auto-graphics, inc.

Quarterly Report

Quarter Ended September 30, 2007

Trading Symbol: **AUGR.PK**

Auto-Graphics, Inc. ▪ 3201 Temple Avenue ▪ Pomona, CA 91768-3279 ▪ (800) 776-6939 ▪ www.auto-graphics.com

AUTO-GRAPHICS, INC.
Quarterly Report
September 30, 2007

TABLE OF CONTENTS

	Page Reference
Financial Statements	
Unaudited Consolidated Balance Sheet at September 30, 2007	2
Unaudited Consolidated Statements of Operations for the Nine Months Ended September 30, 2007 and 2006	3
Unaudited Consolidated Statements of Operations for the Three Months Ended September 30, 2007 and 2006	4
Unaudited Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Nine Months Ended September 30, 2007 and 2006	5
Unaudited Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2007 and 2006	6
Notes to the Unaudited Consolidated Financial Statements	7
Management Discussion & Analysis	13

AUTO-GRAPHICS, INC.
Quarterly Report
September 30, 2007

Unaudited Consolidated Balance Sheet

ASSETS	
Current assets:	
Cash and cash equivalents	$ 824,750
Accounts receivable, less allowance for doubtful accounts ($4,000 in 2007)	308,184
Deferred income taxes – current (Note 4)	58,000
Other current assets	122,946
Total current assets	1,313,880
Software, net	2,131,418
Equipment, furniture and leasehold improvements, net	250,120
Other assets	22,522
	$ 3,717,940
LIABILITIES & STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	$ 73,957
Deferred revenue	1,076,891
Accrued payroll and related liabilities	181,545
Other accrued liabilities	74,755
Total current liabilities	1,407,148
Deferred income taxes (Note 4)	66,000
Total liabilities	1,473,148
Commitments and contingencies	--
Stockholders' equity:	
Common Stock, 12,000,000 shares authorized, 4,282,210 shares issued and outstanding in 2007 (Note 6)	3,242,253
Accumulated deficit	(954,620)
Accumulated other comprehensive loss	(42,841)
Total stockholders' equity	2,244,792
	$ 3,717,940

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
Quarterly Report
September 30, 2007

Unaudited Consolidated
Statements of Operations
For the Nine Months Ended September 30,

	2007	2006
Net sales (Note 3)		
Subscriptions and maintenance	$ 3,489,176	$ 3,427,152
License and services	597,332	396,368
Total net sales	4,086,508	3,823,520
Costs and expenses		
Cost of sales	1,025,007	967,639
Research and development	469,698	349,516
Sales, marketing and customer service	1,761,978	1,669,379
General and administrative	715,010	655,545
Total costs and expenses	3,971,693	3,642,079
Income from operations	114,815	181,441
Other income	18,685	22,170
Income before income taxes	133,500	203,611
Income tax expense (Note 4)	9,000	27,000
Net income	$ 124,500	$ 176,611
Earnings per share (Note 5):		
Basic income per share	$ .03	$ .03
Weighted average shares outstanding	4,342,432	5,340,586
Diluted income per share	.03	$ .03
Weighted average shares outstanding	4,845,665	5,910,486

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
Quarterly Report
September 30, 2007

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

	2007	2006
Net sales (Note 3)		
Subscriptions and maintenance	$ 1,193,669	$ 1,137,085
License and services	239,271	126,321
Total net sales	1,432,940	1,263,406
Costs and expenses		
Cost of sales	350,851	342,605
Research and development	172,483	111,695
Sales, marketing and customer service	628,463	525,783
General and administrative	255,859	211,500
Total costs and expenses	1,407,656	1,191,583
Income from operations	25,284	71,823
Other income	4,684	10,670
Income before income taxes	29,968	82,493
Income tax expense (Note 4)	(1,000)	12,000
Net income	$ 30,968	$ 70,493
Earnings per share (Note 5):		
Basic income per share	$ .01	$ .01
Weighted average shares outstanding	4,292,210	5,340,586
Diluted income per share	.01	$ .01
Weighted average shares outstanding	4,797,110	5,910,486

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
Unaudited Consolidated Statement of Stockholders' Equity
And Comprehensive Income
For the Nine Months Ended September 30,

