IMAGISTICS INTERNATIONAL INC
Form 10-Q
November 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended September 30, 2004

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

For the transition period from _________ to _________

Commission File Number 1-16449

IMAGISTICS INTERNATIONAL INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	06-1611068
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

100 Oakview Drive Trumbull, Connecticut	06611
(Address of Principal Executive Offices)	(Zip Code)

(203) 365-7000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes |X| No |_|

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes |X| No |_|

Number of shares of Imagistics Common Stock, par value $0.01 per share, outstanding as of October 29, 2004: 16,316,269

IMAGISTICS INTERNATIONAL INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

IMAGISTICS INTERNATIONAL INC.

Consolidated Statements of Income
(Dollars in thousands, except per share amounts)
(Unaudited)

	For the three months ended September 30,		For the S
	2004	2003	2004
Revenue:			
Sales	$ 79,589	$ 84,298	$ 237,3
Rentals	51,164	54,239	159,7
Support services	22,302	21,012	65,8
Total revenue	153,055	159,549	462,9
Cost of sales	41,113	52,328	132,4
Cost of rentals	14,159	17,952	45,2
Selling, service and administrative expenses	85,776	76,017	250,6
Operating income	12,007	13,252	34,5
Interest expense	880	4,289	2,6

Income before income taxes	11,127	8,963	31,8
Provision for income taxes	4,720	3,833	13,5
Net income	$ 6,407	$ 5,130	$ 18,2
Earnings per share:			
Basic	$ 0.40	$ 0.31	$ 1.
Diluted	$ 0.38	$ 0.30	$ 1.
Shares used in computing earnings per share:			
Basic	16,145,273	16,471,877	16,255,0
Diluted	16,796,810	17,067,336	16,948,7

See Notes to Consolidated Financial Statements

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IMAGISTICS INTERNATIONAL INC.

Consolidated Balance Sheets
(Dollars in thousands, except per share amounts)
(Unaudited)

	September 3 2004
Assets	
Current assets:	
Cash	$ 12,259
Accounts receivable, net of allowances of $15,537 and $10,575 at September 30, 2004 and December 31, 2003, respectively	111,112
Accrued billings	27,756
Inventories	91,218
Current deferred taxes on income	28,385
Other current assets and prepaid expenses	4,635
Total current assets	275,365
Property, plant and equipment, net	57,756
Rental equipment, net	63,649
Goodwill	65,881
Other assets	5,004
Total assets	$ 467,655
Liabilities and Stockholders' Equity	
Current liabilities:	
Current portion of long-term debt	$ 545
Accounts payable and accrued liabilities	87,635
Advance billings	15,310

Total current liabilities	103,490
Long-term debt	71,495
Deferred taxes on income	19,916
Other liabilities	3,354
Total liabilities	198,255
Commitments and contingencies (see Note 8)	
Stockholders' equity:	
Preferred stock ($1.00 par value; 10,000,000 shares authorized, none issued)	--
Common stock ($0.01 par value; 150,000,000 shares authorized, 19,992,656 and 19,871,061 issued at September 30, 2004 and December 31, 2003, respectively)	200
Additional paid-in-capital	297,572
Retained earnings	53,243
Treasury stock, at cost (3,627,676 and 3,096,878 shares at September 30, 2004 and December 31, 2003, respectively)	(82,746
Unearned compensation	(1,109
Accumulated other comprehensive income	2,240
Total stockholders' equity	269,400
Total liabilities and stockholders' equity	$ 467,655

See Notes to Consolidated Financial Statements

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IMAGISTICS INTERNATIONAL INC.

Consolidated Statements of Cash Flows
(Dollars in thousands)
(Unaudited)

	For the nine months ended September 30,	
	2004	2003
Cash flows from operating activities:		
Net income	$ 18,262	$ 14,922
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	49,763	56,547
Provision for bad debt	10,417	5,686
Provision for inventory obsolescence	2,736	5,147
Deferred taxes on income	(2,196)	4,195
Change in assets and liabilities, net of acquisitions:		
Accounts receivable	(12,114)	7,015
Accrued billings	(6,894)	(1,383)
Inventories	(5,656)	3,664
Other current assets and prepaid expenses	226	2,088
Accounts payable and accrued liabilities	4,986	(14,720)
Advance billings	(1,504)	(1,343)
Other, net	(601)	2,552
Net cash provided by operating activities	57,425	84,370

Cash flows from investing activities:		
Expenditures for rental equipment assets	(34,802)	(28,022)
Expenditures for property, plant and equipment	(11,604)	(13,679)
Acquistions, net of cash acquired	(12,202)	(4,139)
Net cash used in investing activities	(58,608)	(45,840)
Cash flows from financing activities:		
Exercises of stock options, including sales under employee stock purchase plan	2,389	1,964
Purchases of treasury stock	(20,476)	(26,186)
Repayments under term loan	(409)	(20,562)
Net borrowings under revolving credit facility	9,000	--
Net cash used in financing activities	(9,496)	(44,784)
Decrease in cash	(10,679)	(6,254)
Cash at beginning of period	22,938	31,325
Cash at end of period	$ 12,259	$ 25,071

See Notes to Consolidated Financial Statements

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IMAGISTICS INTERNATIONAL INC.
Notes to Consolidated Financial Statements
(Dollars in thousands, except per share amounts and as otherwise indicated)
(Unaudited)

1. Background and Basis of Presentation

Background

Imagistics International Inc. (the "Company" or "Imagistics") is a large direct sales, service and marketing organization offering business document imaging and management solutions, including copiers, multifunctional products and facsimile machines, in the United States, Canada and United Kingdom. The Company's primary customers include large corporate customers known as national accounts, government entities and mid-size and regional businesses known as commercial accounts. Multifunctional products, often referred to as MFPs, offer the multiple functionality of printing, copying, scanning and faxing in a single unit. In addition, the Company offers a range of document imaging options including digital, analog, color and/or networked products and systems.

On December 11, 2000, the board of directors of Pitney Bowes Inc. ("Pitney Bowes") initiated a plan to spin-off substantially all of its office systems businesses to its stockholders as an independent publicly traded company. On December 3, 2001, Imagistics was spun off from Pitney Bowes pursuant to a contribution by Pitney Bowes of substantially all of its United States office systems businesses to the Company and a distribution of the stock of the Company to stockholders of Pitney Bowes based on a distribution ratio of 1 share of Imagistics common stock for every 12.5 shares of Pitney Bowes common stock held at the close of business on November 19, 2001 (the "Distribution").

The Company was incorporated in Delaware on February 28, 2001 as Pitney Bowes Office Systems, Inc., a wholly owned subsidiary of Pitney Bowes. On that date, 100 shares of the Company's common stock, par value $0.01 per share, were authorized, issued and outstanding. On October 12, 2001, the Company changed its

name to Imagistics International Inc. At the Distribution, the Company's authorized capital stock consisted of 10,000,000 shares of preferred stock, par value $1.00 per share and 150,000,000 shares of common stock, par value $0.01 per share. The Company issued 19,463,007 shares of common stock in connection with the Distribution described above.

Pitney Bowes received tax rulings from the Internal Revenue Service stating that, subject to certain representations, the Distribution qualified as tax-free to Pitney Bowes and its stockholders for United States federal income tax purposes.

Basis of presentation

The unaudited interim consolidated financial statements of the Company have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (the "SEC") and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of the management of the Company, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of results of operations, financial position and cash flows as of and for the periods presented have been included. Certain previously reported amounts have been reclassified to conform to the current year presentation.

The Company believes that the disclosures contained in the unaudited interim consolidated financial statements are adequate to keep the information presented from being misleading. The results for the three and nine months ended September 30, 2004 are not necessarily indicative of the results for the full year. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's latest Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC on March 12, 2004.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

2. Summary of Significant Accounting Policies

Revenue recognition

Revenue on equipment and supplies sales is recognized when contractual obligations have been satisfied, title and risk of loss have been transferred to the customer and collection of the resulting receivable is reasonably assured. For copier/MFP equipment, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the installation of the equipment at the customer location. For facsimile equipment and facsimile supplies, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the delivery of the facsimile equipment and the facsimile supplies to the customer location. The Company records a provision for estimated sales returns and other allowances based upon historical experience.

Rental contracts, which often include supplies, are generally for an initial term of three years with automatic renewals unless the Company receives prior notice of cancellation. Under the terms of rental contracts, the Company bills its customers a flat periodic charge and/or a usage-based fee. Revenues related to these contracts are recognized each month as earned, either using the straight-line method or based upon usage, as applicable. The Company records a provision for estimated usage adjustments on rental contracts based upon historical experience.

Support services contracts, which often include supplies, are generally for an initial term of one year with automatic renewals unless the Company receives prior notice of cancellation. Under the terms of support services contracts, the Company bills its customers either a flat periodic charge and/or a usage-based fee. Revenues related to these contracts are recognized each month as earned, either using the straight-line method or based upon usage, as applicable. The Company records a provision for estimated usage adjustments on service contracts based upon historical experience.

Certain rental and support services contracts provide for invoicing in advance, generally quarterly. Revenue on contracts billed in advance is deferred and recognized as earned revenue over the billed period. Certain rental and support services contracts provide for invoicing in arrears, generally quarterly. Revenue on contracts billed in arrears is accrued and recognized in the period in which it is earned.

The Company enters into arrangements that include multiple deliverables, which typically consist of the sale of equipment with a support services contract. The Company accounts for each element within an arrangement with multiple deliverables as separate units of accounting. Revenue is allocated to each unit of accounting based on the residual method, which requires the allocation of the revenue based on the fair value of the undelivered items. Fair value of support services is primarily determined by reference to renewal pricing of support services contracts when sold on a stand-alone basis.

Accounts receivable

Accounts receivable are stated at net realizable value by recording allowances for those accounts receivable amounts that the Company believes are uncollectible. The Company's estimate of losses is based on prior collection experience and includes evaluating the credit worthiness of each of the Company's customers, analyzing historical bad debt write-offs and reviewing the aging of the receivables. The Company's allowance for doubtful accounts includes amounts for specific accounts that it believes are uncollectible, as well as amounts that have been computed by applying certain percentages based on historic loss trends, to certain accounts receivable aging categories and estimated amounts relating to delinquencies associated with the changes in the Company's billing policies and invoice format resulting from the implementation of the Company's enterprise resource planning ("ERP") system.

