

Edgar Filing: SYSVIEW TECHNOLOGY, INC. - Form 10QSB/A

SYSVIEW TECHNOLOGY, INC.  
Form 10QSB/A  
August 16, 2006

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

FORM 10-QSB/A  
AMENDMENT NO. 2

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

For the quarter ended June 30, 2005

or

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

Commission file number: 000-27773

SYSVIEW TECHNOLOGY, INC.  
(Exact Name of Small Business Issuer as Specified in Its Charter)

DELAWARE 59-3134518  
-----  
(State of incorporation) (I.R.S. Employer Identification No.)

1772 TECHNOLOGY DRIVE  
SAN JOSE, CALIFORNIA 95110  
(Address of principal executive offices, including zip code)

(408) 436-9888  
(Issuer's telephone number, including area code)

(Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes  No

The number of shares outstanding of the issuer's Common Stock, \$.001 Par Value, on August 4, 2005, was 23,110,515 shares

Transitional Small Business Disclosure Format (check one): Yes  No

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EXPLANATORY NOTE

This Quarterly Report on Form 10-QSB/A ("Form 10-QSB/A-2") is being filed as Amendment No. 2 to our Quarterly Report on Form 10-QSB for the quarter ended June 30, 2005, which was originally filed with the Securities and Exchange Commission ("SEC") on August 15, 2005 (the "Original Filing") and amendment No.

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1 to the Original Filing was filed with the SEC on August 22, 2005 ("Amendment No. 1"). We are filing this Amendment No. 2 to correct how we accounted for our (i) five percent (5%) Convertible Preferred Stock and related warrants and (ii) stock-based compensation costs. We are amending and restating the following specific items in this Amendment No. 2:

### PART I. FINANCIAL INFORMATION

#### Item 1. Financial Statements:

Condensed Consolidated Balance Sheet as of June 30, 2005  
Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2005  
Condensed Consolidated Statements of Cash Flows for the Three and Six Months Ended June 30, 2005

#### Certain Notes to Condensed Consolidated Financial Statements:

Note 3 - Significant Accounting Policies  
-Earnings Per Share  
-Stock-Based Compensation Cost  
Note 5 - Preferred Stock

#### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations:

Critical Accounting Policies - Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity

Results of Operations - Three and Six Months ended June 30, 2005 compared to Three and Six Months Ended June 30, 2004, specifically the following:

-Operating expenses  
-Other income (expense)  
-Dividend on 5% Convertible Preferred Stock and Accretion of Preferred Stock Redemption Value  
-Net loss

### PART II. OTHER INFORMATION

#### Item 6. Exhibits

31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act - Darwin Hu  
31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act - William Hawkins  
32.1 Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act - Darwin Hu  
32.2 Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act - William Hawkins

We are therefore amending and restating "Item 1. Financial Statements" and "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" in their entirety in this Amendment No. 2 to correct how we account for our (i) five percent (5%) Convertible Preferred Stock and related warrants and (ii) stock-based compensation costs. We are also amending and restating in its entirety "Item 6. Exhibits" to reflect our inclusion of updated Exhibits 31 and 32 for this filing. Other than the above specific items, there have been no other changes to the Original Filing or Amendment No. 1 thereto.

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Items included in the Original Filing and Amendment No. 1 that are not included herein are not amended and remain in effect as of the date of their filings. Except as noted above, this Form 10-QSB/A-2 does not update information that was presented in our Original Filing or Amendment No. 1 to reflect recent developments that have occurred since the date of their filings. Information concerning recent developments since the filing of our Quarterly Report for June 30, 2005 can be found in other filings we have made with the SEC since August 15, 2005.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SYSVIEW TECHNOLOGY, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEET (UNAUDITED)  
(IN THOUSANDS)

	JUNE 30, 2005 (RESTATED)
	-----
ASSETS	
Current assets	
Cash and cash equivalents	\$ 2,167
Trade receivables, net	732
Inventories	483
Prepayments, deposits and other current assets	219
Due from related parties	2,501
	-----
Total current assets	6,102
Fixed assets, net	158
Intangible assets	13
Long-term investment	998
	-----
TOTAL ASSETS	\$ 7,271 =====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities	
Bank line of credit	\$ 933
Trade payables and accruals	46
Accrued dividends on 5% convertible preferred stock	28
	-----
Total current liabilities	1,007
Other liabilities	

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Liability under derivative contracts	204
	-----
Total liabilities	1,211
Commitments and contingencies	
5% Convertible preferred stock \$.001 par value, 2,000 authorized, 19 shares issued and outstanding, liquidation value of \$18,650	182
Stockholders' equity	
Common stock: \$.001 par value; 50,000 shares authorized and 23,111 shares issued and outstanding	23
Additional paid in capital	26,872
Accumulated deficit	(21,017)
	-----
Total stockholders' equity	5,878
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 7,271
	=====

SEE CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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SYSVIEW TECHNOLOGY, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)  
(IN THOUSANDS)

	THREE MONTHS ENDED JUNE 30,		SIX MON JUN
	2005	2004	2005
	----- (RESTATED)	-----	----- (RESTATED)
Net sales	\$ 1,487	\$ 975	\$ 3,195
Cost of sales	883	617	1,987
	-----	-----	-----
Gross profit	604	358	1,208
Operating expenses:			
Selling and marketing	258	172	410
General and administrative	1,335	194	1,631
Research and development	222	117	398
	-----	-----	-----
Total operating expenses	1,815	483	2,439
	-----	-----	-----
Operating loss	(1,211)	(125)	(1,231)
	-----	-----	-----

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Other income (expense):			
Fair value of warrants issued	--	--	(290)
Preferred stock issuance costs	--	--	(237)
Change in fair value of derivative instruments	575	--	1,661
Other	12	1	10
	-----	-----	-----
Total other income (expense)	587	1	1,144
	-----	-----	-----
Net loss before income taxes	(624)	(124)	(87)
Provision for income taxes	--	--	1
	-----	-----	-----
Net loss	(624)	(124)	(88)
Dividend on 5% convertible preferred stock and accretion of preferred stock redemption value	(183)	--	(210)
	-----	-----	-----
Net loss available to common stockholders	\$ (807)	\$ (124)	\$ (298)
	=====	=====	=====
Net loss per common share - basic and diluted:	\$ (0.03)	\$ --	\$ (0.01)
	=====	=====	=====
Weighted average common shares outstanding - basic and Diluted	23,111	23,066	23,111
	=====	=====	=====

SEE CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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SYSVIEW TECHNOLOGY, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(IN THOUSANDS)

	SIX MONTHS ENDED JUNE 30,	
	2005	2004
	-----	-----
	(RESTATED)	
OPERATING ACTIVITIES		
Net loss available to common stockholders	\$ (298)	\$ (110)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation expense	10	4
Stock-based compensation cost - options	1,104	--
Preferred stock issuance expenses paid by issuance of warrants	290	--
Change in fair value of derivative instruments	(1,661)	--
Dividend on 5% convertible preferred stock and accretion of preferred stock redemption value	210	--

