

INFINITE GROUP INC
Form 10-K
March 30, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from to

Commission File Number 0-21816

INFINITE GROUP, INC.
(Exact name of registrant as specified in
its charter)

DELAWARE
(State or other jurisdiction
of
incorporation or
organization)

52-1490422
(I.R.S. Employer Identification No.)

60 Office Park Way
Pittsford, NY 14534
(Address of principal executive offices)

Registrant's telephone number, including area code (585) 385-0610

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock
Par value \$.001

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

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Yes No

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes

No

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant (based upon the closing price on the NASDAQ "Over the Counter Bulletin Board" of \$.77 on June 30, 2008) was approximately \$16,900,000.

As of March 26, 2009, 25,469,078 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

NONE

INFINITE GROUP, INC.

Form 10-K

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FORWARD LOOKING STATEMENT INFORMATION

Certain statements made in this Annual Report on Form 10-K are “forward-looking statements” regarding the plans and objectives of management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove

inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein particularly in view of the current state of our operations, the inclusion of such information should not be regarded as a statement by us or any other person that our objectives and plans will be achieved. Factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include, but are not limited to, the factors set forth herein under the headings “Business,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

PART I

Item 1. Business

Business Overview

We are a provider of information technology (IT) services to federal, state and local governments and commercial clients. Our expertise includes managing leading edge operations and implementing complex programs in advanced server management, server virtualization, cloud computing, network services, wireless technology, human capital services, enterprise architecture, and earned value management. We focus on aligning business processes with technology for delivery of solutions meeting our clients' exact needs and providing expert management services to the lifecycle of technology-based projects. We have a business development office with close proximity to the Washington, D.C. metropolitan area and operate in various locations in the United States and overseas. As of December 31, 2008, we had 83 full-time employees and five full time billable information technology independent contractors. Approximately 24% of our employees hold U.S. Government security clearances.

We have several contract vehicles that enable us to deliver a broad range of our services and solutions to the U.S. Government. The quality and consistency of our services and IT expertise allow us to maintain long-term relationships with the U.S. Government and other major clients.

In 2008, we had sales of approximately \$9.9 million, a 17.3% increase over our 2007 sales of approximately \$8.5 million. During 2008, we derived 77.5% of our sales from one client, including sales under subcontracts for services to several different end clients. Approximately 86% of our total sales in 2008 were from U.S. Government contracts as either a prime contractor or a subcontractor.

U.S. Government IT Market

We believe that the U.S. Government is the largest consumer of information technology services and solutions in the United States and its spending on information technology will continue to increase in the next several years. The growth is driven by the expansion of national defense and homeland security programs, the continued need for sophisticated intelligence gathering and information sharing, increased reliance on technology service providers due to shrinking ranks of government employee technical professionals, and the continuing impact of Office of Management and Budget mandates regarding IT spending. U.S. Government spending on information technology has consistently increased in each year since 1980. According to INPUT, an independent U.S. Government market research firm, this trend is expected to continue, with U.S. Government spending on information technology forecast to increase from \$65.2 billion in fiscal year 2007 to \$85.6 billion in fiscal year 2012, representing a compounded annual growth rate of approximately 5.6% over this five-year period. Moreover, this data may not fully reflect U.S. Government spending on classified intelligence programs, operational support services to our armed forces and complementary technical services, which include sophisticated systems engineering. INPUT forecasts that the percentage of IT spending that is contracted out by the U.S. Government will grow to over 86% of total IT spending for fiscal 2012.

According to INPUT, the Department of Homeland Security's (DHS) portion of the U.S. Government's IT budget is projected by INPUT to grow from \$4.5 billion in fiscal 2007 to \$6.1 billion by fiscal 2012, representing a compounded annual growth rate of 6.1%. During the 2007 to 2012 forecast period, INPUT expects to see additional federal funding for homeland security and terrorism prevention to cover cyber-security, nuclear detection, border protection, and high-tech screening capabilities. Although the total amount to be spent for intelligence applications is classified, INPUT estimated that the addressable U.S. Government IT spending in the intelligence community may have been as much as \$9.4 billion in fiscal 2007, and may grow to \$14.0 billion by fiscal 2012 representing a compounded annual growth rate of 8.3%. In addition, system integration professional services from the intelligence community are expected to grow from \$1.6 billion in 2007 to \$2.5 billion by 2012, at a compounded annual growth

rate of 9.6%.

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We expect that the U.S. Government's need for the types of IT services that we provide, such as IT modernization, project management, systems engineering and server virtualization projects, will continue to grow in the foreseeable future, as a result of the high priority placed on the transformation and modernization of its IT programs. We believe that the U.S. Government is continuing to turn to the IT industry to execute its support processes and functions.

We believe that the rapid pace of technological innovations and the U.S. Government's increasing reliance on complex IT infrastructure, combined with a decline in the size of the U.S. Government workforce, as described above, make it increasingly difficult for many governmental agencies to operate and upgrade their information technology systems. We expect that several trends will contribute to the U.S. Government's increased use of service providers, like us, to fulfill a larger portion of its IT responsibilities, and we believe that we will continue to gain new engagements to the extent that the government increases its reliance on outsourcing for its IT needs. These trends include:

- **Focus on mission-critical initiatives.** Since the events of September 11, 2001, the U.S. Government has made the transformation of its information technology infrastructure a major priority. According to INPUT, the budget for the U.S. Government's IT services "commercial" segment, which is comprised of outsourcing, professional services, consulting, training, systems integration and processing services, is projected to grow from \$27.3 billion in fiscal 2007 to \$36.9 billion by fiscal 2012, representing a projected compounded annual growth rate of 6.2%.
- **Increased U.S. Government reliance on outsourcing.** According to INPUT, U.S. Government outsourcing through the use of outside providers to provide services is projected to grow from \$13.8 billion in fiscal 2007 to \$19.0 billion by fiscal 2012, representing a projected compounded annual growth rate of 6.6%.
- **The aging of the U.S. Government's workforce.** According to INPUT, the U.S. Government has estimated that more than 58% of current supervisory and 42% of non-supervisory members of the government workforce will be eligible for retirement by 2010. This "aging" effect is compounded by the upcoming baby-boomer retirement wave, which INPUT estimates to begin within the next three or four years. In April 2001, the government's accountability office (GAO) concluded in a report that the U.S. Government's human capital challenges were adversely affecting the ability of many agencies to carry out their missions. Agencies are faced with a fiercely competitive market for talent, along with the challenge of attracting skilled IT professionals with uncompetitive U.S. Government salaries compared to those in the private sector. INPUT believes that the expected decline in personnel spending will increase the proportional spending for the outsourcing of IT products and services as IT continues to play an expanding role in government. To the extent that the size of the U.S. Government workforce decreases, we believe it will have an increased need for outsourcing of IT services and products to consulting companies that offer the technical skills, familiarity with government processes and procedures and skilled personnel that are necessary to meet the diverse IT requirements of the various U.S. Government agencies.
- **Increased spending on Homeland Security.** In the wake of the terrorist attacks on September 11, 2001, there has been an increased emphasis on homeland security, including protecting critical infrastructure. According to INPUT, the total addressable IT budget for the DHS is projected to grow from \$4.5 billion in government fiscal 2007 to \$6.1 billion in government fiscal 2012, representing a compound annual growth rate of 6.1%. We believe that homeland security will have the greatest impact on the information security, communications and knowledge management segments of the U.S. Government IT market.
- **Increased simplicity of procurement.** Through changes that began with the U.S. Acquisition Streamlining Act of 1994, or FASA 94, the U.S. Government has developed a variety of accelerated contracting methods. U.S. Government agencies have increasingly been able to rely on multiple contracting vehicles to procure needed services in an expedient manner. According to INPUT, the average time to award was approximately 70 days in fiscal 2006 as compared to 278 days in fiscal 1995.