Inventories

Inventories are valued at the lower of cost or market. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values. Inventory provisions are calculated using management's best estimates of inventory value based on the age of the inventory, quantities on hand compared with historical and projected usage and current and anticipated demands.

IMAGISTICS INTERNATIONAL INC.
Notes to Consolidated Financial Statements - (continued)

Rental equipment

Rental equipment is comprised of equipment on rent to customers and is depreciated on the straight-line method over the estimated useful life of the equipment. Copier/MFP equipment is depreciated over three years and facsimile equipment placed in service prior to October 1, 2003 is depreciated over five years. Facsimile equipment placed in service on or after October 1, 2003 is depreciated over three years.

Stock-based employee compensation

The Company accounts for its stock-based employee compensation plans under the recognition and measurement provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company recognizes stock-based compensation expense on its restricted stock on a straight-line basis over the vesting period. The Company does not recognize stock-based compensation expense on its stock options in its reported results as all options granted, other than adjustment options in connection with the Distribution, had an exercise price equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," to stock-based employee compensation:

	For the three months ended September 30,	
	2004	2003
Net income, as reported	$ 6,407	$ 5,130
Add: Stock-based compensation expense included in net income, net of related tax effects	471	423
Deduct: Total stock-based compensation expense based on the fair value method, net of related tax effects	(1,147)	(956)
Pro forma net income	$ 5,731	$ 4,597
Basic earnings per share:		
As reported	$ 0.40	$ 0.31
Pro forma	$ 0.35	$ 0.28
Diluted earnings per share:		
As reported	$ 0.38	$ 0.30
Pro forma	$ 0.34	$ 0.27

3. Supplemental Information

Inventories

Inventories consisted of the following at September 30, 2004 and December

31, 2003:

	September 30, 2004	December 31, 2003
Finished products	$48,607	$50,726
Supplies and service parts	42,611	35,408
Total inventories	$91,218	$86,134

Fixed assets and rental equipment assets

Fixed assets and rental equipment assets consisted of the following at September 30, 2004 and December 31, 2003:

	September 30, 2004	December 31, 2003
Land	$ 1,356	$ 1,356
Buildings and leasehold improvements	12,125	10,976
Machinery and equipment	24,275	23,474
Computers and software	56,413	47,356
Property, plant and equipment, gross	94,169	83,162
Accumulated depreciation	(36,413)	(29,958)
Property, plant and equipment, net	$ 57,756	$ 53,204
Rental equipment, gross	$ 313,592	$ 333,563
Accumulated depreciation	(249,943)	(266,384)
Rental equipment, net	$ 63,649	$ 67,179

Depreciation and amortization expense was $16.1 million and $49.8 million for the three and nine months ended September 30, 2004, respectively, and $18.5 million and $56.5 million for the three and nine months ended September 30, 2003, respectively. Unamortized software costs totaled $32.5 million as of September 30, 2004 and $27.0 million as of December 31, 2003. Amortization expense on account of capitalized software totaled $1.0 million and $3.0 million for the three and nine months ended September 30, 2004, respectively, and $0.2 million and $0.6 million for the three and nine months ended September 30, 2003, respectively.

Current liabilities

Accounts payable and accrued liabilities consisted of the following at September 30, 2004 and December 31, 2003:

	September 30, 2004	December 31, 2003
Accounts payable	$32,846	$33,237
Income taxes payable	8,669	6,743
Group medical insurance payable	7,137	8,068
Accrued compensation and benefits	8,543	8,321
Other non-income taxes payable	5,856	6,626
Other accrued liabilities	24,584	16,296
Accounts payable and accrued liabilities	$87,635	$79,291

Comprehensive income

Comprehensive income consisted of the following for the three and nine months ended September 30, 2004 and 2003:

	For the three months ended September 30,		For the nine month September 30	
	2004	2003	2004	
Net income	$6,407	$5,130	$18,262	$1
Translation adjustment	399	864	478	
Unrealized gain on cash flow hedges	--	791	--	
Reclassification adjustment for realized loss on cash flow hedges included in net income	--	2,841	--	
Comprehensive income	$6,806	$9,626	$18,740	$2

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IMAGISTICS INTERNATIONAL INC.
Notes to Consolidated Financial Statements - (continued)

Treasury stock

The following table summarizes the Company's treasury stock transactions:

	Treasury stock	
	Shares	Cost
Balance at December 31, 2003	3,096,878	$ 62,783
Purchases under stock buy back program	554,000	20,476
Sales to employees under employee stock purchase plan	(23,202)	(513)

Balance at September 30, 2004	3,627,676	$ 82,746

Cash flow information

Cash paid for income taxes was $14.0 million and $12.5 million for the nine months ended September 30, 2004 and 2003, respectively. Cash paid for interest was $2.0 million and $7.3 million for the nine months ended September 30, 2004 and 2003, respectively.

4. Business Segment Information

The Company operates in two reportable segments based on geographic area: North America and the United Kingdom. Revenues are attributed to geographic regions based on where the revenues are derived.

	For the three months ended September 30,		For the nine months en September 30,	
	2004	2003	2004	2003
Revenues:				
North America	$148,085	$154,778	$446,845	$451,1
United Kingdom	4,970	4,771	16,059	15,2
Total revenues	$153,055	$159,549	$462,904	$466,3
Income before income taxes:				
North America	$ 10,511	$ 8,172	$ 29,382	$ 23,0
United Kingdom	616	791	2,434	2,7
Total income before income taxes	$ 11,127	$ 8,963	$ 31,816	$ 25,7

Revenues from Pitney Bowes, substantially all of which are generated in the North America segment, consisted of the following for the three and nine months ended September 30, 2004 and 2003:

	For the three months ended September 30,		For the nine months en September 30,	
	2004	2003	2004	2003
Revenues from Pitney Bowes:				
Pitney Bowes of Canada	$ 1,688	$ 8,714	$ 13,435	$ 21,39
Other subsidiaries of Pitney Bowes	6,364	5,849	17,366	19,21
Sub-total	8,052	14,563	30,801	40,60
Pitney Bowes Credit Corporation	25,003	23,470	69,513	68,83
Total	$33,055	$38,033	$100,314	$109,43

For the periods presented, Pitney Bowes Credit Corporation ("PBCC") was the Company's primary lease vendor and the Company expects PBCC to continue as the Company's primary lease vendor in the future. However, if PBCC were to cease being the Company's primary lease vendor, the Company is confident that it could obtain a replacement primary lease vendor with substantially the same lease terms as PBCC. No other single customer or controlled group represented 10% or more of the Company's revenues.

The following tables show identifiable long-lived assets and total assets for each reportable segment at September 30, 2004 and December 31, 2003.

	September 30, 2004	December 31, 2003
Identifiable long-lived assets:		
North America	$189,193	$176,157
United Kingdom	3,097	3,954
Total identifiable long-lived assets	$192,290	$180,111
Total assets:		
North America	$451,775	$428,885
United Kingdom	15,880	17,847
Total assets	$467,655	$446,732

Identifiable long-lived assets in North America included goodwill of $65.9 million and $55.4 million at September 30, 2004 and December 31, 2003, respectively.

Concentrations

Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers and relatively small account balances within the majority of the Company's customer base and their dispersion across different businesses. The Company periodically evaluates the financial strength of its customers and believes that its credit risk exposure is limited.

Most of the Company's product purchases are from overseas vendors, the majority of which are from a limited number of Japanese suppliers who operate manufacturing facilities in Asia. Although the Company currently sources products from a number of manufacturers throughout the world, a significant portion of new copier/MFP equipment is currently obtained from four Japanese suppliers. If these suppliers were unable to deliver products for a significant period of time, the Company would be required to find replacement products from an alternative supplier or suppliers, which may not be available on a timely or cost effective basis. The Company's operating results could be adversely affected if a significant supplier was unable to deliver sufficient product.

5. Earnings Per Share Calculation

Basic earnings per share was calculated by dividing net income available

to common stockholders by the weighted average number of common shares outstanding during the applicable period. Diluted earnings per share was calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding plus all dilutive common stock equivalents outstanding during the applicable period. The calculation of diluted earnings per share did not include shares underlying approximately 111,775 and 2,700 options for the three months ended September 30, 2004 and 2003, respectively, since they were antidilutive for the periods presented. The calculation of diluted earnings per share did not include shares underlying approximately 17,900 and 7,900 options for the nine months ended September 30, 2004 and 2003, respectively, since they were antidilutive for the periods presented.

A reconciliation of the basic and diluted earnings per share computation is as follows:

	For the three months ended September 30,	
	2004	2003
Net income available to common stockholders	$ 6,407	$ 5,130
Weighted average common shares for basic earnings per share	16,145,273	16,471,877
Add: dilutive effect of restricted stock	229,141	186,106
Add: dilutive effect of stock options	422,396	409,353
Weighted average common shares and equivalents for diluted earnings per share	16,796,810	17,067,336
Basic earnings per share	$ 0.40	$ 0.31
Diluted earnings per share	$ 0.38	$ 0.30

6. Goodwill and Goodwill Amortization

The Company accounts for goodwill in accordance with SFAS No. 142 "Goodwill and Other Intangible Assets," which requires that goodwill and certain other intangible assets having indefinite lives no longer be amortized to earnings, but instead be tested for impairment annually and on an interim basis if events or changes in circumstances indicate that goodwill might be impaired. The Company performed its annual test for impairment as of October 1, 2004 using the discounted cash flow valuation method. There was no impairment to the value of the Company's recorded goodwill. The carrying value of goodwill as of September 30, 2004 increased $10.1 million as a result of the Company's recent acquisitions (see Note 10). The carrying value of goodwill of $65.9 million as of September 30, 2004 is attributable to the North America geographic segment.

7. Long-Term Debt

Long-term debt consisted of the following at September 30, 2004 and December 31, 2003:

	September 30, 2004	December 31, 2003
Revolving Credit Facillity	$ 19,000	$ 10,000
Term Loan	53,040	53,448
Less: current maturities	(545)	(545)
Total long-term debt	$ 71,495	$ 62,903

On November 9, 2001, the Company entered into a Credit Agreement with a group of lenders (the "Credit Agreement") that provided for secured borrowings and the issuance of letters of credit in an aggregate amount not to exceed $225.0 million, comprised of a $125.0 million Revolving Credit Facility (the "Revolving Credit Facility") and a $100.0 million Term Loan (the "Term Loan"). The Credit Agreement required the Company to manage its interest rate risk with respect to at least 50% of the aggregate principal amount of the Term Loan for a period of at least 36 months. Accordingly, the Company entered into two interest rate swap agreements in notional amounts of $50.0 million and $30.0 million to convert the variable interest rate payable on the Term Loan to a fixed interest rate in order to hedge the exposure to variability in expected future cash flows. These interest rate swap agreements were designated as cash flow hedges.

