



auto-graphics, inc.

MANAGE SHARE SEARCH

## Quarterly Report

Quarter Ended June 30, 2008

Trading Symbol: AUGR.PK

AUTO-GRAPHICS, INC.  
Quarterly Report  
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Unaudited Consolidated Balance Sheet

<u>ASSETS</u>	
Current assets:	
Cash and cash equivalents	\$ 1,031,198
Accounts receivable, less allowance for doubtful accounts (No change in 2008)	244,991
Deferred income taxes – current (Note 4)	58,000
Other current assets	224,081
Total current assets	1,558,270
Software, net	1,957,467
Equipment, furniture and leasehold improvements, net	217,139
Other assets	22,522
	\$ 3,755,398
 <u>LIABILITIES &amp; STOCKHOLDERS' EQUITY</u>	
Current liabilities:	
Accounts payable	\$ 86,369
Deferred revenue	893,696
Accrued payroll and related liabilities	178,358
Other accrued liabilities	55,870
Total current liabilities	1,214,293
Deferred income taxes (Note 4)	66,000
Total liabilities	1,280,293
Commitments and contingencies	--
Stockholders' equity:	
Common Stock, 12,000,000 shares authorized, 4,282,210 shares issued and outstanding in 2008	3,251,582
Accumulated deficit	(733,636)
Accumulated other comprehensive loss	(42,841)
Total stockholders' equity	2,475,105
	\$ 3,755,398

See Notes to Unaudited Consolidated Financial Statements.

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Unaudited Consolidated  
Statements of Operations  
For the Six Months Ended June 30, 2008

	2008	2007
Net sales (Note 3)		
Subscriptions and maintenance	\$ 2,564,923	\$ 2,295,507
License and services	234,964	358,061
Total net sales	2,799,887	2,653,568
Costs and expenses		
Cost of sales	655,674	674,157
Research and development	314,280	297,215
Sales, marketing and customer service	1,142,803	1,133,515
General and administrative	556,415	459,151
Total costs and expenses	2,669,172	2,564,038
Income from operations	130,715	89,530
Other income	9,043	14,000
Income before income taxes	139,758	103,530
Income tax expense (Note 4)	6,000	10,000
Net income	\$ 133,758	\$ 93,530
<u>Earnings per share (Note 5):</u>		
Basic income per share	\$ .03	\$ .02
Weighted average shares outstanding	4,327,377	4,367,543
Diluted income per share	.03	.02
Weighted average shares outstanding	4,647,110	4,869,943

See Notes to Unaudited Consolidated Financial Statements.

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Unaudited Consolidated  
Statements of Operations  
For the Three Months Ended June 30, 2008

	2008	2007
Net sales (Note 3)		
Subscriptions and maintenance	\$ 1,209,425	\$ 1,163,904
License and services	185,086	148,554
Total net sales	1,394,511	1,312,458
Costs and expenses		
Cost of sales	315,757	307,668
Research and development	149,901	160,571
Sales, marketing and customer service	566,737	608,114
General and administrative	288,435	223,962
Total costs and expenses	1,320,830	1,300,315
Income from operations	73,681	12,143
Other income	4,390	4,924
Income before income taxes	78,071	17,067
Income tax expense (Note 4)	3,000	5,000
Net income	\$ 75,071	\$ 12,067
<u>Earnings per share (Note 5):</u>		
Basic income per share	\$ .03	\$ .00
Weighted average shares outstanding	4,327,377	4,390,810
Diluted income per share	.03	.00
Weighted average shares outstanding	4,647,110	4,872,377

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, 2008**

	Common Stock		Retained Earnings/ (Accumulated Deficit)	Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount			
Balances at December 31, 2007	4,282,210	\$ 3,244,926	\$( 867,394)	\$ (42,841)	\$ 2,334,690
Net income	--	--	133,758	--	133,758
Foreign currency translation adjustments	--	--	--	--	--
Comprehensive income	--	--	--	--	133,758
Stock option shares exercised	--	--	--	--	--
Shares repurchased/ Adjustments	--	--	--	--	--
Stock option expense (Note 6)	--	6,656	--	--	6,656
Balances at June 30, 2008	<u>4,282,210</u>	<u>\$ 3,251,582</u>	<u>\$( 733,636)</u>	<u>\$ (42,841)</u>	<u>\$ 2,475,104</u>

See Notes to Unaudited Consolidated Financial Statements.

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Unaudited Consolidated Statements of Cash Flows  
For the Six Months Ended June 30, 2008  
Increase (Decrease) in Cash

	2008	2007
Cash flows from operating activities:		
Net income	\$ 133,758	\$ 93,530
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	348,894	359,079
Provision for doubtful accounts	--	1,000
Stock option expense (Note 6)	6,656	4,388
Changes in operating assets and liabilities:		
Accounts receivable	213,540	297,159
Other current assets	(143,041)	(34,806)
Other assets	--	--
Accounts payable	30,548	13,547
Deferred revenue	(3,415)	(28,464)
Accrued payroll and related liabilities	(49,930)	(34,843)
Other accrued liabilities	(61,758)	(624,021)
Net cash provided by operating activities	475,252	46,569
Cash flows from investing activities:		
Capital expenditures	(43,895)	(60,214)
Capitalized software development	(199,999)	(200,000)
Net cash used in investing activities	(243,894)	(260,214)
Cash flows from financing activities:		
Common stock purchased/adjustments	--	2,185
Net cash provided by (used in) financing activities	--	2,185
Net increase (decrease) in cash	(231,358)	(211,460)
Effect of foreign exchange on cash	--	15,880
Cash at beginning of year	799,840	880,335
Cash at end of year	\$ 1,031,198	\$ 684,755

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, 2008, the results of operations and the statement of cash flows for the six months and three months ended June 30, 2008 and 2007 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, 2007 including, without limitation, the financial statements and notes therein.