- Continuing impact of Federal Procurement Reform. In recent years, U.S. Government agencies have had increased access to alternative choices of contract acquisition vehicles such as indefinite delivery/indefinite quantity (ID/IQ) contracts, Government Wide Acquisition Contracts (GWACs), the General Services Administration (GSA) schedules and agency specific Blanket Purchase Agreements (BPAs). These choices have created a market-based environment in government procurement. The environment has increased contracting flexibility and provides government entities access to multiple channels to contractor services. Contractors' successful past performance, as well as technical capabilities and management skills, remain critical elements of the award process. We believe the increased flexibility associated with multiple channel access will result in the continued use of these contracting vehicles in the future, and will facilitate access to service providers to meet the increased demand for, and delivery of, required services and solutions. We have added certain contract vehicles to our portfolio as discussed below.
- Increasing Reliance on Technology Service Providers. The demand for technology service providers is expected to increase due to the need for U.S. Government agencies to maintain core operational functions while the available technical workforce shrinks. Gartner, Inc.'s research estimates that by 2010 over 70% of U.S. Government employees will be eligible for regular or early retirement. Given the difficulty the U.S. Government has experienced in hiring and retaining skilled technology personnel in recent years, we believe the U.S. Government will need to rely heavily on technology service providers that have experience with government legacy systems, can sustain mission-critical operations and have the required government security clearances to deploy qualified personnel in classified environments.
- Increase in business process outsourcing (BPO). BPO is a relationship in which a contractor is responsible for performing an entire business operations function, including the information systems outsourcing that provides support. INPUT projects that U.S. Government BPO spending will grow from \$598 million in fiscal 2007 to \$894 million by fiscal 2012, which represents a compounded annual growth rate of 8.4%.

Information Technology (IT) Services - Our Core Strengths

We strategically built our business to deliver a wide range of IT services and solutions that address challenges common to many U.S. Government agencies, state and local governments and commercial companies. We believe that our core strengths position us to respond to the long-term trends and changing demands of our market. Our key focus areas are:

IT Infrastructure Management. We manage one of the nation's largest wide area networks for a major establishment of the U.S. Government. We provide this support under a subcontract we entered into in 2004 with a large systems integrator, which subcontract has been renewed annually. Referred to as Advanced Server Management (ASM), our team of server experts supports approximately 3,000 servers (2,000 in 2007) and approximately 250,000 (140,000 in 2007) client stations from facilities in Maryland and Colorado. Operating around the clock, we consistently exceed the requirements of our service level agreements.

Systems Engineering. We provide critical systems engineering support to the ASM Program and on projects for the DHS. Our engineers design and build systems supporting a mix of business activities. We both manage and execute engineering projects supporting complex wide area networks and local area networks in Windows and UNIX environments, and we provided engineering support for a nationwide wireless operation. Our engineers follow proven methodologies to transition systems from concept to operations.

Server Virtualization. Virtualization is the process of presenting a logical grouping of computing resources so they can be accessed in ways that give benefits over the original configuration. A good example of virtualization is multiprocessing computer architectures. This is the practice of partitioning or splitting up one server to appear as multiple servers. Using virtualization software provided by third party vendors such as VMWare, a client can run

multiple operating systems on one physical machine and therefore a broader, richer set of business applications.

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Beginning in 2006 and continuing into 2008, we executed phases of a nationwide physical to virtual server consolidation project for a major establishment of the U.S. Government. We have accomplished this by architecting, designing and migrating approximately 2,400 servers. We led the client's Advanced Computing Environment (ACE) virtual server project utilizing VMware's ESX 3.0.1 to virtualize everything from application and print servers to terminal servers and domain controllers. The migration was transparent to the end user – there was no server downtime and no lost data.

Beginning in late 2007 and throughout 2008, we have provided consultant support to a Fortune 500 client in performing a global data center consolidation effort. In addition, we are working on the initial stage of a major server virtualization program for the Customs and Border Protection (CBP) Directorate of DHS. We began working with CBP in 2007 performing a wide array of services related to the architecture, testing, and implementation of virtualization services. Our staff created the architecture for the first CBP-approved virtualization system. We performed the architecture around, assisted in the testing of, and helped implement the most successful-to-date disaster recovery exercise. We architected the VMware Virtual Infrastructure 3 solution. Our staff has been key in the production of the certified documentation for the CBP virtualization projects. Additionally, we have continually provided key project management assistance to the CBP virtualization projects as well as for the Microsoft Windows engineering teams.

As part of our strategy of staying on the leading edge of complex virtualized solutions, we offer a comprehensive list of cloud computing-related services. Cloud computing is defined as leveraging internet-based resources to deliver services and processing power. By utilizing cloud computing, organizations can respond dynamically to business demands, allaying the need to have extraneous systems on standby in anticipation of such peaks. Cloud computing can involve both on-premise clouds and off-premise clouds. On-premise clouds involve an organization designing and implementing a large processing and storage fabric within its own data center. Off-premise clouds involve using a third-party cloud service provider to host the needs of an organization. In both cases the underlying solution typically involves a virtualized infrastructure managed through intelligent automation. Our service offerings include cloud readiness assessments, cloud migration services and various platform-as-a-service solutions.

Program Management. Our program managers are subject matter experts who are skilled in managing complex programs dealing with leading edge technologies. Our engagements span a broad range of tasks such as feasibility studies, concept and strategy planning, business process development and reengineering, and project execution. Our staff has a thorough understanding of the technical bases for management and therefore provides clients with expertise connecting technical delivery with sound project management using earned value management processes. We have provided program, portfolio and project management, risk management, master scheduling and acquisition management services to the DHS's Wireless Management Office.

Portfolio Management. We define, implement, and manage portfolios as an integral part of program management. We have proven experience in establishing portfolios as an effective strategy to assess the overall performance of a program through the projects that the program manages. Using performance measures that are defined for the program, the project portfolio can be better evaluated. In addition to overall program performance management, financial performance is supported through portfolio management by capturing planned and actual investments and their associated business cases. Through the use of industry standard software, such as ProSight, we ensure that the originator of the business case focuses on the accuracy and completeness of program and project information and that the program management office focuses on program management best practices.

