IMAGISTICS INTERNATIONAL INC
Form 10-Q
May 10, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2004

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

For the transition period from _________ to _________

Commission File Number 1-16449

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

Delaware	06-1611068
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
100 Oakview Drive Trumbull, Connecticut	06611
(Address of Principal Executive Offices)	(Zip Code)

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

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

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

Number of shares of Imagistics Common Stock, par value $0.01 per share, outstanding as of April 30, 2004: 16,650,609

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 March 31,	
	2004	2003
Revenue:		
Sales	$ 82,555	$ 73,053
Rentals	54,411	57,068
Support services	21,356	20,801
Total revenue	158,322	150,922
Cost of sales	48,946	45,244
Cost of rentals	15,790	19,171
Selling, service and administrative expenses	82,567	76,865
Operating income	11,019	9,642
Interest expense	935	1,629
Income before income taxes	10,084	8,013
Provision for income taxes	4,337	3,247

Net income	$ 5,747	$ 4,766
Earnings per share:		
Basic	$ 0.35	$ 0.28
Diluted	$ 0.34	$ 0.27
Shares used in computing earnings per share:		
Basic	16,385,689	17,228,940
Diluted	17,111,771	17,780,016

See Notes to Consolidated Financial Statements

IMAGISTICS INTERNATIONAL INC.

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

	March 31, 2004 (Unaudited
Assets	
Current assets:	
Cash	$ 12,521
Accounts receivable, net of allowances of $11,785 and $10,575 at March 31, 2004 and December 31, 2003, respectively	119,754
Accrued billings	22,171
Inventories	83,614
Current deferred taxes on income	26,666
Other current assets and prepaid expenses	5,835
Total current assets	270,561
Property, plant and equipment, net	53,519
Rental equipment, net	63,166
Goodwill, net	59,000
Other assets	4,253
Total assets	$ 450,499
Liabilities and Stockholders' Equity	
Current liabilities:	
Current portion of long-term debt	$ 545
Accounts payable and accrued liabilities	67,053
Advance billings	15,156
Total current liabilities	82,754
Long-term debt	77,768
Deferred taxes on income	17,867
Other liabilities	3,373

Total liabilities	181,762
Commitments and contingencies (see Note 8)	
Stockholders' equity:	
Preferred stock ($1.00 par value; 10,000,000 shares authorized, none issued)	--
Common stock ($0.01 par value; 150,000,000 shares authorized, 19,939,445 and 19,871,061 issued at March 31, 2004 and December 31, 2003, respectively)	199
Additional paid-in-capital	296,231
Retained earnings	40,727
Treasury stock, at cost (3,245,778 and 3,096,878 at March 31, 2004 and December 31, 2003, respectively)	(69,053
Unearned compensation	(1,486
Accumulated other comprehensive income	2,119
Total stockholders' equity	268,737
Total liabilities and stockholders' equity	$ 450,499

See Notes to Consolidated Financial Statements

IMAGISTICS INTERNATIONAL INC.

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

	For the three months ended March 31,	
	2004	2003
Cash flows from operating activities:		
Net income	$ 5,747	$ 4,766
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,083	18,981
Provision for bad debt	2,380	2,602
Provision for inventory obsolescence	1,368	1,533
Deferred taxes on income	(2,526)	297
Change in assets and liabilities, net of acquisitions:		
Accounts receivable	(13,706)	5,097
Accrued billings	(1,310)	(392)
Inventories	1,508	(1,047)
Other current assets and prepaid expenses	(1,023)	(2,058)
Accounts payable and accrued liabilities	(13,097)	(5,919)
Advance billings	(1,271)	(418)
Other, net	1,153	(966)
Net cash (used in) provided by operating activities	(3,694)	22,476
Cash flows from investing activities:		
Expenditures for rental equipment assets	(9,776)	(10,622)
Expenditures for property, plant and equipment	(2,791)	(4,824)
Acquisitions	(3,806)	--

Net cash used in investing activities	(16,373)	(15,446)
Cash flows from financing activities:		
Exercises of stock options, including sales under employee stock purchase plan	1,056	909
Purchases of treasury stock	(6,270)	(12,597)
Repayments under term loan	(136)	(187)
Net borrowings under revolving credit facility	15,000	--
Net cash provided by (used in) financing activities	9,650	(11,875)
Decrease in cash	(10,417)	(4,845)
Cash at beginning of period	22,938	31,325
Cash at end of period	$ 12,521	$ 26,480

See Notes to Consolidated Financial Statements

IMAGISTICS INTERNATIONAL INC.

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

1. Background and Basis of Presentation

Background

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

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

The Company was incorporated in Delaware on February 28, 2001 as Pitney Bowes Office Systems, Inc., a wholly owned subsidiary of Pitney Bowes. On that date, 100 shares of the Company's common stock, par value $0.01 per share, were authorized, issued and outstanding. On October 12, 2001, the Company changed its name to Imagistics International Inc. At the Distribution, the Company's authorized capital stock consisted of 10,000,000 shares of preferred stock, par value $1.00 per share and 150,000,000 shares of common stock, par value $0.01 per share. The Company issued 19,463,007 shares of common stock in connection with the Distribution described above.

