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IMAGISTICS INTERNATIONAL INC

Form 10-Q

November 13, 2003

=====

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

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
(State or Other Jurisdiction
of Incorporation or Organization)

06-1611068
(I.R.S. Employer Identification No.)

100 OAKVIEW DRIVE
TRUMBULL, CONNECTICUT
(Address of Principal Executive Offices)

06611
(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 \$.01 per share,
outstanding as of October 31, 2003: 16,774,117

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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 |
|----------|---|-----------|---------|
| | 2003 | 2002 | 200 |
| | ----- | ----- | ----- |
| Revenue: | | | |
| Sales | \$ 84,298 | \$ 77,081 | \$ 23 |
| Rentals | 54,239 | 58,088 | 16 |

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| | | | |
|--|------------|------------|-------|
| Support services | 21,012 | 20,900 | 6 |
| Total revenue | 159,549 | 156,069 | 46 |
| Cost of sales | 52,328 | 47,236 | 14 |
| Cost of rentals | 17,952 | 20,991 | 5 |
| Selling, service and administrative expenses | 76,017 | 78,707 | 23 |
| Operating income | 13,252 | 9,135 | 3 |
| Interest expense | 4,289 | 2,240 | |
| Income before income taxes | 8,963 | 6,895 | 2 |
| Provision for income taxes | 3,833 | 2,740 | 1 |
| Net income | \$ 5,130 | \$ 4,155 | \$ 1 |
| Earnings per share: | | | |
| Basic | \$ 0.31 | \$ 0.23 | \$ |
| Diluted | \$ 0.30 | \$ 0.22 | \$ |
| Shares used in computing earnings per share: | | | |
| Basic | 16,471,877 | 17,989,310 | 16,85 |
| Diluted | 17,067,336 | 18,537,611 | 17,33 |

See Notes to Consolidated Financial Statements

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IMAGISTICS INTERNATIONAL INC.

CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | SEPTEMBER 30, 2003 | DECEMBER 2002 |
|--|-----------------------|------------------|
| | (UNAUDITED) | |
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 25,071 | \$ 31 |
| Accounts receivable, net of allowances of \$9,650 and \$5,792 at September 30, 2003 and December 31, 2002, respectively | 72,172 | 84 |
| Accrued billings | 27,508 | 26 |
| Inventories | 98,148 | 106 |
| Current deferred taxes on income | 19,492 | 20 |

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| | | |
|--|------------|--------|
| Other current assets and prepaid expenses | 3,110 | 5 |
| | ----- | ----- |
| Total current assets | 245,501 | 273 |
| Property, plant and equipment, net | 53,214 | 43 |
| Rental equipment, net | 66,470 | 88 |
| Goodwill, net | 55,447 | 52 |
| Other assets | 4,652 | 6 |
| | ----- | ----- |
| Total assets | \$ 425,284 | \$ 464 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$ 545 | \$ |
| Accounts payable and accrued liabilities | 63,855 | 77 |
| Advance billings | 26,111 | 27 |
| | ----- | ----- |
| Total current liabilities | 90,511 | 105 |
| Long-term debt | 53,041 | 73 |
| Deferred taxes on income | 18,338 | 15 |
| Other liabilities | 1,995 | 6 |
| | ----- | ----- |
| Total liabilities | 163,885 | 200 |
| Commitments and contingencies (see Note 8) | | |
| Stockholders' equity: | | |
| Preferred stock (\$1.00 par value; 10,000,000 shares authorized, none issued at September 30, 2003 and December 31, 2002) | - | |
| Common stock (\$0.01 par value; 150,000,000 shares authorized, 19,857,935 and 19,813,517 issued at September 30, 2003 and December 31, 2002, respectively) | 199 | |
| Additional paid-in-capital | 294,904 | 294 |
| Retained earnings | 29,444 | 14 |
| Treasury stock, at cost (3,063,186 and 1,936,760 at September 30, 2003 and December 31, 2002, respectively) | (61,215) | (36) |
| Unearned compensation | (2,302) | (3) |
| Accumulated other comprehensive income (loss) | 369 | (5) |
| | ----- | ----- |
| Total stockholders' equity | 261,399 | 264 |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 425,284 | \$ 464 |
| | ===== | ===== |

See Notes to Consolidated Financial Statements

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IMAGISTICS INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)

(UNAUDITED)

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| | FOR THE NINE MONTHS EN SEPTEMBER 30, | |
|---|---|-----------|
| | 2003 | 2002 |
| Cash flows from operating activities: | | |
| Net income | \$ 14,922 | \$ 12,370 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 56,547 | 60,370 |
| Provision for bad debt | 5,686 | 3,110 |
| Provision for inventory obsolescence | 5,147 | 11,370 |
| Deferred taxes on income | 4,195 | 3,110 |
| Change in assets and liabilities, net of acquisitions: | | |
| Accounts receivable | 7,015 | 12,370 |
| Accrued billings | (1,383) | |
| Inventories | 3,664 | 6,370 |
| Other current assets and prepaid expenses | 2,088 | 1,370 |
| Accounts payable and accrued liabilities | (14,720) | 19,370 |
| Advance billings | (1,343) | |
| Other, net | 2,552 | 1,370 |
| Net cash provided by operating activities | 84,370 | 132,370 |
| Cash flows from investing activities: | | |
| Expenditures for rental equipment assets | (28,022) | (38,370) |
| Expenditures for property, plant and equipment | (13,679) | (14,370) |
| Other investing activities | (4,139) | |
| Net cash used in investing activities | (45,840) | (53,010) |
| Cash flows from financing activities: | | |
| Exercises of stock options, including sales under employee stock purchase plan | 1,964 | |
| Purchases of treasury stock | (26,186) | (29,370) |
| Repayments under term loan | (20,562) | (25,370) |
| Repayments under revolving credit facility | - | (17,370) |
| Net cash used in financing activities | (44,784) | (72,010) |
| (Decrease) increase in cash | (6,254) | 6,370 |
| Cash at beginning of period | 31,325 | 18,370 |
| Cash at end of period | \$ 25,071 | \$ 24,680 |

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)

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1. BACKGROUND AND BASIS OF PRESENTATION