Project Management. Managing technology-driven projects is a complex process requiring skilled personnel to deliver on the actual work, as well as requiring expert project managers who can plan and execute the work. We have a proven methodology for project management, which includes standards for Earned Value Management that can be applied to any project type. We have created web-based project management environments to integrate the entire

process of delivery with project management standards to optimize performance. A portal provides a mechanism to engage the entire stakeholder community in the delivery process and enable team personnel to plan, perform, measure, and report on delivery. We developed a comprehensive project management system and have implemented earned value management-based project management standards for the DHS Wireless Management Office.

Enterprise Architecture. Our approach to developing architecture for our clients' IT needs begins with the business model. Business drives the need for solutions, and technology facilitates the solution. By understanding the business drivers, we establish the architectural framework to build or extend the computing environment with right sized technology solutions that maximize business processes while minimizing the costs and risks to the client. We developed and continue to support the implementation of business processes for a new operation of DHS where we have successfully integrated technology into the business layer of the existing architectural framework.

Software Development. We follow a systematic approach to developing software for specific client projects. Whether it is a full systems development lifecycle or portions of one, we approach our development tasks with process discipline to ensure tasks are defined, objectives established and progress measured. We developed a Human Resource PeopleSoft-based solution for the DHS to manage the entry and exit of personnel. We developed a software application called SmartForms and have converted standard paper forms to electronic forms to greatly enhance the simplicity and efficiency of processing personnel actions. We also created software to automate routine functions performed under a Network Services contract to enhance and speed-up productivity, as well as reduce the client's operating expenses.

During 2008, we derived approximately 50% of our sales from our Advanced Server Management subcontract. During that same period, we derived approximately 9% of our sales from a prime contract with the DHS. We also entered into several subcontracts under which we provided IT services to various programs and divisions of DHS and other U.S. Government agencies. These subcontracts provided the balance of our 2008 sales.

Our Contract and Sales Vehicles

The acquisition of the following contract vehicles allows us additional opportunities to bid on new projects.

Federal Supply Schedule Contract. In 2003, we were awarded a Federal Supply Schedule Contract by the U.S. General Services Administration (GSA) for IT consulting services (Schedule 70). In 2008, our Schedule 70 Contract was extended for an additional five years to December 27, 2013. Having a Schedule 70 allows us to compete for and secure prime contracts with all executive agencies of the U.S. Government, as well as other national and international organizations. Our Schedule 70 contract encompasses 85 different labor categories for a three year term. During 2007, we had one prime contract under our Schedule 70 with sales of approximately \$756,000. Beginning in 2008, this contract was revised such that we are now a subcontractor to a major prime contractor for DHS for these same and additional services. We have used the Schedule 70 as a basis for pricing our current and proposed work. We intend to continue using our Schedule 70 to facilitate the sale of IT consulting services to the U.S. Government.

Navy's SeaPort-Enhanced (SeaPort-e) Program. In June 2006, we were awarded a prime contract under the Department of the Navy's SeaPort-Enhanced (SeaPort-e) program. This contract allows us to compete for and perform service requirements solicited by various Navy commands, the Marine Corps, other organizations within the Department of Defense (DoD), non-DoD agencies, and certain joint agency organizations for work that is integrally related to the scope and mission of the contract. This work involves professional services in all phases of naval ship and weapon systems acquisition and life-cycle support, including research and development support, prototyping, technology analysis, acquisition logistics, project management support, modeling, test and evaluation trials, crisis and consequence management, and engineering support.

VMware Authorized Consultant (VAC). During 2007, we were approved as a VMware Authorized Consultant (VAC) by VMware, Inc. a subsidiary of EMC Corporation. VMware is recognized as the industry leader in virtualization technology. As a VAC, we are trained and certified to deliver consulting services and solutions leveraging VMware technology. We are also certified as a VMware Enterprise VIP Reseller authorized to resell VMware's full product line. We are actively working with a number of current and potential clients in that regard. These certifications are examples of our concerted effort to grow and expand our virtualization practice. Virtualization involves the creation, allocation, and management of "virtual machines," which entails the virtual representation of hardware by a software system. What this means is that traditional "physical servers," which typically run at only 5% to 15% of their capacity, can now be consolidated with the use of specialized software such as VMware to increase server utilization by a factor of ten to one or even greater. Reducing the number of physical machines required in a typical environment provides numerous and obvious benefits, including equipment cost savings, reduced operational maintenance costs, easier backup, improved availability, and better security. Due to the substantial energy savings resulting from reduced infrastructure, virtualization is also a "green" technology.

Microsoft Gold Certified Partner. In 2008, we attained Microsoft Gold Certified Partner status, the highest level of certification available from Microsoft Corporation. Gold Certified Partners have passed Microsoft's stringent requirements and have demonstrated the highest levels of knowledge, skill and technical ability, as well as the commitment to implement of Microsoft technologies. We have specifically been certified for Microsoft Competencies in the areas of advanced infrastructure solutions and unified communications. Created to help partner firms like Infinite Group differentiate their solution and service offerings, Microsoft competencies enable clients to secure a particular type of consulting solution, based on the firm's capabilities and expertise with specific Microsoft technologies. Each Microsoft competency has a unique set of requirements and benefits, formulated to accurately represent the specific skills and services that partners bring to the technology industry.

Hewlett Packard Developer and Solutions Partner Program (DSPP). In July 2007, we were accepted into the Hewlett Packard Developer and Solutions Partner Program (DSPP). DSPP provides us with a mechanism to work with HP and our joint customers and prospects to provide solutions and services that complement HP's broad portfolio of products and services. HP has many tools and resources to help us generate new sales streams, and improve our mutual profitability, while at the same time adding unique value for our joint customers. The program comprises practical tools and services that we hope will help us in the key areas of marketing and selling our solutions, optimizing the technology, and collaborating with other organizations within our industry.

Navy Enterprise Maintenance Automated Information System (NEMAIS). We are a member of a team led by CACI International Inc. that was awarded a \$36 million task order by the U.S. Navy in October 2007 to support its Navy Enterprise Maintenance Automated Information System (NEMAIS) data center operations. The task order, awarded under the Seaport II Enhanced contract vehicle (Seaport-e), provides for one base year and three one-year options. The CACI team will perform the work at the Naval Sea Systems Command (NAVSEA) site in Norfolk, Virginia and the Puget Sound Naval Shipyard in Washington State. As a result of the award CACI was able to maintain the same level of support it has been providing to the Navy for the NEMAIS data center which in turn enhances CACI's and our core lines of business in engineering services, network services and business systems integration. In 2008, we began working with CACI on a portion of this project under the terms of our subcontract.

Competition

We compete mainly with other IT professional services firms operating in the federal, state and local government marketplace. We obtain much of our business on the basis of proposals submitted in response to requests from potential and current clients, who typically also receive proposals from other firms. Many of our proposed services are included with proposals of large prime contractors, where a specific area for our participation has been identified based on our expertise and experience. Certain large prime contractors are required to allocate a portion of their

contract to small businesses and we are able to fill that role. We also face indirect competition from certain government agencies that perform services for themselves similar to those we market.