	Common Stock Shares	Common Stock Amount	Retained Earnings/ (Accumulated Deficit)	Other Comprehensive Loss	Total Stockholders' Equity
Balances at December 31, 2006	4,297,610	$ 3,245,700	$(1,079,120)	$ (40,341)	$ 2,126,239
Net income	--	--	124,500	--	124,500
Foreign currency translation adjustments	--	--	--	(2,500)	(2,500)
Comprehensive income	--	--	--	--	122,000
Stock option shares exercised (Note 6)	140,000	--	--	--	--
Shares repurchased/ Adjustments (Note 6)	(155,400)	(10,565)	--	--	(10,565)
Stock option expense (Note 7)	--	7,118	--	--	7,118
Balances at September 30, 2007	4,282,210	$ 3,242,253	$(954,620)	$ (42,841)	$ 2,244,792

See Notes to Unaudited Consolidated Financial Statements.

AUTO-GRAPHICS, INC.
Quarterly Report
September 30, 2007

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

	2007	2006
Cash flows from operating activities:		
Net income	$ 124,500	$ 176,611
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	551,117	549,350
Provision for doubtful accounts	1,000	(25,000)
Stock option expense (Note 7)	7,118	13,881
Changes in operating assets and liabilities:		
Accounts receivable	116,857	36,230
Other current assets	(54,514)	(21,824)
Other assets	--	42,500
Accounts payable	22,050	(12,755)
Deferred revenue	249,789	250,192
Accrued payroll and related liabilities	(19,062)	(18,042)
Other accrued liabilities (Note 6)	(619,990)	(9,304)
Net cash provided by operating activities	378,865	981,839
Cash flows from investing activities:		
Capital expenditures	(121,383)	(67,222)
Capitalized software development	(300,000)	(361,368)
Net cash used in investing activities	(421,383)	(428,590)
Cash flows from financing activities:		
Common stock purchased/adjustments (Note 6)	(10,565)	(83,250)
Net cash provided by (used in) financing activities	(10,565)	(83,250)
Net increase (decrease) in cash	(53,083)	469,999
Effect of foreign exchange on cash	(2,502)	--
Cash at beginning of year	880,335	775,456
Cash at end of year	$ 824,750	$ 1,245,455

See Notes to Unaudited Consolidated Financial Statements.

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 September 30, 2007, the results of operations and the statement of cash flows for the nine month and three months ended September 30, 2007 and 2006 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, 2006 including, without limitation, the financial statements and notes therein.

Note 2. In August 2007, the bank renewed and extended the Company’s credit facility through May 1, 2009. The credit facility is composed of a $500,000 revolving line of credit for working capital and a second $1,000,000 five-year term facility to fund major investments. The interest rate on both credit facilities is the bank prime rate (7.75% at September 30, 2007) plus a 1.0% margin or 8.75% at September 30, 2007. 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. The Company was in compliance with all of its financial loan covenants, there were no outstanding borrowings under either credit facility and there was $1,500,000 in available credit as of September 30, 2007.

Note 3. 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.

Notes to Unaudited Consolidated 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 nine months ended September 30, 2007, and 2006:

	2007	2006
Geographic areas:		
Net sales:		
United States	$ 3,436,394	$ 3,161,003
Foreign – Canada/Other	650,114	662,517
Long-lived assets, net:		
United States	2,381,538	2,660,207
Foreign – Canada/Other	--	--

Note 4. 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. At December 31, 2006, the Company had available net operating loss carryforwards of $2,552,000 for federal income tax purposes, $1,139,000 for state income tax purposes and $49,000 for foreign income tax purposes. These net operating loss carryforwards expire from 2020 to 2024 for federal taxes, 2012 to 2013 for state taxes, and 2010 to 2013 for foreign taxes.

Note 5. 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 nine months ended September 30, 2007, stock options for 80,000 shares were issued at fair market value on the date of issuance.

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:

	Net Income	Shares	Per Share
Nine Months ended September 30, 2007			
Basic earnings per share			
Net income available to common stockholders	$ 124,500	4,342,432	$ 0.03
Effect of dilutive securities			
Stock options	--	503,233	
Diluted earnings per share			
Net income available to common stockholders	$ 124,500	4,845,665	$ 0.03
Nine Months ended September 30, 2006			
Basic earnings per share			
Net income available to common stockholders	$ 176,611	5,340,586	$ 0.03
Effect of dilutive securities			
Stock options	--	569,900	
Diluted earnings per share			
Net income available to common stockholders	$ 176,611	5,910,486	$ 0.03
Three Months ended September 30, 2007			
Basic earnings per share			
Net income available to common stockholders	$ 30,968	4,292,210	$ 0.01
Effect of dilutive securities			
Stock options	--	504,900	
Diluted earnings per share			
Net income available to common stockholders	$ 30,968	4,797,110	$ 0.01

