INFINITE GROUP INC
Form 10-Q
May 15, 2009

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended: March 31, 2009

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _________ to __________

Commission file number: 0-21816

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

Delaware (State or other jurisdiction of incorporation or organization)	52-1490422 (IRS Employer Identification No.)

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

(585) 385-0610
(Registrant's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large Accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. There were 25,469,078 shares of the issuer’s common stock, par value $.001 per share, outstanding as of May 11, 2009.

Infinite Group, Inc.

Quarterly Report on Form 10-Q
For the Period Ended March 31, 2009

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report on Form 10-Q are "forward-looking statements" regarding the plans and objectives of management for future operations and market trends and expectations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the continued expansion of our business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. We undertake no obligation to revise or update publicly any forward-looking statements for any reason. The terms “we”, “our”, “us”, or any derivative thereof, as used herein refer to Infinite Group, Inc., a Delaware corporation, and its predecessors.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

INFINITE GROUP, INC.
Consolidated Balance Sheets

	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)
ASSETS		
Current assets:		
Cash	$ 71,149	$ 153,336
Accounts receivable, net of allowance of $35,000	1,055,045	1,004,114
Prepaid expenses and other current assets	80,626	47,379
Total current assets	1,206,820	1,204,829
Property and equipment, net	64,432	69,750
Other assets - deposits	15,515	15,515
Total assets	$ 1,286,767	$ 1,290,094
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable	440,307	328,654
Accrued payroll	444,074	304,819
Accrued interest payable	259,316	280,547
Accrued retirement and pension	2,661,905	2,367,312
Accrued expenses-other	54,485	62,516
Current maturities of notes payable	7,655	7,426
Note payable	30,000	30,000
Notes payable-related parties	305,000	40,000
Total current liabilities	4,202,742	3,421,274
Long-term obligations:		
Notes payable	212,264	239,266
Notes payable-related parties	684,624	999,624
Accrued pension expense	1,147,231	1,337,231
Total liabilities	6,246,861	5,997,395
Commitments and contingencies (note 5)		
Stockholders' deficiency:		
Common stock, $.001 par value, 60,000,000 shares authorized; 25,469,078 (24,969,078 - 2008) shares issued and outstanding	25,469	24,969
Additional paid-in capital	29,773,181	29,699,795
Accumulated deficit	(31,541,485)	(31,214,806)
Accumulated other comprehensive loss	(3,217,259)	(3,217,259)
Total stockholders' deficiency	(4,960,094)	(4,707,301)
Total liabilities and stockholders' deficiency	$ 1,286,767	$ 1,290,094

See notes to consolidated financial statements.

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INFINITE GROUP, INC.
Consolidated Statements of Operations (Unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Sales	$ 2,655,930	$ 2,466,810
Cost of services	1,992,710	1,716,271
Gross profit	663,220	750,539
Costs and expenses:		
General and administrative	296,791	262,312
Defined benefit pension plan	164,869	48,961
Selling	455,369	412,320
Total costs and expenses	917,029	723,593
Operating income (loss)	(253,809)	26,946
Other expense - interest expense:		
Related parties	(20,663)	(32,353)
Other	(48,207)	(46,035)
Total other expense - interest expense	(68,870)	(78,388)
Loss before income tax expense	(322,679)	(51,442)
Income tax expense	(4,000)	(615)
Net loss	$ (326,679)	$ (52,057)
Net loss per share - basic and diluted	$ (.01)	$ (.00)
Weighted average number of shares outstanding - basic and diluted	25,230,189	23,774,672

See notes to consolidated financial statements.