We have entered into subcontracts with systems integrators holding multi-year, multi-million dollar contracts with the U.S. Government. In such cases, our competition is mainly with other IT services companies classified as small business entities by government standards. For prime contracts with the U.S. Government, we anticipate that our competition will range from small business set aside contractors to full and open competition with large firms such as Northrop Grumman Information Technologies, Science Applications International Corp., EDS Corp., Computer Sciences Corp., Unisys, SRA International, Inc., and Serco Services Inc.

Our competitors in general have substantially greater capital resources, research and development staffs, manufacturing capabilities, sales and marketing resources, facilities, and experience than we do.

Because of the diverse requirements of U.S. Government customers and the highly competitive nature of large procurements, corporations frequently form teams to pursue contract opportunities. The same companies listed as competitors will often team with us or subcontract to us in the pursuit of new business. We believe that the major competitive factors in our market are distinctive technical competencies, successful past contract performance, price of services, reputation for quality and key management with domain expertise.

Company Information Available on the Internet

We maintain a website at www.IGIus.com. Through a link to the Investor Relations section of our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are available, free of charge, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). The content of our website shall not be deemed part of this report.

Employees

As of December 31, 2008 we had 83 full-time employees, including 70 in information technology services, two in executive management, two in finance and administration, one in employee recruiting, and eight in marketing and sales. We also had five full-time billable information technology independent consultants who worked for us. We are not subject to any collective bargaining agreements and we believe that our relations with our employees are good. We believe that we are currently staffed at an appropriate level to implement and carry out our business plan for the next 12 months.

Our ability to develop and market our services, and to establish and maintain a competitive position in our businesses will depend, in large part, upon our ability to attract and retain qualified technical, marketing and managerial personnel, of which there can be no assurance.

General Information

We were incorporated under the laws of the state of Delaware on October 14, 1986. On January 7, 1998, we changed our name from Infinite Machines Corp. to Infinite Group, Inc. Our principal corporate headquarters are located at 60 Office Park Way, Pittsford, NY 14534. Our business is exclusively in the field of IT services.

Item 1A. Risk Factors

In addition to the other information provided in our reports, you should consider the following factors carefully in evaluating our business and us. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or that are similar to those faced by other companies in our industry or business in general, such as competitive conditions, may also impair our business operations. If any of the following risks occur, our business,

financial condition, or results of operations could be materially adversely affected.

Risks Related to our Industry

We depend on prime contracts or subcontracts with the U.S. Government for a substantial portion of our sales, and our business would be seriously harmed if the government ceased doing business with us or our prime contractors or significantly decreased the amount of business it does with us or our prime contractors.

We derived approximately 86% and 99% of our sales in 2008 and 2007, respectively, from U.S. Government contracts as either a prime contractor or a subcontractor. We expect that we will continue to derive a substantial portion of our sales for the foreseeable future from work performed under U.S. Government contracts, as we have in the past, and from new marketing efforts focused on state and local governments. If we or our prime contractors were suspended or prohibited from contracting with federal, state or local governments, or if our reputation or relationship with the federal, state or local governments were impaired, or if any of the foregoing otherwise ceased doing business with us or our prime contractors or significantly decreased the amount of business it does with us or our prime contractors, our business, prospects, financial condition and operating results would be materially adversely affected.

Our business could be adversely affected by changes in budgetary priorities of the U.S. Government.

Because we derive a significant portion of our sales from contracts with the U.S. Government, we believe that the success and development of our business will continue to depend on our successful participation in U.S. Government contract programs. Changes in U.S. Government budgetary priorities could directly affect our financial performance. A significant decline in government expenditures, a shift of expenditures away from programs which call for the types of services that we provide or a change in U.S. Government contracting policies, could cause U.S. Governmental agencies to reduce their expenditures under contracts, to exercise their right to terminate contracts at any time without penalty, not to exercise options to renew contracts or to delay or not enter into new contracts. Any of those actions could seriously harm our business, prospects, financial condition or operating results. Moreover, although our contracts with governmental agencies often contemplate that our services will be performed over a period of several years, Congress usually must approve funds for a given program each government fiscal year and may significantly reduce or eliminate funding for a program. Significant reductions in these appropriations by Congress could have a material adverse effect on our business. Additional factors that could have a serious adverse effect on our U.S. Government contracting business include:

- changes in U.S. Government programs or requirements;
- budgetary priorities limiting or delaying U.S. Government spending generally, or by specific departments or agencies in particular, and changes in fiscal policies or available funding, including potential governmental shutdowns;
- reduction in the U.S. Government's use of technology solutions firms; and
- a decrease in the number of contracts reserved for small businesses, or small business set asides, which could result in our inability to compete directly for these prime contracts.
- curtailment of the U.S. Government's use of IT or related professional services.

Our profitability will suffer if we are not able to maintain our pricing and utilization rates and control our costs.

Our profit margin, and therefore our profitability, is largely a function of the rates we charge for our IT Services and the utilization rate, or chargeability, of our employees. Accordingly, if we are not able to maintain the rates we charge for our services or an appropriate utilization rate for our employees, we will not be able to sustain our profit margin and our profitability will suffer. The rates we charge for our IT Services are affected by a number of factors, including:

- our clients' perception of our ability to add value through our services;

- - competition;
 - introduction of new services or products by us or our competitors;
 - pricing policies of our competitors; and
 - general economic conditions.

Our utilization rates are also affected by a number of factors, including:

- seasonal trends, primarily as a result of holidays, vacations, and slow downs by our clients, which may have a more significant effect in the fourth quarter;
 - our ability to transition employees from completed engagements to new engagements;
- our ability to forecast demand for our services and thereby maintain an appropriately balanced and sized workforce; and
 - our ability to manage employee turnover.

We have implemented cost-management programs to manage our costs, including personnel costs, support and other overhead costs. Some of our costs, like office rents, are fixed in the short term, which limits our ability to reduce costs in periods of declining sales. Our current and future cost-management initiatives may not be sufficient to maintain our margins as our level of sales varies.

If we fail to meet our contractual obligations to our clients, our ability to compete for future work and our financial condition may be adversely affected.

If we fail to meet our contractual obligations, we could be subject to legal liability, which could adversely affect our business, operating results and financial condition. The provisions we typically include in our contracts which are designed to limit our exposure to legal claims relating to our services may not protect us or may not be enforceable under some circumstances or under the laws of some jurisdictions. It is possible, because of the nature of our business, that we may be exposed to legal claims in the future. We have errors and omissions insurance with coverage limits of \$1,000,000 and a deductible payable by us of \$50,000. The policy limits may not be adequate to provide protection against all potential liabilities. As a consulting firm, we depend to a large extent on our relationships with our clients and our reputation for high-quality services to retain and attract clients and employees. As a result, claims made against us may damage our reputation, which in turn, could impact our ability to compete for new business.

Unfavorable government audits could require us to refund payments we have received, to forego anticipated sales and could subject us to penalties and sanctions.

