ASP (Application Service Provider) services through systems software and outsourced web hosting to its library customers sold on an annual subscription basis. We believe that this is attractive to our customers because it eliminates the large initial capital investment, and ongoing technical management and technical staff requirements that the library would otherwise require. This approach also provides an affordable and predictable monthly budget for the library client. 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 (approximately 89% in 2005) 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 for a more complete description of these factors. The Company assumes no obligation to update the information contained in this Quarterly Report.

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Management's Discussion And Analysis

RESULTS OF OPERATIONS

First Six Months in 2005 as Compared to First Six Months in 2004

Net sales were \$2,547,000 for the six months ended June 30, 2005 down \$21,000 or 1% from \$2,568,000 for the same period in 2004. Recurring subscription and maintenance sales were up \$81,000 or 4% from \$2,176,000 to \$2,257,000 due to contract growth in the Company's ASP business lines. Non-recurring license and services sales were down due to completion of a large software development project in 2004.

Cost of sales was down \$49,000 or 7% to \$634,000 in 2005 compared to \$683,000 in 2004 due to lower depreciation and amortization. Cost of sales includes \$410,000 and \$468,000 in non-cash depreciation and amortization in 2005 and 2004, respectively. Gross margins improved to 75% in 2005 up from 73% in 2004 as the Company has continued to focus on its core library ASP services business.

Research and development expenses were down \$7,000 to \$255,000 from \$262,000 due to additional staff offset by higher software capitalization in 2005. Research and development is presented net of capitalized software of \$250,000 in 2005 and \$217,000 in 2004, respectively. Gross research and development costs were \$505,000 in 2005 compared to \$479,000 in 2004.

Sales, marketing and customer service expenses decreased \$20,000 or 2% from \$1,071,000 in 2004 to \$1,051,000 in 2005 due to lower trade show expenses.

General and administrative expenses increased \$74,000 or 17% to \$514,000 up from \$440,000 due to additional payroll, legal and non-recurring director expenses.

Operating income was down \$20,000 or 18% to \$93,000 in 2005 versus \$112,000 in 2004 due to lower sales and higher general and administrative expenses.

Interest/Other expense was \$3,000 in 2005 down from \$42,000 in 2004 due to lower borrowings in 2005.

Provision for taxes based on income in 2005 and 2004 reflects the effect of federal and state net operating loss carryforwards.

Net income was \$90,000 in 2005 up \$18,000 from \$72,000 in 2004 due primarily to lower borrowings and interest expense. Basic and diluted earnings per share was \$0.02 in 2005 and \$0.01 in 2004, respectively.

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RESULTS OF OPERATIONS

Second Quarter 2005 as Compared to Second Quarter 2004

Net sales were \$1,340,000 for the three months ended June 30, 2005 down \$27,000 or 2% from \$1,367,000 for the same period in 2004. Recurring subscription and maintenance sales were up \$114,000 or 11% from \$1,017,000 to \$1,131,000 due to contract growth in the Company's ASP business lines. Non-recurring license and services sales were down \$142,000 due to completion of a large software development project in the second quarter of 2004.

Cost of sales was down \$27,000 or 8% to \$321,000 in 2005 compared to \$348,000 in 2004 due to lower depreciation and amortization. Cost of sales includes \$211,000 and \$238,000 in non-cash depreciation and amortization in 2005 and 2004, respectively. Gross margins improved to 76% in 2005 up from 75% in 2004 as the Company has continued to focus on its core library ASP services business.

Research and development expenses were down \$17,000 to \$135,000 in 2005 from \$152,000 in 2004 due to higher software capitalization of \$32,000 in 2005. Research and development is presented net of capitalized software of \$125,000 in 2005 and \$93,000 in 2004, respectively. Gross research and development costs were \$260,000 in 2005 compared to \$245,000 in 2004 due to additional staffing.

Sales, marketing and customer service expenses decreased \$45,000 from \$577,000 in 2004 to \$532,000 in 2005 due to lower trade show expenses.

General and administrative expenses increased \$55,000 to \$299,000 up from \$244,000 due to additional payroll, legal and non-recurring director expenses.

Operating income was up \$7,000 to \$53,000 in 2005 versus \$46,000 in 2004 due to higher sales, marketing and customer service expenses and general and administrative expenses.

Interest/Other expense was \$2,000 in 2005 down from \$14,000 in 2004 due to lower borrowings in 2005.

Provision for taxes based on income in 2005 and 2004 reflects the effect of federal and state net operating loss carryforwards.

Net income was \$51,000 in 2005 up \$19,000 or 59% from \$32,000 in 2004. Basic and diluted earnings per share was \$0.01 in 2005 and 2004, respectively.