Background

Imagistics International Inc. (the "Company" or "Imagistics") is a large independent direct sales, service and marketing organization offering document imaging solutions, including copiers, facsimile machines and multifunctional products, primarily to large corporate and government customers, as well as to mid-size and regional businesses. In addition, the Company offers specialized 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 February 28, 2001, the Company was incorporated in Delaware as Pitney Bowes Office Systems, Inc., a wholly owned subsidiary of Pitney Bowes, at which time 100 shares of the Company's common stock, par value \$.01 per share, were authorized, issued and outstanding. On October 12, 2001, the Company changed its name to Imagistics International Inc. On December 3, 2001, Imagistics was spun off from Pitney Bowes pursuant to a contribution by Pitney Bowes of substantially all of its office systems businesses to the Company and a distribution (the "Distribution") of the stock of the Company to stockholders of Pitney Bowes based on a distribution ratio of 1 share of Imagistics stock for every 12.5 shares of Pitney Bowes stock held at the close of business on November 19, 2001. 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 \$.01 per share. The Company issued 19,463,007 shares of common stock in connection with the Distribution.

Pitney Bowes has received a tax ruling from the Internal Revenue Service stating that, subject to certain representations, the Distribution qualifies 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 accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission (the "SEC") and, in the opinion of the Company, include all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of results of operations, financial position and cash flows as of and for the periods presented. 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, 2003 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, 2002 filed with the SEC on March 28, 2003.

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.

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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 equipment, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the installation of the copier 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.

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IMAGISTICS INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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.

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 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.

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.

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

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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," to stock-based employee compensation:

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE SEPTEMBER |
|---|---|----------|---------------------------|
| | 2003 | 2002 | 2003 |
| Net income, as reported | \$ 5,130 | \$ 4,155 | \$ 14,922 |
| Compensation expense based on the fair value method, net of related tax benefits | 533 | 448 | 1,650 |
| Pro forma net income | \$ 4,597 | \$ 3,707 | \$ 13,272 |
| Basic earnings per share: | | | |
| As reported | \$ 0.31 | \$ 0.23 | \$ 0.89 |
| Pro forma | \$ 0.28 | \$ 0.21 | \$ 0.79 |
| Diluted earnings per share: | | | |
| As reported | \$ 0.30 | \$ 0.22 | \$ 0.86 |
| Pro forma | \$ 0.27 | \$ 0.20 | \$ 0.77 |

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IMAGISTICS INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

Recent accounting pronouncements

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and hedging relationships designated after June 30, 2003 and all provisions should be applied prospectively. The provisions of SFAS No. 149 that relate to SFAS No. 133 implementation issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. Certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist, should be applied to existing contracts as well as new contracts entered into after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Company's financial position, results of operations or cash flows.

In September 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 is effective for exit and disposal activities that are initiated after December 31, 2002 and provides

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guidance on the recognition and measurement of liabilities associated with disposal activities. The Company adopted SFAS No. 146 on January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on the Company's financial position, results of operations or cash flows.

In November 2002, the FASB Emerging Issues Task Force reached a consensus on issue No. 00-21 "Accounting for Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). EITF 00-21 applies to certain contractually binding arrangements under which a company performs multiple revenue generating activities and requires that all companies account for each element within an arrangement with multiple deliverables as separate units of accounting if (a) the delivered item has value on a stand-alone basis, (b) there is objective and reliable evidence of fair value and (c) the amount of the total arrangement consideration is fixed or determinable. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 did not have a material impact on the Company's financial position, results of operations or cash flows.

3. 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 using the discounted cash flow valuation method as of October 1, 2003, and, based on that review, has determined that its recorded goodwill was not impaired. For the three and nine months ended September 30, 2003 and 2002, there was no goodwill amortization. The carrying value of goodwill as of September 30, 2003 increased \$2.8 million as a result of the Company's acquisition (see Note 10). The carrying value of goodwill of \$55.4 million as of September 30, 2003 is attributable to the United States geographic segment.

4. SUPPLEMENTAL INFORMATION

Inventories

Inventories consisted of the following at September 30, 2003 and December 31, 2002:

| | SEPTEMBER 30, 2003 | DECEMBER 31, 2002 |
|----------------------------|-----------------------|----------------------|
| | ----- | ----- |
| Finished products | \$ 61,971 | \$ 77,447 |
| Supplies and service parts | 36,177 | 28,555 |
| | ----- | ----- |
| Total inventories | \$ 98,148 | \$ 106,002 |
| | ===== | ===== |

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Fixed assets consisted of the following at September 30, 2003 and December 31, 2002:

| | SEPTEMBER 30, 2003 | DECEMBER 31, 2002 |
|--------------------------------------|-----------------------|----------------------|
| | ----- | ----- |
| Land | \$ 1,356 | \$ 1,356 |
| Buildings and leasehold improvements | 10,722 | 10,088 |
| Machinery and equipment | 22,684 | 21,372 |
| Computers and software | 45,980 | 36,483 |
| | ----- | ----- |
| Property, plant and equipment, gross | 80,742 | 69,299 |
| Accumulated depreciation | (27,528) | (25,487) |
| | ----- | ----- |
| Property, plant and equipment, net | \$ 53,214 | \$ 43,812 |
| | ===== | ===== |
| | | |
| Rental equipment, gross | \$ 348,169 | \$ 365,793 |
| Accumulated depreciation | (281,699) | (277,360) |
| | ----- | ----- |
| Rental equipment, net | \$ 66,470 | \$ 88,433 |
| | ===== | ===== |

Depreciation and amortization expense was \$18.5 million and \$56.5 million for the three and nine months ended September 30, 2003, respectively, and \$19.8 million and \$60.1 million for the three and nine months ended September 30, 2002, respectively. Unamortized software costs totaled \$27.3 million as of September 30, 2003 and \$19.6 million as of December 31, 2002. Amortization expense on account of capitalized software totaled \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2003, respectively. Amortization expense on account of capitalized software totaled \$0.2 million and \$0.5 million for the three and nine months ended September 30, 2002, respectively.

