

FINDEX COM INC
Form 10QSB
November 20, 2006

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

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2006.

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____.

Commission File Number: 0-29963

FINDEX.COM, INC.

(Exact name of small business issuer as specified in its charter)

Nevada 88-0379462
(State or other (I.R.S.
jurisdiction of Employer
incorporation Identification
or No.)
organization)

11204 Davenport Street, Suite 100,
Omaha, Nebraska 68154
(Address of principal executive
offices)

(402) 333-1900
(Issuer's telephone number)

N/A

(Former 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 Exchange Act during the past 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. **Yes [X] No []**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). **Yes** **No**

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. **Yes** **No**

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 50,038,317 common shares as of November 17, 2006.

Transitional Small Business Disclosure Format (Check one): **Yes** **No**

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Findex.com, Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited)	
	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 992	\$ 119,560
Accounts receivable, trade, net	270,209	405,380
Inventory	151,013	214,604
Other current assets	235,887	128,206
Total current assets	658,101	867,750
Property and equipment, net	79,985	114,191
Software license, net	1,384,645	1,762,276
Capitalized software development costs, net	518,216	707,067
Other assets	276,568	253,001
Total assets	\$ 2,917,515	\$ 3,704,285
Liabilities and stockholders' equity		
Current liabilities:		
Note payable	\$ 75,000	\$ ---
Accounts payable, trade	712,411	556,042
Accrued royalties	574,129	472,548
Derivative liabilities	952,914	2,062,462
Other current liabilities	551,991	802,395
Total current liabilities	2,866,445	3,893,447
Long-term obligations	156,961	52,891
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	49,558	48,620
Paid-in capital	7,595,437	7,461,424
Retained (deficit)	(7,750,886)	(7,752,097)
Total stockholders' equity	(105,891)	(242,053)
Total liabilities and stockholders' equity	\$ 2,917,515	\$ 3,704,285

See accompanying notes.

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Findex.com, Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Revenues, net of reserves and allowances	\$ 826,127	\$ 1,023,609	\$ 2,586,197	\$ 3,978,019
Cost of sales	391,771	450,413	1,361,157	1,410,191
Gross profit	434,356	573,196	1,225,040	2,567,828
Operating expenses:				
Sales and marketing	193,223	562,868	580,684	1,297,836
General and administrative	385,658	212,261	1,310,340	1,419,057
Other operating expenses	133,146	152,336	424,567	466,553
Total operating expenses	712,027	927,465	2,315,591	3,183,446
Loss from operations	(277,671)	(354,269)	(1,090,551)	(615,618)
Other expenses, net	(47,898)	(5,234)	(57,929)	(12,009)
Registration rights penalties	---	(158,792)	(49,314)	(277,792)
Gain (loss) on valuation adjustment of derivatives	237,009	(328,121)	1,109,548	(874,992)
Loss before income taxes	(88,560)	(846,416)	(88,246)	(1,780,411)
Income tax (provision) benefit	114,909	(111,976)	89,457	187,182
Net income (loss)	\$ 26,349	\$ (958,392)	1,211	(1,593,229)
Retained deficit at beginning of year			(7,752,097)	(6,170,830)
Retained deficit at end of period			\$ (7,750,886)	\$ (7,764,059)
Net income (loss) per share:				
Basic	\$ 0.00	\$ (0.02)	\$ 0.00	\$ (0.03)
Diluted	\$ 0.00	\$ (0.02)	\$ 0.00	\$ (0.03)
Weighted average shares outstanding:				
Basic	49,558,317	48,619,855	49,294,214	48,619,855
Diluted	51,167,410	48,619,855	51,660,240	48,619,855

See accompanying notes.

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Findex.com, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

Nine Months Ended September 30	2006	2005
Cash flows from operating activities:		
Cash received from customers	\$ 2,683,215	\$ 4,049,153
Cash paid to suppliers and employees	(2,375,960)	(3,565,309)
Other operating activities, net	(16,204)	(3,910)
Net cash provided by operating activities	291,051	479,934
Cash flows from investing activities:		
Software development costs	(412,108)	(766,151)
Other investing activities, net	(12,955)	15,300
Net cash (used) by investing activities	(425,063)	(750,851)
Cash flows from financing activities:		
Proceeds from note payable, net	75,000	---
Payments made on long-term notes payable	(59,556)	(30,604)
Net cash provided (used) by financing activities	15,444	(30,604)
Net (decrease) in cash and cash equivalents	(118,568)	(301,521)
Cash and cash equivalents, beginning of year	119,560	341,359
Cash and cash equivalents, end of period	\$ 992	\$ 39,838
Reconciliation of net income (loss) to cash flows from operating activities:		
Net income (loss)	\$ 1,211	\$ (1,593,229)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Software development costs amortized	600,959	524,989
(Gain) loss on fair value adjustment of derivatives	(1,109,548)	874,992
Bad debts (benefit) provision	(11,216)	29,650
Depreciation & amortization	435,783	436,903
Noncash operating expenses	69,997	---
Loss on disposal of property and equipment	1,746	1,869
Change in assets and liabilities:		
Decrease in accounts receivable	146,387	71,786
Decrease in inventories	63,591	22,231
Decrease in refundable taxes	5,764	7,164
(Increase) decrease in prepaid expenses	(7,603)	55,509
Increase in accrued royalties	101,581	40,831
Increase in accounts payable	164,327	65,858
Increase in income taxes payable	---	180
(Decrease) in deferred taxes	(89,457)	(187,362)
(Decrease) increase in other liabilities	(82,471)	128,563
Net cash provided by operating activities	\$ 291,051	\$ 479,934

See accompanying notes.

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Findex.com, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2006
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles for interim financial information and with the instructions to Form 10-QSB and Item 310 of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect all adjustments that, in the opinion of management, are considered necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. The results of operations for such periods are not necessarily indicative of the results expected for the full fiscal year or for any future period. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements of Findex.com, Inc. included in our Form 10-KSB for the fiscal year ended December 31, 2005.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Significant estimates used in the consolidated financial statements include the estimates of (i) doubtful accounts, sales returns, price protection and rebates, (ii) provision for income taxes and realizability of the deferred tax assets, and (iii) the life and realization of identifiable intangible assets. The amounts we will ultimately incur or recover could differ materially from current estimates.

INVENTORY

Inventory, including out on consignment, consists primarily of software media, manuals and related packaging materials and is recorded at the lower of cost or market value, determined on a first-in, first-out, and adjusted on a per-item, basis.

ACCOUNTING FOR LONG-LIVED ASSETS

We review property and equipment and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by comparison of our carrying amount to future net cash flows the assets are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair market value. Property and equipment to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

INTANGIBLE ASSETS

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*, intangible assets with an indefinite useful life are not amortized. Intangible assets with a finite useful life are amortized on the straight-line method over the estimated useful lives. Our software license is amortized over a ten-year useful life.