INFINITE GROUP, INC.
Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Operating activities:		
Net loss	$ (326,679)	$ (52,057)
Adjustments to reconcile net loss to net cash (used) provided by operating activities:		
Stock based compensation	48,886	61,280
Depreciation	8,180	8,954
Increase in assets:		
Accounts receivable	(50,931)	(188,724)
Other current assets	(33,247)	(6,715)
Increase in liabilities:		
Accounts payable	111,653	43,712
Accrued expenses	134,993	119,640
Accrued pension obligations	104,593	39,777
Net cash (used) provided by operating activities	(2,552)	25,867
Investing activities:		
Purchase of property and equipment	(2,862)	(5,285)
Net cash used by investing activities	(2,862)	(5,285)
Financing activities:		
Repayments of notes payable	(26,773)	(990)
Repayments of note payable-related party	(50,000)	(1,399)
Proceeds from exercise of stock options	-	16,667
Net cash (used) provided by financing activities	(76,773)	14,278
Net (decrease) increase in cash	(82,187)	34,860
Cash - beginning of period	153,336	28,281
Cash - end of period	$ 71,149	$ 63,141
Supplemental disclosure:		
Cash paid for:		
Interest	$ 54,469	$ 59,491
Income taxes	$ 4,000	$ 615

See notes to consolidated financial statements.

INFINITE GROUP, INC.

NOTES TO INTERIM FINANCIAL STATEMENTS
March 31, 2009
(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Infinite Group, Inc. ("Infinite Group, Inc." or the "Company"), included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (U.S.) for interim financial information and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. The accompanying unaudited consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto included in the Company's Annual report on Form 10-K for the year ended December 31, 2008 filed with the U.S. Securities and Exchange Commission (SEC). Results of consolidated operations for the three months ended March 31, 2009 are not necessarily indicative of the operating results that may be expected for the year ending December 31, 2009. The consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiaries. The subsidiaries are inactive. All material inter-company accounts and transactions have been eliminated.

Note 2. Summary of Significant Accounting Policies

There are several accounting policies that the Company believes are significant to the presentation of its consolidated financial statements. These policies require management to make complex or subjective judgments about matters that are inherently uncertain. Note 3 to the Company's audited consolidated financial statements for the year ended December 31, 2008 presents a summary of significant accounting policies.

Reclassification

The Company reclassified certain prior year amounts in its financial statements to conform to the current year's presentation.

Recent Accounting Pronouncements

Business Combinations (SFAS 141R) and Accounting and Reporting of Non-controlling Interest in Consolidated Financial Statements, an amendment of ARB 51 (SFAS 160) - In December 2007, the FASB issued SFAS 141R and SFAS 160 which will significantly change the accounting for and reporting of business combinations and non-controlling (minority) interests in consolidated financial statements. SFAS 141R and 160 have been adopted simultaneously on January 1, 2009 and are not expected to have a material impact on our financial position, results of operations or cash flows.

In April 2009, the FASB issued FSP No. 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4), which provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. This guidance is effective for interim reporting periods ending after June 15, 2009 and will apply to the Company's disclosures beginning with its second fiscal quarter of 2009. The Company does not believe the adoption of this staff position will materially impact its consolidated financial statements and disclosures.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, Interim Disclosures About Fair Value of Financial Instruments (FSP 107-1 and APB 28-1), which require disclosures about fair value of financial instruments for interim reporting periods. This guidance is effective for interim reporting periods ending after June 15, 2009 and will apply to the Company's disclosures beginning with its second fiscal quarter of 2009. The Company has not determined the effect that the adoption of this staff position will have on its consolidated financial statements and disclosures.

In December 2008, the FASB issued FSP No. 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets (FSP 132(R)-1). FSP 132(R)-1 amends the disclosure requirements for employer's disclosure of plan assets for defined benefit pensions and other postretirement plans. The objective of this FSP is to provide users of financial statements with an understanding of how investment allocation decisions are made, the major categories of plan assets held by the plans, the inputs and valuation techniques used to measure the fair value of plan assets, significant concentration of risk within the plan assets, and for fair value measurements determined using significant unobservable inputs a reconciliation of changes between the beginning and ending balances. FSP 132(R)-1 is effective for fiscal years ending after December 15, 2009. The Company is currently evaluating the impact of FSP 132(R)-1 on its financial statements and intends to adopt the new disclosure requirements in the year ending December 31, 2009.

Note 3. Stock Option Plans

The Company has stock options plans covering up to an aggregate of 9,223,833 shares of common stock. Such options may be designated at the time of grant as either incentive stock options or nonqualified stock options.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used for the three months ended March 31, 2009 and 2008.