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Changes in operating assets and liabilities:		
Trade receivables	396	1,150
Inventories	14	9
Prepaid expenses and other current assets	(29)	(470)
Accrued dividends on 5% convertible preferred stock	28	--
Trade payables and other current liabilities	(73)	(254)
	-----	-----
Cash provided (used) by operating activities	(9)	329
	-----	-----
INVESTING ACTIVITIES:		
Cash acquired in reverse acquisition	--	28
Capital expenditures	(145)	(11)
	-----	-----
Cash provided (used) by investing activities	(145)	17
	-----	-----
FINANCING ACTIVITIES:		
Proceeds from issuance of preferred stock	1,865	--
Advances/repayments - related parties	(231)	(907)
	-----	-----
Cash provided (used) by financing activities	1,634	(907)
	-----	-----
Net increase (decrease) in cash and cash equivalents	1,480	(561)
Cash and cash equivalents at beginning of period	687	1,020
	-----	-----
Cash and cash equivalents at end of period	\$ 2,167	\$ 459
	=====	=====

SEE CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

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SYSVIEW TECHNOLOGY, INC. AND SUBSIDIARIES  
 CONDENSED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2005  
 (UNAUDITED)

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1 - STATEMENT OF INFORMATION FURNISHED

The accompanying unaudited condensed consolidated financial statements of Sysview Technology, Inc. ("Sysview", "the Company", "we" or "our") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-QSB and Article 10 of Regulation S-X. Accordingly, they do not include all

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information and disclosures necessary for a presentation of our financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates. The results of operations for the period ended June 30, 2005 are not necessarily indicative of the operating results that may be expected for the entire year ending December 31, 2005. These financial statements should be read in conjunction with the Management's Discussion and Analysis included in the Company's financial statements and accompanying notes thereto as of and for the year ended December 31, 2004, filed with the Company's Annual Report on Form 10-KSB. Certain amounts from prior periods have been reclassified to conform to the current period's presentation.

The Company does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources that is expected to be material.

### 2 - RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R addresses all forms of share-based payment ("SBP") awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS No. 123R will require the Company to expense SBP awards with compensation cost for SBP transactions measured at fair value. On March 29, 2005, the SEC issued Staff Accounting Bulletin (SAB) 107 which expresses the views of the SEC regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the SEC's views regarding the valuation of share-based payment arrangements for public companies. In April 2005, the SEC issued a release which amends the compliance dates for SFAS No. 123R. We expect the adoption of SFAS No. 123R and SAB 107 to have a material impact on the Company's financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections". SFAS No. 154 replaces APB Opinion No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. We do not expect the adoption of SFAS No. 154 to have any impact on the Company's financial statements.

### 3 - SIGNIFICANT ACCOUNTING POLICIES

#### CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to a concentration of credit risk are as follows:

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CASH HELD AT BANKS. We maintain cash balances at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000.

DUE TO GEOGRAPHIC SALES AND SIGNIFICANT CUSTOMERS. We operate in a single industry segment - scanner and fax modules. We market our products in the United States, Europe and the Asia Pacific region through our sales personnel and independent sales representatives.

Our geographic sales as a percent of total revenue were as follows for the quarter ended June 30:

	2005 -----	2004 -----
United States	73.0%	96.5%
Asia Pacific	18.4%	0.1%
Europe and others	8.6%	3.4%

Our geographic sales as a percent of total revenue were as follows for the six month period ended June 30:

	2005 -----	2004 -----
United States	86.4%	97.1%
Asia Pacific	8.8%	0.1%
Europe and others	4.8%	2.8%

Sales to major customers as a percentage of total revenues were as follows for the quarters ended June 30:

	2005 -----	2004 -----
Customer A	42%	54%
Customer B	15%	14%
Customer C	7%	10%
Customer D	7%	6%

Sales to major customers as a percentage of total revenues for the six month period ended June 30:

	2005 -----	2004 -----
Customer A	34%	33%
Customer B	15%	20%
Customer C	15%	13%
Customer D	12%	8%



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DUE TO ACCOUNTS RECEIVABLE. Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of trade receivables. Our customers are concentrated in the industrial/consumer electronics channels and with major original equipment manufacturers. As of June 30, 2005, the concentration was approximately 75% (3 customers). The loss of any of these customers could have a material adverse effect on our results of operations, financial position and cash flows.

DUE TO SIGNIFICANT VENDORS. For each of the periods ended June 30, 2005 and 2004, our purchases have primarily been concentrated with the wholly-owned subsidiary of our majority stockholder. If this vendor was unable to provide materials in a timely manner and we were unable to find alternative vendors, our business, operating results and financial condition would be materially adversely affected.

DUE TO PRODUCT SALES. We had 5 different product categories in the second quarter of 2005 (2004: 5 products) and 3 different products during the six months ended June 30, 2005 (2004: 5 products) that each accounted for more than 10% of sales. We have made positive efforts to mitigate the impact of loss of any single category, however if any of these products were to become obsolete or unmarketable and we were unable to successfully develop and market alternative products, our business, operating results and financial condition could be adversely affected.

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### RELATED PARTY TRANSACTIONS

A related party is generally defined as (i) any person that holds 10% or more of the Company's securities and their immediate families, (ii) the Company's management, (iii) someone that directly or indirectly controls, is controlled by or is under common control with the Company, or (iv) anyone who can significantly influence the financial and operating decisions of the Company. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

The Company purchases significantly all its finished scanner imaging products from the parent company of its majority stockholder, Syscan Technology Holdings Limited ("STH"). Our Chairman and CEO, Darwin Hu, was formerly the CEO of STH, and beneficially owns approximately 5.33% of the issued and outstanding capital stock of STH.

During the three and six months ended June 30, 2005 and 2004, related party purchases from entities that are wholly-owned subsidiaries of STH were \$713,000, \$1,979,000, \$526,000 and \$1,610,000, respectively. The purchases were carried out in the normal course of business.

Amounts due from related parties are unsecured, interest-free and repayable on demand and consisted of the following:

Due from STH	\$	446,000
Due from Majority Stockholder		100,000

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Due from various subsidiaries wholly-owned by STH	1,955,000
	-----
	\$ 2,501,000
	=====

EARNINGS PER SHARE

Basic net earnings (loss) per share is computed by dividing net earnings (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted net earnings (loss) per share is computed by dividing net loss by the weighted average number of shares of common stock and common stock equivalents outstanding during the period. Common stock equivalents were not considered in calculating diluted net loss per common share for the three and six months ended June 30, 2005 and 2004 as their effect would be anti-dilutive. As a result, for all periods presented, the Company's basic and diluted net earnings (loss) per share is the same.

STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Compensation cost for stock options, if any, is measured as the excess of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. SFAS No.123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. The Company has elected to remain on its current method of accounting as described above, and has adopted the disclosure requirements of SFAS No. 123. In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, amending FASB No. 123, and "Accounting for Stock-Based Compensation". This statement amends Statement No. 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation.