The government agencies we work for generally have the authority to audit and review our contracts with them and/or our subcontracts with prime contractors. As part of that process, the government agency reviews our performance on the contract, our pricing practices, our cost structure and our compliance with applicable laws, regulations and standards. If the audit agency determines that we have improperly received payment or reimbursement, we would be required to refund any such amount. If a government audit uncovers improper or illegal activities by us, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or disqualification from doing business with the government. Any such unfavorable determination could adversely impact our ability to bid for new work which would have a negative impact on our business.

The IT services industry is highly competitive, and we may not be able to compete effectively.

We operate in a highly competitive industry that includes a large number of participants. We believe that we currently compete principally with other IT professional services firms, technology vendors and the internal information systems groups of our clients. Many of the companies that provide services in our markets have significantly greater financial, technical and marketing resources than we do. Our marketplace is experiencing rapid changes in its competitive landscape. Some of our competitors have sought access to public and private capital and others have merged or consolidated with better-capitalized partners. These changes may create more or larger and better-capitalized competitors with enhanced abilities to compete for market share generally and our clients

specifically, in some cases, through significant economic incentives to clients to secure contracts. These competitors may also be better able to compete for skilled professionals by offering them large compensation incentives. In addition, one or more of our competitors may develop and implement methodologies that result in superior productivity and price reductions without adversely affecting the competitors' profit margins. In addition, there are relatively few barriers to entry into our markets and we have faced, and expect to continue to face, competition from new entrants into our markets. As a result, we may be unable to continue to compete successfully with our existing or any new competitors.

The failure by Congress to approve budgets on a timely basis for the U.S. Government agencies we support could delay procurement of our services and solutions and cause us to lose future revenues.

On an annual basis, Congress must approve budgets that govern spending by the U.S. Government agencies that we support. In years when Congress is not able to complete its budget process before the end of the U.S. Government's fiscal year on September 30, Congress typically funds government operations pursuant to a continuing resolution. A continuing resolution allows U.S. Government agencies to operate at spending levels approved in the previous budget cycle. When the U.S. Government operates under a continuing resolution, it may delay funding we expect to receive from clients on work we are already performing and will likely result in new initiatives being delayed or in some cases cancelled.

Our future success depends on our ability to continue to retain and attract qualified employees.

We believe that our future success depends upon our ability to continue to train, retain, effectively manage and attract highly skilled technical, managerial, sales and marketing personnel. Employee turnover is generally high in the IT services industry. If our efforts in these areas are not successful, our costs may increase, our sales efforts may be hindered, and our customer service may degrade. Although we invest significant resources in recruiting and retaining employees, there is often significant competition for certain personnel in the IT services industry. From time to time, we experience difficulties in locating enough highly qualified candidates in desired geographic locations, or with required specific expertise.

Our contracts with the U.S. Government may be terminated or adversely modified prior to completion, which could adversely affect our business.

U.S. Government contracts generally contain provisions, and are subject to laws and regulations, that give the U.S. Government rights and remedies not typically found in commercial contracts, including provisions permitting the U.S. Government to:

- terminate our existing contracts;
- reduce potential future income from our existing contracts;
- modify some of the terms and conditions in our existing contracts;
- suspend or permanently prohibit us from doing business with the U.S. Government or with any specific government agency;
- impose fines and penalties;
- subject us to criminal prosecution;
- subject the award of some contracts to protest or challenge by competitors, which may require the contracting U.S. agency or department to suspend our performance pending the outcome of the protest or challenge and which may also require the government to solicit new bids for the contract or result in the termination, reduction or modification of the awarded contract;
- suspend work under existing multiple year contracts and related task orders if the necessary funds are not appropriated by Congress;
 - decline to exercise an option to extend an existing multiple year contract; and
 - claim rights in technologies and systems invented, developed or produced by us.

The U.S. Government may terminate a contract with us either "for convenience" (for instance, due to a change in its perceived needs or its desire to consolidate work under another contract) or if we default by failing to perform under the contract. If the U.S. Government terminates a contract with us for convenience, we generally would be entitled to recover only our incurred or committed costs, settlement expenses and profit on the work completed prior to termination. If the U.S. Government terminates a contract with us based upon our default, we generally would be

denied any recovery for undelivered work, and instead may be liable for excess costs incurred by the U.S. Government in procuring undelivered items from an alternative source. We may in the future receive show-cause or cure notices under contracts that, if not addressed to the U.S. Government's satisfaction, could give the government the right to terminate those contracts for default or to cease procuring our services under those contracts.

Our U.S. Government contracts typically have terms of one or more base years and one or more option years. Many of the option periods cover more than half of the contract's potential term. U.S. Governmental agencies generally have the right not to exercise options to extend a contract. A decision to terminate or not to exercise options to extend our existing contracts could have a material adverse effect on our business, prospects, financial condition and results of operations.

Certain of our U.S. Government contracts also contain "organizational conflict of interest" clauses that could limit our ability to compete for certain related follow-on contracts. For example, when we work on the design of a particular solution, we may be precluded from competing for the contract to install that solution. While we actively monitor our contracts to avoid these conflicts, we cannot guarantee that we will be able to avoid all organizational conflict of interest issues.

In addition, U.S. Government contracts are frequently awarded only after formal competitive bidding processes, which have been and may continue to be protracted, and typically impose provisions that permit cancellation in the event that funds are unavailable to the public agency.

The competitive bidding process presents a number of risks, including the following:

- we expend substantial funds, managerial time and effort to prepare bids and proposals for contracts that we may not win;
- we may be unable to estimate accurately the resources and cost that will be required to service any contract we win, which could result in substantial cost overruns; and
- we may encounter expense and delay if our competitors protest or challenge awards of contracts to us in competitive bidding, and any such protest or challenge could result in a requirement to resubmit bids on modified specifications or in the termination, reduction or modification of the awarded contract.

We may lose money on some contracts if we do not accurately estimate the expenses, time and resources necessary to satisfy our contractual obligations.

We enter into two types of U.S. Government contracts for our services: time-and-materials and fixed-price. For 2008 and 2007, we derived revenue from such contracts as follows:

Contract type	2008	2007
Time and materials	53%	50%
Fixed price	47%	50%
	100%	100%

Each of these types of contracts, to varying degrees, involves some risk that we could underestimate our cost of fulfilling the contract, which may reduce the profit we earn or lead to a financial loss on the contract.

Under time and materials contracts, we are reimbursed for labor at negotiated hourly billing rates and for certain expenses. We assume financial risk on time and material contracts because we assume the risk of performing those contracts at negotiated hourly rates.

Under fixed-price contracts, we perform specific tasks for a fixed price. Compared to cost-plus contracts, fixed price contracts generally offer higher margin opportunities, but involve greater financial risk because we bear the impact of

cost overruns and bear the risk of underestimating the level of effort required to perform the contractual obligations, which could result in increased costs and expenses.

Our profits could be adversely affected if our costs under any of these contracts exceed the assumptions we used in bidding for the contract. Over time, and particularly if we acquire other businesses, our contract mix may change, thereby potentially increasing our exposure to these risks.