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

Basis of presentation

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

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

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

2. Summary of Significant Accounting Policies

Revenue recognition

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

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

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

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

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

Stock-based employee compensation

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

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

For the three months ended
March 31,

	2004	2003
Net income, as reported	$ 5,747	$ 4,766
Add: Stock-based compensation expense included in net income, net of related tax effects	449	388
Deduct: Total stock-based compensation expense based on the fair value method, net of related tax effects	(1,012)	(837)
Pro forma net income	$ 5,184	$ 4,317
Basic earnings per share:		
As reported	$ 0.35	$ 0.28
Pro forma	$ 0.31	$ 0.25
Diluted earnings per share:		
As reported	$ 0.34	$ 0.27
Pro forma	$ 0.30	$ 0.24

3. Supplemental Information

Inventories

Inventories consisted of the following at March 31, 2004 and December 31, 2003:

	March 31, 2004	December 31, 2003
Finished products	$48,313	$50,726
Supplies and service parts	35,301	35,408
Total inventories	$83,614	$86,134

Fixed assets

Fixed assets consisted of the following at March 31, 2004 and December 31, 2003:

	March 31, 2004	December 31, 2003
Land	$ 1,356	$ 1,356
Buildings and leasehold improvements	11,220	10,976
Machinery and equipment	24,135	23,474
Computers and software	49,317	47,356
Property, plant and equipment, gross	86,028	83,162
Accumulated depreciation	(32,509)	(29,958)

Property, plant and equipment, net	$ 53,519	$ 53,204
Rental equipment, gross	$ 323,592	$ 333,563
Accumulated depreciation	(260,426)	(266,384)
Rental equipment, net	$ 63,166	$ 67,179

Depreciation and amortization expense was $17.1 million and $19.0 million for the three months ended March 31, 2004 and 2003, respectively. Unamortized software costs totaled $27.8 million as of March 31, 2004 and $27.0 million as of December 31, 2003. Amortization expense on account of capitalized software totaled $1.0 million and $0.2 million for the three months ended March 31, 2004 and 2003, respectively.

Current liabilities

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

	March 31, 2004	December 31, 2003
Accounts payable	$20,252	$33,237
Accrued compensation and benefits	5,562	8,321
Other non-income taxes payable	6,160	6,626
Other accrued liabilities	35,079	31,107
Accounts payable and accrued liabilities	$67,053	$79,291

Comprehensive income

Comprehensive income consisted of the following for the three months ended March 31, 2004 and 2003:

	For the three months ended March 31,	
	2004	2003
Net income	$5,747	$4,766
Translation adjustment	357	47
Unrealized gain on cash flow hedges	--	29
Comprehensive income	$6,104	$4,842

Treasury stock

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

Treasury stock

	Shares	Cost
Balance at December 31, 2003	3,096,878	$62,783
Purchases under stock buy back program	148,900	6,270
Balance at March 31, 2004	3,245,778	$69,053

Cash flow information

Cash paid for income taxes was $637 and $1,898 for the three months ended March 31, 2004 and 2003, respectively. Cash paid for interest was $682 and $1,424 for the three months ended March 31, 2004 and 2003, respectively.

4. Business Segment Information

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

	For the three months ended March 31,	
	2004	2003
Revenues:		
North America	$152,633	$145,503
United Kingdom	5,689	5,419
Total revenues	$158,322	$150,922
Income before income taxes:		
North America	$ 9,033	$ 6,901
United Kingdom	1,051	1,112
Total income before income taxes	$ 10,084	$ 8,013

Revenues from Pitney Bowes, substantially all of which are generated in the North America segment, consisted of the following for the three months ended March 31, 2004 and 2003:

	For the three months ended March 31,	
	2004	2003
Revenues from Pitney Bowes:		
Pitney Bowes of Canada	$10,143	$ 6,369
Other subsidiaries of Pitney Bowes	5,407	6,421
Sub-total	15,550	12,790
Pitney Bowes Credit Corporation	19,648	21,436
Total	$35,198	$34,226

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.

IMAGISTICS INTERNATIONAL INC.

Notes to Consolidated Financial Statements - (continued)

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

	March 31, 2004	December 31, 2003
Identifiable long-lived assets:		
North America	$176,164	$176,157
United Kingdom	3,775	3,954
Total identifiable long-lived assets	$179,939	$180,111
Total assets:		
North America	$435,388	$428,885
United Kingdom	15,111	17,847
Total assets	$450,499	$446,732

Identifiable long-lived assets in North America included goodwill of $59.0 million and $55.4 million at March 31, 2004 and December 31, 2003, respectively.