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In accordance with SFAS 148, the following table illustrates the effect on the Company's net loss and loss per share as if the Company had applied the fair value recognition provisions of SFAS 123 to its stock-based employee compensation awards, and recognized expense over the applicable award vesting period (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS):

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2005	2004	2005	2004
	(RESTATED)		(RESTATED)	
Net loss available to common stockholders	\$ (807)	\$ (124)	\$ (298)	\$ (110)
Add: Stock-based compensation cost included in reported net loss	1,104	--	1,104	--

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Less: Stock-based employee compensation cost determined under fair value based method for all awards, net of related tax effects	(1,118)	(3)	(1,118)	(3)
	-----	-----	-----	-----
Pro forma net loss	\$ (821)	\$ (127)	\$ (312)	\$ (113)
	=====	=====	=====	=====
Basic and diluted net loss per share, as reported	\$ (0.03)	\$ --	\$ (0.01)	\$ --
	=====	=====	=====	=====
Pro-forma basic and diluted net loss per share	\$ (0.03)	\$ --	\$ (0.01)	\$ --
	=====	=====	=====	=====

The weighted average fair value on the date of grant was \$0.7695 for those options granted in 2005. The fair value of each option grant is estimated on the date of grant using the Black-Scholes Option pricing model with the following weighted-average assumptions: dividend yield of 0%, expected volatility of 144%, risk-free interest rate of 5%, and expected life of two years.

4 - STOCK OPTIONS

STOCK OPTIONS OUTSTANDING

The Company has a stock option plan, the objectives of which include attracting and retaining the best personnel, providing for additional performance incentives, and promoting the success of the Company by providing directors, consultants, and key employees the opportunity to acquire common stock. The plan is administrated by the Board of Directors, which determine among other things, those individuals who shall receive options, the time period during which the options may be partially or fully exercised, the number of common stock to be issued upon the exercise of the options and the option exercise price.

The maximum term of the plan is ten years and options may be granted to officers, directors, consultants, employees, and similar parties who provide their skills and expertise to the Company.

Options granted under the plans have a maximum term of ten years and shall be at an exercise price that may not be less than 85% of the fair market value of the common stock on the date of the grant. Options are non-transferable and if a participant ceases affiliation with the company for a reason other than death or permanent and total disability, the participant will have 90 days to exercise the option subject to certain extensions. In the event of death or permanent and total disability, the option holder or their representative may exercise the option within one (1) year. Any unexercised options that expire or that terminate upon an employee's ceasing to be employed by the Company become available again for issuance under the plan, subject to applicable securities regulation. The plan may be terminated or amended at any time by the Board of Directors. No options were forfeited, canceled or exercised during the six months ended June 30, 2005. Information about options outstanding and exercisable at June 30, 2005 is summarized below:

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RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)
\$0.01	3,700,000	1.75	\$0.01	1,293,333	1.75
\$0.90-\$2.50	60,000	1.50	\$1.17	60,000	1.50

BOARD OF DIRECTOR APPROVED STOCK OPTIONS SUBJECT TO SHAREHOLDER APPROVAL

On April 2, 2004, the Company's Board of Directors authorized the increase in the number of stock options available under the 2002 Stock Option Plan (the "Plan") from 200,000 to 2,200,000. On July 21, 2004, the Company's Board of Directors further authorized the increase in the number of stock options available under the 2002 Stock Option Plan from 2,200,000 to 3,200,000. The subject increases are subject to stockholder ratification at the next annual or special meeting of stockholders, which has not been obtained as of the date this filing.

On April 13, 2004, the Company's Board of Directors authorized an aggregate of 1,700,000 options under the Plan to certain individuals at \$1.50 per share, and expiring through April 2014. These options were canceled by the Board of Directors on May 7, 2004. On July 21, 2004, the Company's Board of Directors further authorized an aggregate of 2,200,000 options under the 2002 Stock Option Plan to be issued to certain individuals at \$2.00 per share and expiring through July 2014, of which 165,000 have been canceled as a result of an employment termination subsequent to year end and 55,000 options exercisable through May 4, 2005. The grant of the above options are subject to stockholder ratification of the Company's increase in the number of stock options available for grant under the Plan. The Company plans to obtain stockholder approval at its annual or special meeting of stockholders, which has not yet been scheduled as of the date of this filing.

On April 26, 2005, the Company entered into employment agreements with its executive officers, the terms of which were previously approved by the independent members of the Company's board of directors. The employment agreements extend through 2008 and provide for a base salary, annual bonus to be determined by the Board of Directors, termination payments, stock options, non-competition provisions, and other terms and conditions of employment. In addition, the Company maintains employment agreements with other key employees with similar terms and conditions.

Total options granted under the agreements with the Company's executive officers were 3,300,000, exercisable at \$0.01 per share. One-third of the options vest on the date of execution of the employment agreement, one-third vest on April 3, 2006 and one-third vest on April 2, 2007.

Additionally, the Company issued an aggregate of 400,000 options exercisable at \$0.01 per share to two of its key employees in connection with the execution of employment agreements with such individuals. One-third of such options vest on April 26, 2005, one-third vest on April 3, 2006 and one-third vest on April 2, 2007.

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The Company has authorized 2,000,000 shares of preferred stock, of which an aggregate of 60,000 have been designated Series A Preferred Stock and of which 18,650 shares are outstanding.

On March 15, 2005, the Company sold \$1,865,000 of its Series A Convertible Preferred Stock to institutional and accredited retail investors in a private offering pursuant to exemption from registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"). Starboard Capital Markets, LLC, a NASD member firm, acted as placement agent in the sale of the Preferred Stock, for which it received \$186,500 in commissions and 186,500 warrants to purchase shares of the Company's common stock at an exercise price equal to \$1.00 per share.

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In connection with the financing, the Company also issued to the purchasers common stock purchase warrants to purchase up to an aggregate of 932,500 shares of the Company's common stock at an exercise price of \$2.00 per share. The warrants are exercisable for a period of five years from the date of issuance. Pursuant to a registration rights agreement, the Company has registered the shares of common stock issuable upon conversion of the Preferred Stock and upon exercise of the warrants with the Securities and Exchange Commission on Form SB-2.

The warrants must be exercised by the payment of cash, except if there is no effective registration statement covering the resale of the shares of Common stock underlying the warrants, a holder may exercise their warrants on a cashless basis. Holders of the warrants are entitled to full ratchet anti-dilution protection for issuances of common stock or common stock equivalents, prior to the effective date of the registration statement covering the resale of the shares of common stock underlying the Preferred Stock, at less than the exercise price of such warrants. Holders of warrants also have standard anti-dilution protection for splits, dividends, subdivisions, distributions, reclassifications and combinations of our common stock. None of the individual holders of the Warrants are entitled to exercise any such Warrant held by them, if such exercise would cause such holder to be deemed to beneficially own in excess of 4.999% of the outstanding shares of our Common stock on the date of issuance of such shares.

**PREFERRED STOCK CONVERSION RIGHTS.** All or any portion of the stated value of Preferred Stock outstanding may be converted into common stock at anytime by the purchasers. The initial fixed conversion price of the preferred stock is \$1.00 per share ("Conversion Price"). The Conversion Price is subject to anti-dilution protection adjustments, on a full ratchet basis, at anytime that the preferred stock is outstanding and prior to the effective date of the registration statement required to be filed pursuant to the Registration Rights Agreement, upon our issuance of additional shares of common stock, or securities convertible into common stock, at a price that is less than the then Conversion Price.