Current liabilities

Accounts payable and accrued liabilities consisted of the following at September 30, 2003 and December 31, 2002:

| | SEPTEMBER 30, 2003 | DECEMBER 31, 2002 |
|--|-----------------------|----------------------|
| | ----- | ----- |
| Accounts payable | \$ 22,558 | \$ 21,553 |
| Accrued compensation and benefits | 7,287 | 8,631 |
| Other non-income taxes payable | 6,152 | 6,973 |
| Other accrued liabilities | 27,858 | 40,433 |
| | ----- | ----- |
| Accounts payable and accrued liabilities | \$ 63,855 | \$ 77,590 |
| | ===== | ===== |

Comprehensive income

Comprehensive income consisted of the following for the three and nine months ended September 30, 2003 and 2002:

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
|------------------------|---|----------|--|-----------|
| | ----- | ----- | ----- | ----- |
| | 2003 | 2002 | 2003 | 2002 |
| | ----- | ----- | ----- | ----- |
| Net income | \$ 5,130 | \$ 4,155 | \$ 14,922 | \$ 12,392 |
| Translation adjustment | 864 | 998 | 1,736 | 1,289 |

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| | | | | |
|--|----------|----------|-----------|----------|
| Unrealized gain (loss) on cash flow hedges | 791 | (1,995) | 868 | (3,762) |
| Reclassification adjustment for realized loss on cash flow hedges included in net income | 2,841 | - | 2,841 | - |
| Comprehensive income | \$ 9,626 | \$ 3,158 | \$ 20,367 | \$ 9,919 |

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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, 2002 | 1,936,760 | \$ 36,549 |
| Purchases under stock buy back program | 1,205,900 | 26,186 |
| Sales to employees under employee stock purchase plan | (79,474) | (1,520) |
| Balance at September 30, 2003 | 3,063,186 | \$ 61,215 |

Cash flow information

Cash paid for income taxes was \$12,513 and \$2,846 for the nine months ended September 30, 2003 and 2002, respectively. Cash paid for interest was \$7,303 and \$6,605 for the nine months ended September 30, 2003 and 2002, respectively.

5. BUSINESS SEGMENT INFORMATION

The Company operates in two reportable segments based on geographic area: the United States 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 ENDED SEPTEMBER 30, | |
|-----------------------------|--|------------|---|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenues: | | | | |
| United States | \$ 154,778 | \$ 150,368 | \$ 451,180 | \$ 453,388 |
| United Kingdom | 4,771 | 5,701 | 15,207 | 16,133 |
| Total revenues | \$ 159,549 | \$ 156,069 | \$ 466,387 | \$ 469,521 |
| Income before income taxes: | | | | |
| United States | \$ 8,172 | \$ 6,129 | \$ 23,021 | \$ 18,226 |
| United Kingdom | 791 | 766 | 2,778 | 2,334 |
| Total income before | | | | |

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| | | | | |
|--------------|----------|----------|-----------|-----------|
| income taxes | \$ 8,963 | \$ 6,895 | \$ 25,799 | \$ 20,560 |
| | ===== | ===== | ===== | ===== |

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IMAGISTICS INTERNATIONAL INC,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

Revenues from Pitney Bowes, substantially all of which are generated in the United States segment, consisted of the following for the three and nine months ended September 30, 2003 and 2002:

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
|---------------------------------------|---|-----------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenues from Pitney Bowes: | | | | |
| Pitney Bowes Canada | \$ 8,714 | \$ 4,725 | \$ 21,396 | \$ 18,163 |
| Other subsidiaries of Pitney Bowes | 5,849 | 9,642 | 19,210 | 22,776 |
| Sub-total | 14,563 | 14,367 | 40,606 | 40,939 |
| Pitney Bowes Credit Corporation | 23,470 | 22,717 | 68,830 | 65,387 |
| Total | \$ 38,033 | \$ 37,084 | \$ 109,436 | \$ 106,326 |

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, 2003 and December 31, 2002.

| | SEPTEMBER 30, 2003 | DECEMBER 31, 2002 |
|--------------------------------------|-----------------------|----------------------|
| Identifiable long-lived assets: | | |
| United States | \$ 175,741 | \$ 187,310 |
| United Kingdom | 4,043 | 4,311 |
| Total identifiable long-lived assets | \$ 179,784 | \$ 191,621 |
| Total assets: | | |
| United States | \$ 398,448 | \$ 440,508 |
| United Kingdom | 26,836 | 24,398 |
| Total assets | \$ 425,284 | \$ 464,906 |

Identifiable long-lived assets in the United States at September 30, 2003 included goodwill of \$55.4 million and at December 31, 2002 included goodwill of

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\$52.6 million.

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 Japan and China. Although the Company currently sources products from a number of manufacturers throughout the world, a significant portion of new copier equipment is currently obtained from three 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 is unable to deliver sufficient product.

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IMAGISTICS INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

6. 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 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 period. The calculation of diluted earnings per share did not include 2,700 options for the three months ended September 30, 2003, since they were antidilutive for the periods presented. There were no antidilutive options for the three months ended September 30, 2002. The calculation of earnings per share did not include 344,500 and 54,445 options for the nine months ended September 30, 2003 and 2002, 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, | | FO |
|---|---|------------|-------|
| | 2003 | 2002 | EN |
| Net income available to common stockholders | \$ 5,130 | \$ 4,155 | \$ 1 |
| Weighted average common shares outstanding | 16,822,907 | 18,336,310 | 17,20 |
| Less: non-vested restricted stock | 351,030 | 347,000 | 34 |
| Weighted average common shares for basic earnings per share | 16,471,877 | 17,989,310 | 16,85 |
| Add: dilutive effect of restricted stock | 186,106 | 347,000 | 18 |

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| | | | |
|---|------------|------------|-------|
| Add: dilutive effect of stock options | 409,353 | 201,301 | 29 |
| Weighted average common shares and equivalents for diluted earnings per share | 17,067,336 | 18,537,611 | 17,33 |
| Basic earnings per share | \$ 0.31 | \$ 0.23 | \$ |
| Diluted earnings per share | \$ 0.30 | \$ 0.22 | \$ |

7. LONG-TERM DEBT

Long-term debt consisted of the following at September 30, 2003 and December 31, 2002:

| | SEPTEMBER 30, 2003 | DECEMBER 31, 2002 |
|--------------------------|-----------------------|----------------------|
| Term loan | \$ 53,586 | \$ 74,148 |
| Less: current maturities | 545 | 749 |
| Total long-term debt | \$ 53,041 | \$ 73,399 |

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 million, comprised of a \$125 million Revolving Credit Facility (the "Revolving Credit Facility") and a \$100 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 million and \$30 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 million to \$30 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 million to \$58 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

IMAGISTICS INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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 million to \$78 million, to reduce the minimum earnings before interest, taxes, depreciation and amortization covenant to \$100 million for the remainder of the term of the Credit Agreement and to revise the limitation on capital expenditures.