Concentrations

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

Most of the Company's product purchases are from overseas vendors, the majority of which are from a limited number of Japanese suppliers who operate manufacturing facilities in Asia. Although the Company currently sources products from a number of manufacturers throughout the world, a significant portion of new copier/MFP equipment is currently obtained from 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 were unable to deliver sufficient product.

5. Earnings Per Share Calculation

Basic earnings per share was calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the 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 shares underlying approximately 7,300 and 312,250 options for the three months ended March 31, 2004 and 2003, respectively, since they were antidilutive for the periods presented.

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

	For the three months ended March 31, 2004	For the three months ended March 31, 2003
Net income available to common stockholders	$ 5,747	$ 4,766
Weighted average common shares outstanding	16,735,389	17,568,605
Less: non-vested restricted stock	349,700	339,665
Weighted average common shares for basic earnings per share	16,385,689	17,228,940
Add: dilutive effect of restricted stock	211,994	339,665
Add: dilutive effect of stock options	514,088	211,411
Weighted average common shares and equivalents for diluted earnings per share	17,111,771	17,780,016
Basic earnings per share	$ 0.35	$ 0.28
Diluted earnings per share	$ 0.34	$ 0.27

6. Goodwill and Goodwill Amortization

The Company accounts for goodwill in accordance with SFAS No. 142 "Goodwill and Other Intangible Assets," which requires that goodwill and certain other intangible assets having indefinite lives no longer be amortized to earnings, but instead be tested for impairment annually and on an interim basis if events or changes in circumstances indicate that goodwill might be impaired. The Company performed its annual test for impairment as of October 1, 2003 using the discounted cash flow valuation method.There was no impairment to the value of the Company's recorded goodwill. As of March 31, 2004, there were no events or changes in circumstances that would indicate that goodwill might be impaired. The carrying value of goodwill as of March 31, 2004 increased $3.5 million as a result of an acquisition (see Note 10). The carrying value of goodwill of $59.0 million as of March 31, 2004 is attributable to the North America geographic segment.

7. Long-Term Debt

Long-term debt consisted of the following at March 31, 2004 and December

31, 2003:

	March 31, 2004	December 31, 2003
Revolving Credit Facillity	$25,000	$10,000
Term Loan	53,313	53,448
Less: current maturities	545	545
Total long-term debt	$77,768	$62,903

On November 9, 2001 the Company entered into a Credit Agreement with a group of lenders (the "Credit Agreement") that provided for secured borrowings and the issuance of letters of credit in an aggregate amount not to exceed $225 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 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. On May 16, 2003, the Credit Agreement was 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. On May 7, 2004, the Credit Agreement was further amended (the "Fifth Amendment") to increase the amount of the Company's stock permitted to be repurchased from $78 million to $108 million, to increase the aggregate amount of acquisition consideration paid for acquisitions from $30 million to $60 million and to remove the requirement for annual borrowing base audits so long as $50 million or more of borrowings are available under the Credit Agreement and the fixed charge ratio, as defined in the Fifth Amendment, is 2.0 or higher.

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 income (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 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 income (loss) into interest expense because it was no longer probable that the hedged forecasted transactions would occur.

8. Commitments and Contingencies

Guarantees and indemnifications

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

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

Notes to Consolidated Financial Statements - (continued)

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

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 March 31, 2004, the Company has not paid any material amounts pursuant to the above indemnifications other than expenses incurred in connection with the defense and settlement of assumed claims asserted in connection with the operation of the Company in the ordinary course of business. The Company believes that if it were to incur a loss in any of these matters, such loss would not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Legal matters

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

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

Risks and uncertainties

In October 2003, the Company began the implementation of Phase II of its enterprise resource planning ("ERP") system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation. As a result of this implementation, the Company has experienced, as expected, certain temporary processing inefficiencies, which have resulted in a short-term increase in working capital requirements, particularly accounts receivable, due to the standardization of the Company's billing practices and schedules across all product lines, the initial temporary suspension in invoicing the Company's customers during the conversion to the new ERP system and delays in collections resulting from customer inquiries relating to changes to the Company's billing policies and invoice format and an increase in rebilling activity to satisfy customer requirements. The Company believes that the increase in accounts receivable is temporary and that its collection losses related to these temporarily suspended amounts will not be materially different than its historical experience. However, if collection losses related to these amounts are significantly higher than the Company's historical experience, the Company would recognize an increase in its provision for bad debt in the near future. In addition, certain of the temporary processing inefficiencies have resulted in delays in certain product shipments, service responsiveness and potential inaccuracies in calculated sales compensation. These issues, coupled with certain revisions to the Company's billing practices, could have a negative impact on customer service and satisfaction and employee retention, which could result in a potential loss of business. The Company is engaged in a period of stabilization and clean up, as is typical of a large ERP implementation and the Company anticipates that this transition will be completed during 2004. Although no assurance can be given that these efforts will be successful in the time periods expected, other than the temporary increase in working capital requirements, the Company does not anticipate that these issues will have a material adverse effect on its financial position, results of operations or future cash flows.