**DIVIDENDS.** The Preferred Stock accrues dividends at a rate of 5% per annum, payable semiannually on July 1 and January 1 in cash, by accretion of the stated value or in shares of common stock. Subject to certain terms and conditions, the decision whether to accrete dividends to the stated value of the Preferred Stock or to pay for dividends in cash or in shares of common stock, shall be at our discretion. During the three and six months ended June 30, 2005, preferred stock dividends were approximately \$28,000 and recorded as a non-operating expense on the Company's statement of operations.

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REDEMPTION. On March 15, 2008 (the "Redemption Date"), all of the outstanding Preferred Stock shall be redeemed for a per share redemption price equal to the stated value on the Redemption Date (the "Redemption Price"). The Redemption Price is payable by us in cash or in shares of common stock at our discretion and shall be paid within five trading days after the Redemption Date. In the event we elect to pay all or some of the Redemption Price in shares of common stock, the shares of common stock to be delivered to the purchasers shall be valued at 85% of the fifteen-day volume weighted average price of the common stock on the Redemption Date.

RIGHT TO COMPEL CONVERSION. If, on any date after March 15, 2006, (A) the closing market price per share of our common stock for ten (10) consecutive trading days equals at least \$4.00 (subject to adjustment for certain events), and (B) the average reported daily trading volume during such ten-day period equals or exceeds 100,000 shares, then we shall have the right, at our option, to convert, all, but not less than all, of the outstanding shares of Preferred Stock at the Conversion Price; provided that there shall be an effective registration statement covering the resale of the shares of common stock underlying the preferred stock at all times during such 10-day period and during the 30-day notice period to the holders thereof.

RESTRICTIONS ON CONVERSION OF PREFERRED STOCK. No holder of our Preferred Stock is entitled to receive shares upon payment of dividends on the Preferred Stock, or upon conversion of the Preferred Stock held by such holder if such receipt would cause such holder to be deemed to beneficially own in excess of 4.999% of the outstanding shares of our common stock on the date of issuance of such shares (such provision may be waived by such holder upon 61 days prior written notice to us). In addition, no individual holder is entitled to receive shares upon payment of dividends on the Preferred Stock, or upon conversion of the Preferred Stock held by such holder if such receipt would cause such holder to be deemed to beneficially own in excess of 9.999% of the outstanding shares of our common stock on the date of issuance of such shares (such provision may be waived by such holder upon 61 days prior written notice to us).

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REGISTRATION RIGHTS. Pursuant to the terms of a Registration Rights Agreement between us and the holders of the preferred stock, we are obligated to file a registration statement on Form SB-2 registering the resale of shares of our common stock issuable upon conversion of the preferred stock and exercise of the warrants. We are required to file the registration statement on or before April 24, 2005 and have the registration statement declared effective on or before July 13, 2005. If the registration statement is not declared effective within the timeframe described, or if the registration is suspended other than as permitted in the Registration Rights Agreement, we will be obligated to pay each holder a fee equal to 1.0% of such holders purchase price of the Preferred Stock during the first 90 days, and 2.0% for each 30 day period thereafter (pro rated for partial periods), that such registration conditions are not satisfied.

RIGHT OF FIRST REFUSAL. Subject to certain conditions, we have granted the holders a right of first refusal, for a period until one (1) year from the effective date of the registration statement required to be filed in connection with the purchase of the Preferred Stock, to participate in any subsequent financing that we conduct.

VOTING RIGHTS. Holders of the Preferred Stock shall have no voting rights. However, so long as any shares of Preferred Stock are outstanding, we shall not, without the affirmative vote of the holders of a majority of the shares of the Preferred Stock then outstanding, (a) alter or change adversely the powers,

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preferences or rights given to the Preferred Stock or alter or amend the Series A Certificate of Designation, (b) authorize or create any class of stock ranking as to dividends or distribution of assets upon a liquidation senior to or otherwise pari passu with the Preferred Stock, (c) amend our certificate or articles of incorporation or other charter documents so as to affect adversely any rights of the holders of the Preferred Stock, (d) increase the authorized number of shares of Preferred Stock, or (e) enter into any agreement with respect to the foregoing.

**LIQUIDATION PREFERENCE.** Upon our liquidation, dissolution or winding up, whether voluntary or involuntary (a "Liquidation"), the holders of the Preferred Stock shall be entitled to receive out of our assets, whether such assets are capital or surplus, for each share of Preferred Stock an amount equal to the stated value per share before any distribution or payment shall be made to the holders of any of our securities with rights junior to the Preferred Stock, and if our assets shall be insufficient to pay in full such amounts, then the entire assets to be distributed to the holders of the Preferred Stock shall be distributed among such holders ratably in accordance with the respective amounts that would be payable on such shares if all amounts payable thereon were paid in full.

**ANTI-DILUTION.** Holders of the Preferred Stock are entitled to full ratchet anti-dilution protection for issuances of common stock or common stock equivalents, prior to the effective date of the registration statement covering the resale of the shares of common stock underlying the Preferred Stock, at less than the Conversion Price. Holders of Preferred Stock also have standard anti-dilution protection for splits, dividends, subdivisions, distributions, reclassifications and combinations of our common stock.

**PREFERRED STOCK ACCOUNTING TREATMENT.** Pursuant to SFAS 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES" ("SFAS 133") and EITF Abstract No. 00-19, "ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS" ("EITF 00-19"), the Company's 5% Convertible Preferred Stock and related warrants, are deemed derivative instruments as a result of the embedded conversion feature. Accordingly, the fair value of these derivative instruments has been recorded in the Company's consolidated balance sheet as a liability with the corresponding amount as a discount to the 5% Convertible Preferred Stock. The discount is being accreted from the issuance date, March 15, 2005, through the redemption date, March 15, 2008, adjusted for conversions. Accretion of the preferred stock redemption value for the three and six months ended June 30, 2005 was approximately \$155,000 and \$182,000, respectively and is disclosed as a non-operating expense on the Company's consolidated statement of operations. The decrease in the fair value of the liability for derivative contracts totaled approximately \$575,000 and \$1,661,000 for the three and six months ended June 30, 2005, respectively and is included with other income (expense) in the consolidated statements of operations.

The Company computes fair value of these derivatives using the Black-Scholes valuation model. The Black-Scholes model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The Company's derivative instruments have characteristics significantly different from traded options, and the input assumptions used in the model can materially affect the fair value estimate. The assumptions used in this model to estimate fair value of each derivative instrument and the resulting value of the derivative liability as of June 30, 2005 are as follows:

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	WARRANTS	WARRANTS	EMBEDDED CONVERSION FEATURE ASSOCIATED WITH THE 5% CONVERTIBLE PREFERRED STOCK
	-----	-----	-----
Exercise/conversion Price	\$1.00	\$2.00	\$1.00
Fair value of the Company's common stock	\$0.52	\$0.52	\$0.52
Expected life in years	3.0	3.0	3.0
Expected volatility	61%	61%	61%
Expected dividend yield	0%	0%	0%
Risk free interest rate	4%	4%	4%
Calculated fair value per share	\$0.27	\$0.14	\$0.27

6 - COMMITMENTS AND CONTINGENCIES

OPERATING LEASES - The Company is committed under various non-cancelable operating leases which expire through November 2006. Future minimum rental commitments are as follows: 2005-\$53,000 and 2006-\$101,000. Rent expense charged to operations was approximately \$61,000 for the six months ended June 30, 2005 (2004: \$59,000).