On March 19, 2002, the Credit Agreement was amended to increase the total amount of the Company's stock permitted to be repurchased from $20.0 million to $30.0 million. On July 19, 2002, the Credit Agreement was amended to increase the total amount of the Company's stock permitted to be repurchased from $30.0 million to $58.0 million and to reduce the Term Loan interest rates to LIBOR plus a margin of from 2.75% to 3.75%, from LIBOR plus a margin of from 3.50% to 3.75%, depending on the Company's leverage ratio, or the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, from the Fleet Bank base lending rate plus a margin of from 2.50% to 2.75%, depending on the Company's leverage ratio. On March 5, 2003, the Credit Agreement was amended to increase the total amount of the Company's stock permitted to be repurchased from $58.0 million to $78.0 million, to reduce the minimum earnings before interest, taxes, depreciation and amortization covenant to $100.0 million for the remainder of the term of the Credit Agreement and to revise the limitation on capital expenditures. On May 16, 2003, the Credit Agreement was amended (the "Fourth Amendment") to reduce the aggregate amount of the Revolving Credit

Facility from $125.0 million to $95.0 million, to delete the requirement that the Company maintain interest rate protection with respect to at least 50% of the aggregate principal amount of the Term Loan, to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 2.25%, from LIBOR plus a margin of from 2.75% to 3.75%, depending on the Company's leverage ratio, or to the Fleet Bank base lending rate plus a margin of 1.25%, from the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, depending on the Company's leverage ratio, to reduce and fix the Revolving Credit Facility interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of from 2.25% to 3.00%, depending on the Company's leverage ratio, or to the Fleet Bank base lending rate plus a margin of 0.25%, from the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on the Company's leverage ratio and to fix the

commitment fee at 0.375% on the average daily unused portion of the Revolving Credit Facility from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility, depending on the Company's leverage ratio. On May 7, 2004, the Credit Agreement was amended (the "Fifth Amendment") to increase the amount of the Company's stock permitted to be repurchased from $78.0 million to $108.0 million, to increase the aggregate amount of acquisition consideration payable for acquisitions from $30.0 million to $60.0 million and to remove the requirement for annual borrowing base audits so long as $50.0 million or more of borrowings are available under the Credit Agreement and the fixed charge ratio, as defined in the Fifth Amendment, is 2.0 or higher. Effective June 1, 2004, the Credit Agreement was further amended (the "Sixth Amendment") to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of 2.25%, or to the Fleet Bank base lending rate plus a margin of 0.25%, from the Fleet Bank base lending rate plus a margin of 1.25%.

During the third quarter of 2003, the Company revised its cash flow estimates and prepaid $20.0 million of the amount outstanding under the Term Loan. In light of this revision, the deletion of the interest rate protection requirement resulting from the Fourth Amendment and the Company's consistent historical positive cash flow and near term estimated operating and capital expenditure requirements, the Company disposed of its two interest rate swap agreements in the notional amounts of $50.0 million and $22.0 million. Accordingly, the Company reclassified $2.8 million from accumulated other comprehensive income (loss) into interest expense because it was no longer probable that the hedged forecasted transactions would occur.

8. Commitments and Contingencies

Guarantees and indemnifications

The Company has applied the disclosure provisions of FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Direct Guarantees of Indebtedness of Others," to its agreements that contain guarantee or indemnification clauses. FIN No. 45 expands the disclosure provisions required by SFAS No. 5, "Accounting for Contingencies," by requiring the guarantor to disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance is remote. The following is a description of the arrangements in which the Company is a guarantor.

In connection with the Distribution, the Company entered into certain agreements pursuant to which it may be obligated to indemnify Pitney Bowes with respect to certain matters. The Company agreed to assume all liabilities associated with the Company's business, and to indemnify Pitney Bowes for all claims relating to the Company's business. These may be claims by or against Pitney Bowes or the Company relating to, among other things, contractual rights under vendor, insurance or other contracts, trademark, patent and other intellectual property rights, equipment, service or payment disputes with customers and disputes with employees.

The Company and Pitney Bowes entered into a tax separation agreement, which governs the Company's and Pitney Bowes' respective rights, responsibilities and obligations after the Distribution with respect to taxes for the periods ending on or before the Distribution. In addition, the tax separation agreement generally obligated the Company not to enter into any transaction that would adversely affect the tax-free nature of the Distribution for the two-year period following the Distribution, and obligates the Company to indemnify Pitney Bowes and affiliates to the extent that any action the Company takes or fails to take gives rise to a tax liability with respect to the Distribution.

It is not possible to predict the maximum potential future payments under

these agreements. As of September 30, 2004, the Company has not paid any material amounts pursuant to the above indemnifications other than expenses incurred in connection with the defense and settlement of assumed claims asserted in connection with the operation of the Company in the ordinary course of business. The Company believes that if it were to incur a loss in any of these matters, such loss would not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Legal matters

In connection with the Distribution, the Company agreed to assume all liabilities associated with its business, and to indemnify Pitney Bowes for all claims relating to its business. In the normal course of business, the Company has been party to occasional lawsuits relating to the Company's business. These may involve litigation or other claims by or against Pitney Bowes or the Company relating to, among other things, contractual rights under vendor, insurance or other contracts, trademark, patent and other intellectual property rights, equipment, service or payment disputes with customers and disputes with employees.

In connection with the Distribution, liabilities were transferred to the Company for matters where Pitney Bowes was a plaintiff or a defendant in lawsuits, relating to the business or products of the Company. The Company has not recorded liabilities for loss contingencies related to these and other subsequent proceedings since the ultimate resolutions of the legal matters cannot be determined and a minimum cost or amount of loss cannot be reasonably estimated. In the opinion of the Company's management, none of these proceedings, individually or in the aggregate, should have a material adverse effect on the Company's financial position, results of operations or cash flows.

Risks and uncertainties

In October 2003, the Company implemented Phase II of its ERP system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. The Company believes that it has satisfactorily resolved the issues relating to delays in product shipments and service responsiveness initially experienced in connection with the ERP system implementation. However, as the Company stabilizes the ERP system, it continues to experience certain processing inefficiencies affecting billings, which in turn have negatively impacted accounts receivable levels and the calculation of sales compensation. In addition, delays in the implementation of certain automated tools to assist in collection activities have contributed to the increase in accounts receivable. The Company's ability to return accounts receivable to historical levels has been impacted by delays in collections resulting from customer inquiries relating to changes to billing policies and invoice format, an increase in billing adjustment activity, the temporary suspension of account statement and collection notice mailings on delinquent amounts and delays in processing customer invoicing. In August 2004, the Company resumed mailing account statements and delinquent account notices to customers. The Company believes that much of the increase in accounts receivable will not be permanent. However, a portion of the Company's increase in accounts receivable results from the standardization of its billing practices and schedules across all product lines and the continuing shift in product mix towards the copier/MFP product line, for

which the usage-based billing is more complex. The Company believes that the portion of the increase in accounts receivable related to changes in billing schedules and product mix represents a permanent structural change. The Company has provided for collection losses on the increase in accounts receivable at rates higher than its historical experience. However, if collection losses related to accounts receivable are higher than the amounts provided, the Company would recognize an additional increase in its provision for bad debt.

With respect to the calculation of sales compensation, the Company continues to work through certain of the processing inefficiencies resulting in data inaccuracies and potential inaccuracies in calculated sales compensation. Due to these issues, the Company has continued to apply alternate methodologies to calculate and pay sales compensation. The Company believes that it has recognized the proper amount of sales compensation. However, there is a potential that the resolution of these data inaccuracies could result in additional expense for sales compensation.

The Company remains engaged in a period of stabilization and clean up, as is typical of a large ERP system implementation. During the fourth quarter of 2004 and the first quarter of 2005, the Company will be implementing Phase III of its ERP system, primarily comprised of certain automated tools to assist in invoice dispute resolution and collection activities. The Company believes that the implementation of these automated tools will assist the Company's progress in collecting its accounts receivable beginning in the fourth quarter of 2004. In the month of October, the Company experienced certain unforeseen system performance issues, which have resulted in delays in invoicing the Company's customers. While the Company believes that the performance issues are temporary, the Company expects to experience delays in customer cash receipts negatively impacting accounts receivable during the fourth quarter as a result of the delayed October invoicing. The Company believes it has identified the causes of these performance issues and that it has implemented appropriate remedies.

The Company anticipates that it will resolve the issues related to its ERP system implementation that are impacting its customer billings, accounts receivable and sales compensation. However, if the Company is unable to do so in a reasonable time frame, these issues could have a negative impact on customer and employee satisfaction and retention, which could result in a potential loss of business. Although no assurance can be given that these efforts related to customer billings, accounts receivable and sales compensation will be successful in the time periods expected, other than the temporary increase in working capital requirements, the Company does not anticipate that these issues will have a material adverse effect on its financial position, results of operations or future cash flows.

The Company is in the process of evaluating and documenting its internal control systems and performing the testing required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires management to document, test and report on the Company's internal controls over financial reporting in its Annual Report on Form 10-K for the year ending December 31, 2004 and for the Company's Independent Auditors to attest to management's assertions. Over the past twelve months, the Company implemented a new ERP system, which has significantly impacted customer billings, accounts receivable and sales compensation. The Company is in a period of stabilization and clean up and additional system implementations are being undertaken in the fourth quarter of 2004 to address issues encountered to date. Management intends to complete its

assessment of internal controls over financial reporting in order to comply with the Section 404 requirements. However, during the course of the Company's testing the Company may identify deficiencies or weaknesses and can provide no assurance that any remediation required will be successful or completed in the time required.

9. Distribution Agreements

The Company and Pitney Bowes entered into a transition services agreement that provided for Pitney Bowes to provide certain services to the Company for a limited time following the Distribution. These services were provided at cost and included information technology, computing, telecommunications, certain accounting, field service of equipment and dispatch call center services. The Company and Pitney Bowes had agreed to an extension until December 31, 2003, of the transition services agreement as it related to information technology and related services. Services provided under this extension were at negotiated market rates. Except for field service of equipment, all of the services provided by Pitney Bowes under these agreements have ceased in accordance with the terms of the agreements.