9. Separation Agreements

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

market rates. Except for field service of equipment, all of the services provided by Pitney Bowes under these agreements have ceased in accordance with the terms of the agreements.

The Company and Pitney Bowes entered into a one-year service agreement on an arms-length basis relating to field service of equipment in certain remote geographic locations not covered by the Company's direct service organization. This agreement expires on July 1, 2004. Services provided under this agreement are at negotiated prices.

The Company paid Pitney Bowes $1.3 million for the three months ended March 31, 2004 in connection with field service of equipment. The Company paid Pitney Bowes $6.4 million for the three months ended March 31, 2003 in connection with the transition services agreement, field service of equipment and other administrative expenses.

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

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

10. Acquisitions

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

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

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

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

OVERVIEW

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

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

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

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

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT ESTIMATES

Revenue Recognition

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

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

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

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

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

Accounts Receivable

Accounts receivable are stated at net realizable value by recording allowances for those accounts receivable amounts that we believe are uncollectible. Our estimate of losses is based on prior collection experience 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/MFP equipment is depreciated over three years and facsimile equipment placed in service prior to October 1, 2003 is depreciated over five years. Facsimile equipment placed in service on or after October 1, 2003 is depreciated over three years.

Revenues

(Dollars in thousands)

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

	For the three months ended March 31,	
	2004	2003
Copier/MFP product line	$105,295	$ 92,223
Facsimile product line	53,027	58,699
Total revenue	$158,322	$150,922

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

	For the three months ended March 31,	
	2004	2003
North America	$152,633	$145,503
United Kingdom	5,689	5,419
Total revenue	$158,322	$150,922

The following table shows our revenue from sales to Pitney Bowes of Canada under a reseller agreement, presented separately, for the three months ended March 31, 2004 compared with the same period in the prior year.

	For the three months ended March 31,	
	2004	2003
Revenue excluding Pitney Bowes of Canada	$148,179	$144,553
Sales to Pitney Bowes of Canada	10,143	6,369
Total revenue	$158,322	$150,922

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

The following table shows our revenue and growth rates by revenue type and product line for the periods indicated.

	For the three months ended March 31,			
	2004		2003	
	Revenue	Growth rate	Revenue	Growth rate

Sales				
Copier/MFP products	$ 59,623	21.4%	$ 49,115	(0.8%)
Facsimile products	22,932	(4.2%)	23,938	(6.5%)
Total sales	82,555	13.0%	73,053	(2.8%)
Rentals				
Copier/MFP products	26,149	6.1%	24,650	8.2%
Facsimile products	28,262	(12.8%)	32,418	(9.4%)
Total rentals	54,411	(4.7%)	57,068	(2.5%)
Support services				
Copier/MFP products	19,523	5.8%	18,458	(1.7%)
Facsimile products	1,833	(21.8%)	2,343	(13.5%)
Total support services	21,356	2.7%	20,801	(3.2%)
Total revenue	$158,322	4.9%	$150,922	(2.7%)

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 March 31,	
	2004	2003
Equipment sales	28%	24%
Supplies sales	24%	24%
Total sales	52%	48%
Equipment rentals	34%	38%
Support services	14%	14%
Total revenue	100%	100%
Cost of sales	31%	30%
Cost of rentals	10%	13%
Selling, service and administrative expenses	52%	51%
Operating income	7%	6%
Interest expense	1%	1%
Income before income taxes	6%	5%
Provision for income taxes	2%	2%
Net income	4%	3%

Cost of sales as a percentage of sales revenue	59.3%	61.9%
Cost of rentals as a percentage of rental revenue	29.0%	33.6%
Effective tax rate	43.0%	40.5%

Three months ended March 31, 2004 and March 31, 2003

Revenue. For the three months ended March 31, 2004, total revenue of $158,322 increased 5% versus revenue of $150,922 for the three months ended March 31, 2003 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 of Canada, which operates under a reseller arrangement, total revenue for the first quarter increased 3% versus the prior year.

Equipment and supplies sales revenue of $82,555 increased 13% for the three months ended March 31, 2004 from $73,053 for the three months ended March 31, 2003, reflecting higher copier/MFP sales, partially offset by lower facsimile sales. Excluding the impact of sales to Pitney Bowes of Canada, total sales revenue increased 9% compared with the prior year. Copier/MFP sales increased 16% with particular improvement in our color product category and our mid-market digital black-and-white multifunctional products as well as increased copier/MFP supplies sales. Facsimile equipment and supplies sales declined 6% compared with the prior year. The rate of decline for facsimile equipment and supplies sales moderated during the first quarter as a result of a large sale to a national account customer. However, we still anticipate future revenue declines in our facsimile product line as part of the continuing decline in industry-wide facsimile usage.