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On May 16, 2003, the Credit Agreement was further amended (the "Fourth Amendment") to reduce the aggregate amount of the Revolving Credit Facility from \$125 million to \$95 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.

During the third quarter of 2002, the Company revised its cash flow estimates and prepaid \$8 million of the amount outstanding under the Term Loan. This prepayment was covered by a portion of the \$30 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 million Term Loan prepayment would occur, the Company 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 loss into interest expense. The Company also unwound \$8 million of the \$30 million interest rate swap agreement.

During the third quarter of 2003, the Company again revised its cash flow estimates and prepaid \$20 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 million and \$22 million. Accordingly, the Company reclassified \$2.8 million from accumulated other comprehensive 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 Company is a guarantor in the arrangements described below.

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

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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 obligates 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

In each of these circumstances, payment by the Company is contingent on Pitney Bowes making a claim. As such, it is not possible to predict the maximum potential future payments under these agreements. As of September 30, 2003, the Company has not paid any 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 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

Prior to the Distribution, the Company's business was operated by Pitney Bowes as a division of its broader corporate organization rather than as a separate stand-alone entity. Pitney Bowes assisted the Company by providing corporate functions such as legal, tax and information technology functions. Following the Distribution, Pitney Bowes has no obligation to provide assistance to the Company other than certain interim and transitional services to be provided by Pitney Bowes. Because the Company has a limited history operating as a stand-alone entity, there can be no assurance that the Company will be able to successfully implement the changes necessary to operate independently in the

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future. The Company's inability to successfully implement the changes necessary to operate independently would have a material adverse effect on the Company's financial position, results of operations and cash flows.

In October 2003, the Company began the implementation of Phase II of its enterprise resource planning ("ERP") system, consisting of order management, order fulfillment, billing, cash collection and service management, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. As a result of this implementation, the Company has experienced, as expected, certain temporary processing inefficiencies. These inefficiencies are expected to result in a temporary increase in working capital requirements. The Company is effectively addressing these typical issues encountered with an ERP implementation and believes that it has an appropriate action plan to address each issue. However, if the Company is unable to timely resolve these issues or if additional unforeseen issues were to arise, operational inefficiencies could affect customer satisfaction levels and could result in a loss of business. Other than the temporary increase in working capital requirements, the Company does not anticipate that these issues or potential issues will have a material adverse effect on the Company's financial position, results of operations and cash flows.

9. SEPARATION AGREEMENTS

The Company and Pitney Bowes entered into a transition services agreement that provided for Pitney Bowes to supply certain services to the Company at cost for a limited time following the Distribution. These services included information technology, computing, telecommunications, certain accounting, field service of equipment and dispatch call center services. The Company and Pitney Bowes have agreed to an extension until December 31, 2003, of the transition services agreement as it relates to information technology and related services, if required. Services provided under this extension are at negotiated market rates. Effective July 1, 2003, the Company and Pitney Bowes entered into a separate one-year service agreement relating to field service of equipment and dispatch call center services.

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IMAGISTICS INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (CONTINUED)

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 and other administrative services. The Company paid Pitney Bowes \$4.9 million and \$17.1 million for the three and nine months ended September 30, 2002, respectively, in connection with the transition services agreement and certain shared corporate and administrative services.

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 obligates 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

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gives rise to a tax liability with respect to the Distribution.

10. ACQUISITIONS

Effective August 30, 2003, the Company completed its acquisition of substantially all of the assets and business of one independent dealer of copier and multifunctional equipment and related support services, 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 goodwill. The acquisition was accounted for using the purchase method of accounting and, accordingly, the results of the acquired business have been included in the Company's consolidated financial statements from the date of the acquisition.

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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, 2002 filed with the Securities and Exchange Commission on March 28, 2003, 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." and "Imagistics," refers to Imagistics International Inc. and subsidiary.

The unaudited interim consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and, in our opinion, include all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of results of operations, financial position and cash flows as of and for the periods presented. We believe 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, 2003 are not necessarily indicative of the results for the full year.

OVERVIEW

Imagistics is a large direct sales, service and marketing organization offering document imaging solutions, including copiers, facsimile machines and multifunctional products, sometimes referred to as MFPs, primarily to large corporate customers known as national accounts, government entities and mid-size and regional businesses known as commercial accounts. 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

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focus on multiple location customers, thus building value for our shareholders. Our strategic initiatives include:

- o Executing our unique business model,
- o Leveraging product and marketplace strengths to drive market share,
- o Leveraging strengths in customer support to drive customer loyalty,
- o Achieving operational excellence and benchmark productivity and
- o Pursuing opportunistic expansion and investments.

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 equipment, the satisfaction of contractual obligations and the passing of title and risk of loss to the customer occur upon the installation of the copier 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.

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

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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.

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

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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 including 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.

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 equipment is depreciated over three years and facsimile equipment is depreciated over five years. Facsimile equipment placed in service on or after October 1, 2003 will be depreciated over three years.

REVENUES

(Dollars in thousands)

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

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
|------------------------|---|------------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Copier product line | \$ 105,651 | \$ 94,169 | \$ 297,187 | \$ 276,946 |
| Facsimile product line | 53,898 | 61,900 | 169,200 | 192,575 |
| Total revenue | \$ 159,549 | \$ 156,069 | \$ 466,387 | \$ 469,521 |

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, | |
|----------------|---|------------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| United States | \$ 154,778 | \$ 150,368 | \$ 451,180 | \$ 453,388 |
| United Kingdom | 4,771 | 5,701 | 15,207 | 16,133 |
| Total revenue | \$ 159,549 | \$ 156,069 | \$ 466,387 | \$ 469,521 |

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The following table shows our revenue with sales to Pitney Bowes Canada under a reseller agreement, presented separately, for the three and nine months ended September 30, 2003 compared with the same periods in the prior year.