The Company and Pitney Bowes entered into a one-year service agreement on an arms-length basis relating to field service of equipment in certain remote geographic locations not covered by the Company's direct service organization. This agreement, the initial term of which expired on July 1, 2004, had been extended under the same terms and conditions, through September 30, 2004. Effective October 1, 2004, the Company and Pitney Bowes entered into a three-year service agreement under similar terms and conditions. This agreement expires on September 30, 2007. Services provided under this agreement are at negotiated prices.

The Company paid Pitney Bowes $1.3 million and $3.9 million for the three and nine months ended September 30, 2004, respectively, in connection with field service of equipment. The Company paid Pitney Bowes $3.3 million and $13.7 million for the three and nine months ended September 30, 2003, respectively, in connection with the transition services agreement including field service of equipment and other administrative expenses.

The Company also entered into certain other agreements covering intellectual property, commercial relationships and leases and licensing arrangements. The pricing terms of the products and services covered by the other commercial agreements reflect negotiated prices.

The Company and Pitney Bowes entered into a tax separation agreement, which governs the Company's and Pitney Bowes' respective rights, responsibilities and obligations after the Distribution with respect to taxes for the periods ending on or before the Distribution. In addition, the tax separation agreement generally obligated the Company not to enter into any transaction that would adversely affect the tax-free nature of the Distribution for the two-year period following the Distribution, and obligates the Company to indemnify Pitney Bowes and affiliates to the extent that any action the Company takes or fails to take gives rise to a tax liability with respect to the Distribution.

10. Acquisitions

Effective August 30, 2004, the Company acquired of all of the stock and business of an independent dealer of copier and multifunctional equipment and related support services in Canada, to continue to expand the Company's geographic sales and service capabilities. The aggregate purchase price was $2.4 million, of which $0.4 million was allocated to the net liabilities assumed at the date of acquisition and $2.8 million was allocated to goodwill.

Effective June 15, 2004, the Company acquired substantially all of the assets and business of an independent dealer of copier and multifunctional equipment and related support services in the United States, to expand the Company's geographic sales and service capabilities. The aggregate purchase price was $7.4 million, consisting of $6.0 million cash paid at closing, $0.3 million payable 120 days from closing and four equal annual installments of $0.3 million payable June 15, 2005 through June 15, 2008. Of the aggregate purchase price, $2.3 million was allocated to the assets acquired and liabilities assumed at the date of acquisition and $5.1 million was allocated to intangible and other assets, of which $3.8 million was allocated to goodwill.

Effective March 16, 2004, the Company acquired substantially all of the assets and business of an independent dealer of copier and multifunctional equipment and related support services in Canada, to continue to expand the Company's geographic sales and service capabilities. The aggregate purchase price was $4.4 million, consisting of $3.8 million cash paid at closing, $0.3 million payable 120 days from closing and $0.3 million payable 24 months after closing. Of the aggregate purchase price, $0.6 million was allocated to the assets acquired and liabilities assumed at the date of acquisition and $3.8 million was allocated to intangible and other assets, of which $3.5 million was allocated to goodwill.

Effective August 30, 2003, the Company completed its acquisition of substantially all of the assets and business of an independent dealer of copier and multifunctional equipment and related support services in the United States, to expand the Company's geographic sales and service capabilities. The aggregate purchase price was $4.1 million, of which $0.8 million was allocated to the assets acquired and liabilities assumed at the date of acquisition and $3.3 million was allocated to intangible and other assets, of which $2.8 million was allocated to goodwill.

The above acquisitions were accounted for using the purchase method of accounting and, accordingly, the results of the acquired businesses have been included in the Company's consolidated financial statements from the respective dates of acquisition.

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

The following discussion should be read in conjunction with the audited consolidated financial statements and the notes thereto, included in our latest Annual Report on Form 10-K for the year ended December 31, 2003 filed with the United States Securities and Exchange Commission on March 12, 2004, as well as the unaudited consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Please see "Risk Factors That Could Cause Results To Vary" and "Special Note About Forward-Looking Statements" for a discussion of the uncertainties, risks and assumptions associated with these forward-looking statements. Our actual results could differ materially from those forward-looking statements discussed in this

section. For the purposes of the following discussion, unless the context otherwise requires, "Imagistics International Inc.," "Imagistics," "We" and "Our," refers to Imagistics International Inc. and subsidiaries.

OVERVIEW

Imagistics is a direct sales, service and marketing organization offering business document imaging and management solutions, including copiers, multifunctional products and facsimile machines, in the United States, Canada and United Kingdom. Our primary customers include large corporate customers known as national accounts, government entities and mid-size and regional businesses known as commercial accounts. Multifunctional products, often referred to as MFPs, offer the multiple functionality of printing, copying, scanning and faxing in a single unit. In addition, we offer a range of document imaging options including digital, analog, color and/or networked products and systems.

Our strategic vision is to become the leading independent direct provider of enterprise office imaging and document solutions by providing world-class products and services with unparalleled customer support and satisfaction with a focus on multiple location customers, thus building value for our shareholders, customers and employees. Our strategic initiatives include:

- Maintaining and further strengthening major account relationships,
- Expanding our product offerings through our sourcing and distribution relationships,
- Increasing outreach of our direct sales and service force to the copier/MFP market,
- Focusing on customer needs and
- Pursuing opportunistic expansion and investments.

The principal evolution in our industry and business has been the transition to networked digital copiers/MFPs, away from single-function stand-alone facsimile machines and analog copiers. This transition has resulted in decreased demand for and usage of single function facsimile equipment in the marketplace. We have responded to this market development by focusing our efforts on the growth opportunities existing in our digital copier/MFP product line. As a result, the decrease in facsimile product line revenues has been offset by an increase in our copier/MFP product line revenues.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES

Revenue recognition

Revenue on equipment and supplies sales is recognized when contractual obligations have been satisfied, title and risk of loss have been transferred to the customer and collection of the resulting receivable is reasonably assured. For copier/MFP equipment, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the installation of the equipment at the customer location. For facsimile equipment and facsimile supplies, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the delivery of the facsimile equipment and the facsimile supplies to the customer location. We record a provision for estimated sales returns and other allowances based upon historical experience.

Rental contracts, which often include supplies, are generally for an

initial term of three years with automatic renewals unless we receive prior notice of cancellation. Under the terms of rental contracts, we bill our customers a flat periodic charge and/or a usage-based fee. Revenues related to these contracts are recognized each month as earned, either using the straight-line method or based upon usage, as applicable. We record a provision for estimated usage adjustments on rental contracts based upon historical experience.

Support services contracts, which often include supplies, are generally for an initial term of one year with automatic renewals unless we receive prior notice of cancellation. Under the terms of support services contracts, we bill our customers either a flat periodic charge or a usage-based fee. Revenues related to these contracts are recognized each month as earned, either using the straight-line method or based upon usage, as applicable. We record a provision for estimated usage adjustments on service contracts based upon historical experience.

Certain rental and support services contracts provide for invoicing in advance, generally quarterly. Revenue on contracts billed in advance is deferred and recognized as earned revenue over the billed period. Certain rental and support services contracts provide for invoicing in arrears, generally quarterly. Revenue on contracts billed in arrears is accrued and recognized in the period in which it is earned.

We enter into arrangements that include multiple deliverables, which typically consist of the sale of equipment with a support services contract. We account for each element within an arrangement with multiple deliverables as separate units of accounting. Revenue is allocated to each unit of accounting based on the residual method, which requires the allocation of the revenue based on the fair value of the undelivered items. Fair value of support services is primarily determined by reference to renewal pricing of support services contracts when sold on a stand-alone basis.

Accounts receivable

Accounts receivable are stated at net realizable value by recording allowances for those accounts receivable amounts that we believe are uncollectible. Our estimate of losses is based on prior collection experience and includes evaluating the credit worthiness of each of our customers, analyzing historical bad debt write-offs and reviewing the aging of the receivables. Our allowance for doubtful accounts includes amounts for specific accounts that we believe are uncollectible, as well as amounts that have been computed by applying certain percentages based on historic loss trends, to certain accounts receivable aging categories and estimated amounts relating to delinquencies associated with the changes in our billing policies and invoice format resulting from the implementation of our enterprise resource planning ("ERP") system.

Inventories

Inventories are valued at the lower of cost or market. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values. Inventory provisions are calculated using management's best estimates of inventory value based on the age of the inventory, quantities on hand compared with historical and projected usage and current and anticipated demands.

Rental equipment

Rental equipment is comprised of equipment on rent to customers and is depreciated on the straight-line method over the estimated useful life of the equipment. Copier/MFP equipment is depreciated over three years and facsimile equipment placed in service prior to October 1, 2003 is depreciated over five years. Facsimile equipment placed in service on or after October 1, 2003 is depreciated over three years.

Revenues

(Dollars in thousands)

The following table shows our revenue sources by segment for the periods indicated.

	For the three months ended September 30,		For the nine months ended September 30,	
	2004	2003	2004	2003
North America	$148,085	$154,778	$446,845	$451,180
United Kingdom	4,970	4,771	16,059	15,207
Total revenue	$153,055	$159,549	$462,904	$466,387

Our revenue is generated from three lines of business: copier/MFP, facsimile and sales to Pitney Bowes of Canada. The following table shows our revenue and growth rates versus the prior year by revenue type for our three business lines, for the periods indicated. Sales to Pitney Bowes of Canada are presented separately as it operates under a separate reseller agreement. There is no rental or support service revenue associated with Pitney Bowes of Canada.

	For the three months ended September 30,				Fo
	2004		2003		200
	Revenue	Growth Rate	Revenue	Growth Rate	Revenue
Sales					
Copier/MFP products	$ 59,085	8.3%	$ 54,581	11.9%	$ 167,473
Facsimile products	18,816	(10.4%)	21,003	(10.9%)	56,426
Pitney Bowes of Canada	1,688	(80.6%)	8,714	84.4%	13,435
Total sales	79,589	(5.6%)	84,298	9.4%	237,334
Rentals					
Copier/MFP products	28,812	13.1%	25,465	5.8%	82,313
Facsimile products	22,352	(22.3%)	28,774	(15.4%)	77,441

Total rentals	51,164	(5.7%)	54,239	(6.6%)	159,754
Support services					
Copier/MFP products	20,540	7.2%	19,154	3.0%	60,441
Facsimile products	1,762	(5.2%)	1,858	(19.5%)	5,375
Total support services	22,302	6.1%	21,012	0.5%	65,816
Total revenue	$ 153,055	(4.1%)	$ 159,549	2.2%	$ 462,904

The following table shows our revenue and growth rates versus the prior year for our three business lines, for the periods indicated. Sales to Pitney Bowes of Canada are presented separately as it operates under a separate reseller agreement.