Equipment rental revenue of $54,411 for the three months ended March 31, 2004 declined 5% versus equipment rental revenue of $57,068 for the three months ended March 31, 2003, reflecting the continuing expected decline in facsimile rental revenues, partially offset by an increase in copier/MFP rental revenues resulting from a continuing copier/MFP marketing focus. Rental revenue derived from our copier/MFP product line increased 6% primarily reflecting the impact of an increase in page volumes. Rental revenue from our facsimile product line declined 13% versus the prior year reflecting a lower installed base and lower pricing.

Support services revenue for the three months ended March 31, 2004 of $21,356, primarily derived from stand-alone service contracts, increased 3% versus support services revenue of $20,801 for the three months ended March 31, 2003, reflecting higher

copier/MFP service revenue resulting primarily from higher page volumes, partially offset by lower facsimile service revenue due to lower pricing.

Cost of sales. Cost of sales was $48,946 for the three months ended March 31, 2004 compared with $45,244 for the same period in 2003 and cost of sales as a percentage of sales revenue decreased to 59.3% for the three months ended March 31, 2004 from 61.9% for the three months ended March 31, 2003. This decrease was primarily due to our disciplined focus on improving profit margins and lower product cost, partially offset by an increase in lower margin sales to Pitney Bowes of Canada and the continuing shift in product mix toward lower margin copier/MFP products, away from the facsimile product line.

Cost of rentals. Cost of rentals was $15,790 for the three months ended March 31, 2004 compared with $19,171 for the three months ended March 31, 2003 and cost of rentals as a percentage of rental revenue declined 4.6 percentage points to 29.0% for the three months ended March 31, 2004 from 33.6% for the three months ended March 31, 2003. This decline was due to product cost improvements coupled with the impact of our disciplined focus on improving profit margins, partially offset by an increase in the continuing mix of copier/MFP product rentals which have a higher cost as a percentage of rental revenue than facsimile machines.

Selling, service and administrative expenses. Selling, service and administrative expenses of $82,567 were 52.2% of total revenue for the three months ended March 31, 2004 compared with $76,865, or 50.9% of total revenue for the three months ended March 31, 2003. Selling, service and administrative expenses increased 7% versus the prior year primarily resulting from higher compensation and benefit expenses relating to higher sales volume, increased sales headcount and adjustments to the sales compensation plans coupled with a higher proportion of enterprise resource planning ("ERP") and related costs expensed versus prior year, partially offset by lower costs resulting from the absence of payments to Pitney Bowes for information technology and related charges under the transition services agreement and lower advertising expenses.

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

Interest expense. Interest expense decreased to $935 for the three months ended March 31, 2004 from $1,629 for the three months ended March 31, 2004 due to lower interest rates, partially offset by higher debt levels. The weighted average interest rate for the three months ended March 31, 2004 was 3.1% versus 6.9% for the three months ended March 31, 2003.

Effective tax rate. Our effective tax rate was 43.0% for the three months ended March 31, 2004 compared with 40.5% for the three months ended March 31, 2003 due to an increase in state and local income taxes and a foreign dividend net of foreign tax credits.

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 subsidiaries as security for our obligations under the Credit Agreement. Available borrowings and letter of credit issuance under the Revolving Credit Facility are determined by a borrowing base consisting of a percentage of our eligible accounts receivable, inventory, rental assets and accrued and advance billings, less outstanding borrowings under the Term Loan.

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

Originally, amounts borrowed under the Revolving Credit Facility bore interest at variable rates based, at our option, on either the LIBOR rate plus a margin of from 2.25% to 3.00%, depending on our leverage ratio, or the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on our leverage ratio. Amounts borrowed under the Term Loan bore interest at variable rates based, at our option, on either the LIBOR rate plus a margin of 3.50% or 3.75%, depending on our leverage ratio, or the Fleet Bank base lending rate plus a margin of 2.50% to 2.75%, depending on our leverage ratio. A commitment fee of from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility was payable quarterly, in arrears, depending on our leverage ratio.

The Credit Agreement required us to manage our interest rate risk with respect to at least 50% of the aggregate principal amount of the Term Loan for a period of at least 36 months. Accordingly, we entered into two interest rate swap agreements in the notional amounts of $50 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 had been designated as cash flow hedges. The counterparties to the interest rate swap agreements were major international financial institutions. Under the terms of the swap agreements, we received payments based upon the 90-day LIBOR rate and remitted payments based upon a fixed rate. The fixed interest rates were 4.17% and 4.32% for the $50 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 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 we maintain interest rate protection with respect to at least 50% of the aggregate principal amount of the Term Loan, to reduce and fix the Term Loan interest rate to LIBOR plus a margin of 2.25%, from LIBOR plus a margin of from 2.75% to 3.75%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of 1.25%, from the Fleet Bank base lending rate plus a margin of from 1.75% to 2.75%, depending on our leverage ratio, to reduce and fix the Revolving Credit Facility interest rate to LIBOR plus a margin of 1.25%, from LIBOR plus a margin of from 2.25% to