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
|---------------------------------|---|------------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenue | | | | |
| Sales excluding | | | | |
| Pitney Bowes Canada | \$ 75,584 | \$ 72,356 | \$ 214,831 | \$ 213,053 |
| Sales to Pitney Bowes Canada | 8,714 | 4,725 | 21,396 | 18,163 |
| Total sales | 84,298 | 77,081 | 236,227 | 231,216 |
| Rentals | 54,239 | 58,088 | 167,414 | 175,506 |
| Support services | 21,012 | 20,900 | 62,746 | 62,799 |
| Total revenue | \$ 159,549 | \$ 156,069 | \$ 466,387 | \$ 469,521 |

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
|---------------------------------|---|------------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Revenue | | | | |
| Revenue excluding | | | | |
| Pitney Bowes Canada | \$ 150,835 | \$ 151,344 | \$ 444,991 | \$ 451,358 |
| Sales to Pitney Bowes Canada | 8,714 | 4,725 | 21,396 | 18,163 |
| Total revenue | \$ 159,549 | \$ 156,069 | \$ 466,387 | \$ 469,521 |

Sales to Pitney Bowes Canada under the reseller agreement, the initial term of which expires in December 2003, are at margins significantly below the margins on sales to our direct customers. We expect to maintain a reseller arrangement with Pitney Bowes Canada, however, we are unable to predict the future level of sales to Pitney Bowes Canada. We also believe it is useful to analyze sales excluding sales to Pitney Bowes Canada in order to better evaluate the effectiveness of our direct sales and marketing initiatives and our pricing policies.

The following table shows our growth rates by revenue type and product line for the three and nine months ended September 30, 2003 compared with the same periods in the prior year.

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
|--------------------|---|--------|--|--------|
| | 2003 | 2002 | 2003 | 2002 |
| Sales | | | | |
| Copier products | 18.5% | (2.2%) | 9.4% | 2.3% |
| Facsimile products | (9.0%) | (4.2%) | (11.5%) | (1.8%) |
| Total sales | 9.4% | (2.9%) | 2.2% | 0.8% |

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| | | | | |
|------------------------|---------|--------|---------|--------|
| Rentals | | | | |
| Copier products | 5.8% | 7.6% | 7.2% | 8.1% |
| Facsimile products | (15.4%) | (8.8%) | (12.4%) | (6.3%) |
| Total rentals | (6.6%) | (2.6%) | (4.6%) | (1.1%) |
| Support services | | | | |
| Copier products | 3.0% | 6.6% | 1.9% | 2.8% |
| Facsimile products | (19.5%) | 24.9% | (15.0%) | 8.9% |
| Total support services | 0.5% | 8.3% | (0.1%) | 3.5% |
| Total revenue | 2.2% | (1.4%) | (0.7%) | (0.5%) |

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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, EXCEPT AS NOTED | | | |
|---|---|-------|--|-------|
| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | | FOR THE NINE MONTHS ENDED SEPTEMBER 30, | |
| | 2003 | 2002 | 2003 | 2002 |
| Equipment sales | 29% | 25% | 27% | 25% |
| Supplies sales | 24% | 24% | 24% | 24% |
| Total sales | 53% | 49% | 51% | 49% |
| Equipment rentals | 34% | 37% | 36% | 38% |
| Support services | 13% | 14% | 13% | 13% |
| Total revenue | 100% | 100% | 100% | 100% |
| Cost of sales | 33% | 30% | 31% | 31% |
| Cost of rentals | 11% | 14% | 12% | 13% |
| Selling, service and administrative expenses | 48% | 50% | 50% | 50% |
| Operating income | 8% | 6% | 7% | 6% |
| Interest expense | 3% | 1% | 2% | 1% |
| Income before income taxes | 5% | 5% | 5% | 5% |
| Provision for income taxes | 2% | 2% | 2% | 2% |
| Net income | 3% | 3% | 3% | 3% |
| Cost of sales as a percentage of sales revenue | 62.1% | 61.3% | 61.7% | 62.7% |
| Cost of rentals as a percentage of rental | | | | |

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| | | | | |
|--------------------|-------|-------|-------|-------|
| revenue | 33.1% | 36.1% | 33.3% | 36.7% |
| | ===== | ===== | ===== | ===== |
| Effective tax rate | 42.8% | 39.7% | 42.2% | 39.7% |
| | ===== | ===== | ===== | ===== |

THREE MONTHS ENDED SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002

Revenue. For the three months ended September 30, 2003, total revenue of \$159,549 increased 2% versus revenue of \$156,069 for the three months ended September 30, 2002 primarily reflecting higher copier/MFP sales, rentals and support services revenue, partially offset by lower facsimile revenue. Excluding the impact of revenue attributable to sales to Pitney Bowes Canada, total revenue for the third quarter declined less than one half percent versus the prior year.

Equipment and supply sales revenue of \$84,298 increased 9% for the three months ended September 30, 2003 from \$77,081 for the three months ended September 30, 2002 reflecting higher copier/MFP sales, partially offset by lower facsimile sales. Excluding the impact of sales to Pitney Bowes Canada, total sales revenue increased 4% compared with the prior year. Copier/MFP sales increased 12% with particular improvement in our color product category and our mid-market digital black-and-white multifunctional products as well as increased copier supply sales. Facsimile sales declined 11% due to lower equipment and supply sales resulting from the decline in industry-wide facsimile usage.

Equipment rental revenue of \$54,239 for the three months ended September 30, 2003 declined 7% versus equipment rental revenue of \$58,088 for the three months ended September 30, 2002, reflecting the continuing expected decline in facsimile rental revenues, partially offset by an increase in copier rental revenues resulting from a continuing copier marketing focus on national accounts, which prefer a rental placement strategy similar to that of our historic facsimile product placement strategy. Rental revenue derived from our copier product line increased 6% reflecting the impact of an increase in page volumes and increased placements of our mid-range digital black and white and color copiers/MFPs. Rental revenue from our facsimile product line declined 15% versus the prior year reflecting a lower installed base and lower pricing.