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SOFTWARE DEVELOPMENT COSTS

In accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*, software development costs are expensed as incurred until technological feasibility and marketability has been established, generally with release of a beta version for customer testing. Once the point of technological feasibility and marketability is reached, direct production costs (including labor directly associated with the development projects), indirect costs (including allocated fringe benefits, payroll taxes, facilities costs, and management supervision), and other direct costs (including costs of outside consultants, purchased software to be included in the software product being developed, travel expenses, material and supplies, and other direct costs) are capitalized until the product is available for general release to customers. We amortize capitalized costs on a product-by-product basis. Amortization for each period is the greater of the amount computed using (i) the straight-line basis over the estimated product life (generally from 12 to 18 months), or (ii) the ratio of current revenues to total projected product revenues. Total cumulative capitalized software development costs were \$2,973,151, less accumulated amortization of \$2,454,935 at September 30, 2006.

Capitalized software development costs are stated at the lower of amortized costs or net realizable value. Recoverability of these capitalized costs is determined at each balance sheet date by comparing the forecasted future revenues from the related products, based on management's best estimates using appropriate assumptions and projections at the time, to the carrying amount of the capitalized software development costs. If the carrying value is determined not to be recoverable from future revenues, an impairment loss is recognized equal to the amount by which the carrying amount exceeds the future revenues. To date, no capitalized costs have been written down to net realizable value.

SFAS No. 2, *Accounting for Research and Development Costs*, established accounting and reporting standards for research and development. In accordance with SFAS No. 2, costs we incur to enhance our existing products after general release to the public (bug fixes) are expensed in the period they are incurred and included in research and development costs. Research and development costs incurred prior to determination of technological feasibility and marketability and after general release to the public and charged to expense were \$131,013 and \$130,407 for the nine months ended September 30, 2006 and 2005, respectively, included in general and administrative expenses.

We capitalize costs related to the development of computer software developed or obtained for internal use in accordance with the American Institute of Certified Public Accountants Statement of Position ("SOP") 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Software obtained for internal use has generally been enterprise level business and finance software that we customize to meet our specific operational needs. We have not sold, leased, or licensed software developed for internal use to our customers and have no intention of doing so in the future.

We capitalize costs related to the development and maintenance of our website in accordance with Financial Accounting Standard Board's ("FASB's") Emerging Issues Task Force ("EITF") Issue No. 00-2, *Accounting for Website Development Costs*. Under EITF Issue No. 00-2, costs expensed as incurred are as follows:

- planning the website,
- developing the applications and infrastructure until technological feasibility is established,
- developing graphics such as borders, background and text colors, fonts, frames, and buttons,
- and
- operating the site such as training, administration and maintenance.

Capitalized costs include those incurred to:

obtain and register an Internet domain name,
develop or acquire software tools necessary for the development work,
develop or acquire software necessary for general website operations,
develop or acquire code for web applications,
develop or acquire (and customize) database software and software to integrate applications
such as corporate databases and accounting systems into web applications,
develop HTML web pages or templates,
install developed applications on the web server,
create initial hypertext links to other websites or other locations within the website, and
test the website applications.

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We amortize website development costs on a straight-line basis over the estimated life of the site, generally 36 months. Total cumulative website development costs, included in other assets on our condensed consolidated balance sheets, were \$111,034, less accumulated amortization of \$67,921 at September 30, 2006.

NET REVENUE

We derive revenues from the sale of packaged software products, product support and multiple element arrangements that may include any combination of these items. We recognize software revenue for software products and related services in accordance with SOP 97-2, *Software Revenue Recognition*, as modified by SOP 98-9, *Modification of SOP 97-2, With Respect to Certain Transactions*. We recognize revenue when persuasive evidence of an arrangement exists (generally a purchase order), we have delivered the product, the fee is fixed or determinable and collectibility is probable.

In some situations, we receive advance payments from our customers. We defer revenue associated with these advance payments until we ship the products or offer the support.

In accordance with EITF Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Product*, we generally account for cash considerations (such as sales incentives - rebates and coupons) that we give to our customers as a reduction of revenue rather than as an operating expense.

Product Revenue

We typically recognize revenue from the sale of our packaged software products when we ship the product. We sell some of our products on consignment to a limited number of resellers. We recognize revenue for these consignment transactions only when the end-user sale has occurred. Revenue for software distributed electronically via the Internet is recognized when the customer has been provided with the access codes that allow the customer to take immediate possession of the software on its hardware and evidence of the arrangement exists (web order).

Some of our software arrangements involve multiple copies or licenses of the same program. These arrangements generally specify the number of simultaneous users the customer may have (multi-user license), or may allow the customer to use as many copies on as many computers as it chooses (a site license). Multi-user arrangements, generally sold in networked environments, contain fees that vary based on the number of users that may utilize the software simultaneously. We recognize revenue when evidence of an order exists and upon delivery of the authorization code to the consumer that will allow them the limited simultaneous access. Site licenses, generally sold in non-networked environments, contain a fixed fee that is not dependent on the number of simultaneous users. Revenue is recognized when evidence of an order exists and the first copy is delivered to the consumer.

Many of our software products contain additional content that is "locked" to prevent access until a permanent access code, or "key," is purchased. We recognize revenue when evidence of an order exists and the customer has been provided with the access code that allows the customer immediate access to the additional content. All of the programs containing additional locked content are fully functional and the keys are necessary only to access the additional content. The customer's obligation to pay for the software is not contingent on delivery of the "key" to access the additional content.

We reduce product revenue for estimated returns and price protections that are based on historical experience and other factors such as the volume and price mix of products in the retail channel, trends in retailer inventory and economic trends that might impact customer demand for our products. We also reduce product revenue for the estimated redemption of end-user rebates on certain current product sales. Our rebate reserves are estimated based on the terms and conditions of the specific promotional rebate program, actual sales during the promotion, the amount of

redemptions received and historical redemption trends by product and by type of promotional program. We did not offer any rebate programs to our customers during the three and nine months ended September 30, 2006 and 2005 and maintain a reserve for rebate claims remaining unpaid from 2000 and 2001.

Service Revenue

We offer several technical support plans and recognize support revenue over the life of the plans, generally one year.

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Multiple Element Arrangements

We also enter into certain revenue arrangements for which we are obligated to deliver multiple products or products and services (multiple elements). For these arrangements, which include software products, we allocate and defer revenue for the undelivered elements based on their vendor-specific objective evidence (“VSOE”) of fair value. VSOE is generally the price charged when that element is sold separately.