If we fail to establish and maintain important relationships with government entities and agencies, our ability to successfully bid for new business may be adversely affected.

To develop new business opportunities, we rely on establishing and maintaining relationships with various government entities and agencies. We may be unable to successfully maintain our relationships with government entities and agencies, and any failure to do so could materially adversely affect our ability to compete successfully for new business.

Our business may suffer if our facilities or our employees are unable to obtain or retain the security clearances or other qualifications needed to perform services for our clients.

Many of our U.S. Government contracts require employees and facilities used in specific engagements to hold security clearances and to clear National Agency Checks and Defense Security Service checks. Some of our contracts require us to employ personnel with specified levels of education, work experience and security clearances. Depending on the level of clearance, security clearances can be difficult and time-consuming to obtain. If our employees or our facilities lose or are unable to obtain necessary security clearances or successfully clear necessary National Agency or Defense Security Service checks, we may not be able to win new business and our existing clients could terminate their contracts with us or decide not to renew them, and in each instance our operating results could be materially adversely affected. During 2007 and 2008, we worked on projects that required secret or top secret clearance.

We must comply with a variety of laws, regulations and procedures and our failure to comply could harm our operating results.

We must observe laws and regulations relating to the formation, administration and performance of U.S. Government contracts which affect how we do business with our clients and impose added costs on our business. For example, the Federal Acquisition Regulation and the industrial security regulations of the Department of Defense and related laws include provisions that:

- allow our U.S. Government clients to terminate or not renew our contracts if we come under foreign ownership, control or influence;
 - require us to disclose and certify cost and pricing data in connection with contract negotiations;
 - require us to prevent unauthorized access to classified information; and
- require us to comply with laws and regulations intended to promote various social or economic goals.

We are subject to industrial security regulations of the Department of Homeland Security and other U.S. Government agencies that are designed to safeguard against foreigners' access to classified information. If we were to come under foreign ownership, control or influence, we could lose our facility security clearance, which could result in our U.S. Government customers terminating or deciding not to renew our contracts, and could impair our ability to obtain new contracts.

In addition, our employees often must comply with procedures required by the specific agency for which work is being performed, such as time recordation or prohibition on removal of materials from a location.

Our failure to comply with applicable laws, regulations or procedures, including U.S. Government procurement regulations and regulations regarding the protection of classified information, could result in contract termination, loss

of security clearances, suspension or prohibition from contracting with the U.S. Government, civil fines and damages and criminal prosecution and penalties, any of which could materially adversely affect our business.

The U.S. Government may revise its procurement or other practices in a manner adverse to us.

The U.S. Government may revise its procurement practices or adopt new contracting rules and regulations, such as cost accounting standards. It could also adopt new contracting methods relating to GSA contracts, government-wide contracts, or adopt new standards for contract awards intended to achieve certain social or other policy objectives, such as establishing new set-aside programs for small or minority-owned businesses. In addition, the U.S. Government may face restrictions from new legislation or regulations, as well as pressure from government employees and their unions, on the nature and amount of services the U.S. Government may obtain from private contractors. These changes could impair our ability to obtain new contracts or contracts under which we currently perform when those contracts are put up for recompetition bids. Any new contracting methods could be costly or administratively difficult for us to implement, and, as a result, could harm our operating results. For example, the Truthfulness, Responsibility and Accountability in Contracting Act, proposed in 2001, would have limited and severely delayed the U.S. Government's ability to use private service contractors. Although this proposal was not enacted, it or similar legislation could be proposed at any time. Any reduction in the U.S. Government's use of private contractors to provide federal information technology services could materially adversely impact our business.

Failure to maintain strong relationships with other government contractors could result in a decline in our sales.

We derived all of our sales in 2008 and 91% of our sales in 2007 from contracts under which we acted as a subcontractor. Our subcontracts with prime contractors contain many of the same provisions as the prime contracts and therefore carry many of the same risks previously identified in these Risk Factors. As a subcontractor, we often lack control over fulfillment of a contract, and poor performance on the contract by others could tarnish our reputation, even when we perform as required. We expect to continue to depend on relationships with other contractors for a significant portion of our sales in the foreseeable future. Moreover, our sales and operating results could be materially adversely affected if any prime contractor chooses to offer services of the type that we provide or if any prime contractor teams with other companies to independently provide those services.

Risks Related to our Business

We experienced an operating loss in 2007 and net losses in 2008 and 2007.

We generated an operating loss of approximately \$474,000 in 2007 and net losses of approximately \$177,000 in 2008 and \$750,000 in 2007. As of December 31, 2008, we had an accumulated deficit of approximately \$31.2 million. We have maintained our selling expenses for marketing and selling efforts at approximately \$1.4 million and \$1.6 million for 2008 and 2007, respectively, which has contributed to our net losses. Until we close new contracts and earn additional sales or curtail our marketing and selling efforts, we cannot assure you when we will be profitable on a consistent basis, or at all.

We are highly leveraged, which increases our operating deficit and makes it difficult for us to grow.

At December 31, 2008, we had current liabilities, including trade payables, of approximately \$3.4 million and long-term liabilities of \$2.6 million. We had a working capital deficit of approximately \$2.2 million and a current ratio of .35. We may continue to experience working capital shortages that impair our business operations and growth strategy if we again experience operating losses or continue to incur net losses and as a result, our business, operations and financial condition will be materially adversely affected.

We have significant liabilities related to the O&W pension plan.

At December 31, 2008, the Osley & Whitney, Inc. (O&W) defined benefit pension plan (O&W Plan) had an accrued pension obligation liability of \$3,622,122 and an accumulated other comprehensive loss of \$3,217,259 which we recorded as a reduction of stockholders' deficiency.

If it is determined by the Department of the Treasury (DOT) that we are the O&W Plan sponsor, we may be required to contribute amounts for the O&W Plan years 2004 through 2008 and in future years to fund the deficiency. We did not make a contribution in 2004, 2006, 2007, or 2008. During 2005, we did not make all required contributions. We do not have the funds available to make required contributions which currently approximate \$2.2 million. We recorded defined benefit pension expense of approximately \$234,000 in 2008 and \$351,000 in 2007 including legal and professional fees and interest costs. We have accrued amounts related to excise taxes on unfunded contributions for 2004, 2005 and 2006 of \$420,362 at December 31, 2008 and potentially could incur additional excise taxes of 10% and additional excise taxes of 100% of required plan contributions for each year that contributions were not made.

During 2007, we incurred legal and professional fees in connection with submitting information to the Department of Treasury (DOT) advocating our position that we had no legal obligation to act as the sponsor of the O&W Plan to ascertain whether the DOT concurred or disagreed with this position. We subsequently provided responses to DOT inquiries related to this determination. In February 2009, we received a draft of a proposed revenue agent report from the DOT that indicates that the DOT staff disagrees with our position. The draft revenue agent response indicates that we are responsible for excise taxes attributed to the funding deficiency of \$1,836,359 for the years 2002 through 2007 which funding deficiency can only be corrected by contributing \$1,836,359 to the O&W Plan. The draft response also states that additional penalties could be imposed. Our management with our outside legal counsel disagrees with significant aspects of both the factual findings and legal conclusions set forth in the draft report and, in accordance with DOT procedures, we are in the process of responding with a detailed analysis of our opposition to their findings.