	Net Income		Shares	Per Share	
Three Months ended September 30, 2006					
Basic earnings per share					
Net income available to common stockholders	$	70,493	5,340,586	$	0.01
Effect of dilutive securities					
Stock options		--	569,900		
Diluted earnings per share					
Net income available to common stockholders	$	70,493	5,910,486	$	0.01

Note 6. Stockholders' Equity

Tender Offer

On October 12, 2006, the Company commenced a tender offer to repurchase up to 1,000,000 shares of common stock from the public at a price not less than $0.50 per share or greater than $0.85 per share payable in cash. The tender offer expired on November 15, 2006. The Company purchased approximately 405,000 shares of its common stock at a total cost of approximately $356,000 including fees and expenses. Funding for the tender offer was provided by available cash. These shares were retired and returned to authorized but unissued common stock.

Stock Purchases

In February 2006, the Company purchased 185,000 shares of its outstanding common stock in a private transaction for a total cost of approximately $83,250. The share repurchase transaction was approved by the Board of Directors, major shareholders and reviewed by the Company's primary bank. These shares were retired and returned to authorized but unissued common stock.

On December 21, 2006, James R. Yarter, a director and member of the Audit Committee since June, 2001 retired from the Board of Directors. In association with Mr. Yarter's retirement, the Board of Directors agreed to purchase Mr. Yarter's 637,710 shares of common stock at $0.85 per share for a total cost of approximately $542,000 in the first quarter of 2007. These shares were purchased in February 2007 and were retired and returned to authorized but unissued common stock. The Board also agreed to fully vest and purchase Mr. Yarter's 140,000 stock options at $0.85 per share for a cost of approximately $44,000 (net of tax). The Company accrued a liability in the amount of $119,000 at December 31, 2006 for the purchase, which was completed in June, 2007. These shares were retired and returned to authorized but unissued common stock.

Notes to Unaudited Consolidated Financial Statements

Note 7. 2002 Qualified and Non-qualified Stock Option Plan

The Company adopted a qualified and non-qualified stock option plan following approval by its shareholders at its 2001 annual shareholder's meeting held on February 27, 2002. The 2002 Stock Option Plan was amended on October 21, 2004 to increase the number of available options to purchase shares to 800,000. As of September 30, 2007, the Board of Directors has granted options for a total of 785,000 shares of which 140,000 have since been forfeited, 140,100 shares exercised for a net total of 504,900 shares granted and unexercised at an average market price of $0.48. Of these granted shares, 302,400 shares have vested and are eligible for exercise at an average market price of $0.36. Under the plan, the stock option price per share for options granted is determined by the Board of Directors and is based on the market price of the Company's common stock on the date of grant. The stock options vest over four years and no option can be exercised later than ten years from the date it was granted.

In December 2005, the Financial Accounting Standards Board ("FASB") reissued SFAS No. 123R, "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 beginning after December 15, 2005. The Company has adopted this Standard in 2006 and applied the Standard using the modified prospective method from January 1, 2006. The valuation provisions of SFAS 123R apply to new awards and to awards that are outstanding on the effective date and subsequently modified or cancelled. Under the modified prospective method, prior periods are not revised for comparative purposes. The Company determined compensation cost based on the fair value for its fully vested stock options at grant date, under SFAS 123R, the Company's total compensation expense will be approximately $6,000 (net of tax) in 2007 with approximately $4,000 (net of tax) charged to expense in the nine months ended September 30, 2007.

Notes to Unaudited Consolidated Financial Statements

Note 8. Recently Issued Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities. This Statement applies to all entities and permits entities to choose to measure many financial instruments and certain other eligible items at fair value at specified election dates and report unrealized gains and losses for which the fair value option has been elected in earnings. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements (see below). The adoption of SFAS No. 159 is not expected to affect the Company's financial condition or results of operations.

In September 2005, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is in the process of evaluating the provisions of the statement, but does not anticipate that the adoption of SFAS No. 157 will have a material impact on the Company's consolidated financial statements.

In June 2005, the FASB issued Financial Interpretation ("FIN") No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109 – Accounting for Income Taxes. The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition. The provisions of this Interpretation will become effective for fiscal years beginning after December 15, 2006. The adoption of FIN No. 48 in 2007 is not expected to have a significant impact upon the Company's financial condition or results of operations.