	For the three months ended September 30,				For
	2004		2003		200
	Revenue	Growth Rate	Revenue	Growth Rate	Revenue
Revenue					
Copier/MFP products	$ 108,437	9.3%	$ 99,200	8.5%	$ 310,227
Facsimile products	42,930	(16.9%)	51,635	(13.8%)	139,242
Revenue excluding Pitney Bowes of Canada	151,367	0.4%	150,835	(0.3%)	449,469
Pitney Bowes of Canada	1,688	(80.6%)	8,714	84.4%	13,435
Total revenue	$ 153,055	(4.1%)	$ 159,549	2.2%	$ 462,904

Sales to Pitney Bowes of Canada are pursuant to a reseller agreement and are at margins significantly below the typical margins on sales to our direct customers. We expect to maintain a reseller agreement with Pitney Bowes of Canada, however, we are unable to predict the future level of sales to Pitney Bowes of Canada. Although revenue, excluding sales to Pitney Bowes of Canada represents a non-GAAP financial measure, we believe it is useful to analyze revenue excluding sales to Pitney Bowes of Canada in order to better evaluate the effectiveness of our direct sales and marketing initiatives and our pricing policies.

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Results of Operations

The following table shows our statement of income data, expressed as a percentage of total revenue, for the periods indicated. The table also shows cost of sales as a percentage of sales revenue, cost of rentals as a percentage of rental revenue and our effective tax rate:

	As a % of total revenue, excep		
	For the three months ended September 30,		For
	2004	2003	20
Equipment sales	30%	29%	29
Supplies sales	22%	24%	23
Total sales	52%	53%	52
Equipment rentals	33%	34%	34
Support services	15%	13%	14
Total revenue	100%	100%	100
Cost of sales	27%	33%	28
Cost of rentals	9%	11%	10
Selling, service and administrative expenses	56%	48%	54
Operating income	8%	8%	8
Interest expense	1%	3%	1
Income before income taxes	7%	5%	7
Provision for income taxes	3%	2%	3
Net income	4%	3%	4
Cost of sales as a percentage of sales revenue	51.7%	62.1%	55.
Cost of rentals as a percentage of rental revenue	27.7%	33.1%	28.
Effective tax rate	42.4%	42.8%	42.

Three months ended September 30, 2004 and September 30, 2003

Revenue. For the three months ended September 30, 2004, total revenue of $153.1 million decreased 4.1% versus revenue of $159.5 million for the three months ended September 30, 2003 reflecting lower sales to Pitney Bowes of Canada and lower facsimile revenue, partially offset by higher copier/MFP rentals, sales and support services revenue. Excluding the impact of revenue attributable to sales to Pitney Bowes of Canada, which operates under a reseller agreement, total revenue for the third quarter was 0.4% higher versus the prior year.

Equipment and supplies sales revenue of $79.6 million decreased 5.6% for the three months ended September 30, 2004 from $84.3 million for the three months ended September 30, 2003, reflecting lower sales to Pitney Bowes of Canada and lower facsimile sales, partially offset by higher copier/MFP sales. Excluding the impact of sales to Pitney Bowes of Canada, total sales revenue increased 3.1% compared with the prior year. Copier/MFP sales increased 8.3% reflecting growth across all market segments including our geographic expansion of sales as described in Note 10 of our "Notes to Consolidated Financial Statements." Facsimile sales declined 10.4% compared with the prior year primarily due to lower supplies sales from the acceleration in the expected

continuing industry-wide reduction in facsimile usage.

Equipment rental revenue of $51.2 million for the three months ended September 30, 2004 declined 5.7% versus equipment rental revenue of $54.2 million for the three months ended September 30, 2003, reflecting acceleration of the continuing expected decline in facsimile revenues, partially offset by an increase in copier/MFP rental revenues resulting from a continuing copier/MFP marketing focus. Rental revenue derived from our copier/MFP product line increased 13.1% primarily reflecting the impact of additional rental placements and a continuing increase in page volumes. The rate of growth in copier/MFP rental revenue is expected to moderate in the fourth quarter as certain copier/MFP rental contracts with the federal government are expiring and are not expected to be renewed. Rental revenue from our facsimile product line declined 22.3% versus the prior year reflecting acceleration of the decline in the rental installed base due in part to rental to sale conversions and lower per unit pricing.

Support services revenue for the three months ended September 30, 2004 of $22.3 million, primarily derived from stand-alone service contracts, increased 6.1% versus support services revenue of $21.0 million for the three months ended September

30, 2003, reflecting higher copier/MFP service revenue in response to copier/MFP equipment sales growth, partially offset by lower facsimile service revenue.

Cost of sales. Cost of sales was $41.1 million for the three months ended September 30, 2004 compared with $52.3 million for the same period in 2003 and cost of sales as a percentage of sales revenue decreased to 51.7% for the three months ended September 30, 2004 from 62.1% for the three months ended September 30, 2003. This decrease was primarily due to lower copier/MFP product cost, lower inventory obsolescence charges and a lower proportion of sales to Pitney Bowes of Canada, which are at substantially lower gross margins than direct sales, partially offset by the continuing shift in product mix toward copier/MFP products, which have a higher cost as a percentage of sales revenue than the facsimile product line.

Cost of rentals. Cost of rentals was $14.2 million for the three months ended September 30, 2004 compared with $18.0 million for the three months ended September 30, 2003 and cost of rentals as a percentage of rental revenue declined 5.4 percentage points to 27.7% for the three months ended September 30, 2004 from 33.1% for the three months ended September 30, 2003. This decline was due to product cost improvements and the impact of our disciplined focus on improving profit margins, partially offset by an increase in the continuing mix of copier/MFP product rentals, which have a higher cost as a percentage of rental revenue than facsimile machines.

Selling, service and administrative expenses. Selling, service and administrative expenses of $85.8 million were 56.0% of total revenue for the three months ended September 30, 2004 compared with $76.0 million, or 47.6% of total revenue for the three months ended September 30, 2003. Selling, service and administrative expenses increased 12.8% versus the prior year primarily resulting from higher compensation costs related to the increase in copier/MFP revenue coupled with increased sales headcount, higher ERP-related administrative costs, increased bad debt expense, higher operating expenses associated with expansion of direct distribution capabilities and the absence of a property damage insurance claim recovery we recorded in the third quarter of 2003 related to the World Trade Center.

Field sales and service operating expenses are included in selling, service and administrative expenses because no meaningful allocation of these expenses to cost of sales, cost of rentals or cost of support services is practicable.

Interest expense. Interest expense decreased to $0.9 million for the three months ended September 30, 2004 from $4.3 million for the three months ended September 30, 2003 primarily resulting from the reclassification of $2.8 million to interest expense from other comprehensive income (loss) related to our interest rate swap agreements in the third quarter of 2003 as well as lower interest rates, partially offset by higher debt levels. The weighted average interest rate for the three months ended September 30, 2004 was 2.8% versus 6.0% for the three months ended September 30, 2003.

Effective tax rate. Our effective tax rate was 42.4% for the three months ended September 30, 2004 compared with 42.8% for the three months ended September 30, 2003 due to a decrease in state and local income taxes.

Nine months ended September 30, 2004 and September 30, 2003

Revenue. For the nine months ended September 30, 2004, total revenue of $462.9 million decreased slightly versus revenue of $466.4 million for the nine months ended September 30, 2003 reflecting lower sales to Pitney Bowes of Canada and lower facsimile revenue, partially offset by higher copier/MFP revenue. Excluding the impact of revenue attributable to sales to Pitney Bowes of Canada, which operates under a reseller agreement, total revenue for the nine months ended September 30, 2004 increased 1.0% versus the same period in the prior year.

Equipment and supplies sales revenue of $237.3 million increased 0.5% for the nine months ended September 30, 2004 from $236.2 million for the nine months ended September 30, 2003, reflecting higher copier/MFP sales, partially offset by lower sales to Pitney Bowes of Canada and lower facsimile sales. Excluding the impact of sales to Pitney Bowes of Canada, total sales revenue increased 4.2% compared with the prior year. Copier/MFP sales increased 11.6% primarily due to growth in the mid market black and white product segments, our geographic expansion of sales as described in Note 10 of our "Notes to Consolidated Financial Statements" and increased copier/MFP supplies sales. Facsimile equipment and supplies sales declined 13.0% compared with the prior year reflecting the expected continuing industry-wide reduction in facsimile usage.

Equipment rental revenue of $159.8 million for the nine months ended September 30, 2004 declined 4.6% versus equipment rental revenue of $167.4 million for the nine months ended September 30, 2003, reflecting the continuing expected decline in facsimile rental revenues, partially offset by an increase in copier/MFP rental revenues resulting from a continuing copier/MFP marketing focus. Rental revenue derived from our copier/MFP product line increased 9.6% primarily reflecting increased unit placements and the impact of an increase in page volumes. Rental revenue from our facsimile product line declined 16.1% versus the prior year reflecting a decline in the installed base and lower pricing.

Support services revenue for the nine months ended September 30, 2004 of $65.8 million, primarily derived from stand-alone service contracts, increased 4.9% versus support services revenue of $62.7 million for the nine months ended September 30, 2003, reflecting higher copier/MFP service revenue resulting primarily from higher page volumes, partially offset by lower facsimile service revenue.

Cost of sales. Cost of sales was $132.5 million for the nine months ended September 30, 2004 compared with $145.7 million for the same period in 2003 and cost of sales as a percentage of sales revenue decreased to 55.8% for the nine months ended September 30, 2004 from 61.7% for the nine months ended September 30, 2003. This decrease was primarily due to lower copier/MFP product cost, lower inventory obsolescence charges and a lower proportion of sales to Pitney Bowes of Canada, which are at substantially lower gross margins than direct sales, partially offset by the continuing shift in product mix toward copier/MFP products, which have a higher cost as a percentage of sales revenue than the facsimile product line.