In situations where VSOE exists for all elements (delivered and undelivered), we allocate the total revenue to be earned under the arrangement among the various elements, based on their relative fair value. For transactions where VSOE exists only for the undelivered elements, we defer the full fair value of the undelivered elements and recognize the difference between the total arrangement fee and the amount deferred for the undelivered items as revenue (residual method). If VSOE does not exist for undelivered items that are services, we recognize the entire arrangement fee ratably over the remaining service period. If VSOE does not exist for undelivered elements that are specified products, we defer revenue until the earlier of the delivery of all elements or the point at which we determine VSOE for these undelivered elements.

We recognize revenue related to the delivered products or services only if (i) the above revenue recognition criteria are met, (ii) any undelivered products or services are not essential to the functionality of the delivered products and services, (iii) payment for the delivered products or services is not contingent upon delivery of the remaining products or services, and (iv) we have an enforceable claim to receive the amount due in the event that we do not deliver the undelivered products or services.

Shipping and Handling Costs

We record the amounts we charge our customers for the shipping and handling of our software products as product revenue and we record the related costs as cost of sales on our condensed consolidated statements of operations.

Customer Service and Technical Support

Customer service and technical support costs include the costs associated with performing order processing, answering customer inquiries by telephone and through websites, email and other electronic means, and providing technical support assistance to our customers. In connection with the sale of certain products, we provide a limited amount of free technical support assistance to customers. We do not defer the recognition of any revenue associated with sales of these products, since the cost of providing this free technical support is insignificant. The technical support is provided within one year after the associated revenue is recognized and free product enhancements (bug fixes) are minimal and infrequent. We accrue the estimated cost of providing this free support upon product shipment and include it in cost of sales.

INCOME TAXES

We utilize SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires the use of the asset and liability method of accounting for income taxes. Under this method, deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

EARNINGS PER SHARE

We follow SFAS No. 128, *Earnings Per Share*, to calculate and report basic and diluted earnings per share (“EPS”). Basic EPS is computed by dividing income available to common shareholders by the weighted average number of shares of common stock outstanding for the period. Diluted EPS is computed by giving effect to all dilutive potential shares of common stock that were outstanding during the period. For us, dilutive potential shares of common stock consist of the incremental shares of common stock issuable upon the exercise of stock options and warrants for all periods, convertible notes payable and the incremental shares of common stock issuable upon the conversion of convertible preferred stock.

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When discontinued operations, extraordinary items, and/or the cumulative effect of an accounting change are present, income before any of such items on a per share basis represents the “control number” in determining whether potential shares of common stock are dilutive or anti-dilutive. Thus, the same number of potential shares of common stock used in computing diluted EPS for income from continuing operations is used in calculating all other reported diluted EPS amounts. In the case of a net loss, it is assumed that no incremental shares would be issued because they would be anti-dilutive. In addition, certain options and warrants are considered anti-dilutive because the exercise prices were above the average market price during the period. Anti-dilutive shares are not included in the computation of diluted EPS, in accordance with SFAS No. 128.

RECLASSIFICATIONS

Certain accounts in our 2005 financial statements have been reclassified for comparative purposes to conform with the presentation in our 2006 financial statements.

NOTE 2 - INVENTORIES

At September 30, 2006, inventories consisted of the following:

Raw materials	\$ 95,366
Finished goods	55,647
Inventories	\$ 151,013

NOTE 3 - NOTE PAYABLE

In July 2006, we entered into a loan agreement with an individual for \$150,000. The agreement bears interest at a rate of 10% per thirty-day period and carried an original due date of September 18, 2006. On September 19, 2006, for additional consideration of \$750, we entered into a modification and extension agreement which extended the repayment term of the balance of the outstanding principal under the loan, as well as the interest payable thereon, until October 20, 2006. The loan agreement is secured by a first priority security interest in all of our assets, including the intellectual property comprising the software products upon which we are dependent for revenue, and is convertible, together with any accrued interest thereon, into restricted shares of our common stock at a conversion price per share equal to \$0.07 per share. In further consideration, we issued the lender a three-year common stock purchase warrant to acquire up to an aggregate of 100,000 restricted shares of common stock at an exercise price of \$0.07 per share. See Note 6, Common Stock and Note 11, Subsequent Events.

NOTE 4 - DERIVATIVES

At September 30, 2006, our derivative liability consisted of the following:

Warrant A	\$ 12,544
Warrant B	488,717
Warrant C	451,653
Derivatives	\$ 952,914

In May 2004, we issued a three-year warrant (Warrant A) to purchase up to 600,000 shares of our common stock to a consultant. This warrant may be exercised on a cashless basis at the option of the warrant holder at a price per share of \$0.15. We will receive up to \$90,000 from the warrant holder upon the exercise of this warrant. This warrant has been accounted for as a liability according to the guidance of EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, and the fair value of the warrant has been determined

using the Black-Scholes valuation method with the assumptions listed in the table below.

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In November 2004, we issued two five-year warrants to purchase up to an aggregate of 21,875,000 shares of our common stock in connection with a certain Stock Purchase Agreement completed with a New York-based private investment partnership on July 19, 2004. The first warrant (Warrant B) entitles the holder to purchase up to 10,937,500 shares of our common stock at a price of \$0.18 per share, and the second warrant (Warrant C) entitles the holder to purchase up to 10,937,500 additional shares of our common stock at a price of \$0.60 per share. Each warrant is subject to standard adjustment provisions and each provides for settlement in registered shares of our common stock and may, at the option of the holder, be settled in a cashless, net-share settlement. The warrant holder is prevented from electing a cashless exercise so long as there is in effect a registration statement covering the shares underlying these warrants. The maximum number of shares of our common stock to be received for each warrant in a net-share settlement would be 10,937,500 but the actual number of shares settled would likely be significantly less and would vary based on the last reported sale price (as reported by Bloomberg) of our common stock on the date immediately preceding the date of the exercise notice. These warrants are accounted for as a liability according to the guidance of EITF 00-19 and the fair value of each warrant has been determined using the Black-Scholes valuation method with the assumptions listed in the table below.

	Warrant A	Warrant B	Warrant C
Expected term - years	.58	3.11	3.11
Stock price at September 30, 2006	\$ 0.05	\$ 0.05	\$ 0.05
Expected dividend yield	0%	0%	0%
Expected stock price volatility	235%	212%	212%
Risk-free interest rate	4.83%	4.50%	4.50%

The warrants are revalued at each balance sheet date by using the parameters above, reducing the expected term to reflect the passing of time, and using the stock price at the balance sheet date. Net fair value adjustments included in other income and expenses on the consolidated statements of operations were income adjustments of \$237,009 and \$1,109,548 for the three and nine months ended September 30, 2006, and expense adjustments of (\$328,121) and (\$874,992) for the three and nine months ended September 30, 2005, respectively.