LINE OF CREDIT - The Company has a line of credit to borrow up to \$1,000,000, bearing interest at the rate of prime plus 1% and secured by all of the assets of the Company. Interest payments are due monthly and all unpaid interest and principal is due in full on August 24, 2005. Upon certain events of default as more fully described in the agreement, the default variable interest rate increases to prime plus 3%. The Company had \$66,964 available for use at June 30, 2005.

LETTERS OF CREDIT - The Company issues letters of credit in the normal course of business. Sysview had no outstanding letters of credit as of June 30, 2005.

EMPLOYMENT AGREEMENTS - The Company maintains employment agreements with its executive officers which extend through 2008. The agreements provide for a base salary, annual bonus to be determined by the Board of Directors, termination payments, stock options, non-competition provisions, and other terms and conditions of employment. In addition, the Company maintains employment agreements with other key employees with similar terms and conditions.

LITIGATION, CLAIMS AND ASSESSMENTS - On May 20, 2003, Syscan, Inc., the Company's wholly-owned subsidiary, filed a lawsuit named SYSCAN, INC. V. PORTABLE PERIPHERAL CO., LTD. ("PPL"), IMAGING RECOGNITION INTEGRATED SYSTEMS, INC., CARDREADER INC. AND TARGUS INC. (Case No. C03-02367 VRW) in United States District Court, Northern District of California. Syscan, Inc. alleges claims against the above-mentioned parties for patent infringement of patent nos. 6,054,707, 6,275,309 and 6,459,506, and unfair competition. Syscan, Inc. expects to continue the case unless a reasonable settlement amount from the defendants or a licensing agreement to the satisfaction of Syscan, Inc. is entered.

Syscan, Inc. is seeking: (1) a temporary restraining order, preliminary injunction and permanent injunction against defendants, restraining defendants from patent infringement and unfair competition; (2) treble damages due to defendants' willful infringement; (3) punitive damages; (4) accounting of unjust



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enrichment by defendants, resulting from defendants' unfair competition; and (5) attorney's fees and costs.

The defendants are jointly represented by PPL's counsel. PPL has initiated counterclaims against Syscan, Inc. for patent invalidity. Syscan, Inc. has not yet been able to quantify its damage claim against PPL. Syscan, Inc. intends to vigorously pursue this claim and denies PPL's counterclaim of patent invalidity.

The Company experiences routine litigation in the normal course of its business and does not believe that any pending litigation will have a material adverse effect on the Company's financial condition, results of operations or cash flows.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis of financial condition and results of operations (MD&A) is provided as a supplement to the accompanying consolidated financial statements and footnotes to help provide an understanding of our financial condition, changes in financial condition and results of operations. The MD&A is organized as follows:

- o OVERVIEW. This section provides a general description of our business, as well as recent developments that we believe are important in understanding the results of operations and to anticipate future trends in those operations.
- o CRITICAL ACCOUNTING POLICIES. This section provides an analysis of the significant estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.
- o RECENT ACCOUNTING PRONOUNCEMENTS. This section provides an overview of recent accounting pronouncements and their expected impact on our financial condition and results of operations.
- o RESULTS OF OPERATIONS. This section provides an analysis of our results of operations for the periods ended June 30, 2005 compared to the same periods in 2004. A brief description is provided of transactions and events, including related party transactions that impact the comparability of the results being analyzed.
- o LIQUIDITY AND CAPITAL RESOURCES. This section provides an analysis of our financial condition and cash flows as of and for the quarter ended June 30, 2005.

The following management's discussion and analysis should be read in conjunction with our consolidated unaudited financial statements for the three and six months periods ended June 30, 2005 and 2004 and related condensed notes to those financial statements.

#### OVERVIEW

Management's Discussion and Analysis (MD&A) contains statements that are

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forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in our Form 10-KSB as filed with the Securities and Exchange Commission on March 31, 2005, as well as other factors which we cannot predict and that are not within our control. We undertake no duty to update any forward-looking statement to conform the statement to actual results or changes in our expectations.

We are in the business of developing, designing and delivering imaging technology solutions. Our approach to research and development (R&D) is focused on creating new deliverable and marketable technologies. We sell our products to clients' throughout the world, including the United States, Canada, Europe, South America, Australia and Asia. We intend to expand our business and product offerings into the much larger image display market where we intend to leverage our experience and expertise. We also believe that we may benefit from a level of transfer of technologies from image capture to image display.

We design and manufacture imaging technology solutions for a worldwide customer base. Our core business is currently focused on the manufacturing and worldwide delivery of 20 plus mobile image-scanning products, which has allowed us to become the largest OEM - private label manufacturer of USB driven mobile scanning systems for a large number of major brands. Our strong intellectual property portfolio in the imaging area consists of 19 patents with an additional 3 patents pending. We have 3 patent applications currently pending with the US Patent & Trademark Office, 2 of which relate to image display technology and one of which relates to image scanning.

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In 2003, we began developing new technologies targeted towards the flat panel LCD display market. A natural extension of their patented image scanning technologies multiple products are in development with the first expected to reach the marketplace in the second half of 2006. The products are designed to significantly enhance picture quality, decrease power consumption, extend product life and greatly reduce the manufacturing costs associated with flat-panel televisions.

Our strategy continues to be to expand our image capture product line and technology while leveraging our assets in other areas of the imaging industry. We are actively shipping five categories of image capture products under the Travel Scan marquee or their OEM counterparts. These categories include A4 format document scanners which represented approximately 23% of our sales during the three month period ended June 30, 2005 and 28% of our sales during the six month period ended June 30, 2005. The A6 format scanners that are ideal for ID cards & checks, is our best selling product and represented approximately 40% and 46%, respectively, of our sales during each of the three and six month periods ended June 30, 2005. The A8 format that is primarily sold for use as a business card reader represented approximately 17% and 12%, respectively, of our sales during each of the three and six month periods ended June 30, 2005. The A5 format scanner also used for ID cards and security documents represented approximately 11% and 7%, respectively, of our sales during each of the three and six month periods ended June 30, 2005. We also manufacture and sell the Contact Image Sensor (CIS) Modules that we use in our products and separately as a component to other manufacturers which represented 11% of our three month sales and 5% of our six month sales for the period ended June 30, 2005.

For the remainder of this year, we will expand our image capture product line with three new products. The first product is a true-duplex high-speed A4 scanner in which we have strong market interest. The second product is an A6

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scanner that follows in the footsteps of the current 662 but is high speed and will have the expanded ability of duplex scanning. The third product is a specialized security document scanner that utilizes infrared light sources to help in the process of identifying fraudulent or tampered with documents.