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Support services revenue for the three months ended September 30, 2003 of \$21,012, primarily derived from stand-alone service contracts, increased 1% versus support services revenue of \$20,900 for the three months ended September 30, 2002, reflecting higher copier/MFP service revenue resulting from higher page volumes, partially offset by lower per unit revenue resulting from the product mix shift to high-end digital copier/MFP products and lower facsimile service revenue due to lower pricing.

Cost of sales. Cost of sales was \$52,328 for the three months ended September 30, 2003 compared with \$47,236 for the same period in 2002 and cost of sales as a percentage of sales revenue increased to 62.1% for the three months ended September 30, 2003 from 61.3% for the three months ended September 30, 2002. This increase was primarily due to an increase in lower margin sales to Pitney Bowes Canada and the continuing shift in product mix toward lower margin copier/MFP products, partially offset by lower inventory obsolescence provisions.

Cost of rentals. Cost of rentals was \$17,952 for the three months ended September 30, 2003 compared with \$20,991 for the three months ended September

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30, 2002 and cost of rentals as a percentage of rental revenue declined 3.0 percentage points to 33.1% for the three months ended September 30, 2003 from 36.1% for the three months ended September 30, 2002. 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 \$76,017 were 47.6% of total revenue for the three months ended September 30, 2003 compared with \$78,707, or 50.4% of total revenue for the three months ended September 30, 2002. Selling, service and administrative expenses decreased 3% versus the prior year primarily resulting from lower advertising, lower employee benefit and service expenses and an insurance recovery in partial settlement of property damage claims related to the World Trade Center, partially offset by the anticipated higher information technology and related administrative expenses related to maintaining legacy systems while incurring costs relating to our enterprise resource planning ("ERP") project.

Interest expense. Interest expense increased to \$4,289 for the three months ended September 30, 2003 from \$2,240 for the three months ended September 30, 2002 due to the reclassification of \$2.8 million from accumulated other comprehensive loss related to our interest rate swap agreements, partially offset by lower interest rates. The weighted average interest rate for the three months ended September 30, 2003 was 6.0% versus 7.1% for the three months ended September 30, 2002.

Effective tax rate. Our effective tax rate was 42.8% for the three months ended September 30, 2003 compared with 39.7% for the three months ended September 30, 2002 due to a change in the estimate of the deductibility for tax purposes of certain expenses and an increase in state and local income taxes.

NINE MONTHS ENDED SEPTEMBER 30, 2003 AND SEPTEMBER 30, 2002

Revenue. For the nine months ended September 30, 2003, total revenue of \$466,387 declined 1% versus revenue of \$469,521 for the nine months ended September 30, 2002 primarily reflecting lower rental revenue, partially offset by higher sales.

Equipment and supply sales revenue of \$236,227 increased 2% for the nine months ended September 30, 2003 from \$231,216 for the nine months ended September 30, 2002. Copier/MFP sales increased 9% resulting from increased placements of our mid-market digital black and white and color copiers/MFPs and higher supply sales. Facsimile sales declined 12% due to lower equipment and supply sales resulting from lower industry-wide facsimile usage.

Equipment rental revenue of \$167,414 for the nine months ended September 30, 2003 declined 5% versus equipment rental revenue of \$175,506 for the nine months ended September 30, 2002, reflecting the continuing expected decline in facsimile rental revenues, partially offset by an increase in copier rental revenues. Rental revenue derived from our copier/MFP product line increased 7% reflecting increases in page volumes and new placements in the mid-level digital black and white and color product categories as well as growth in the overall installed rental population resulting from a continuing copier marketing focus on national accounts, which prefer a rental placement strategy similar to that of our historic facsimile product placement strategy. Rental revenue from our facsimile product line declined 12% versus the prior year reflecting a lower installed base and lower pricing on new placements and renewals compared to expiring contracts.

Support services revenue for the nine months ended September 30, 2003 of

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\$62,746, primarily derived from stand-alone service contracts, declined slightly versus support services revenue of \$62,799 for the nine months ended September 30, 2002, reflecting a product mix shift toward higher-end copiers/MFPs, offset by lower facsimile service revenue due to lower pricing.

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Cost of sales. Cost of sales was \$145,738 for the nine months ended September 30, 2003 compared with \$145,044 for the same period in 2002 and cost of sales as a percentage of sales revenue declined to 61.7% for the nine months ended September 30, 2003 from 62.7% for the nine months ended September 30, 2002. This decline was due to lower obsolete inventory provisions, the impact of our disciplined focus on improving profit margins and lower product cost, partially offset by an increase in the mix of copier/MFP product sales, which have a higher cost of sales percentage than facsimile sales.

Cost of rentals. Cost of rentals was \$55,800 for the nine months ended September 30, 2003 compared with \$64,446 for the nine months ended September 30, 2002 and cost of rentals as a percentage of rental revenue declined 3.4 percentage points to 33.3% for the nine months ended September 30, 2003 from 36.7% for the nine months ended September 30, 2002. 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 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 \$231,540 were 49.6% of total revenue for the nine months ended September 30, 2003 compared with \$233,042, or 49.6% of total revenue for the nine months ended September 30, 2002. Selling, service and administrative expenses decreased 1% over the prior year primarily resulting from lower employee compensation and benefit expenses, lower advertising and lower service expenses, partially offset by higher information technology and associated administrative expenses related to maintaining legacy systems while incurring costs relating to our ERP project.

Interest expense. Interest expense increased to \$7,510 for the nine months ended September 30, 2003 from \$6,429 for the nine months ended September 30, 2002 due to the reclassification of \$2.8 million from accumulated other comprehensive loss related to our interest rate swap agreements, partially offset by lower debt levels and lower interest rates. The weighted average interest rate for the nine months ended September 30, 2003 was 6.5% versus 7.1% for the nine months ended September 30, 2002.

Effective tax rate. Our effective tax rate was 42.2% for the nine months ended September 30, 2003 compared with 39.7% for the nine months ended September 30, 2002 due to a change in the estimate of the deductibility for tax purposes of certain expenses and 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 million, comprised of a \$125 million Revolving Credit Facility (the "Revolving Credit Facility") and a \$100 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 subsidiary as security for our obligations under the Credit Agreement.