NOTE 5 - INCOME TAXES

The provision (benefit) for taxes on net income for the three and nine months ended September 30, 2006 and 2005 consisted of the following:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Current:				
Federal	\$ ---	\$ ---	\$ ---	\$ ---
State	---	---	---	180
	---	---	---	180
Deferred:				
Federal	(112,543)	116,472	(84,655)	(165,714)
State	(2,366)	(4,496)	(4,802)	(21,648)
	(114,909)	111,976	(89,457)	(187,362)
Total tax provision	\$ (114,909)	\$ 111,976	\$ (89,457)	\$ (187,182)

(benefit)

NOTE 6 - STOCKHOLDERS' EQUITY

COMMON STOCK

In March 2006, we committed to issue a total of 146,154 restricted shares of common stock to each of our then outside directors (a total of 438,462 shares), at the closing price as of March 30, 2006 (\$0.13), in lieu of cash payments of amounts accrued for their services as members of our board from the period of September 1, 2004 through March 31, 2006. This issuance was valued at \$57,000.

In April 2006, we committed to issue a total of 500,000 restricted shares of common stock to a company for investor relations services, at the closing price as of April 2, 2006 (\$0.13), in accordance with the terms of a twelve-month agreement. This issuance was valued at \$65,000.

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Table of Contents**COMMON STOCK WARRANTS**

In March 2006, we committed to issue a three-year warrant to purchase up to 300,000 restricted shares of our common stock, at a price per share of \$0.13, to our legal counsel, in lieu of cash as payment for certain accrued legal fees. This warrant was valued at \$7,958 based on the negotiated fair value of the services provided as prescribed by SFAS No. 123(R), *Share-Based Payments*, for share-based transactions with non-employees.

In July 2006, we issued a three-year warrant to purchase up to 100,000 restricted shares of our common stock, at a price of \$0.07, to an individual, in connection with the issuance of a convertible note payable. This warrant was valued at \$4,997 based on the Black-Scholes method using a stock price of \$0.05 per share, volatility of 196%, an annual dividend rate of 0% and a risk-free interest rate of 4.91%. The value was treated as a discount on debt issued with detachable stock purchase warrants, per APB No. 14, and amortized to interest expense over the original life of the note. See Note 3, Note Payable.

NOTE 7 - EARNINGS PER COMMON SHARE

Earnings per common share are computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the year. Common stock equivalents are the net additional number of shares that would be issuable upon the exercise of our outstanding common stock options and warrants, assuming that we reinvested the proceeds to purchase additional shares at market value.

The following table shows the amounts used in computing earnings per common share and the effect on income and the average number of shares of dilutive potential common stock:

For the Three Months		
Ended September 30	2006	2005
Net income (loss)	\$ 26,349	\$ (958,392)
Preferred stock dividends	---	---
Net income (loss) available to common shareholders	\$ 26,349	\$ (958,392)
Basic weighted average shares outstanding	49,558,317	48,619,855
Dilutive effect of:		
Convertible debt	1,535,714	---
Stock options	---	---
Warrants	73,379	---
Diluted weighted average shares outstanding	51,167,410	48,619,855
For the Nine Months		
Ended September 30	2006	2005
Net loss	\$ 1,211	\$ (1,593,229)
Preferred stock dividends	---	---
	\$ 1,211	\$ (1,593,229)

Net loss available to
common shareholders

Basic weighted average shares outstanding	49,294,214	48,619,855
Dilutive effect of:		
Convertible debt	1,535,714	---
Stock options	676,043	---
Warrants	154,269	---
Diluted weighted average shares outstanding	51,660,240	48,619,855

NOTE 8 - COMMITMENTS AND CONTINGENCIES

We are subject to legal proceedings and claims that arise in the ordinary course of our business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect our financial statements taken as a whole.

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Our employment agreements with our management team each contain a provision for an annual bonus equal to 1% of our net income (3% total). We accrue this bonus on a quarterly basis. Our management team consists of our Chief Executive Officer (with a base annual salary of \$150,000), our Chief Financial Officer (with a base annual salary of \$110,000), and our Chief Technology Officer (with a base annual salary of \$150,000). In addition to the bonus provisions and annual base salary, each employment agreement provides for payment of all accrued base salaries (\$8,703 included in Other current liabilities at September 30, 2006), bonuses (\$37,033 included in other current liabilities at September 30, 2006), and any vested deferred vacation compensation (\$30,443 included in other current liabilities at September 30, 2006) for termination by reason of disability. The agreements also provide for severance compensation equal to the then base salary until the later of (i) the expiration of the term of the agreement as set forth therein or (ii) one year, when the termination is other than for cause (including termination by reason of disability). There is no severance compensation in the event of voluntary termination or termination for cause.

In 2003 and 2004, we reduced our reserve for rebates payable based, in part, on our ability to meet the financial obligation of claims carried forward from our last rebate program in 2001. As such, we may have a legal obligation to pay rebates in excess of the liability recorded.

Our royalty agreements for new content generally provide for advance payments to be made upon contract signing. In addition, several new agreements provide for additional advance payments to be made upon delivery of usable content and publication. We accrue and pay these advances when the respective milestone is met.

NOTE 9 - RISKS AND UNCERTAINTIES

Our future operating results may be affected by a number of factors. We depend upon a number of major inventory and intellectual property suppliers. If a critical supplier had operational problems or ceased making material available to us, operations could be adversely affected.

NOTE 10 - GOING CONCERN

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States applicable to a going concern. As of September 30, 2006, we had a year-to-date net income of \$1,211, and negative working capital of \$2,208,344 and \$3,025,697, and an accumulated deficit of \$7,750,886 and \$7,752,097 as of September 30, 2006 and December 31, 2005, respectively. Although these factors raise substantial doubt as to our ability to continue as a going concern through December 31, 2006, we have taken several measures to mitigate against this risk, including expanding our in-house telemarketing efforts to increase our direct-to-consumer revenue while at the same time reducing commissions paid to third-party telemarketing firms. In addition, we are focused on distilling both our sales and marketing, and general and administrative expenses to include only those providing the most return on investment.

NOTE 11 - SUBSEQUENT EVENTS

On October 19, 2006, we repaid the note payable in full.

On October 26, 2006, we granted 850,000 nonqualified stock options to non-executive employees. These options carry an exercise price of \$0.10 per share, vest immediately, and have a three-year term.