**Note 2.** In May 2008, the Company initiated the transfer of banking operations and as of June 30, 2008 was reviewing the new loan documents with the Company's Corporate Attorney for the Company's credit facility for 2008 and into 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 without the additional 1.0% margin the prior loan required. 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.

**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.

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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 six months ended June 30, 2008, and 2007:

Geographic areas:	2008	2007
Net sales:		
United States	\$ 2,340,216	\$ 2,246,244
Foreign – Canada/Other	459,671	407,324
Long-lived assets, net:		
United States	2,174,606	2,412,406
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, 2007, the Company had available net operating loss carryforwards of \$2,180,000 for federal income tax purposes, \$845,000 for state income tax purposes and \$77,000 for foreign income tax purposes. These net operating loss carryforwards expire from 2020 to 2025 for federal taxes, 2008 to 2012 for state taxes, and 2010 to 2014 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 six months ended June 30, 2008, stock options for 52,000 shares were issued at fair market value on the date of issuance.

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

	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
<u>Six Months ended June 30, 2008</u>			
Basic earnings per share			
Net income available to common stockholders	\$ 133,758	4,327,727	\$ 0.03
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>      319,733</u>	
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 133,758</u>	<u>      4,647,110</u>	\$ 0.03
 <u>Six Months ended June 30, 2007</u>			
Basic earnings per share			
Net income available to common stockholders	\$ 93,530	4,367,543	\$ 0.02
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>      502,400</u>	
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 93,530</u>	<u>      4,869,943</u>	\$ 0.02
 <u>Three Months ended June 30, 2008</u>			
Basic earnings per share			
Net income available to common stockholders	\$ 75,071	4,327,277	\$ 0.02
Effect of dilutive securities			
Stock options	<u>          --</u>	<u>      319,733</u>	
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 75,071</u>	<u>      4,647,110</u>	\$ 0.02

	<u>Net Income</u>	<u>Shares</u>	<u>Per Share</u>
<u>Three Months ended June 30, 2007</u>			
Basic earnings per share			
Net income available to common stockholders	\$ 12,067	4,390,810	\$ 0.00
Effect of dilutive securities			
Stock options	--	<u>481,567</u>	
Diluted earnings per share			
Net income available to common stockholders	<u>\$ 12,067</u>	<u>4,872,377</u>	\$ 0.00

**Note 6. 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 June 30, 2008, the Board of Directors has granted options for a total of 837,000 shares of which 140,000 have since been forfeited, 140,100 shares exercised for a net total of 556,900 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.

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**Note 7. 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.

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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." 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 13 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.

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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 increased by \$487,000 to a working capital surplus of \$344,000 in 2008 up from a working capital deficit of \$143,000 in 2007 and was sufficient to fund capital expenditures internally, which resulted in an increase in cash of \$346,000 to \$1,031,000 in 2008. The Company's excess cash is invested mostly in insured certificate accounts on a short-term basis.

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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. A growing percentage of sales (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, 2007, 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 five years total approximately \$1,675,000.

The Company's principal use of cash for investing activities during 2008 and 2007 were directed primarily towards continuing development of the Company's AGent™ and VERSO™ software and software as a service (“SaaS”) services.

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, 2007, 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.

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.

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RESULTS OF OPERATIONS

First Six Months 2008 as Compared to First Six Months 2007

Net sales increased \$146,000 or 5% from \$2,654,000 in 2007 to \$2,800,000 in 2008.

Cost of sales decreased \$18,000 or 3% from \$674,000 in 2007 to \$656,000 in 2008. Cost of sales includes \$349,000 and \$359,000 in non-cash depreciation and amortization in 2008 and 2007, respectively. Gross margins increased to 77% in 2008 from 75% in 2007.

Sales, marketing and customer service increased \$9,000 or 1% to \$1,143,000 in 2008 from \$1,134,000 in 2007 due to lower outsourced marketing expenses.

General and administrative expenses increased \$97,000 or 17% from \$459,000 in 2007 to \$556,000 in 2008.

Operating income increased \$41,000 to \$131,000 in 2008 versus \$90,000 in 2007.

Interest/other income was \$9,000 in 2008 down from \$14,000 in 2007 due to lower interest rates on cash investments.

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 \$134,000 in 2008 up \$40,000 or 43% from \$94,000.

Second Quarter 2008 as Compared to Second Quarter 2007

Net sales increased \$83,000 or 6% from \$1,312,000 in 2007 to \$1,395,000 in 2008.

Cost of sales increased \$21,000 in 2008 or 7% from \$307,000 in 2007 to \$316,000 in 2008. Gross margins held at 77% in 2008 from 77% in 2007.

Research and development decreased \$11,000 or 7% from \$161,000 in 2007 to \$150,000 in 2008. Research and development is presented net of capitalized software of \$200,000 in 2008 and \$200,000 in 2007.

Sales, marketing and customer service decreased \$41,000 or 7% to \$567,000 in 2008 from \$608,000 in 2007 due to higher sales and marketing payroll, higher sales expenses, and higher advertising and show expenses.

General and administrative expenses increased \$64,000 or 3% from \$224,000 in 2007 to \$288,000 in 2008.

Operating income increased \$62,000 to \$74,000 in 2008 versus \$12,000 in 2007.

Interest/other income was \$4,000 in 2008 down from \$5,000 in 2007 due to lower investment income.

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 \$75,000 in 2008 up \$63,000 from \$12,000 in 2007.

#### 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.