Cost of rentals. Cost of rentals was $45.3 million for the nine months ended September 30, 2004 compared with $55.8 million for the nine months ended September 30, 2003 and cost of rentals as a percentage of rental revenue declined 5.0 percentage points to 28.3% for the nine months ended September 30, 2004 from 33.3% for the nine months ended September 30, 2003. This decline was due to product cost improvements coupled with the impact of our disciplined focus on improving profit margins, partially offset by an increase in the continuing mix of copier/MFP product rentals which have a higher cost as a percentage of rental revenue than facsimile machines.

Selling, service and administrative expenses. Selling, service and administrative expenses of $250.6 million were 54.1% of total revenue for the nine months ended September 30, 2004 compared with $231.5 million, or 49.6% of total revenue for the nine months ended September 30, 2003. Selling, service and administrative expenses increased 8.2% versus the prior year primarily resulting from higher compensation and benefit expenses relating to higher copier/MFP revenue coupled with increased sales headcount, higher operating expenses associated with direct distribution expansion, higher administrative costs related to the implementation and stabilization of our ERP system and an increase in bad debt expense. This was partially offset by lower costs resulting from the absence of payments to Pitney Bowes for information technology charges, lower service charges from Pitney Bowes under the transition services agreement, lower advertising expenses and the receipt of a business interruption insurance claim related to the World Trade Center.

Field sales and service operating expenses are included in selling, service and administrative expenses because no meaningful allocation of these expenses to cost of sales, cost of rentals or cost of support services is practicable.

Interest expense. Interest expense decreased to $2.7 million for the nine months ended September 30, 2004 from $7.5 million for the nine months ended September 30, 2003 primarily resulting from the reclassification of $2.8 million to interest expense from other comprehensive income (loss) related to our interest rate swap agreements in the third quarter of 2003 as well as lower interest rates, partially offset by higher debt levels. The weighted average interest rate for the nine months ended September 30, 2004 was 2.9% versus 6.5% for the nine months ended September 30, 2003.

Effective tax rate. Our effective tax rate was 42.6% for the nine months ended September 30, 2004 compared with 42.2% for the nine months ended September 30, 2003 primarily due to an increase in state and local income taxes.

Liquidity and Capital Resources

On November 9, 2001, we entered into a Credit Agreement with a group of lenders (the "Credit Agreement") that provided for secured borrowings or the issuance of letters of credit in an aggregate amount not to exceed $225.0 million, comprised of a $125.0 million Revolving Credit Facility (the "Revolving Credit Facility") and a $100.0 million Term Loan (the "Term Loan"). The term of

the Revolving Credit Facility is five years and the term of the Term Loan is six years.

We have pledged substantially all of our assets plus 65% of the stock of our direct, wholly-owned subsidiaries as security for our obligations under the Credit Agreement. Available borrowings and letter of credit issuance under the Revolving Credit Facility are determined by a borrowing base consisting of a percentage of our eligible accounts receivable, inventory, rental assets and accrued and advance billings, less outstanding borrowings under the Term Loan.

The Credit Agreement contains financial covenants that require the maintenance of minimum earnings before interest, taxes, depreciation and amortization ("EBITDA") and a maximum leverage ratio (total debt to EBITDA), as well as other covenants, which, among other things, place limits on dividend payments and capital expenditures.

Originally, amounts borrowed under the Revolving Credit Facility bore interest at variable rates based, at our option, on either the LIBOR rate plus a margin of from 2.25% to 3.00%, depending on our leverage ratio, or the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on our leverage ratio. Amounts borrowed under the Term Loan bore interest at variable rates based, at our option, on either the LIBOR rate plus a margin of 3.50% or 3.75%, depending on our leverage ratio, or

the Fleet Bank base lending rate plus a margin of 2.50% to 2.75%, depending on our leverage ratio. A commitment fee of from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility was payable quarterly, in arrears, depending on our leverage ratio.

The Credit Agreement required us to manage our interest rate risk with respect to at least 50% of the aggregate principal amount of the Term Loan for a period of at least 36 months. Accordingly, we entered into two interest rate swap agreements in the notional amounts of $50.0 million and $30.0 million to convert the variable interest rate payable on the Term Loan to a fixed interest rate in order to hedge the exposure to variability in expected future cash flows. These interest rate swap agreements had been designated as cash flow hedges. The counterparties to the interest rate swap agreements were major international financial institutions. Under the terms of the swap agreements, we received payments based upon the 90-day LIBOR rate and remitted payments based upon a fixed rate. The fixed interest rates were 4.17% and 4.32% for the $50.0 million and the $30.0 million swap agreements, respectively.

Our initial borrowings of $150.0 million under the Credit Agreement, consisting of $100.0 million under the Term Loan and $50.0 million under the Revolving Credit Facility, were used to repay amounts due to Pitney Bowes and to pay a dividend to Pitney Bowes.

On March 19, 2002, the Credit Agreement was amended to increase the total amount of our stock permitted to be repurchased from $20.0 million to $30.0 million. On July 19, 2002, the Credit Agreement was amended to increase the total amount of our stock permitted to be repurchased from $30.0 million to $58.0 million and to reduce the Term Loan interest rates to LIBOR plus a margin of from 2.75% to 3.75%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, depending on our leverage ratio. On March 5, 2003, the Credit Agreement was amended to increase the total amount of stock permitted to be repurchased from $58.0 million to $78.0 million, to reduce the minimum EBITDA covenant to $100.0 million for the remainder of the term of the Credit Agreement and to revise the limitation on

capital expenditures. On May 16, 2003, the Credit Agreement was amended (the "Fourth Amendment") to reduce the aggregate amount of the Revolving Credit Facility from $125.0 million to $95.0 million, to delete the requirement that we maintain interest rate protection with respect to at least 50% of the aggregate principal amount of the Term Loan, to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 2.25%, from LIBOR plus a margin of from 2.75% to 3.75%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of 1.25%, from the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, depending on our leverage ratio, to reduce and fix the Revolving Credit Facility interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of from 2.25% to 3.00%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of 0.25%, from the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on our leverage ratio and to fix our commitment fee at 0.375% on the average daily unused portion of the Revolving Credit Facility from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility, depending on our leverage ratio. On May 7, 2004, the Credit Agreement was amended (the "Fifth Amendment") to increase the amount of our stock permitted to be repurchased from $78.0 million to $108.0 million, to increase the aggregate amount of acquisition consideration payable for acquisitions from $30.0 million to $60.0 million and to remove the requirement for annual borrowing base audits so long as $50.0 million or more of borrowings are available under the Credit Agreement and the fixed charge ratio, as defined in the Fifth Amendment, is 2.0 or higher. Effective June 1, 2004, the Credit Agreement was further amended (the "Sixth Amendment") to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of 2.25%, or to the Fleet Bank base lending rate plus a margin of 0.25%, from the Fleet Bank base lending rate plus a margin of 1.25%. At September 30, 2004, we were in compliance with all of the financial covenants.

During the third quarter of 2002, we revised our cash flow estimates and prepaid $8.0 million of the amount outstanding under the Term Loan. This prepayment was covered by a portion of the $30.0 million interest rate swap agreement that had been designated as a cash flow hedge. Since it was no longer probable that the hedged forecasted transactions related to the $8.0 million Term Loan prepayment would occur, we recognized a loss related to that portion of the swap agreement underlying the amount of the prepayment by reclassifying $0.4 million from accumulated other comprehensive income (loss) into interest expense. We also unwound $8.0 million of the $30.0 million interest rate swap agreement.

During the third quarter of 2003, we revised our cash flow estimates and prepaid $20.0 million of the amount outstanding under the Term Loan. In light of this revision, the deletion of the interest rate protection requirement resulting from the Fourth Amendment and our consistent historical positive cash flow and near term estimated operating and capital expenditure requirements, we disposed of our two interest rate swap agreements in the notional amounts of $50.0 million and $22.0 million. Accordingly, we reclassified $2.8 million from accumulated other comprehensive income (loss) into interest expense because it was no longer probable that the hedged forecasted transactions would occur.

At September 30, 2004, $72.0 million of borrowings were outstanding under the Credit Agreement, consisting of $19.0 million of borrowings under the Revolving Credit Facility and $53.0 million of borrowings under the Term Loan, and the borrowing base amounted to approximately $118.9 million. Approximately $75.0 million of the Revolving Credit Facility was available for borrowing at September 30, 2004. The Term Loan is payable in 9 consecutive equal quarterly installments of $0.1

million due December 31, 2004 through December 31, 2006, three consecutive equal quarterly installments of $12.9 million due March 31, 2007 through September 30, 2007 and a final payment of $12.9 million due at maturity.

At September 30, 2004 and December 31, 2003, one irrevocable standby letter of credit in the amount of $0.9 million was outstanding as security for our casualty insurance program.

The ratio of current assets to current liabilities decreased to 2.7 to 1 at September 30, 2004 compared to 2.8 to 1 at December 31, 2003 due to an increase in accounts payable and accrued liabilities, partially offset by increases in accrued billings, inventories, current deferred taxes and accounts receivable. At September 30, 2004, our total debt as a percentage of total capitalization increased to 21.1% from 19.2% at December 31, 2003 due to an increase in our debt and stock repurchases under our stock buy back program.

In October 2003, we implemented Phase II of our ERP system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. We believe that we have satisfactorily resolved the issues relating to delays in product shipments and service responsiveness initially experienced in connection with the ERP system implementation. However, as we stabilize the ERP system, we continue to experience certain processing inefficiencies affecting billings, which in turn have negatively impacted accounts receivable levels and the calculation of sales compensation. In addition, delays in the implementation of certain automated tools to assist in collection activities has contributed to the increase in accounts receivable. Our ability to return accounts receivable to historical levels have been impacted by delays in collections resulting from customer inquiries relating to changes to our billing policies and invoice format, an increase in billing adjustment activity, the temporary suspension of account statement and collection notice mailings on delinquent amounts and delays in processing customer invoicing. In August 2004, we resumed mailing account statements and delinquent account notices to customers. We believe that much of the increase in accounts receivable will not be permanent. However, a portion of our increase in accounts receivable results from the standardization of our billing practices and schedules across all product lines and the continuing shift in product mix towards the copier/MFP product line, for which the usage-based billing is more complex. We believe that the portion of the increase in accounts receivable related to changes in billing schedules and product mix represents a permanent structural change. We have provided for collection losses on the increase in accounts receivable at rates higher than our historical experience. However, if collection losses related to accounts receivable are higher than the amounts provided, we would recognize an additional increase in our provision for bad debt.