On October 26, 2006, we committed to issue 480,000 restricted shares of common stock to our outside director, at the closing price as of October 26, 2006 (\$0.025), in lieu of cash payments of amounts accrued for his service as a member of our board from the period of April 1, 2006 through September 30, 2006.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

Cautionary Statement Regarding Forward-Looking Statements

This quarterly report on Form 10-QSB, press releases and certain information provided periodically in writing or verbally by our officers or our agents contain statements which constitute forward-looking statements. The words "may", "would", "could", "will", "expect", "estimate", "anticipate", "believe", "intend", "plan", "goal", and similar expressions and variations thereof are intended to specifically identify forward-looking statements. These statements appear in a number of places in this Form 10-QSB and include all statements that are not statements of historical fact regarding the intent, belief or current expectations of us, our directors or our officers, with respect to, among other things (i) our liquidity and capital resources, (ii) our financing opportunities and plans, (iii) our ability to attract customers to generate revenues, (iv) competition in our business segment, (v) market and other trends affecting our future financial condition or results of operations, (vi) our growth strategy and operating strategy, and (vii) the declaration and/or payment of dividends.

Investors and prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors. Factors that might cause such differences include, among others, those set forth in Part I, Item 2 of this quarterly report on Form 10-QSB, entitled "Management's Discussion and Analysis or Plan of Operation", and including without limitation the "Risk Factors" contained in our annual report on Form 10-KSB for the period ended December 31, 2005. Except as required by law, we undertake no obligation to update any of the forward-looking statements in this Form 10-QSB after the date of this report.

This information should be read in conjunction with our unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this quarterly report on Form 10-QSB, and our audited financial statements and the notes thereto and our Management's Discussion and Analysis or Plan of Operation contained in our annual report on Form 10-KSB for the fiscal year ended December 31, 2005.

MANAGEMENT OVERVIEW

During the third quarter of 2006 we released an upgrade to our flagship product, QuickVerse[®], which was one month earlier compared to our upgrade release of QuickVerse[®] in 2005. In addition, this marked the second year in a row that we released an upgrade to the QuickVerse[®] (Windows) product line that would reach the retail stores prior to the holiday season beginning. QuickVerse[®] 2007 is currently available in six editions, QuickVerse[®] 2007 Bible Suite, QuickVerse[®] 2007 Essentials, QuickVerse[®] 2007 Standard, QuickVerse[®] 2007 Expanded, QuickVerse[®] 2007 Deluxe and QuickVerse[®] 2007 Platinum. These QuickVerse[®] 2007 editions range in retail price from \$39.95 to \$799.95. The QuickVerse[®] 2007 new features include web dictionary support, integrated PDF files, integrated RSS subscriptions and integrated web pages. We believe that the unique features of the new QuickVerse[®] 2007 editions will provide us with an opportunity to broaden our customer base as our products appeal not only to those just beginning their journey into Bible study but also to the scholars who are searching for an in-depth knowledge of the Bible.

During the second quarter of 2006 we released QuickVerse[®] 2006 Macintosh[®] Gold Edition, with a suggested retail price of \$349.95, which offers more content to Mac users than ever before. This edition offers 19 Bibles and 144 reference titles, a retail value of over \$4,000 if sold separately. We also released the Holman Christian Standard Bible[®], with a suggested retail price of \$29.95, which is sponsored by Broadman & Holman Publishers. This Bible translation provides English-speaking people across the world with an accurate, readable Bible in contemporary English and equips serious Bible students with an accurate translation for personal study, private devotions and memorization.

Finally, during the first quarter of 2006, we released QuickVerse® 2006 Parable Edition, with a suggested retail price of \$49.95, and QuickVerse® 2006 Bible Suite, with a suggested retail price of \$29.95. QuickVerse® 2006 Bible Suite appeals to those customers seeking their first Bible study software. QuickVerse® 2006 Parable Edition is sold exclusively at Parable® retail outlets and through Parable®'s website, at [www.possible.com](http://www.parable.com), and unlike other QuickVerse® editions, QuickVerse® 2006 Parable contains exclusive Parable® content such as *Books That Change Lives* and *Standing Firm Devotional*.

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Comparatively, during the third quarter of 2005, we released QuickVerse® 2006 three months earlier than our upgrade release of QuickVerse® in 2004. During the second quarter of 2005, and for the first time in our operating history, we introduced QuickVerse® to the Macintosh Operating System in two editions, QuickVerse® Macintosh Black Box (includes 12 Bibles and 56 reference titles), with a suggested retail price of \$99.95 and QuickVerse® Macintosh White Box (includes 9 Bibles and 40 reference titles), with a suggested retail price of \$49.95. We also released an updated version of Bible Illustrator® 3.0 entitled Sermon Builder® 4.0, with a suggested retail price of \$69.95. Lastly, during the first quarter of 2005, we released an upgrade to our top-selling financial and data management software, Membership Plus®, with a suggested retail price of between \$149.95 and \$349.95, and introduced QuickVerse® 2005 Essentials, with a suggested retail price of \$49.95, and QuickVerse® 2005 Platinum, with a suggested retail price of \$799.95.

Although we did not release an upgrade version of Membership Plus® during the first three quarters of 2006, we did release one in our fourth quarter of 2006. Furthermore, we anticipate the releases of enhanced versions of QuickVerse® Mobile and QuickVerse® Macintosh during our fourth quarter of 2006, as well as the introduction of a few new titles that will offer additional content to our QuickVerse® users.

Despite our decreased gross revenues during the nine months ended September 30, 2006, and although there can be no assurance, we anticipate that revenues will increase in real terms throughout the remainder of our 2006 fiscal year based upon our development schedule for the remainder of the fiscal year and the broadened content made available for our QuickVerse® products.

Results Of Operations for Quarters Ended September 30, 2006 and September 30, 2005

Statement of Operations for Nine Months Ended September 30				
	2006	2005	Change	%
Net revenues	\$ 2,586,197	\$ 3,978,019	\$ (1,391,822)	35%
Cost of sales	1,361,157	1,410,191	(49,034)	3%
Gross profit	\$ 1,225,040	\$ 2,567,828	\$ (1,342,788)	52%
Total operating expenses	(2,315,591)	(3,183,446)	867,855	27%
Loss from operations	\$ (1,090,551)	\$ (615,618)	\$ (474,933)	77%
Registration rights penalties	(49,314)	(277,792)	228,478	82%
Gain (loss) on fair value adjustment of derivatives	1,109,548	(874,992)	1,984,540	227%
Other expenses, net	(57,929)	(12,009)	(45,920)	382%
Loss before income taxes	\$ (88,246)	\$ (1,780,411)	\$ 1,692,165	95%
Income tax benefit	89,457	187,182	(97,725)	52%
Net income (loss)	\$ 1,211	\$ (1,593,229)	\$ 1,594,440	100%

Our software products are highly seasonal. More than 50% of our annual sales are expected to occur in the five months of September through January; the five months of April through August are generally our weakest, historically generating only approximately 29% of our annual sales.