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." The Company collects and segregates software development labor hours applied to design, development, quality assurance and product documentation associated with the software development process. All labor hours associated with the design and specification development process are expensed as incurred until a detailed design has been developed. All labor hours associated with coding, debugging, alpha testing, software bug corrections, quality assurance testing and documentation are eligible for capitalization under SFAS No. 86. Generally, the Company capitalizes approximately up to 70% of eligible costs based on an average actual cost per labor hour and charges the balance to research and development expense. On an annual basis, the Company evaluates its capitalized software for recoverability against the estimated future revenues over the next five years from the products or services. 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 14 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 13.5% of total sales.

Management Discussion and Analysis

The Company recognizes revenue in accordance with the American Institute of Certified Public Accountant's Statement of Position ("SOP") 97-2, "Software Revenue Recognition", as amended by SOP 98-4 and SOP 98-9 and Emerging Issues Task Force ("EITF") Issue No. 00-3, "Application of AICPA SOP 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware" and EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." The SOP provides that revenue may be recognized when persuasive evidence of an agreement (contract or purchase order) exists, delivery has occurred, the price is fixed or readily determinable and collectability is probable with some exceptions.

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 on a pro-rata basis 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 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 and hardware sales are billed when the product is shipped or access rights are provided to the customer. Certain revenue transactions may include multiple deliverables, which may or may not be separately priced. For deliverables which are not separately priced, the Company uses the relative fair values of the separate deliverables to allocate revenues. Each deliverable is then treated in accordance with the above revenue recognition policies depending on the nature of the deliverable.

Liquidity and Capital Resources

Working capital declined by $320,000 to a working capital deficit of $93,000 in 2007 down from a working capital surplus of $338,000 in 2006 due primarily to the purchase of stock from a retired director in 2007 (See Note 6). Following the cash payment of $672,000 for the repurchase of stock, the cash flow from operations of $379,000 was insufficient to fund $421,000 in capital expenditures internally, which resulted in a decrease in cash of $53,000 to $825,000 in 2007. The Company's excess cash is invested in uninsured investment grade securities on a short-term basis.

AUTO-GRAPHICS, INC.
Quarterly Report
September 30, 2007

Management Discussion and Analysis

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. Approximately 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 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 for customers who have paid in advance.

At December 31, 2006, 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 the next six years total approximately $1,675,000.

The Company's principal use of cash for investing activities during 2007 and 2006 were directed primarily towards continuing development of the Company's AGent™ and VERSO™ software and software as a service ("SaaS"). The Company invested $770,000 in 2007 and $711,000 in 2006 in software development of which $300,000 and $361,000 was capitalized in 2007 and 2006, respectfully. The remainder of investing activities of $121,000 in 2007 and $67,000 in 2006 was to acquire hardware and software used to expand and enhance online services to the Company's current and prospective SaaS customers. Total capital expenditures and investments were $421,000 in 2007 down from $429,000 in 2006 due to lower outsourced software development in 2007.

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. At December 31, 2006, the Company had available net operating loss carryforwards of $2,552,000 for federal income tax purposes, $1,139,000 for state income tax purposes and $49,000 for foreign income tax purposes. These net operating loss carryforwards expire from 2020 to 2024 for federal taxes, 2012 to 2013 for state taxes, and 2010 to 2013 for foreign taxes.

In August 2007, the bank renewed and extended the Company's credit facility through May 1, 2009. The credit facility is composed of a $500,000 revolving line of credit for working capital and a second $1,000,000 five-year term facility to fund major investments. The interest rate on both credit facilities is the bank prime rate (7.75% at September 30, 2007) plus a 1.0% margin or 8.75% at September 30, 2007. 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. The Company was in compliance with all of its financial loan covenants, there were no outstanding borrowings under either credit facility and there was $1,500,000 in available credit as of September 30, 2007.

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 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 software as a service services through outsourced web hosting to its library customers sold on an annual subscription basis. We believe that 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 (approximately 85%) of this subscription business also forms an ongoing stream of recurring business each year under multiple year contracts.

RESULTS OF OPERATIONS

First Nine Months 2007 as Compared to First Nine Months 2006

Net sales increased $263,000 or 7% from $3,824,000 in 2006 to $4,087,000 in 2007 due to an increase in software as a service hosting and implementation and license revenues from new AGent Verso™ contracts including the Southwest Kansas Library System, Heartland Educational Agency, State of Wisconsin and various publishing contracts.