3.00%, depending on our leverage ratio, or to the Fleet Bank base lending rate plus a margin of 0.25%, from the Fleet Bank base lending rate plus a margin of from 1.25% to 2.00%, depending on our leverage ratio and to fix our commitment fee at 0.375% on the average daily unused portion of the Revolving Credit Facility from 0.375% to 0.500% on the average daily unused portion of the Revolving Credit Facility, depending on our leverage ratio. On May 7, 2004, the Credit Agreement was further amended (the "Fifth Amendment") to increase the amount of our stock permitted to be repurchased from $78 million to $108 million, to increase the aggregate amount of acquisition consideration paid for acquisitions from $30 million to $60 million and to remove the requirement for annual borrowing base audits so long as $50 million or more of borrowings are available under the Credit Agreement and the fixed charge ratio, as defined in the Fifth Amendment, is 2.0 or higher. At March 31, 2004, we were in compliance with all of the financial covenants.

During the third quarter of 2002, we revised our cash flow estimates and prepaid $8 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 income (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 income (loss) into interest expense because it was no longer probable that the hedged forecasted transactions would occur.

At March 31, 2004, $78 million of borrowings were outstanding under the Credit Agreement, consisting of $25 million of borrowings under the Revolving Credit Facility and $53 million of borrowings under the Term Loan, and the borrowing base amounted to approximately $129 million. Approximately $69 million of the Revolving Credit Facility was available for borrowing at March 31, 2004. The Term Loan is payable in 11 consecutive equal quarterly installments of $0.1 million due June 30, 2004 through December 31, 2006, three consecutive equal quarterly installments of $12.9 million due March 31, 2007 through September 30, 2007 and a final payment of $12.9 million due at maturity.

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

The ratio of current assets to current liabilities increased to 3.3 to 1 at March 31, 2004 compared to 2.8 to 1 at December 31, 2003 due to reductions in accounts payable and accrued liabilities, a reduction in accrued billings and an increase in accounts receivable, partially offset by a reduction in inventories. At March 31, 2004, our total debt as a percentage of total capitalization increased to 22.6% from 19.2% at December 31, 2003 due to an increase in our debt and stock repurchases under our stock buy back program.

In October 2003, we began the implementation of Phase II of our ERP system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. As a result of this implementation, we have experienced, as expected, certain temporary processing inefficiencies, which have resulted in a short-term increase in our working capital requirements, particularly accounts receivable, due to the standardization of our billing practices and schedules across all product lines and the initial temporary suspension in invoicing our customers during the conversion to our new ERP system and delays in collections resulting from customer inquiries relating to changes to our billing policies and invoice format and an increase in rebilling activity to satisfy our customer requirements. We believe that the increase in accounts receivable is temporary and that our collection losses related to these temporarily suspended amounts will not be materially different than our historical experience. However, if collection losses related to these amounts are significantly higher than our historical experience, we would recognize an increase in our provision for bad debt in the near future. In addition, certain of the temporary processing inefficiencies have resulted in delays in certain product shipments, service responsiveness and potential inaccuracies in calculated sales compensation. These issues, coupled with certain revisions to our billing practices, could have a negative impact on customer service and satisfaction and employee retention, which could result in a potential loss of business. We are engaged in a period of stabilization and clean up, as is typical of a large ERP implementation and we anticipate this transition will be completed during 2004. Although no assurance can be given that these efforts will be successful in the time periods expected, other than the temporary increase in working capital requirements, we do not anticipate that these issues will have a material adverse effect on our financial position, results of operations or future cash flows.

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

Net cash used in operating activities was $3,694 for the three months ended March 31, 2004 compared with net cash provided by operating activities of $22,476 for the three months ended March 31, 2003. Net income was $5,747 and $4,766, respectively. Non-cash charges for depreciation and amortization and provisions for bad debt and inventory obsolescence in the aggregate provided cash of $20,831 and $23,116 for the three months ended March 31, 2004 and 2003, respectively. Changes in the principal components of working capital required $28,899 and $4,737 of cash in the three months ended March 31, 2004 and 2003, respectively. Of the $28,899 increase in our working capital requirements in the three months ended March 31, 2004, approximately $13.7 million resulted from an increase in accounts receivable due to delays in collections resulting from customer inquiries related to changes to the Company's billing policies and invoice format associated with the implementation of our ERP system and a decrease in accounts payable and accrued liabilities of approximately $13.1 million primarily consisting of approximately $6.9 million related to timing of payments for inventory shipped from Asia in late 2003, approximately $4.9 million of incentive compensation payments and approximately $2.4 million related to timing of insurance payments. The $4,737 of cash used by working capital changes in the three months ended March 31, 2003 resulted from a decrease in accounts payable and accrued liabilities consisting of approximately $3.5 million of incentive compensation payments and approximately $1.2 million related to the timing of inventory and other payments.