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Our gross profit decreased approximately \$1,343,000 from a gross profit of approximately \$2,568,000 for the nine months ended September 30, 2005 to a gross profit of approximately \$1,225,000 for the nine months ended September 30, 2006. Further, we incurred a loss from operations of approximately \$1,091,000 for the nine months ended September 30, 2006, representing an increase of approximately \$475,000 in our loss from operations of approximately \$616,000 for the nine months ended September 30, 2005. These negative results of operations are primarily attributable to the following:

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For the nine months ended September 30, 2006:

our gross revenues decreased approximately \$1,951,000 to approximately \$ 2,794,000 for the nine months ended September 30, 2006 from approximately \$4,745,000 for the nine months ended September 30, 2005. This decrease is primarily attributable to the following:

an overall net decrease in unit sales of our QuickVerse® product line due to a reduction in the perceived value on the part of customers of certain upgrades based on the relative frequency thereof;

the lack of product releases during the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005, including our annual release of Membership Plus®; and

the decreased suggested retail price in those products that were released during the nine months ended September 30, 2006 compared to those released during the nine months ended September 30, 2005;

our cost of sales remained relatively high, only decreasing approximately \$49,000 from approximately \$1,410,000 for the nine months ended September 30, 2005 to approximately \$1,361,000 for the nine months ended September 30, 2006 due to the increased amortization of software development costs;

we incurred liquidated damage penalties of approximately \$49,000 in connection with our failure to meet certain contractual registration obligations; and

our interest expense increased approximately \$45,000 for the nine months ended September 30, 2006 due to a loan agreement that was entered into in order to fund our working capital deficit.

Our net income increased approximately \$1,594,000 from a net loss of approximately \$1,593,000 for the nine months ended September 30, 2005 to a net income of approximately \$1,000 for the nine months ended September 30, 2006. This increase is mainly attributed to the valuation gain of approximately \$1,110,000 we recognized from the fair value adjustment of our derivative liabilities during the nine months ended September 30, 2006. We do anticipate, however, this valuation gain to be temporary. If our stock price rebounds during the fourth quarter of 2006 to a level consistent with our stock price at December 2005, the fair value of the derivative liabilities will increase and therefore, the valuation gain recognized during the nine months ended September 30, 2006 will reverse and we will again reflect a year-to-date valuation loss (see *Derivatives*).

Offsetting to some degree the negative results of operations detailed above were three positive developments during the nine months ended September 30, 2006. First, our registration statement on Form SB-2, originally filed on November 22, 2004, was declared effective by the SEC on February 1, 2006, and therefore, the liquidated damage penalties have stopped accruing. Second, we released our annual upgrade of our QuickVerse® (Windows) product line which will reach the retail stores prior to the holiday season beginning. Third, we were able to remain operating cash positive despite our decrease in gross revenues for the nine months ended September 30, 2006.

Revenues

We derive revenues from the sale of packaged software products, product support and multiple element arrangements that may include any combination of these items. Revenue is recognized when persuasive evidence of an arrangement exists (generally a purchase order), we have delivered the product, the fee is fixed or determinable and collectibility is

probable. For our packaged software products, we typically recognize revenue from the sale when we ship the product. We sell some of our products on consignment to a limited number of resellers. We recognize revenue for these consignment transactions only when the end-user sale has occurred. Service revenue resulting from technical support plans is recognized over the life of the plan, which is generally one year. Revenue associated with advance payments from our customers is deferred until we ship the product or offer the support service. Revenue for software distributed electronically via the Internet is recognized when the customer has been provided with the access codes that allow the customer to take immediate possession of the software on its hardware and evidence of the arrangement exists. For revenue arrangements involving multiple products or product and service packages, we allocate and defer revenue for the undelivered products or product and service packages based on their vendor-specific objective evidence of fair value, which is generally the price charged when that product or product and service package is sold separately.

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We reduce product revenue for estimated returns and price protections that are based on historical experience and other factors such as the volume and price mix of products in the retail channel, trends in retailer inventory and economic trends that might impact customer demand for our products. Estimated returns are also based upon a percentage of total retail and direct sales. Direct sales accounted for approximately 61% of our 2005 fiscal year revenue. We account for cash considerations (such as sales incentives - rebates and coupons) that we give our customers as a reduction of revenue rather than as an operating expense. Product revenue is also reduced for the estimated redemption of end-user rebates on certain current product sales. We did not have any rebate programs during the nine months ended September 30, 2005 and 2006, respectively.

Trends that our returns typically follow include (i) the seasonality of sales, and (ii) the fact that, generally, relatively higher return rates occur during periods of new title or title version releases. Historically, actual returns have been within management's prior estimates, however, we cannot be certain that any future write-offs exceeding reserves will not occur or that amounts written off will not have a material adverse effect on our business, our financial condition, including liquidity and profitability, and our results of operations. Management continually monitors and adjusts these allowances to take into account actual developments and sales results in the marketplace. In the past, particularly during title and title version transitions, we have had to increase price concessions to our retail customers.

Product returns from distributors and Christian bookstores are allowed primarily in exchange for new products or for credit towards purchases as part of a stock-balancing program. These returns are subject to certain limitations that may exist in the contract. Under certain circumstances, such as termination or when a product is defective, distributors and bookstores could receive a cash refund if returns exceed amounts owed. Returns from sales made directly to the consumer are accepted within 45 days of purchase and are issued a cash refund. Product returns, price protections or price concessions that exceed our reserves could materially adversely affect our business and operating results and could increase the magnitude of quarterly fluctuations in our operating and financial results. Although we released QuickVerse® 2007 in late August 2006 to the Christian Booksellers Association retail channel, we did not implement a price protection program within the three months ended September 30, 2006 on our QuickVerse® 2006 titles. Furthermore, we do not anticipate implementing a price protection program in the near future.

Software products are sold separately, without an obligation of future performance such as upgrades, enhancements or additional software products, and are sold with post contract customer support services such as customer service and technical support assistance. In connection with the sale of certain products, we provide a limited amount of free technical support assistance to our customers. We do not defer the recognition of any revenue associated with sales of these products, since the cost of providing this free technical support is insignificant. The technical support is provided within one year after the associated revenue is recognized and free product enhancements (bug fixes) are minimal and infrequent. We accrue the estimated cost of providing this free support upon product shipment and include it in cost of sales.

Shipping and handling costs in connection with our software products are expensed as incurred and included in cost of sales.