We expect defined benefit pension plan expense will increase by approximately \$214,000 for 2009 as a result of the O&W Plan actuary's estimate of periodic pension costs increasing from \$154,000 for 2008 to approximately \$368,000 for 2009. This increase is principally due to an approximate 25% loss in the market value of O&W Plan investment securities during 2008 due to adverse market conditions. If we fail to ultimately prevail in proceedings with the DOT, our financial condition will be adversely impacted.

We have been dependent on a limited number of high net worth individuals to fund our working capital needs.

From 2003 through 2008, we raised approximately \$2.7 million in a combination of equity, debt conversion and debt transactions from a limited number of high net worth investors. We cannot provide assurance that we will be able to continue to raise additional capital from this group of investors, or that we will be able to secure funding from additional sources. Certain debt holders have agreed to extensions of the maturity dates of their note. We have maturities of \$524,000 in 2010 for three investor notes payable. We cannot provide assurance that we will be able to obtain further extensions of maturity dates or that we will be able to repay or otherwise refinance the notes at their scheduled maturities.

We may require additional financing in the future, which may not be available on acceptable terms.

We may require additional funds for working capital and general corporate purposes. We cannot provide assurance that adequate additional financing will be available or, if available, will be offered on acceptable terms.

Moreover, our IT Services billings generate accounts receivable that are generally paid within 30 to 60 days from the invoice date. The cost of those sales generally consists of employee salaries and benefits that we must pay prior to our

receipt of the accounts receivable to which these costs relate. We therefore need sufficient cash resources to cover such employee-related costs which, in many cases, require us to borrow funds on disadvantageous terms.

We have secured an accounts receivable financing line of credit in the amount of \$800,000 from an independent finance organization that provides us with the cash needed to cover such employee-related costs. At December 31, 2008, we had \$516,000 of borrowing availability under this line. As we grow, additional working capital may be required to support this difference in the timing of cash receipts versus payroll disbursements. Moreover, our accounts receivable financing lender may decide to cease subsequent advances at any time in its discretion, upon our failure to meet certain contractual requirements or upon the occurrence of certain events or contingencies that are out of our control. In such event, our short-term cash requirements would exceed available cash on hand resulting in material adverse consequences to our business.

Finally, any additional equity financing and conversions by the holders of existing notes payable to common stock will be dilutive to stockholders. Debt financings, if available, may involve restrictive covenants that further limit our ability to make decisions that we believe will be in our best interests. In the event we cannot obtain additional financing on terms acceptable to us when required, our operations will be materially adversely affected and we may have to cease or substantially reduce operations.

Recent events affecting the credit markets may restrict our ability to access additional financing.

The U.S. and worldwide capital and credit markets have recently experienced significant price volatility, dislocations and liquidity disruptions, which have caused market prices of many stocks to fluctuate substantially and the spreads on prospective debt financings to widen considerably. These circumstances have materially impacted liquidity in the financial markets, making terms for certain financings less attractive, and in some cases have resulted in the unavailability of financing. Continued uncertainty in the capital and credit markets may negatively impact our business, including our ability to access additional financing at reasonable terms, which may negatively affect our ability to make future acquisitions or expand our business. A prolonged downturn in the financial markets may cause us to seek alternative sources of potentially less attractive financing, and may require us to adjust our business plan accordingly. These events also may make it more difficult or costly for us to raise capital through the issuance of our equity securities. The disruptions in the financial markets may have a material adverse effect on the market value of our common stock and other adverse effects on our business.

If we do not successfully integrate the businesses that we acquire, our results of operations could be adversely affected.

We may grow our business by acquiring companies and businesses that we feel have synergy and will complement our business plan. We regularly evaluate potential business combinations and pursue attractive transactions. We may be unable to profitably manage businesses that we may acquire or we may fail to integrate them successfully without incurring substantial expenses, delays or other problems that could negatively impact our results of operations.

Acquisitions involve additional risks, including:

- diversion of management's attention;
- difficulty in integration of the acquired business;
- loss of significant clients acquired;
- loss of key management and technical personnel acquired;
- assumption of unanticipated legal or other financial liabilities;
- becoming significantly leveraged as a result of debt incurred to finance acquisitions;
- unanticipated operating, accounting or management difficulties in connection with the acquired entities;
- costs of our personnel's time, travel, legal services and accounting services in connection with a proposed acquisition; that may not be recovered;
- impairment charges for acquired intangible assets, including goodwill that decline in value; and

- dilution to our earnings per share as a result of issuing shares of our stock to finance acquisitions.

Also, client dissatisfaction or performance problems with an acquired firm could materially and adversely affect our reputation as a whole. Further, the acquired businesses may not achieve the sales and earnings we anticipated. We will continue to evaluate from time to time, on a selective basis, other strategic acquisitions if we believe they will help us obtain well-trained, high-quality employees, new product or service offerings, additional industry expertise, a broader client base or an expanded geographic presence. There can be no assurance that we will be successful in identifying candidates or consummating acquisitions on terms that are acceptable or favorable to us. In addition, there can be no assurance that financing for acquisitions will be available on terms that are acceptable or favorable. We may issue shares of our common stock as part of the purchase price for some or all of these acquisitions. Future issuances of our common stock in connection with acquisitions may dilute our earnings per share.

If we fail to adequately manage the size of our business, it could have a severe negative impact on our financial results or stock price.

Our management believes that in order to be successful we must appropriately manage the size of our business. This may mean reducing costs and overhead in certain economic periods, and selectively growing in periods of economic expansion. In addition, we will be required to implement operational, financial and management information procedures and controls that are efficient and appropriate for the size and scope of our operations. The management skills and systems currently in place may not be adequate and we may not be able to manage any significant reductions or growth effectively.

We may have difficulties in managing our growth.

Our future growth depends, in part, on our ability to implement and expand our financial control systems and to expand, train and manage our employee base and provide support to an expanded customer base. If we cannot manage growth effectively, it could have a material adverse effect on our results of operations, business and financial condition. In addition, acquisitions and expansion involve substantial infrastructure costs and working capital. We cannot provide assurance that we will be able to integrate acquisitions, if any, and expansions efficiently. Similarly, we cannot provide assurance that we will continue to expand or that any expansion will enhance our profitability. If we do not achieve sufficient sales growth to offset increased expenses associated with our expansion, our results will be adversely affected.

We depend on the continued services of our key personnel.

Our future success depends, in part, on the continuing efforts of our senior executive officers, Michael S. Smith James D. Frost and William S. Hogan. The loss of any of these key employees may materially adversely affect our business.

Our business depends upon obtaining and maintaining required security clearances.