We remain engaged in a period of stabilization and clean up, as is typical of a large ERP system implementation. During the fourth quarter of 2004 and the first quarter of 2005, we will be implementing Phase III of our ERP system, primarily comprised of certain automated tools to assist in invoice dispute resolution and collection activities. We believe that the implementation of these automated tools will assist in our progress in collecting our accounts receivable beginning in the fourth quarter of 2004. In the month of October, we experienced certain unforeseen system performance issues, which have resulted in delays in invoicing our customers. While we believe that the performance issues are temporary, we expect to experience delays in customer cash receipts negatively impacting accounts receivable during the fourth quarter as a result of the delayed October invoicing. We believe we have identified the causes of these performance issues and that we have implemented appropriate remedies.

Our cash flows from operations, together with borrowings under the Credit

Agreement, are expected to adequately finance our ordinary operating cash requirements and capital expenditures for the foreseeable future. We expect to fund further expansion and long-term growth primarily with cash flows from operations, together with borrowings under the Credit Agreement and possible future sales of additional equity or debt securities.

Net cash provided by operating activities was $57.4 million for the nine months ended September 30, 2004 compared with $84.4 million for the nine months ended September 30, 2003. Net income was $18.3 million and $14.9 million for the nine months ended September 30, 2004 and 2003, respectively. Non-cash charges for depreciation and amortization and provisions for bad debt and inventory obsolescence in the aggregate provided cash of $62.9 million and $67.4 million for the nine months ended September 30, 2004 and 2003, respectively. Changes in the principal components of working capital required $21.0 million and $4.7 million of cash in the nine months ended September 30, 2004 and 2003, respectively. Of the $21.0 million increase in our working capital requirements in the nine months ended September 30, 2004, $12.1 million resulted from an increase in accounts receivable due to delays in collections resulting from customer inquiries related to changes to the Company's billing policies and invoice format, an increase in billing adjustment activity and the temporary suspension of account statement and collection notice mailings on delinquent amounts. In addition, $6.9 million resulted from an increase in accrued billings and $1.5 million resulted from a decrease in advance billings, both related to timing of invoicing to customers. Inventory levels increased $5.6 million resulting from our geographic expansion of sales and service capabilities through our dealer acquisitions (See Note 10 of our "Notes to Consolidated Financial Statements,") and to support new product introductions made in the fourth quarter. This was partially offset by an increase in accounts payable and accrued liabilities of $5.0 million primarily related to the increased inventory purchases. Of the $4.7 million of cash used by working capital changes in the nine months ended September 30, 2003, $14.7 million resulted from a decrease in accounts payable and accrued liabilities primarily related to timing of income tax payments and payments related to 2002 compensation programs. In addition, $1.4 million resulted from an increase in accrued billings and $1.3 million resulted from a decrease in advance billings, both related to timing of invoicing our customers. This was

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partially offset by $7.0 million of net reductions in accounts receivable resulting primarily from collections, $3.7 million resulting from a decrease in inventory levels and $2.0 million resulting from a decrease in other current assets and prepaid expenses.

We used $58.6 million and $45.8 million in investing activities for the nine months ended September 30, 2004 and 2003, respectively. Investment in rental equipment assets totaled $34.8 million and $28.0 million for the nine months ended September 30, 2004 and 2003, respectively. The increased level of rental asset expenditures results primarily from awards of new state rental contracts, partially offset by lower facsimile placements. Capital expenditures for property, plant and equipment were $11.6 million and $13.7 million for the nine months ended September 30, 2004 and 2003, respectively, of which the investment in our ERP system accounted for $8.5 million and $8.3 million, respectively. During the nine months ended September 30, 2004, we acquired three independent dealers to expand our sales and service capabilities as described in Note 10 of our "Notes to Consolidated Financial Statements."

Cash used in financing activities was $9.5 million for the nine months ended September 30, 2004 compared with $44.8 million for the nine months ended September 30, 2003. Net borrowings under the Revolving Credit Facility were $9.0

million for the nine months ended September 30, 2004, while repayments under the Term Loan totaled $20.6 million for the nine months ended September 30, 2003. For the nine months ended September 30, 2004 and 2003 cash was used to repurchase 554,000 shares of our stock at a cost of $20.5 million and 1,205,900 shares at a cost of $26.2 million, respectively.

During the nine month period ended September 30, 2004, we had no material changes in our contractual obligations and commitments. We had no material commitments other than supply agreements with vendors that extend only to equipment supplies and parts ordered under purchase orders; there are no long-term purchase requirements. We will continue to make additional investments in facilities, rental equipment, computer equipment and systems and our distribution network as required to support our operations. We anticipate investments in rental equipment assets for new and replacement programs in amounts consistent with the recent past. We estimate that we will spend approximately $5.0 million over the remainder of 2004 to continue to enhance our information systems infrastructure and implement our ERP system.

Risk Factors that Could Cause Results to Vary

Risk factors relating to our business

The document imaging and management industry is undergoing an evolution in product offerings, moving toward the use of networked, digital and color technology in a multifunctional office environment. Our continued success will depend to a great extent on our ability to respond to this changing environment by developing new options and document imaging solutions for our customers.

The proliferation of e-mail, multifunctional products and other technologies in the workplace has led to a reduction in the use of traditional copiers and facsimile machines. We must be able to continue to obtain products with the appropriate technological advancements in order to remain successful. We cannot anticipate whether other technological advancements will substantially minimize the need for our products in the future.

Because the document imaging solutions industry is very competitive, we may be unable to compete favorably, causing us to lose sales to our competitors, many of whom are substantially larger and possess greater financial resources. Our future success depends, in part, on our ability to deliver enhanced products, service packages and business processes such as e-commerce capabilities, while also offering competitive price levels.

We rely on outside suppliers to manufacture the products that we distribute, many of whom are located in Asia. In addition, our primary suppliers sell products in competition with us, either directly or through dealer channels. Four manufacturers supply a significant portion of our new copier and multifunctional equipment. If these manufacturers discontinue their products or are unable to deliver us products in the future or if political changes, economic disruptions or natural disasters occur where their production facilities are located, we will be forced to identify an alternative supplier or suppliers for the affected product. In addition, although we have worked with our suppliers and freight forwarders to mitigate the potential impacts of an outbreak of infectious disease affecting our supply chain, should our manufacturers become affected by epidemics of infectious diseases, including outbreaks such as severe acute respiratory syndrome, we could be forced to identify an alternative supplier or suppliers for the affected product. Although we are confident that we can identify alternate sources of supply, we may not be successful in doing so. Even if we are successful, the replacement product may be more expensive or may lack certain features of the discontinued product and we may experience some delay in obtaining the product. Other events that disrupt the shipment to or receipt of ocean freight at U.S. ports, such as labor unrest, war or terrorist activity could delay, prevent or add substantial cost to our

receipt of such products. Any of these events would cause disruption to our customers and could have an adverse effect on our business.

We have a geographic dispersion of business and assets located across North America comprised of our sales, service and distribution facilities. Changes in international, national or political conditions, including terrorist attacks could impact the sales, service and distribution of our products to our customers and could have an adverse effect on our business.

A portion of our international business is transacted in local currency. Currently, approximately 14% of our total product purchases, based on costs, are denominated in yen. The majority of our remaining product purchases are denominated in U.S. dollars and are produced by Japanese suppliers in manufacturing facilities located in China. Currently, the exchange rate of the Chinese renminbi and the U.S. dollar is fixed. If the Chinese government was to revalue the Chinese renminbi and the nominal value of the renminbi rises, the resultant impact on the exchange rate of the Chinese renminbi and the U.S. dollar could have a negative impact on our product cost. We do not currently utilize any form of derivative financial instruments to manage our exchange rate risk. We manage our foreign exchange risk by attempting to pass through to our customers any cost increases related to foreign currency exchange. However, no assurance can be given that we will be successful in passing cost increases through to our customers in the future.

We are in the process of evaluating and documenting our internal control systems and performing the testing required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires management to document, test and report on our internal controls over financial reporting in our Annual Report on Form 10-K for the year ending December 31, 2004 and for our Independent Auditors to attest to management's assertions. Over the past twelve months, we have implemented a new ERP system, which has significantly impacted customer billings, accounts receivable and sales compensation. We are in a period of stabilization and clean up and additional system implementations are being undertaken in the fourth quarter of 2004 to address issues encountered to date. Management intends to complete our assessment of internal controls over financial reporting in order to comply with the Section 404 requirements. However, during the course of our testing we may identify deficiencies or weaknesses and we can provide no assurance that any remediation required will be successful or completed in the time required.

Risk factors relating to separating our company from Pitney Bowes

In October 2003, we implemented Phase II of our ERP system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. We believe that we have satisfactorily resolved the issues relating to delays in product shipments and service responsiveness initially experienced in connection with the ERP system implementation. However, as we stabilize the ERP system, we continue to experience certain processing inefficiencies affecting billings, which in turn have negatively impacted accounts receivable levels and the calculation of sales compensation. In addition, delays in the implementation of certain automated tools to assist in collection activities have contributed to the increase in accounts receivable. Our ability to return accounts receivable to historical levels have been impacted by delays in collections resulting from customer inquiries relating to changes to our billing policies and invoice format, an increase in billing adjustment activity, the temporary suspension of account statement and collection notice mailings on delinquent amounts and

delays in processing customer invoicing. In August 2004, we resumed mailing account statements and delinquent account notices to customers. We believe that much of the increase in accounts receivable will not be permanent. However, a portion of our increase in accounts receivable results from the standardization of our billing practices and schedules across all product lines and the continuing shift in product mix towards the copier/MFP product line, for which the usage-based billing is more complex. We believe that the portion of the increase in accounts receivable related to changes in billing schedules and product mix represents a permanent structural change. We have provided for collection losses on the increase in accounts receivable at rates higher than our historical experience. However, if collection losses related to accounts receivable are higher than the amounts provided, we would recognize an additional increase in our provision for bad debt.

With respect to the calculation of sales compensation, we continue to work through certain of the processing inefficiencies resulting in data inaccuracies and potential inaccuracies in calculated sales compensation. Due to these issues, we have continued to apply alternate methodologies to calculate and pay sales compensation. We believe that we have recognized the proper amount of sales compensation. However, there is a potential that the resolution of these data inaccuracies could result in additional expense for sales compensation.