Revenues for Three Months Ended September 30	2006	% to Sales	% to		Change	%
			2005	Sales		
Gross revenues	\$ 910,896	100%	\$ 1,233,389	100%	\$(322,493)	26%
	---	0%	4,910	0%	(4,910)	100%

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Add rebate adjustment						
Less reserve for sales returns and allowances	(84,769)	-9%	(214,690)	-17%	129,921	61%
Net revenues	\$ 826,127	91%	\$ 1,023,609	83%	\$ (197,482)	19%

Revenues for Nine Months Ended September 30						
	2006	% to Sales	2005	% to Sales	Change	%
Gross revenues	\$ 2,793,594	100%	\$ 4,744,759	100%	\$ (1,951,165)	41%
Add rebate adjustment	---	0%	14,730	0%	(14,730)	100%
Less reserve for sales returns and allowances	(207,397)	-7%	(781,470)	-16%	574,073	73%
Net revenues	\$ 2,586,197	93%	\$ 3,978,019	84%	\$ (1,391,822)	214%

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Gross revenues decreased approximately \$322,000 from approximately \$1,233,000 for the three months ended September 30, 2005 to approximately \$911,000 for the three months ended September 30, 2006 and decreased approximately \$1,951,000 from approximately \$4,745,000 for the nine months ended September 30, 2005 to approximately \$2,794,000 for the nine months ended September 30, 2006. We believe that this decrease was primarily attributable to the lack of product releases during the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005, and most notably the prolonged delay in our annual release of Membership Plus®. During 2005 and 2006, the following products were released during our first, second and third quarters, respectively:

First Quarter 2005

an enhanced version of our top financial and data management product, Membership Plus®, including Membership Plus® Standard Edition, with a suggested retail price of \$149.95, and Membership Plus® Deluxe Edition, with a suggested retail price of \$349.95; an enhanced version of QuickVerse® 2005 Essentials, with a suggested retail price of \$49.95; and QuickVerse® 2005 Platinum Edition, with a suggested retail price of \$799.95.

Second Quarter 2005

QuickVerse® 2006 Macintosh, including QuickVerse® 2006 Macintosh Black Box Edition, with a suggested retail price of \$99.95, and QuickVerse® 2006 Macintosh White Box Edition, with a suggested retail price of \$49.95; and an enhanced version of Bible Illustrator® 3.0 entitled Sermon Builder® 4.0, with a suggested retail price of \$69.95.

Third Quarter 2005

an enhanced version of our flagship product, QuickVerse®, including QuickVerse® 2006 Essentials with a suggested retail price of \$49.95, QuickVerse® 2006 Standard with a suggested retail price of \$99.95, QuickVerse® 2006 Expanded with a suggested retail price of \$199.95, QuickVerse® 2006 Deluxe with a suggested retail price of \$299.95 and QuickVerse® 2006 Platinum with a suggested retail price of \$799.95.

First Quarter 2006

QuickVerse® 2006 Parable Edition, with a suggested retail price of \$49.95; and QuickVerse® 2006 Bible Suite, with a suggested retail price of \$29.95.

Second Quarter 2006

QuickVerse® 2006 Macintosh Gold Box Edition, with a suggested retail price of \$349.95; and Holman Christian Standard Bible®, with a suggested retail price of \$29.95.

Third Quarter 2006

an enhanced version of our flagship product, QuickVerse®, including QuickVerse® 2007 Bible Suite with a suggested retail price of \$39.95, QuickVerse® 2007 Essentials with a suggested retail price of \$59.95, QuickVerse® 2007 Standard with a suggested retail price of \$129.95, QuickVerse® 2007 Expanded with a suggested retail price of \$249.95, QuickVerse® 2007

Deluxe with a suggested retail price of \$349.95 and QuickVerse® 2007 Platinum with a suggested retail price of \$799.95.

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Of note, and generally, the retail price points for our products released during the nine months ended September 30, 2006 were significantly less than those released during the nine months ended September 30, 2005. Furthermore, due to the unexpected loss of our primary developer for Membership Plus® in May 2005, we have experienced a delay in our annual release of Membership Plus®, which typically is released in the month of February. Membership Plus® 2007 was released in October 2006, following the close of our third quarter. Finally, we believe we experienced a decrease in gross revenues due to the annual early releases of our flagship product, QuickVerse®, which in turn has resulted in an overall net decrease in unit sales. QuickVerse® 2007 Windows was released in August 2006, eleven months following our 2005 QuickVerse® upgrade release and QuickVerse® 2006 Windows was released in September 2005, nine months following our 2004 QuickVerse® upgrade release. In the past, we have experienced greater sales within the first and second quarter of the fiscal year due to the then recent upgrade releases of our two main product lines, QuickVerse® and Membership Plus®.

During each of the quarters ended September 30, 2005 and 2006, our sales efforts were focused on directly targeting end-users through telemarketing and Internet sales. Due to the consistency in our development schedule and the annual releases of our flagship product, QuickVerse®, upgrade sales are not increasing at a rapid rate. However, we anticipate that revenues will increase through 2006 as we continue to expand the content available for our QuickVerse® products, develop new products for multiple platforms, and offer our products at a range of price points intended to appeal to various market sub-segments.

Sales returns and allowances decreased approximately \$130,000 from approximately \$215,000 for the three months ended September 30, 2005 to approximately \$85,000 for the three months ended September 30, 2006, and decreased approximately \$574,000 from approximately \$781,000 for the nine months ended September 30, 2005 to approximately \$207,000 for the nine months ended September 30, 2006. Sales returns and allowances also decreased as a percentage of gross sales from approximately 17% for the nine months ended September 30, 2005 to approximately 7% for the nine months ended September 30, 2006. While this decrease reflects lower actual returns during the nine months ended September 30, 2006, it is mainly attributable to our relative lack of product releases during the nine months ended September 30, 2006. Typically after a new product release, sales returns and allowances trend upward as distributors and retail stores will return old product in exchange for the new product release. With QuickVerse® 2006 Windows shipping in September 2005 as compared to QuickVerse® 2005 Windows in December 2004, just nine months earlier, we experienced a greater increase in sales returns and allowances during the fourth quarter of 2005. Furthermore, sales returns and allowance for the nine months ended September 30, 2005 reflect the release of Membership Plus® 2005 compared to no release of the Membership Plus® product line for the nine months ended September 30, 2006. In addition, due to the extended time-line between the releases of the Membership Plus® product line, we have experienced fewer returns from retail stores as there is no new product to exchange the old product with. During the nine months ended September 30, 2005 the following items contributed to the sales returns and allowances:

- price protections afforded to consumers and retailers who had purchased prior versions of Membership Plus® and QuickVerse® within one year or less of our release of upgraded versions of each of Membership Plus®, in February 2005, and QuickVerse®, in September 2005. Historically, our product upgrades have extended over two to three years and therefore, price protections were not issued;
- increased price points associated with products introduced; and
- higher actual returns on the Membership Plus® 2005 product line due to some then unresolved maintenance issues and the loss of our primary developer of Membership Plus®.