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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 million and \$30 million expiring in February 2005 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

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rate and remitted payments based upon a fixed rate. The fixed interest rates were 4.17% and 4.32% for the \$50 million and the \$30 million swap agreements, respectively.

Our initial borrowings of \$150 million under the Credit Agreement, consisting of \$100 million under the Term Loan and \$50 million under the Revolving Credit Facility, were used to repay amounts due to Pitney Bowes and to pay a dividend to Pitney Bowes. At December 31, 2001, Pitney Bowes Credit Corporation ("PBCC") provided substantially all of our Term Loan. During 2002, PBCC disposed of its commitments under the Credit Agreement and is no longer a participant in the Credit Agreement.

On March 19, 2002, the Credit Agreement was amended to increase the total amount of our stock permitted to be repurchased from \$20 million to \$30 million. On July 19, 2002, the Credit Agreement was further amended to increase the total amount of our stock permitted to be repurchased from \$30 million to \$58 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 million to \$78 million, to reduce the minimum EBITDA covenant to \$100 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 further amended (the "Fourth Amendment") to reduce the aggregate amount of the Revolving Credit Facility from \$125 million

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to \$95 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. At September 30, 2003, 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 million of the amount outstanding under the Term Loan. This prepayment was covered by a portion of the \$30 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 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 loss into interest expense. We also unwound \$8 million of the \$30 million interest rate swap agreement.

During the third quarter of 2003, we revised our cash flow estimates and prepaid \$20 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 million and \$22 million. Accordingly, we reclassified \$2.8 million from accumulated other comprehensive loss into interest expense because it was no longer probable that the hedged forecasted transactions would occur.

At September 30, 2003, \$54 million of borrowings were outstanding under the Credit Agreement, consisting solely of \$54 million of borrowings under the Term Loan and the borrowing base amounted to approximately \$124 million. Approximately \$94 million of the Revolving Credit Facility was available for borrowing at September 30, 2003. The Term Loan is payable in 13 consecutive equal quarterly installments of \$0.1 million due December 31, 2003 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, 2003, one irrevocable standby letter of credit in the amount of \$0.6 million was outstanding as security for our casualty insurance program. There were no letters of credit outstanding at December 31, 2002.

The ratio of current assets to current liabilities increased to 2.7 to 1 at September 30, 2003 compared to 2.6 to 1 at December 31, 2002 due to reductions in accounts payable and accrued liabilities, partially offset by reductions in accounts receivable and inventories. At September 30, 2003, our total debt as a percentage of total capitalization decreased to 17.0% from 21.9% at December 31, 2002 due to our debt repayment, offset in part by stock repurchases under our stock buy back program.

Net cash provided by operating activities was \$84,370 and \$132,273 for the nine months ended September 30, 2003 and 2002, respectively. Net income was \$14,922 and \$12,392, respectively. Non-cash charges for depreciation and amortization and provisions for bad debt and inventory obsolescence in the

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aggregate provided cash of \$67,380 and \$75,275 for the nine months ended September 30, 2003 and 2002, respectively. The provision for bad debt of \$5,686 for the nine months ended September 30,

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2003 was higher than historical levels reflecting an increase in the rate of delinquencies. For the nine months ended September 30, 2003, the provision to write down excess and obsolete inventory amounted to \$5,147 and was lower than the prior year as substantially all of the value of analog equipment has been written down to its nominal net realizable value. For the nine months ended September 30, 2002, the provision to write down excess and obsolete inventory amounted to \$11,417. Changes in the principal components of working capital required \$4,679 of cash in the nine months ended September 30, 2003 and provided cash of \$39,255 in the nine months ended September 30, 2002. Cash used by working capital changes in the nine months ended September 30, 2003 of \$4,679 included a reduction in accounts payable and other liabilities of \$15 million primarily consisting of \$7 million of net reductions in income taxes payable resulting from timing of income tax payments, \$4 million for 2002 compensation programs, partially offset by \$7 million of net reductions in accounts receivable resulting primarily from collections.

We used \$45,840 and \$53,583 in investing activities for the nine months ended September 30, 2003 and 2002, respectively. Investment in rental equipment assets totaled \$28,022 and \$38,723 for the nine months ended September 30, 2003 and 2002, respectively. The decline in rental asset expenditures reflects product cost improvements and a reduction in new facsimile rental equipment placements resulting from continuing lower demand. Capital expenditures for property, plant and equipment were \$13,679 and \$14,860 for the nine months ended September 30, 2003 and 2002, respectively, of which the investment in ERP accounted for \$8,330 and \$9,110, respectively.

Cash used in financing activities was \$44,784 and \$72,628 for the nine months ended September 30, 2003 and 2002, respectively. Cash used in financing activities in 2003 reflects repayments under the Term Loan of \$20,562. As a result of the repayment, the remaining outstanding borrowings under the Term Loan at September 30, 2003 are payable in 13 equal quarterly installments of \$0.1 million due December 31, 2003 through December 31, 2006, three 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. Cash used in financing activities for the nine months ended September 30, 2003 and 2002 reflects the repurchase of 1,205,900 shares of our stock at a cost of \$26,186 and 1,607,460 shares at a cost of \$29,998, respectively. In March 2002, the Board of Directors approved a \$30 million stock buy back program. In October 2002, the Board of Directors authorized the repurchase of an additional \$28 million of our stock, raising the total authorization to \$58 million. In July 2003, the Board of Directors authorized the repurchase of an additional \$20 million of our stock, raising the total authorization to \$78 million and, as of September 30, 2003, we have accumulated approximately 3.1 million shares of treasury stock at a cost of approximately \$63 million.

During the nine month period ended September 30, 2003, 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 million to \$10 million over the next three to six months to

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continue to enhance our information systems infrastructure and implement our ERP system.

Historically, our cash flow has been positive. We expect our cash flow to remain positive although we do expect our cash generation to moderate compared with the same period in the prior year as our ability to continue to provide cash through changes in working capital is reduced. Our cash flow 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, borrowings under the Credit Agreement and possible future sales of additional equity or debt securities.

