INFINITE GROUP INC
Form 10QSB
August 11, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2005

Commission File Number 0-21816

INFINITE GROUP INC.
(Exact name of small business issuer as specified in its charter)

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

595 Blossom Rd. Suite 309
Rochester, New York 14610
(Address of principal executive office)

(585) 654-5525
(Issuer's telephone number, including area code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes |X| No | |

Number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of July 31, 2005, there were 19,206,965 shares of common stock outstanding.

Transitional Small Business Disclosure Format. Yes |_| No |X|

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INFINITE GROUP INC.
FORM 10-QSB REPORT

Infinite Group Inc.

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report on Form 10-QSB are "forward-looking statements" within the meaning of Section 21E of the Securities and Exchange Act of 1934 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. The terms "we", "our", "us", or any derivative thereof, as used herein refer to Infinite Group Inc., a Delaware corporation.

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

INFINITE GROUP, INC.

Consolidated Balance Sheets

	June 30, 2005 (unaudited)	Dec 2 (au
ASSETS		
Current assets:		
Cash	$ 338,205	$
Restricted cash	--	
Accounts receivable, net of allowance of $56,202 ($25,000 - 2004)	1,285,175	
Current portion of notes receivable	--	
Inventories	23,239	
Other current assets	53,207	
Assets of discontinued operations	--	
Total current assets	1,699,826	
Property and equipment, net	275,442	
Other assets:		
Note receivable	73,897	
Intangible assets, net	--	
Total other assets	73,897	
Total assets	$ 2,049,165	$
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Notes payable:		
Bank	--	
Other	175,427	
Related parties	9,906	
Accounts payable	537,272	
Accrued expenses	823,653	
Current maturities of long-term obligations	11,725	
Current maturities of long-term obligations-related party	44,000	
Liabilities of discontinued operations	--	
Total current liabilities	1,601,983	
Long-term obligations		
Bank notes payable	57,425	
Notes payable-related parties	1,100,124	
Accrued pension expense	2,236,687	

Total liabilities	4,996,219	
Commitments and contingencies		
Stockholders' deficiency:		
Common stock, $.001 par value, 20,000,000 shares authorized; 19,206,965 (17,561,965 in 2004) shares issued and outstanding	19,207	
Additional paid-in capital	28,455,803	2
Accumulated deficit	(28,666,173)	(2
Accumulated other comprehensive loss	(2,755,891)	(
Total stockholders' deficiency	(2,947,054)	(
Total liabilities and stockholders' deficiency	$ 2,049,165	$

See notes to consolidated financial statements.

INFINITE GROUP, INC.

Consolidated Statements of Operations (Unaudited)

	Six Months Ended June 30,		Thr
	2005	2004	2005
Sales	$ 4,134,550	$ 1,829,823	$ 2,009,8
Cost of goods and services	2,886,028	1,193,950	1,371,1
Gross profit	1,248,522	635,873	638,6
Costs and expenses:			
General and administrative	787,554	574,954	399,7
Depreciation and amortization	23,749	12,517	12,5
Write-off of capitalized financing costs	44,857	--	44,8
Selling	140,072	4,364	139,1
Research and development	161,924	142,955	90,2
Total costs and expenses	1,158,156	734,790	686,5
Operating income (loss)	90,366	(98,917)	(47,8
Other income (expense):			
Interest income	66,255	--	32,1
Interest expense:			
Related parties	(44,333)	(36,653)	(22,4
Other	(69,431)	--	(33,8
	(113,764)	(36,653)	(56,3
Total other expense	(47,509)	(36,653)	(24,1
Income (loss) from continuing operations before income tax expense	42,857	(135,570)	(72,0

Income tax expense	(1,300)	(350)	
Income (loss) from continuing operations	41,557	(135,920)	(72,0
Discontinued operations:			
Income (loss) from discontinued operations	12,233	(74,731)	4,9
Net income (loss)	$ 53,790	$ (210,651)	$ (67,0
Net income (loss) per share-basic:			
Income (loss) from continuing operations	$ .00	$ (.01)	$ (.
Income (loss) from discontinued operations	.00	(.01)	.
Net income (loss)	$ .00	$ (.02)	$ (.
Net income (loss) per share-diluted:			
Income (loss) from continuing operations	$ .00	$ (.01)	$ (.
Income (loss) from discontinued operations	.00	(.01)	.
Net income (loss)	$ .00	$ (.02)	$ (.
Weighted average number of shares outstanding:			
Basic	18,910,805	13,692,968	19,206,9
Diluted	20,181,583	13,692,968	19,206,9

See notes to consolidated financial statements.