We used $16,373 and $15,446 in investing activities for the three months ended March 31, 2004 and 2003, respectively. Investment in rental equipment assets totaled $9,776 and $10,622 for the three months ended March 31, 2004 and 2003, respectively. The lower level of rental asset expenditures results from product cost improvements and lower facsimile placements. Capital expenditures for property, plant and equipment were $2,791 and $4,824 for the three months ended March 31, 2004 and 2003, respectively, of which the investment in ERP accounted for $1,698 and $3,236, respectively. During the three months ended March 31, 2004, we acquired an independent dealer to expand our sales and service capabilities as described in Note 10 of our "Notes to Consolidated Financial Statements."

Cash provided by financing activities was $9,650 for the three months ended March 31, 2004 compared with cash used in financing activities of $11,875 for the three months ended March 31, 2003. Cash provided by financing activities in the three months ended March 31, 2004 reflects net borrowings under the Revolving Credit Facility of $15.0 million. For the three months ended March 31, 2004 and 2003 cash was used to repurchase 148,900 shares of our stock at a cost of $6,270 and 642,000 shares at a cost of $12,597, respectively.

During the three month period ended March 31, 2004, we had no material changes in our contractual obligations and commitments. We had no material commitments other than supply agreements with vendors that extend only to equipment supplies and parts ordered under purchase orders; there are no long-term purchase requirements. We will continue to make additional investments in facilities, rental equipment, computer equipment and systems and our distribution network as required to support our operations. We anticipate investments in rental equipment assets for new and replacement programs in amounts consistent with the recent past. We estimate that we will spend approximately $11 million over the remainder of 2004 to continue to enhance our information systems infrastructure and implement our ERP system.

Risk Factors that Could Cause Results to Vary

Risk Factors Relating to Our Business

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

The proliferation of e-mail, multifunctional products and other technologies in the workplace has led to a reduction in the use of traditional copiers and facsimile machines. We must be able to continue to obtain products with the appropriate technological advancements in order to remain successful. We cannot anticipate whether other technological advancements will substantially minimize the need for our products in the future. 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. Although many of our existing rental placements are analog equipment, the depreciable life of this equipment is three years and most of this equipment is reaching a fully depreciated status. All of our new product purchases and new product placements are digital equipment.

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

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

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

A portion of our international business is transacted in local currency. Currently, approximately 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 was to revalue the Chinese renminbi and the nominal value of the renminbi rises, the resultant impact on the exchange rate of the Chinese renminbi and the U.S. dollar could have a negative impact on our product cost. We do not currently utilize any form of derivative financial instruments to manage our exchange rate risk. We manage our foreign exchange risk by attempting to pass through to our customers any cost increases

related to foreign currency exchange. However, no assurance can be given that we will be successful in passing cost increases through to our customers in the future.

Risk Factors Relating to Separating Our Company From Pitney Bowes

In October 2003, we began the implementation of Phase II of our ERP system, consisting of order management, order fulfillment, billing, cash collection, service management and sales compensation, which replaced the information technology services provided by Pitney Bowes under the transition services agreement. As a result of this implementation, we have experienced, as expected, certain temporary processing inefficiencies, which have resulted in a short-term increase in our working capital requirements, particularly accounts receivable, due to the standardization of our billing practices and schedules across all product lines and the initial temporary suspension in invoicing our customers during the conversion to our new ERP system and delays in collections resulting from customer inquiries relating to changes to our billing policies and invoice format and an increase in rebilling activity to satisfy our customer requirements. We believe that the increase in accounts receivable is temporary and that our collection losses related to these temporarily suspended amounts will not be materially different than our historical experience. However, if collection losses related to these amounts are significantly higher than our historical experience, we would recognize an increase in our provision for bad debt in the near future. In addition, certain of the temporary processing inefficiencies have resulted in delays in certain product shipments, service responsiveness and potential inaccuracies in calculated sales compensation. These issues, coupled with certain revisions to our billing practices, could have a negative impact on customer service and satisfaction and employee retention, which could result in a potential loss of business. We are engaged in a period of stabilization and clean up, as is typical of a large ERP implementation and we anticipate this transition will be completed during 2004. Although no assurance can be given that these efforts will be successful in the time periods expected, other than the temporary increase in working capital requirements, we do not anticipate that these issues will have a material adverse effect on our financial position, results of operations or future cash flows.

Pitney Bowes has been and is expected to continue to be a significant customer. For the three months ended March 31, 2004 and 2003, revenues from Pitney Bowes, exclusive of equipment sales to PBCC for lease to the end user, accounted for approximately 10% and 8%, respectively, of our total revenue. However, no assurance can be given that Pitney Bowes will continue to purchase our products and services.

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

Special Note About Forward-Looking Statements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have certain exposures to market risk related to changes in interest rates and foreign currency exchange rates. Currently, we do not utilize any form of derivative financial instruments to manage our interest rate risk or our exchange rate risk. We manage our foreign exchange risk by attempting to pass through to our customers any cost increases related to foreign currency exchange. In addition, we are exposed to foreign exchange rate fluctuations with respect to the British Pound and the Canadian Dollar as the financial results of our U.K. subsidiary and Canadian subsidiary are translated into U.S. dollars for consolidation. The effect of foreign exchange rate fluctuation for the quarter ended March 31, 2004 was not material.