Overall, we expect to release enhanced versions of our biggest-selling products on an annual basis generally going forward, and anticipate sales returns and allowances as a percentage of gross revenues to decrease over time as a result of increased stability in the functionality of our products, decreasing reliance on retail sales and increasing reliance on

direct sales, which have historically resulted in fewer returns, and improved planning in the timing of new product version releases.

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Cost of Sales for Nine Months Ended September 30			% to			
	2006	% to Sales	2005	% to Sales	Change	%
Direct costs	\$ 372,033	13%	\$ 485,674	10%	\$(113,641)	23%
Less reserve for sales returns and allowances	(30,810)	-1%	(116,940)	-2%	86,130	74%
Amortization of software development costs	600,959	22%	524,989	11%	75,970	14%
Royalties	256,737	9%	300,000	6%	(43,263)	14%
Freight-out	76,218	3%	111,188	2%	(34,970)	31%
Fulfillment	86,020	3%	105,280	2%	(19,260)	18%
Cost of sales	\$ 1,361,157	49%	\$ 1,410,191	30%	\$ (49,034)	3%

Cost of sales consists primarily of royalties paid to third party providers of intellectual property and the direct costs and manufacturing overhead required to reproduce, package, fulfill and ship our software products. Direct costs and manufacturing overhead also include amortized software development costs and non-capitalized technical support wages. The direct costs and manufacturing overhead decreased approximately \$6,000 from approximately \$1,110,000 for the nine months ended September 30, 2005 to approximately \$1,104,000 for the nine months ended September 30, 2006 and increased as a percentage of gross revenues approximately 16% for the nine months ended September 30, 2006. The overall percentage increase resulted directly from amortization of software development costs. The amortization recognized during the nine months ended September 30, 2006 resulted from several new software releases in 2005 and 2006 including Membership Plus® 2005, QuickVerse® 2006 Macintosh, Sermon Builder® 4.0, QuickVerse® 2006 Windows, QuickVerse® 2006 Mobile, QuickVerse® 2006 Bible Suite, QuickVerse® 2006 Macintosh Gold Edition, Holman Christian Standard Bible® and QuickVerse 2007® Windows. The shorter timeframes between our product upgrades along with the increased amount of product releases during the fiscal year 2005 led to the increased amount of amortization recognized. During the nine months ended September 30, 2005 we continued to amortize the December 2004 release of QuickVerse® 2005 Windows, the February 2005 release of Membership Plus® 2005, the June 2005 releases of QuickVerse® Macintosh and Sermon Builder® 4.0, the late September 2005 release of QuickVerse® 2006 and the remainder of QuickVerse® 8.0 and Membership Plus® 8.0. The direct costs and manufacturing overhead percentage are expected to continue at these levels as more development projects are implemented in a shortened timeframe.

Fulfillment costs from a third-party warehouse and included in the manufacturing overhead costs noted above decreased approximately \$19,000 from approximately \$105,000 for the nine months ended September 30, 2005 to approximately \$86,000 for the nine months ended September 30, 2006. This decrease is a direct result of decreased sales volume. Furthermore, our fulfillment center continues to improve its efficiency which has led to the lower rate in fulfillment costs.

Similar to the fulfillment costs, freight costs, included in the manufacturing overhead costs noted above, decreased approximately \$35,000 from approximately \$111,000 for the nine months ended September 30, 2005 to approximately

\$76,000 for the nine months ended September 30, 2006. This decrease, too, is related to the decrease in sales volume.

Royalties paid to third party providers of intellectual property decreased approximately \$43,000 from approximately \$300,000 for the nine months ended September 30, 2005 to approximately \$257,000 for the nine months ended September 30, 2006 and increased approximately 3% as a percentage of gross revenues for the nine months ended September 30, 2006. The overall percentage increase in royalties paid for the nine months ended September 30, 2006 reflects the following:

sales of QuickVerse® 2005 editions to a liquidator in the first and third quarters of 2006 and no sales to a liquidator in the first and third quarters of 2005;

our increased sales focus on the QuickVerse® product line which have associated royalty fees;

an increase in retail sales for the QuickVerse® 2007 product line during the month of September 2006 compared to only upgrade sales for the QuickVerse® 2006 product line during the same time frame in 2005; and

our decreased sales focus on the Membership Plus® product line, which has no associated royalty fees. We have experienced a delay in our annual upgrade release of Membership Plus® 2007 and, during the first quarter of 2005, we released an upgrade to Membership Plus® in February 2005.

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The royalty rate as a percentage of gross sales is expected to increase in the future as sales to new users are expected to increase, more development projects are implemented for new and/or enhanced products, and as we continue to expand the content available for our QuickVerse® line of products. Upgrade sales will remain only subject to royalties on their content additions.

We expect all cost of sales will increase in the future as we also anticipate revenues will increase throughout the remainder of our 2006 fiscal year based upon our development schedule for the remainder of the fiscal year and the broadened content made available for our QuickVerse® products.

Software development costs are expensed as incurred as research and development until technological feasibility and marketability have been established, at which time development costs are capitalized until the software title is available for general release to customers. Software development is segregated by title and technology platform. Once a product has been successfully released, subsequent revisions and upgrades are deemed to constitute development, and, accordingly, the costs of the revision and upgrade are capitalized. Capitalized costs are amortized on a product-by-product basis using the greater of (i) straight-line amortization over the estimated life of the product or (ii) the ratio of current revenues from the product to the total projected revenue over the life of the product. Generally, we consider technological feasibility to have been established with the release of a “beta” version for testing.

Our software development costs for the three and nine months ended September 30, 2005 and 2006 are summarized in the table below. These costs, consisting primarily of direct and indirect labor and related overhead charges, capitalized during the three months ended September 30, 2005 and 2006, were approximately \$172,000 and approximately \$174,000, respectively, and during the nine months ended September 30, 2005 and 2006, were approximately \$766,000 and approximately \$412,000, respectively. Accumulated amortization of these development costs, which were included in cost of sales, totaled approximately \$161,000 and approximately \$143,000 for the three months ended September 30, 2005 and 2006, respectively, and approximately \$525,000 and approximately \$601,000 for the nine months ended September 30, 2005 and 2006, respectively. The overall increase in the amortization is a result of the shorter timeframes between our product upgrades along with the increased amount of product releases. Furthermore, the overall decrease in the capitalized costs reflects the decreased amount of product releases for the nine months ended September 30, 2006 as well as that during the nine months ended September 30, 2005 we were capitalizing the development costs related to our QuickVerse® Macintosh product line which was our first product line for the Macintosh platform.

Software Development Costs for	Three Months		Nine Months Ended	
	Ended September 30, 2006	2005	September 30, 2006	2005