We remain engaged in a period of stabilization and clean up, as is typical of a large ERP system implementation. During the fourth quarter of 2004 and the first quarter of 2005, we will be implementing Phase III of our ERP system, primarily comprised of certain automated tools to assist in invoice dispute resolution and collection activities. We believe that the implementation of these automated tools will assist in our progress in collecting our accounts receivable beginning in the fourth quarter of 2004. In the month of October, we experienced certain unforeseen system performance issues, which have resulted in delays in invoicing our customers. While we believe that the performance issues are temporary, we expect to experience delays in customer cash receipts negatively impacting accounts receivable during the fourth quarter as a result of the delayed October invoicing. We believe we have identified the causes of these performance issues and that we have implemented appropriate remedies.

We anticipate that we will resolve the issues related to our ERP system implementation that are impacting our customer billings, accounts receivable and sales compensation. However, if we are unable to do so in a reasonable time frame, these issues could have a negative impact on customer and employee satisfaction and retention, which could result in a potential loss of

business. Although no assurance can be given that these efforts related to customer billings, accounts receivable and sales compensation will be successful in the time periods expected, other than the temporary increase in working capital requirements, we do not anticipate that these issues will have a material adverse effect on our financial position, results of operations or future cash flows.

Pitney Bowes has been and is expected to continue to be a significant customer. For the three months ended September 30, 2004 and 2003, revenues from Pitney Bowes, exclusive of equipment sales to PBCC for lease to the end user, accounted for approximately 5% and 9%, respectively, of our total revenue and for the nine months ended September 30, 2004 and 2003, accounted for approximately 7% and 9% of our total revenue, respectively. However, no assurance can be given that Pitney Bowes will continue to purchase our products and services.

In connection with the Distribution, Imagistics and Pitney Bowes entered into a non-exclusive intellectual property agreement that allowed us to operate under the "Pitney Bowes" brand name for a term of up to two years after the Distribution. In 2002, we began introducing new products under the "Imagistics" brand name and we initiated a major brand awareness advertising campaign to establish our new brand name. Effective December 2003, we are no longer using the Pitney Bowes brand name and all new products are introduced under the Imagistics brand name. Brand name recognition is an important part of our overall business strategy and we cannot assure you that customers will maintain the same level of interest in our products now that we can no longer use the Pitney Bowes brand name.

Special Note About Forward-Looking Statements

Statements contained in this discussion and elsewhere in this report that are not purely historical are forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, and are based on management's beliefs, certain assumptions and current expectations. These statements may be identified by their use of forward-looking terminology such as the words "expects", "projects", "anticipates", "intends" and other similar words. Such forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected. The forward-looking statements contained herein are made as of the date hereof and, except as required by law, we do not undertake any obligation to update any forward-looking statements, whether as a result of future events, new information or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have certain limited exposures to market risk related to changes in interest rates and foreign currency exchange rates. Currently, we do not utilize any form of derivative financial instruments to manage our interest rate risk or our exchange rate risk. We manage our foreign exchange risk by attempting to pass through to our customers any cost increases related to foreign currency exchange. In addition, we are exposed to foreign exchange rate fluctuations with respect to the British Pound and the Canadian Dollar as the financial results of our U.K. subsidiary and Canadian subsidiaries are translated into U.S. dollars for consolidation. The effect of foreign exchange rate fluctuation for the quarter ended September 30, 2004 was not material.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as described in Exchange Act Rule 13a-15. Based on our evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in ensuring items are recorded, processed, summarized and reported and alerting them to material information required to be included in our periodic SEC filings relating to the Company, including its consolidated subsidiaries, in a timely manner.

We implemented an ERP system in the fourth quarter of 2003 and as a result, we are in a period of stabilization and clean up. During this period, we are refining our procedures surrounding order management and fulfillment, billing, cash application, service management and sales compensation, and the

controls surrounding processing in these areas have been adjusted accordingly. For additional details, see Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Risk Factors that Could Cause Results to Vary."

We did not implement any changes to our monitoring controls and we believe the changes to our processing controls have not materially affected, nor are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In connection with the Distribution, we agreed to assume all liabilities associated with our business, and to indemnify Pitney Bowes for all claims relating to our business. In the normal course of business, we have been party to occasional lawsuits relating to our business. These may involve litigation or other claims by or against Pitney Bowes or Imagistics relating to, among other things, contractual rights under vendor, insurance or other contracts, trademark, patent and other intellectual property matters, equipment, service or payment disputes with customers, bankruptcy preference claims and disputes with employees.

We have not recorded liabilities for loss contingencies since the ultimate resolutions of the legal matters cannot be determined and a minimum cost or amount of loss cannot be reasonably estimated. In our opinion, none of these proceedings, individually or in the aggregate, should have a material adverse effect on our consolidated financial position, results of operations or cash flows.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information with respect to the purchase of shares of our common stock under the stock buy back program during each month in the third quarter of 2004:

(Dollars in thousands, except per share data)

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan
July 1, 2004 - July 31, 2004	52,500	$ 33.36	52,500
August 1, 2004 - August 31, 2004	191,600	$ 31.75	191,600
September 1, 2004 - September 30, 2004	11,000	$ 33.01	11,000
Total	255,100	$ 32.14	255,100

In March 2002, the Board of Directors approved a $30.0 million stock buy back program. In October 2002, the Board of Directors authorized the repurchase of an additional $28.0 million of our stock, raising the total authorization to

$58.0 million. In July 2003, the Board of Directors authorized the repurchase of an additional $20.0 million of our stock, raising the total authorization to $78.0 million. In May 2004, the Board of Directors authorized the repurchase of an additional $30.0 million of our stock, raising the total authorization to $108.0 million and, as of September 30, 2004, we have accumulated approximately 3.8 million shares of treasury stock at a cost of approximately $85.4 million. The stock buy back program has no fixed termination date.

ITEM 6. EXHIBITS

The following documents are filed as exhibits hereto:

EXHIBIT NUMBER	DESCRIPTION
3.1	Amended and Restated Certificate of Incorporation (3)
3.2	Amended and Restated Bylaws (1)
3.3	Certificate of Designation of Series A Junior Participating Preferred Stock, dated August 1, 2002 (6)
4.1	Form of Imagistics International Inc. Common Stock Certificate (1)
10.1	Tax Separation Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.2	Transition Services Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.3	Distribution Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.4	Intellectual Property Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.5	Reseller Agreement between Pitney Bowes Management Services and Imagistics International Inc. (3)
10.6	Reseller Agreement between Pitney Bowes of Canada and Imagistics International Inc. (3)
10.7	Vendor Financing Agreement between Pitney Bowes Credit Corporation and Imagistics International Inc. (3)
10.8	Form of Sublease Agreement between Pitney Bowes Inc. and Imagistics International Inc. (2)

10.9	Form of Sublease and License Agreement between Pitney Bowes Inc. and Imagistics International Inc. (2)
10.10	Form of Assignment and Novation Agreement between Pitney Bowes Inc. and Imagistics International Inc. (2)
10.11	Imagistics International Inc. 2001 Stock Plan (1)
10.12	Imagistics International Inc. Key Employees' Incentive Plan (3)

10.13	Imagistics International Inc. Non-Employee Directors' Stock Plan (1)
10.14	Letter Agreement between Pitney Bowes Inc. and Marc C. Breslawsky (1)
10.15	Letter Agreement between Pitney Bowes Inc. and Joseph D. Skrzypczak (1)
10.16	Letter Agreement between Pitney Bowes Inc. and Mark S. Flynn (1)
10.17	Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent (3)
10.18	Rights Agreement between Imagistics International Inc. and EquiServe Trust Company, N.A. (3)
10.19	Employment Agreement between Imagistics International Inc. and Marc C. Breslawsky (3)
10.20	Employment Agreement between Imagistics International Inc. and Joseph D. Skrzypczak (3)
10.21	Employment Agreement between Imagistics International Inc. and Christine B. Allen (3)
10.22	Employment Agreement between Imagistics International Inc. and John C. Chillock (3)
10.23	Employment Agreement between Imagistics International Inc. and Chris C. Dewart (3)
10.24	Employment Agreement between Imagistics International Inc. and Mark S. Flynn (3)
10.25	Employment Agreement between Imagistics International Inc. and Nathaniel M. Gifford (3)
10.26	Employment Agreement between Imagistics International Inc. and Joseph W. Higgins (3)
10.27	Amendment No. 1 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (4)
10.28	Amendment No. 2 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (5)
10.29	First Amendment to Imagistics International Inc. 2001 Stock Plan (6)
10.30	First Amendment to Rights Agreement between Imagistics International Inc. and EquiServe Trust Company, N.A. (6)
10.31	Amendment No. 3 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (7)

10.32	Amendment No. 1 to Transition Services Agreement between Pitney Bowes Inc. and Imagistics International Inc. (8)
10.33	Amendment No. 4 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (9)
10.34	Reseller Agreement between Pitney Bowes of Canada Ltd. and Imagistics International Inc. (10)
10.35	Amendment No. 5 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (11)
10.36	Amendment No. 6 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (12)
10.37	Second Amendment to the Imagistics International Inc. Employee Stock Purchase Plan
31.1	Certification of the Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(1) Incorporated by reference to Amendment No. 1 to the Registrant's Form 10 filed July 13, 2001.

(2) Incorporated by reference to Amendment No. 2 to the Registrant's Form 10 filed August 13, 2001.

(3) Incorporated by reference to the Registrant's Form 10-K filed March 28, 2002.

(4) Incorporated by reference to the Registrant's Form 10-Q filed May 14, 2002.

(5) Incorporated by reference to the Registrant's Form 8-K dated July 23, 2002.

(6) Incorporated by reference to the Registrant's Form 10-Q filed August 14, 2002.

(7) Incorporated by reference to the Registrant's Form 8-K dated March 7, 2003.

(8) Incorporated by reference to the Registrant's Form 10-K dated March 28, 2003.

(9) Incorporated by reference to the Registrant's Form 8-K dated May 16, 2003.

(10) Incorporated by reference to the Registrant's Form 10-K filed March 12, 2004.

(11) Incorporated by reference to the Registrant's Form 10-Q filed May 10, 2004.

(12) Incorporated by reference to the Registrant's Form 10-Q filed August 3, 2004.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 9, 2004

Imagistics International Inc.
(Registrant)

By /s/ Timothy E. Coyne

Name: Timothy E. Coyne
Title: Chief Financial Officer and Authorized Signatory