	2009	2008
Risk-free interest rate	2.09%	3.74%
Expected dividend yield	0%	0%
Expected stock price volatility	75%	50%
Expected life of options	5.75 years	10 years

The Company recorded expense for options, warrants and common stock issued to employees and independent service providers of $48,886 and $61,280 for the three months ended March 31, 2009 and 2008, respectively. There was no impact on net loss per share for the three months ended March 31, 2009 and 2008.

A summary of all stock option activity for the three months ended March 31, 2009 follows:

	Number of Options	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2008	4,851,500	$ .28		
Options granted	882,500	$ .18		
Options expired	(150,000)	$ .54		
Outstanding at March 31, 2009	5,584,000	$ .26	6.9 years	$ 245,940
Exercisable at March 31, 2009	4,370,667	$ .24	6.2 years	$ 231,807

The weighted average fair value of options granted during the three months ended March 31, 2009 was approximately $.12 ($.50 during the three months ended March 31, 2008). No options were exercised during the three months ended March 31, 2009. Options for 66,667 shares at $.25 per share were exercised during the three months ended March 31, 2008 with an intrinsic value of $38,000.

A summary of the status of nonvested stock option activity for the three months ended March 31, 2009 follows:

Nonvested Shares	Shares	Weighted Average Fair Value at Grant Date
Nonvested at December 31, 2008	623,333	$ .33
Granted	882,500	$ .12
Vested	(200,833)	$ .16
Forfeited or expired	(91,667)	$ .52
Nonvested at March 31, 2009	1,213,333	$ .19

At March 31, 2009, there was approximately $176,500 of total unrecognized compensation cost related to non-vested options. That cost is expected to be recognized over a weighted average period of approximately 1.25 years. The total fair value of shares vested during the three months ended March 31, 2009 was approximately $32,900.

Note 4. Earnings Per Share

Basic net income (loss) per share is based on the weighted average number of common shares outstanding during the periods presented. Diluted income (loss) per share is based on the weighted average number of common shares outstanding, as well as dilutive potential common shares which, in the Company's case, comprise shares issuable under stock options, stock warrants and convertible notes payable including convertible accrued interest payable. Stock options and warrants with exercise prices that exceeded the average fair market value of common stock had an antidilutive effect and therefore, were excluded from the computation of net income (loss) per share. The treasury stock method is used to calculate dilutive shares, which reduces the gross number of dilutive shares by the number of shares purchasable from the proceeds of the options assumed to be exercise. In a loss period, the calculation for basic and diluted net loss per share is considered to be the same, as the impact of potential common shares is anti-dilutive.

For the three months ended March 31, 2009 and 2008, the Company had 25,230,189 and 23,774,672 weighted average shares of its common stock outstanding, respectively. If the Company had generated earnings during the three months ended March 31, 2009 and 2008, 18,097,864 and 20,305,455 common stock equivalents, respectively, would have been added to the weighted average shares outstanding. These additional shares represent the assumed exercise of common stock options, warrants and convertible notes payable whose exercise price is less than the average of common stock during the period. The proceeds of the exercise are assumed to be used to purchase common stock for treasury and the incremental shares are added to the weighted average shares outstanding.

Note 5. – Employee Pension Plan

Prior to December 30, 2002, the Company owned 100% of the common stock of Osley & Whitney, Inc. (O&W). On December 30, 2002, the Company sold 100% of the O&W common stock to a third party, but continued to act as the sponsor of the Osley & Whitney, Inc. Retirement Plan (Plan). Although the Company continued to act as the sponsor of the Plan after the sale, during 2007 management determined that it had no legal obligation to do so.

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

If the Treasury staff does not reconsider and conclude in the Company's favor, the Company expects that the Treasury will issue a formal revenue agent report reiterating its preliminary position. In this event, the Company will commence and diligently pursue all appropriate steps to perfect its appeal rights and attempt to prevail on the merits of its position, which will include filing a protest, requesting an appeals conference, and, if needed, petitioning the tax court and advocating its position in that forum.