ITEM 4. CONTROLS AND PROCEDURES

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

We implemented an ERP system in the fourth quarter of 2003 and as a result, we are in a period of stabilization and clean up. During this period, we are refining our procedures surrounding order management and fulfillment, billing, cash application, service management and sales compensation, and the controls surrounding processing in these areas have been adjusted accordingly. We did not implement any changes to our monitoring controls and we believe the changes to our processing controls have not materially affected, nor are reasonably likely to materially affect, our internal control over financial reporting.

PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

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

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan
January 1, 2004 - January 31, 2004	35,800	$39.47	35,800
February 1, 2004 - February 29, 2004	42,000	$41.64	42,000
March 1, 2004 - March 31, 2004	71,100	$43.71	71,100
Total	148,900	$42.11	148,900

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 March 31, 2004, we have accumulated approximately 3.4 million shares of treasury stock at a cost of approximately $71 million. The stock buy back program has no fixed termination date.

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, 2002 (6)
4.1	Form of Imagistics International Inc. Common Stock Certificate (1)
10.1	Tax Separation Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.2	Transition Services Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.3	Distribution Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)
10.4	Intellectual Property Agreement between Pitney Bowes Inc. and Imagistics International Inc. (3)

10.5	Reseller Agreement between Pitney Bowes Management Services and Imagistics International Inc. (3)
10.6	Reseller Agreement between Pitney Bowes of Canada and Imagistics International Inc. (3)
10.7	Vendor Financing Agreement between Pitney Bowes Credit Corporation and Imagistics International Inc. (3)
10.8	Form of Sublease Agreement between Pitney Bowes Inc. and Imagistics International Inc. (2)
10.9	Form of Sublease and License Agreement between Pitney Bowes Inc. and Imagistics International Inc. (2)
10.10	Form of Assignment and Novation Agreement between Pitney Bowes Inc. and Imagistics International Inc. (2)

10.11	Imagistics International Inc. 2001 Stock Plan (1)
10.12	Imagistics International Inc. Key Employees' Incentive Plan (3)
10.13	Imagistics International Inc. Non-Employee Directors' Stock Plan (1)
10.14	Letter Agreement between Pitney Bowes Inc. and Marc C. Breslawsky (1)
10.15	Letter Agreement between Pitney Bowes Inc. and Joseph D. Skrzypczak (1)
10.16	Letter Agreement between Pitney Bowes Inc. and Mark S. Flynn (1)
10.17	Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent (3)
10.18	Rights Agreement between Imagistics International Inc. and EquiServe Trust Company, N.A. (3)
10.19	Employment Agreement between Imagistics International Inc. and Marc C. Breslawsky(3)
10.20	Employment Agreement between Imagistics International Inc. and Joseph D. Skrzypczak(3)
10.21	Employment Agreement between Imagistics International Inc. and Christine B. Allen (3)
10.22	Employment Agreement between Imagistics International Inc. and John C. Chillock (3)
10.23	Employment Agreement between Imagistics International Inc. and Chris C. Dewart (3)
10.24	Employment Agreement between Imagistics International Inc. and Mark S. Flynn (3)

10.25	Employment Agreement between Imagistics International Inc. and Nathaniel M. Gifford(3)
10.26	Employment Agreement between Imagistics International Inc. and Joseph W. Higgins (3)
10.27	Amendment No. 1 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (4)
10.28	Amendment No. 2 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (5)
10.29	First Amendment to Imagistics International Inc. 2001 Stock Plan (6)
10.30	First Amendment to Rights Agreement between Imagistics International Inc. and EquiServe Trust Company, N.A. (6)
10.31	Amendment No. 3 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (7)
10.32	Amendment No. 1 to Transition Services Agreement between Pitney Bowes Inc. and Imagistics International Inc. (8)
10.33	Amendment No. 4 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein (9)
10.34	Reseller Agreement between Pitney Bowes of Canada Ltd. and Imagistics International Inc. (10)
10.35	Amendment No. 5 to Credit Agreement between Imagistics International Inc. and Merrill Lynch & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agent, Fleet Capital Corporation, as Administrative Agent, and the Lenders identified therein
31.1	Certification of the Chief Executive Officer Pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer Pursuant to Securities Exchange Act Rule 13a-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

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

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

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

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

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

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

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

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

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

(b) Reports on Form 8-K.

On February 19, 2004, we filed a Current Report on Form 8-K, under Item 12, which included a copy of our press release dated February 19, 2004 in which we announced our earnings for the fiscal quarter ended December 31, 2003 and certain additional matters.

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: May 10, 2004

Imagistics International Inc.
(Registrant)

By /s/ Joseph D. Skrzypczak

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