While we continue to grow our presence in image capture technology, we have begun creating, through research and development, new technology solutions for the substantially larger, image display market. More specifically we are creating products and technologies to accent and enhance the Liquid Crystal Display (LCD) and Plasma Display Panel (PDP) television market. Our first image display products are expected to be available for delivery during the second half of 2006 under the SysView brand name. These SysView display products will include highly integrated, high performance video processors that combine state-of-the-art scaling and video processing techniques for displaying analog and digital video/graphics on our LCD-PDP TV products. We believe that these products will provide advanced image processing, including High-Definition (HD) products, that will greatly enhance display quality. The next product/technology that we are developing is a Light Emitting Diode (LED) backlighting solution to replace the industries current standard Cold Cathode Fluorescent Lamp (CCFL). The principal behind this technology is related to the proprietary technology used in our image capture products. The benefits are substantial, including longer life, higher dimming ratio, sharper contrast, and near high definition resolution without filters, all at a performance value.

In addition to future products and technologies in various stages of research and development, one of our objectives is to acquire companies in the image capture and display industry that could compliment our business model, improve our competitive positioning and expand our offerings to the marketplace, of which there can be no assurance. In identifying potential acquisition candidates we will seek to acquire companies with varied distribution channels, rich intellectual property (IP) and high caliber engineering personnel.

### CRITICAL ACCOUNTING POLICIES

Our discussion and analysis is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, accounts receivable and allowance for doubtful accounts, inventories, intangible and long-lived assets, and income taxes. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used or changes in the accounting estimate that are reasonably likely to occur could materially change the financial statements.

We believe the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements:

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### REVENUE RECOGNITION

Revenues consist of sales of merchandise, including optical image capturing devices, modules of optical image capturing devices, and chips and other optoelectronic products. Revenue is recognized when the product is shipped and the risks and rewards of ownership have transferred to the customer. We recognize shipping and handling fees as revenue, and the related expenses as a component of cost of sales. All internal handling charges are charged to selling, general and administrative expenses.

### ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

We present accounts receivable, net of allowances for doubtful accounts, to ensure accounts receivable are not overstated due to uncollectibility. The allowances are calculated based on detailed review of certain individual customer accounts, historical rates and an estimation of the overall economic conditions affecting our customer base. We review a customer's credit history before extending credit. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. In the event that our trade receivables became uncollectible after exhausting all available means of collection, we would be forced to record additional adjustments to receivables to reflect the amounts at net realizable value. The effect of this entry would be a charge to income, thereby reducing our net profit. Although we consider the likelihood of this occurrence to be remote based on past history and the current status of our accounts, there is a possibility of this occurrence.

### INVENTORIES

Inventories consist of finished goods, which are stated at the lower of cost or net realizable value, with cost computed on a first in, first-out basis. Provision is made for obsolete, slow-moving or defective items where appropriate. The amount of any provision of inventories is recognized as an expense in the period the provision occurs. The amount of any reversal of any provision is recognized as other income in the period the reversal occurs. Our inventory purchases and commitments are made in order to build inventory to meet future shipment schedules based on forecasted demand for our products. We perform a detailed assessment of inventory for each period, which includes a review of, among other factors, demand requirements, product life cycle and development plans, component cost trends, product pricing and quality issues. Based on this analysis, we record adjustments to inventory for excess, obsolescence or impairment, when appropriate, to reflect inventory at net realizable value. Revisions to our inventory adjustments may be required if actual demand, component costs or product life cycles differ from our estimates. In the event we were unable to sell our products, the demand for our products diminished, other competitors offered similar or better technology, and/or the product life cycles deteriorated causing quality issues, we would be forced to record an adjustment to inventory for impairment or obsolescence to reflect inventory at net realizable value. The effect of this entry would be a charge to income, thereby reducing our net profit. Although we consider the likelihood of this occurrence to be remote based on our forecasted demand for our products, there is a possibility of this occurrence.

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### INTANGIBLE AND LONG-LIVED ASSETS

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We evaluate our intangible assets and long-lived assets, which represent goodwill, long-term investments, and fixed assets, for impairment annually and when circumstances indicate the carrying value of an asset may not be recoverable. If impairment exists, an adjustment is made to write the asset down to its fair value, and a loss is recorded as the difference between the carrying value and fair value would be charged to operations. We do not believe any impairment exists for any of these types of assets as of June 30, 2005.

### INCOME TAXES

We account for income taxes under the provisions of Statement of Financial Accounting Standards ("SFAS" No. 109), "Accounting for Income Taxes," whereby deferred income tax assets and liabilities are computed for differences between the financial statements and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized.

### CONTINGENCIES

Currently, there are no outstanding legal proceedings or claims, other than that disclosed in Note 6 of the Consolidated Financial Statements. The outcomes of potential legal proceedings and claims brought against us are subject to significant uncertainty. SFAS 5, ACCOUNTING FOR CONTINGENCIES, requires that an estimated loss from a loss contingency such as a legal proceeding or claim should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our financial position or results of operations.

### ACCOUNTING FOR CERTAIN FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF BOTH LIABILITIES AND EQUITY

We account for our 5% Convertible Preferred Stock pursuant to Statement of Financial Accounting Standards ("SFAS") "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES" ("SFAS 133") and the Emerging Issues Task Force ("EITF") Abstract No. 00-19, "ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS" ("EITF 00-19"). Accordingly, the embedded conversion feature associated with the 5% Convertible Preferred Stock and the warrants issued to the 5% Convertible Preferred Stock purchasers have been determined to be derivative instruments. The fair value of these derivative instruments, as determined by applying the Black-Scholes valuation model, is adjusted quarterly. The Black-Scholes valuation model requires the input of highly subjective assumptions, including the expected stock price volatility. Additionally, although the Black-Scholes model meets the requirements of SFAS 133, the fair values generated by the model may not be indicative of the actual fair values of our 5% Convertible Preferred Stock as our derivative instruments have characteristics significantly different from traded options. Accordingly, the results obtained could be significantly different if other assumptions were used. The effect of this entry would be a charge to net earnings, thereby either increasing or reducing our net earnings based upon the results obtained,

### RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123 (Revised 2004) "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R addresses all forms of share-based

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payment ("SBP") awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. SFAS No. 123R will require the Company to expense SBP awards with compensation cost for SBP transactions measured at fair value. On March 29, 2005, the SEC issued Staff Accounting Bulletin (SAB) 107 which expresses the views of the SEC regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provides the SEC's views regarding the valuation of share-based payment arrangements for public companies. In April 2005, the SEC issued a release which amends the compliance dates for SFAS No. 123R. We expect the adoption of SFAS No. 123R and SAB 107 to have a material impact on the Company's financial statements.

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In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections". SFAS No. 154 replaces APB Opinion No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. We do not expect the adoption of SFAS No. 154 to have any impact on the Company's financial statements.