Cost of sales increased $57,000 or 6% from $968,000 in 2006 to $1,025,000 in 2007 due to higher recurring variable costs associated with resale of third-party products and services, additional payroll and facility costs. Cost of sales includes $551,000 and $549,000 in non-cash depreciation and amortization in 2007 and 2006, respectively. Gross margins were unchanged at 75% in 2007 and 2006.

Research and development increased $120,000 or 34% from $350,000 in 2006 to $470,000 in 2007 due to additional recruiting and payroll expenses. Research and development is presented net of capitalized software of $300,000 in 2007 and $361,000 in 2006. Gross research and development expenses increased $59,000 or 8% from $711,000 in 2006 to $770,000 in 2007 due to additional recruiting and payroll expenses.

Management Discussion and Analysis

Sales, marketing and customer service increased $93,000 or 6% to $1,762,000 in 2007 from $1,669,000 in 2006 due to increases in sales and marketing payroll and promotional and trade show expenses.

General and administrative expenses increased $59,000 or 9% from $656,000 in 2006 to $715,000 in 2007 due to increases in compensation, bad debts and recruiting expenses and foreign exchange losses.

Operating income decreased $67,000 to $115,000 in 2007 versus $181,000 in 2006 due to increases in research and development and sales and marketing expenses.

Interest/other income was $19,000 in 2007 down from $22,000 in 2006 due to investment income on lower average cash balances.

Provision for taxes based on income generally reflects minimum state tax payments and the effect of federal and state net operating loss carryforwards (See Note 4).

Net income was $124,500 in 2007 down $52,000 from $177,000 in 2006 due to a decrease in operating income. Basic and diluted earnings per share was unchanged at $0.03 in 2007 and 2006.

Third Quarter 2007 as Compared to Third Quarter 2006

Net sales increased $170,000 or 13% from $1,263,000 in 2006 to $1,433,000 in 2007 due to an increase in software as a service hosting and implementation and license revenues from new AGent Verso™ contracts including the Southwest Kansas Library System, Heartland Educational Agency, State of Wisconsin and publishing contracts.

Cost of sales increased $8,000 in 2007 or 2% from $343,000 in 2006 to $351,000 in 2007 due to higher software amortization. Cost of sales includes $192,000 and $182,000 in non-cash depreciation and amortization in 2007 and 2006, respectively. Gross margins increased to 76% in 2007 from 73% in 2006 for due to higher sales.

Research and development increased $61,000 or 54% from $112,000 in 2006 to $172,000 in 2007 due to additional payroll and outsourced development expenses. Research and development is presented net of capitalized software of $100,000 in 2007 and $112,000 in 2006. Gross research and development expenses increased $48,000 or 21% to $272,000 in 2007 from $224,000 in 2006 due to additional staffing and recruiting expenses.

Sales, marketing and customer service increased $103,000 or 20% to $628,000 in 2007 from $526,000 in 2006 due to higher sales, marketing and customer service payroll and trade show expenses.

General and administrative expenses increased $44,000 or 21% from $212,000 in 2006 to $256,000 in 2007 due to non-cash foreign exchange losses.

Operating income decreased $47,000 to $25,000 in 2007 versus $72,000 in 2006 due to higher research and development and sales and marketing expenses.

Interest/other income was $5,000 in 2007 down from $11,000 in 2006 due to lower investment income on lower average cash balances.

Provision for taxes based on income generally reflects minimum state tax payments and the effect of federal and state net operating loss carryforwards (See Note 4).

Net income was $31,000 in 2007 down $39,000 from $70,000 in 2006 due to lower operating income. Basic and diluted earnings per share was $0.01 in 2007 and 2006, respectively.

Stock-based Compensation

Effective January 1, 2006, the Company adopted SFAS No. 123R, “Shared-Based Payment” using the modified prospective application transition method. The modified prospective method applies the expense recognition requirements of SFAS No. 123R to new awards outstanding at the effective date and does not restate prior periods for comparative purposes. The Company applies the Black-Scholes valuation method in determining the fair value of share-based payments to employees, which is then amortized on a straight-line basis over the requisite service period. The adoption of SFAS No. 123R did not have a significant impact on the Company’s financial position, results of operations and cash flows. (See Note 7).

Information Relating To Forward-Looking Statements

This Report includes forward-looking statements which reflect the Company's current views with respect to future events and financial performance. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.