Some of our U.S. Government contracts require our employees to maintain various levels of security clearances. Obtaining and maintaining security clearances for employees involves a lengthy process, and it is difficult to identify, recruit and retain employees who already hold security clearances. If our employees are unable to obtain or retain security clearances or if our employees who hold security clearances terminate employment with us, the client whose work requires cleared employees could terminate the contract or decide not to renew it upon its expiration. To the extent we are not able to engage employees with the required security clearances for a particular contract, we may not be able to bid on or win new contracts, or effectively rebid on expiring contracts. During 2007 and 2008, we worked on projects that required secret or top secret clearance.

Our employees or subcontractors may engage in misconduct or other improper activities, which could cause us to lose contracts.

While we have ethics and compliance programs in place, we are exposed to the risk that employee fraud or other misconduct could occur. We enter into arrangements with prime contractors and joint venture partners to bid on and execute particular contracts or programs; as a result, we are exposed to the risk that fraud or other misconduct or improper activities by such persons may occur. Misconduct by employees, prime contractors or joint venture partners could include intentional failures to comply with federal laws including; U.S. Government procurement regulations; proper handling of sensitive or classified information; compliance with the terms of our contracts that we receive; falsifying time records or failures to disclose unauthorized or unsuccessful activities to us. These actions could lead to civil, criminal, and/or administrative penalties (including fines, imprisonment, suspension and/or bars from performing U.S. Government contracts) and harm our reputation. The precautions we take to prevent and detect such activity may not be effective in controlling unknown or unmanaged risks or losses, and such misconduct by employees, prime contractors or joint venture partners could result in serious civil or criminal penalties or sanctions or harm to our reputation, which could cause us to lose contracts or cause a reduction in revenue.

Risks Related to our Common Stock

Five stockholders own a significant portion of our stock and may delay or prevent a change in control or adversely affect the stock price through sales in the open market.

As of February 28, 2009, five individuals or their affiliates owned approximately 14.2%, 5.7%, 3.9%, 2.0%, and 1.8%, respectively, (27.6% in the aggregate) of our outstanding common stock (excluding stock options, warrants and convertible notes).

Two holders have the right to convert notes payable and accrued interest into shares of common stock at \$.05 per share. One holder has the right to convert notes payable at \$.16 per share. If these parties converted all of the principal and accrued interest into common stock, these three individuals, including their current holdings, would own approximately 20.6%, 20.0% and 4.3%, respectively, of our then outstanding common stock. However, the shares of common stock issuable upon the proposed conversions may not result in a change in control which would limit the use of our net operating loss carryforwards. We estimate at February 28, 2009, that substantially all convertible notes payable and accrued interest could be converted to shares of common stock, (representing 38.8% of the then outstanding common stock) without affecting a change of control that would limit the use of our net operating loss carryforwards. If these holders converted all of their notes payable and accrued interest into shares of common stock, then five individuals or their affiliates would own approximately 54.1% in the aggregate of our then outstanding common stock (excluding stock options and warrants).

The concentration of large percentages of ownership by a single stockholder may delay or prevent a change in control. Additionally, the sale of a significant number of our shares in the open market by a single stockholder or otherwise could adversely affect our stock price.

The price of our common stock may be adversely affected by the possible issuance of shares as a result of the conversion of notes payable and exercise of outstanding warrants and options.

The sale of substantial amounts of our common stock could also adversely impact its price. As of February 28, 2009, we had outstanding approximately 25.5 million shares of our common stock and convertible notes payable and exercisable common stock options and warrants to purchase approximately 22.8 million shares of our common stock. The sale or the availability for sale of a large number of shares of our common stock in the public market could cause the price of our common stock to decline.

Our stock price is volatile and could be further affected by events not within our control.

The trading price of our common stock has been volatile and will continue to be subject to:

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- volatility in the trading markets generally;
- significant fluctuations in our quarterly operating results;
- announcements regarding our business or the business of our competitors;
- changes in prices of our or our competitors' products and services;
- changes in product mix; and
- changes in sales and sales growth rates for us as a whole or for geographic areas, and other events or factors.

Statements or changes in opinions, ratings or earnings estimates made by brokerage firms or industry analysts relating to the markets in which we operate or expect to operate could also have an adverse effect on the market price of our common stock. In addition, the stock market as a whole has from time to time experienced extreme price and volume fluctuations which have particularly affected the market price for the securities of many small cap companies and which often have been unrelated to the operating performance of these companies. Finally, the market on which our stock trades may have a significant impact on the price and liquidity of our shares.

During 2008, the market price for our common stock varied between a high of \$0.85 in January 2008 and a low of \$0.18 in November 2008. This volatility may affect the price at which a stockholder could sell its shares of common stock, and the sale of substantial amounts of our common stock could adversely affect the price of our common stock. Our stock price is likely to continue to be volatile and subject to significant price and volume fluctuations in response to market and other factors, including variations in our quarterly operating results; and announcement by us or our competitors of significant acquisitions, strategic partnerships, joint ventures, or capital commitments.

Our common stock is currently traded on the OTC Bulletin Board. Because there is a limited public market for our common stock, a stockholder may not be able to sell shares when it wants. We cannot assure you that an active trading market for our common stock will ever develop.

There is limited trading in our common stock and we cannot assure you that an active public market for our common stock will ever develop. The lack of an active public trading market means that a stockholder may not be able to sell their shares of common stock when it wants, thereby increasing its market risk. Until our common stock is listed on an exchange, we expect that the shares will continue to be listed on the OTC Bulletin Board. However, an investor may find it difficult to obtain accurate quotations regarding the common stock's market value. In addition, if we failed to meet the criteria set forth in SEC regulations, various requirements would be imposed by law on broker-dealers who sell our securities to persons other than established customers and accredited investors. Consequently, such regulations may deter broker-dealers from recommending or selling our common stock, which may further affect the shares liquidity. Moreover our ability to obtain future financing may be adversely affected by the consequences of our common stock trading on the Over the Counter Bulletin Board.

Our sales, operating results and profitability will vary from quarter to quarter and other factors may result in increased volatility of our share price.

Our quarterly sales, operating results and profitability have varied in the past and are likely to vary significantly from quarter to quarter, making them difficult to predict. This may lead to volatility in our share price. The changes in the market price of our common stock may also be for reasons unrelated to our operating performance. Some other factors that may cause the market price of our common stock to fluctuate substantially include:

- the failure to be awarded a significant contract on which we have bid;
 - the termination by a client of a material contract;
 - announcement of new services by us or our competitors;
- announcement of acquisitions or other significant transactions by us or our competitors;

- sales of common stock by IGI or existing stockholders, or the perception that such sales may occur;
 - adverse judgments or settlements obligating us to pay liabilities;
 - unforeseen legal expenses, including litigation costs;
- changes in the value of the defined pension plan assets, required cash contributions and related pension expense as well as the impact of regulatory oversight of pension plans in general;
 - changes in management;
 - general economic conditions and overall stock market volatility;
- changes in or the application of accounting principles generally accepted in the U.S.;
- reduced demand for services caused, for example, by competitors;