RESULTS OF OPERATIONS - THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2005 COMPARED TO THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2004

### REVENUE

Product revenues increased to \$1.49 million for the quarter ended June 30, 2005 from \$0.975 million for the same period in fiscal 2004, an increase of approximately \$512,000 or 52.5%. For the six month period ended June 30, 2005 revenues were \$3.195 million, an increase of \$0.714 million, or 28.7%, from the first six month period of 2004. This increase in revenues for the period is primarily the result of improved product sales and marketing efforts to shift our business emphasis to less seasonal sensitive channels. Once again, scanner and sensor imaging products represented over 98% of our revenues for the quarter ended and year-to-date. During the quarter ended June 30, 2005, our top four customers accounted for approximately 71% of total revenues. During the same period ended June 30, 2004, our top four customers accounted for approximately 84% of total revenues. For the six months ended June 30, 2005, our top four customers accounted for approximately 76% of total revenues versus 74% for the same six month period in 2004. The loss of any of these larger clients could have a material adverse effect on our business.

### COST OF SALES AND GROSS PROFIT

Cost of goods sold (COGS) includes all direct costs related to the transfer of scanners, imaging modules and services related to the delivery of those items manufactured in China. COGS was approximately 59.3% and 62.1% for the three and six months ended June 30, 2005, respectively, compared to 63.3% and 66.7%, respectively, for the same period in 2004. Our COGS decreased as a percentage of revenues primarily as a result of slightly higher gross margins and better price elasticity, particularly with the A6 format products. We expect that our COGS will remain the same or slightly higher during 2005 as a result of higher fuel costs and currency exchange rates in Mainland China. Accordingly, gross profit increased for all periods presented compared to the same periods in the prior

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period as a direct result of increased higher sales revenue and better margins on specialty scanning products related to unique or proprietary design of our products. We anticipate that our gross profit margins may continue to increase as we gain better control over our source parts cost and logistics.

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### SELLING AND MARKETING

Selling and marketing expenses include payroll, employee benefits, stock-based compensation cost and other costs associated with sales, marketing and account management personnel. Other direct selling and marketing costs include market development funds and promotions (retail channels only), tradeshow, website support costs, warehousing, logistics and certain sales representative fees. Selling and marketing expenses increased to \$258,000 for the quarter ended June 30, 2005 from \$172,000 in the comparable period in 2004 and to \$410,000 for the six months ended June 30, 2005 from \$366,000 in the comparable period in 2004. This represents an increase of \$86,000 or approximately 50% for the quarter ended June 30, 2005 over the same period in 2004, and \$44,000 or 12% for the six months ended June 30, 2005 over the same period in 2004. The increase in both the three and six months ended June 30, 2005 as compared to the same period in 2004 is mainly attributable to \$60,000 stock-based compensation cost (a non-cash charge) as a result of granting stock options to certain executives and key employees at less than fair market value on the grant date. We had no stock-based compensation cost during the corresponding periods in 2004. To a lesser extent, the increase for the quarter ended June 30, 2005 over the same period in 2004 was a result of attending major trade shows located in Philadelphia (AIIM Show), Boston (SID show) and Taipei (Computex show). The timing on these industry keynote shows happened to occur during the quarter ended June 30, 2005 and significantly contributed to the increased expenditures. In 2004 we only attended the Computex show during the comparable period.

### GENERAL AND ADMINISTRATIVE

General and administrative (G&A) costs include payroll, employee benefits, and stock-based compensation cost and other headcount-related costs associated with the finance, legal, facilities and certain human resources, as well as legal and other professional and administrative fees. General and administrative expenses increased to \$1,335,000 for the quarter ended June 30, 2005 and \$1,631,000 for the six months ended June 30, 2005 from \$194,000 and \$342,000, respectively, for the comparable three and six month periods in fiscal 2004, an increase of \$1,141,000 and \$1,289,000, respectively, for the three and six month periods ended June 30, 2005 or approximately an 588% and 377% increase for three and six month periods ended June 30, 2005. The increase in both the three and six months ended June 30, 2005 as compared to the same period in 2004 is mainly attributable to \$985,000 stock-based compensation cost (a non-cash charge) as a result of granting stock options to certain executives and key employees at less than fair market value on the grant date. We had no stock-based compensation cost during the corresponding periods in 2004. To a lesser extent, the increase for each of the three and six month periods ended June 30, 2005 is primarily attributable to additional personnel costs and outside fees incurred in connection with our public listing compliance expense. We see our costs in this area continuing to increase over the remainder of this year, possibly in excess of \$1.2M for FY 2005.

### RESEARCH AND DEVELOPMENT

Research and Development (R&D) costs include payroll, employee benefits, stock-based compensation cost and other headcount-related costs associated with

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the product design, development, compliance testing, documentation and transition to production. R&D expenses increased to \$222,000 for the quarter ended June 30, 2005 from \$117,000 for the same period in fiscal 2004, an increase of \$105,000 or approximately 90%. For the six months ended June 30, 2005, R&D expenses increased by \$167,000, or 72%, to \$398,000 from \$231,000 for the same comparable in fiscal 2004. The increase in both the three and six months ended June 30, 2005 as compared to the same period in 2004 is mainly attributable to \$60,000 stock-based compensation cost (a non-cash charge) as a result of granting stock options to certain executives and key employees at less than fair market value on the grant date. We had no stock-based compensation cost during the corresponding periods in 2004. Additionally, during the quarter ended June 30, 2005, we placed a greater emphasis on the development of new products such as the planned line of duplex scanners and advanced display systems, which also increased our R&D expenses. These products were not being developed during 2004.

### OTHER INCOME (EXPENSE)

During the six months ended June 30, 2005 our other income (expense) was a result of issuing our 5% Convertible Preferred Stock as follows:

- o The \$1,661,000 decrease in the fair value of the liability for derivative contracts (associated with our 5% Convertible Series A Preferred Stock) from the date of issuance, March 15, 2005 through June 30, 2005. Pursuant to SFAS 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES" ("SFAS 133") and EITF Abstract No. 00-19, "ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS" ("EITF 00-19"), the decrease in the fair value of the liability for derivative contracts is included as other income in our consolidated statements of operations.
- o Cash paid for issuance costs of \$237,000 in connection with our offering; and
- o A non-cash charge of \$290,000 representing the fair value of 186,500 warrants issued to the placement agent for the sale of the preferred stock.

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During the three months ended June 30, 2005 our other income (expense) was a result of the \$575,000 decrease in value of our derivative instruments associated with our 5% Convertible Series A Preferred Stock.

Our other income (expense) for the three and six months ended June 30, 2004 was immaterial to the overall financial statements.

### ACCRETION OF PREFERRED STOCK REDEMPTION VALUE AND PREFERRED DEEMED DIVIDENDS

During the three and six months ended June 30, 2005 accretion on our 5% Convertible Series A Preferred Stock was approximately \$155,000 and \$182,000, respectively. Preferred dividends were \$28,000 for both the three and six months ended June 30, 2005. As our 5% Convertible Series A Preferred Stock was issued at the end of the March 2005, we did not accrue any accretion or dividends during the three and six months ended June 30, 2004.