We began the implementation of Phase II of our enterprise resource planning ("ERP") system in October 2003, consisting of order management, order fulfillment, billing, cash collection and service management. As a result of this implementation, we have experienced, as expected, certain temporary processing inefficiencies. These inefficiencies are expected to result in a temporary increase in working capital requirements. Other than the temporary increase in working capital requirements, we do not anticipate that these issues or potential issues will have a material adverse effect on our financial position, results of operations and cash flows.

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 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 rapidly changing environment by developing new options and document imaging solutions for our customers.

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The proliferation of e-mail, multifunctional products and other technologies in the workplace may lead to a reduction in the use of traditional copiers and fax machines. We cannot anticipate whether other technological advancements will substantially minimize the need for our products in the future.

Many of our rental customers have contract provisions allowing for technology and product upgrades during the term of their contract. If we have priced these upgrades improperly, this may have an adverse effect on our profitability and future business. If many of our customers exercise their contractual rights to upgrade to digital equipment, we may experience returns of a large number of analog machines and a subsequent loss of book value on these machines.

The document imaging solutions industry is very competitive; we may be unable to compete favorably, causing us to lose sales to our competitors. 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 the Far East. In addition, two 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

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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 the recent outbreak of 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.

Much of our international business is transacted in local currency. Currently, approximately 20% 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 were 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.

Risk Factors Relating to Separating Our Company From Pitney Bowes

We have a limited history operating as an independent entity and may be unable to make the changes necessary to operate successfully as a stand-alone entity, or may incur greater costs as a stand-alone entity that may cause our profitability to decline.

Prior to the Distribution, our business was operated by Pitney Bowes as a division of its broader corporate organization, rather than as a separate stand-alone entity. Pitney Bowes assisted us by providing corporate functions such as legal, tax and information technology functions. Following the Distribution, Pitney Bowes has no obligation to provide assistance to us other than certain interim and transitional services. Because our business had not previously been operated as a stand-alone entity, there can be no assurance that we will be able to successfully implement the changes necessary to operate independently or will not incur additional costs as a result of operating independently.

In October 2003, we began the implementation of Phase II of our ERP system, consisting of order management, order fulfillment, billing, cash collection and service management, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. As a result of this implementation, we have experienced, as expected, certain temporary processing inefficiencies. These inefficiencies are expected to result in a temporary increase in working capital requirements. We are effectively addressing these typical issues encountered with an ERP implementation and we believe that we have an appropriate action plan to address each issue. However, if we are unable to timely resolve these issues or if additional unforeseen issues were to arise, operational inefficiencies could affect customer satisfaction levels and could result in a loss of business. Other than the temporary increase in working

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capital requirements, we do not anticipate that these issues or potential issues will have a material adverse effect on our financial position, results of operations and cash flows.

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Pitney Bowes has been and is expected to continue to be a significant customer. For three months ended September 30, 2003 and 2002, revenues from Pitney Bowes, exclusive of equipment sales to PBCC for lease to the end user, accounted for approximately 9% and 8%, respectively, of our total revenue and for the nine months ended September 30, 2003 and 2002, accounted for approximately 9% 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 allows us to operate under the "Pitney Bowes" brand name for a term of up to two years after the Distribution. However, this agreement may be terminated if we or Pitney Bowes elect to terminate the non-competition obligations contained in the distribution agreement. 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. 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 when 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.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and hedging relationships designated after June 30, 2003 and all provisions should be applied prospectively. The provisions of SFAS No. 149 that relate to SFAS No. 133 implementation issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. Certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist, should be applied to existing contracts as well as new contracts entered into after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on our financial position, results of operations or cash flows.

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In September 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 is effective for exit and disposal activities initiated after December 31, 2002 and provides guidance on the recognition and measurement of liabilities associated with disposal activities. We adopted SFAS No. 146 on January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on our financial position, results of operations or cash flows.

In November 2002, the FASB Emerging Issues Task Force reached a consensus on issue No. 00-21 "Accounting for Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). EITF 00-21 applies to certain contractually binding arrangements under which a company performs multiple revenue generating activities and requires that all companies account for each element within an arrangement with multiple deliverables as separate units of accounting if (a) the delivered item has value on a stand-alone basis, (b) there is objective and reliable evidence of fair value and (c) the amount of the total arrangement consideration is fixed or determinable. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 did not have a material impact on our financial position, results of operations or cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have certain exposures to market risk related to changes in interest rates, foreign currency exchange rates and commodities. Historically, we used interest rate swap agreements to manage our risk related to interest payments on our debt instruments and to hedge the exposure to variability in future cash flows. During the third quarter of 2003, we disposed of our interest rate swap agreements.

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ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this quarterly 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. In conducting the evaluation, such officers noted that we continued to be reliant on certain Pitney Bowes information systems for the generation of financial information. Based upon our existing internal controls, such officers' knowledge of Pitney Bowes' systems and internal controls and a review of Pitney Bowes' Exchange Act filings and related certifications, the Chief Executive Officer and the Chief Financial Officer have concluded that the information generated by the Pitney Bowes information systems is subject to adequate controls. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings relating to our Company (including our consolidated subsidiary).

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2003 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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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 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) 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, 2001 (3) |
| 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. (3) |
| 10.9 | Form of Sublease and License Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3) |
| 10.10 | Form of Assignment and Novation Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3) |
| 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) |

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- 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, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Administrative Agent, and the Lenders identified therein (4)

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- 10.28 Amendment No. 2 to Credit Agreement between Imagistics International Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, 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
- 10.31 Amendment No. 3 to Credit Agreement between Imagistics International Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital 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.
- 10.33 Amendment No. 4 to Credit Agreement between Imagistics International Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Administrative Agent, and the Lenders identified therein (9)
- 31.1 Certification of the Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-15 and Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-15 and Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-15 and 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, 2002.
- (2) Incorporated by reference to Amendment No. 2 to the Registrant's Form 10 filed August 13, 2002.
- (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.

(b) Reports on Form 8-K.

On July 31, 2003, we filed a Current Report on Form 8-K, under Item 9 furnished pursuant to Item 12, which included a copy of our press release dated July 31, 2003 in which we announced our earnings for the fiscal quarter ended June 30, 2003 and certain additional matters.

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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 13, 2003

Imagistics International Inc.

(Registrant)

By: /s/ Joseph D. Skrzypczak

Name: Joseph D. Skrzypczak
Title: Chief Financial Officer
and Authorized Signatory