If the Company does not ultimately prevail, it may become obligated for additional estimated excise taxes on accumulated unfunded Plan contributions for the Plan years ended December 31, 2006 and 2007 of approximately $165,000 and $184,000, respectively, which have not been accrued based upon the Company's determination that it has no legal obligation to act as the Plan sponsor and the Company's belief that the likelihood is not probable that it will be required to pay these excise taxes. Further, if the Company does not ultimately prevail, it may be required to pay interest on these excise taxes and potentially incur additional excise taxes up to 100% of all required Plan contributions, which required contributions were $1,836,359 at December 31, 2008. No excise taxes for 2006 and 2007 or related interest have been assessed and no portion of this amount has been accrued at December 31, 2008 and March 31, 2009. The Company has accrued amounts related to excise taxes on unfunded contributions for 2003, 2004 and 2005 of $427,240 as of March 31, 2009 ($420,362 - December 31, 2008), which does not include any amounts disclosed above.

On April 29, 2009, acting for the Plan, the Company sent the Plan participants a notice of intent to terminate the Plan in a distress termination with a proposed termination date of June 30, 2009. Plan termination is subject to approval by the Pension Benefit Guaranty Corporation and requires providing additional documentation regarding the Company's status and the status of the Plan.

At March 31, 2009, the Company had accrued liabilities of $3,740,373, which includes $427,240 recorded for excise taxes on unfunded contributions, related to the Plan and accumulated other comprehensive loss of $3,217,259 which was recorded as a reduction of stockholders' deficiency. The market value of the Plan assets decreased from $2,150,094 at December 31, 2008 to $1,827,624 at March 31, 2009. The decrease was comprised of investment losses of $207,669, benefit payments of $113,741 and expenses paid of $1,060.

Net periodic pension cost recorded in the accompanying statements of operations includes the following components of expense (benefit) for the periods presented.

	Three Months Ended March 31,	
	2009	2008
Interest cost	$ 71,996	$ 74,248
Expected return on plan assets	(42,115)	(72,686)
Service cost	17,750	16,250
Actuarial loss	37,343	27,455
Net periodic pension cost	$ 84,974	$ 45,267

Note 6. Supplemental Cash Flow Information

Non-cash investing and financing transactions, including non-monetary exchanges, consisted of the conversion of accrued interest payable of $25,000 into 500,000 shares of common stock during the three months ended March 31, 2009 and the conversion of $12,500 of accrued interest payable into 250,000 shares of common stock during the three months ended March 31, 2008.

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

IT Consulting

We are a provider of IT services to federal, state and local government and commercial clients. Our expertise includes managing leading edge operations and implementing complex programs in advanced server management, server virtualization, cloud computing, wireless technology, human capital services, enterprise architecture, and earned value management. We focus on aligning business processes with technology for delivery of solutions meeting our clients' exact needs and providing expert management services to the lifecycle of technology-based projects. We have a business development office in the Washington, D.C. metropolitan area.

We have several contract vehicles that enable us to deliver a broad range of our services and solutions to the U.S. Government. The quality and consistency of our services and IT expertise allow us to maintain long-term relationships with our major clients. We have entered into various subcontract agreements with prime contractors to the U.S. government, state and local governments and commercial customers.

Results of Operations

Comparison of the Three Months ended March 31, 2009 and 2008

The following table compares our statement of operations data for the three months ended March 31, 2009 and 2008. The trends suggested by this table are not indicative of future operating results.

	Three Months Ended March 31,					
					2009 vs. 2008	
	2009	As a % of Sales	2008	As a % of Sales	Amount of Change	% Increase (Decrease)
Sales	$ 2,655,930	100.0%	$ 2,466,810	100.0%	$ 189,120	7.7%
Cost of services	1,992,710	75.0	1,716,271	69.6	276,439	16.1
Gross profit	663,220	25.0	750,539	30.4	(87,319)	(11.6)
General and administrative	296,791	11.2	262,312	10.6	34,479	13.1
Defined benefit pension plan	164,869	6.2	48,961	2.0	115,908	236.7
Selling	455,369	17.1	412,320	16.7	43,049	10.4
Total operating expenses	917,029	34.5	723,593	29.3	193,436	26.7
Operating income (loss)	(253,809)	(9.6)	26,946	1.1	(280,755)	(1,041.9)
Interest expense	(68,870)	(2.6)	(78,388)	(3.2)	9,518	