### NET LOSS

Net loss for the quarter ended June 30, 2005 was approximately (\$807,000) compared to net loss of approximately (\$124,000) during the same period in 2004. The increased net loss was primarily attributable to the increased operating



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expenses, primarily the \$1,104,000 stock-based compensation cost (a non-cash charge) as a result of granting stock options to certain executives and key employees at less than fair market value on the grant date. This increase in operating expenses was somewhat offset by (i) growth in revenue of \$512,000 and (ii) the accounting for our preferred stock as discussed above, which resulted in a net increase to our earnings of \$575,000.

### RELATED PARTY TRANSACTIONS

We purchase significantly all our finished scanner imaging products from the parent company of our majority stockholder, Syscan Technology Holdings Limited ("STH"). Our Chairman and CEO, Darwin Hu, was formerly the CEO of STH, and beneficially owns approximately 5.33% of the issued and outstanding capital stock of STH.

During the three and six months ended June 30, 2005 and 2004, related party purchases from entities that are wholly-owned subsidiaries of STH were \$713,000, \$1,979,000, \$526,000 and \$1,610,000, respectively. The purchases were carried out in the normal course of business.

Amounts due from related parties are unsecured, interest-free and repayable on demand and consisted of the following:

Due from STH	\$ 446,000
Due from Majority Stockholder	100,000
Due from various subsidiaries wholly-owned by STH	1,955,000
	-----
	\$ 2,501,000
	=====

### LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were approximately \$2,167,000 as of June 30, 2005 and working capital on June 30, 2005 was approximately \$5,095,000. Cash and working capital increased from year end primarily attributable to the cash proceeds of approximately \$1,630,000 received from our convertible preferred stock offering completed in March 2005.

OPERATING ACTIVITIES. Net cash flows provided (used) by operating activities was (\$9,000) and \$329,000 for the six months ended June 30, 2005 and 2004, respectively. Net cash provided by operating activities for both periods presented is primarily explained by decreases in accounts receivable representing cash collections from the prior year's fourth quarter and decreases in inventory levels as sales increased. Other factors affecting net cash used in operating activities for 2005 primarily reflects net loss adjusted by (i) non-cash accounting entries in connection with the sale of our 5% Series A Preferred Stock and (ii) non-cash entries in connection with issuing stock options below fair market value.

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INVESTING ACTIVITIES. Net cash flows provided by investing activities during the

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six months ended June 30, 2005 and 2004 consisted primarily of cash paid for capital expenditures.

FINANCING ACTIVITIES. Net cash flows provided (used) by financing activities for the six months ended June 30, 2005 and 2004 was \$1,634,000 and (\$907,000), respectively. For 2005, we raised net cash of approximately \$1,630,000 from the sale of our convertible preferred stock offering completed in March 2005. For both periods presented, advances to and/or repayments from related party receivables and payables were made in the ordinary course of business.

We have financed our activities primarily with cash flows from operations, the sale of our equity securities and borrowings under our credit facilities. We have a \$1,000,000 bank line of credit, which bears interest at prime plus one percent, which is secured by all of our general business assets. The subject bank line of credit had \$933,000 outstanding as of June 30, 2005. We are currently negotiating with two insured banks to increase our line of credit or other financing arrangements. We believe the existing working capital and anticipated cash flows from operations are expected to be adequate to satisfy our operating and capital requirements for the next 12 months at our current run rate and our anticipated expansion.

Our plans for the next twelve months include continuing to increase our presence in the image capture market, heavily investing our resources into the image display market and adding future products and technologies to our current product offerings. Additionally, we intend to seek to identify acquisition candidates in the image capture and display industry that we believe could compliment our business model, improve our competitive positioning and expand our offerings to the marketplace, of which there can be no assurance. In identifying potential acquisition candidates, we will seek to acquire companies with varied distribution channels, rich intellectual property (IP) and high caliber engineering personnel.

To finance our business expansion plans, we plan to aggressively pursue additional sources of funds, the form of which will vary depending on the prevailing market and other conditions, and may include the issuance and sale of debt or equity securities. However, there is no assurance that such additional funds will be available for us to finance our expansion plans. Furthermore, there is no assurance the net proceeds from any successful financing arrangement will be sufficient to cover cash requirements as we expand our business operations.

### CONCENTRATION OF CREDIT RISK

CONCENTRATION OF CREDIT RISK FOR CASH HELD AT BANKS. We maintain cash balances at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000.

CONCENTRATION OF CREDIT RISK DUE TO GEOGRAPHIC SALES AND SIGNIFICANT CUSTOMERS. We operate in a single industry segment - scanner and fax modules. We market our products in the United States, Europe and the Asia Pacific region through our sales personnel and independent sales representatives.

Our geographic sales as a percent of total revenue were as follows for the quarters ended June 30:

	2005	2004
	-----	-----
United States	73.0%	96.5%
Asia Pacific	18.4%	0.1%
Europe and others	8.6%	3.4%

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Our geographic sales as a percent of total revenue were as follows for the six month period ended June 30:

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	2005	2004
	-----	-----
United States	86.4%	97.1%
Asia Pacific	8.8%	0.1%
Europe and others	4.8%	2.8%

Sales to major customers as a percentage of total revenues were as follows for the quarters ended June 30:

	2005	2004
	-----	-----
Customer A	42%	54%
Customer B	15%	14%
Customer C	7%	10%
Customer D	7%	6%

Sales to major customers as a percentage of total revenues for the six month period ended June 30:

	2005	2004
	-----	-----
Customer A	34%	33%
Customer B	15%	20%
Customer C	15%	13%
Customer D	12%	8%

CONCENTRATION OF CREDIT RISK DUE TO ACCOUNTS RECEIVABLE. Financial instruments that potentially subject us to a concentration of credit risk consist primarily of trade receivables. Our customers are concentrated in the industrial/consumer electronics channels and with major original equipment manufacturers. As of June 30, 2005, the concentration was approximately 75% (3 customers). The loss of any of these customers could have a material adverse effect on our results of operations, financial position and cash flows.

CONCENTRATION OF CREDIT RISK DUE TO SIGNIFICANT VENDORS. For each of the periods ended June 30, 2005 and 2004, our purchases have primarily been concentrated with the wholly-owned subsidiary of our majority stockholder. If this vendor was unable to provide materials in a timely manner and we were unable to find

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alternative vendors, our business, operating results and financial condition would be materially adversely affected.

DUE TO PRODUCT SALES. We had 5 different product categories in the second quarter of 2005 (2004: 5 products) and 3 different products during the six months ended June 30, 2005 (2004: 5 products) that each accounted for more than 10% of sales. We have made positive efforts to mitigate the impact of loss of any single category, however if any of these products were to become obsolete or unmarketable and we were unable to successfully develop and market alternative products, our business, operating results and financial condition could be adversely affected.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 16, 2006

By: /S/ DARWIN HU

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Name: Darwin Hu  
Title: Chief Executive Officer

Dated: August 16, 2006

By: /S/ WILLIAM HAWKINS

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Name: William Hawkins  
Title: Acting Chief Financial Officer,  
Chief Operating Officer and Secretary

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