INFINITE GROUP, INC.

Consolidated Statements of Cash Flows (Unaudited)

	For the Six Month June 30, 2005	
Operating activities:		
Net income (loss)	$ 53,790	$
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
(Income) loss from discontinued operations	(12,233)	
Depreciation and amortization	24,019	
Write-off of capitalized financing costs	44,587	
Increase in:		
Accounts receivable	(230,552)	
Inventories	(23,239)	

Other current assets	(12,000)
Increase (decrease) in:	
Accounts payable	35,195
Accrued expenses	281,587
Accrued pension obligations	59,400
Net cash provided by (used in) operating activities of continuing operations	220,554
Net cash provided by (used in) operating activities of discontinued operations	854
Net cash provided by (used in) operating activities	221,408
Investing activities:	
Decrease in restricted funds	30,327
Purchase of property and equipment	(53,615)
Proceeds from notes receivable	2,137,307
Net cash provided by (used in) investing activities	2,114,019
Financing activities:	
Net repayments of bank notes payable	(50,207)
Net repayments of notes payable-other	(757)
Proceeds from issuance of long-term obligations-related parties	--
Repayment of notes payable-related parties	--
Repayments of long-term obligations	(2,123,555)
Proceeds from issuance of common stock, net of costs	80,000
Net cash provided by (used in) financing activities	(2,094,519)
Net increase in cash	240,908
Cash - beginning of period	97,297
Cash - end of period	$ 338,205
Supplemental disclosure:	
Cash paid for:	
Interest	$ 103,196
Income taxes	$ 1,300

See notes to consolidated financial statements.

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INFINITE GROUP INC.

Notes to Consolidated Financial Statements (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 for interim financial information and with instructions to Form 10-QSB. Accordingly, they 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 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 footnotes for the year ended December 31, 2004 and the notes thereto included in the Company's Annual report on Form 10-KSB filed with the United States Securities and Exchange Commission. Results of consolidated operations for the six month period ended June 30, 2005 are not necessarily indicative of the operating results to be attained in the year ending December 31, 2005. The consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiaries. All material inter-company accounts and transactions have been eliminated.

Note 2. Summary of Significant Accounting Policies

Critical Accounting Policies and Estimates

There are several accounting policies that we believe are significant to the presentation of our consolidated financial statements. These policies require management to make complex or subjective judgments about matters that are inherently uncertain. Note 3 to our audited consolidated financial statements presents a summary of significant accounting policies. The most critical accounting policies follow.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and consist of component parts for the TouchThru(TM) biometric product.

Revenue Recognition

Beginning in the second quarter of 2003, we commenced providing services in the field of information technology (IT) consulting services through our IT Services Group. Consulting revenues are recognized as the consulting services are provided. Customer deposits received in advance are recorded as liabilities until associated services are completed.

Stock-Based Compensation

We disclose the pro forma compensation cost relating to stock options granted under employee stock option plans, based on the fair value of those options at the date of grant. This valuation is determined utilizing the Black-Scholes option-pricing model, which takes into account certain assumptions, including the expected life of the option and the expected stock volatility and dividend yield over this life. These assumptions are made based on past experience and expected future results. In the event the actual performance varies from the estimated amounts, the value of these options may be misstated.

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Effect of New Accounting Pronouncements

In February 2003, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation: A Comparison of FASB Statement No. 123, Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-based Payments." SFAS 148 amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based

method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based compensation. The statement also amends APB Opinion No. 28, "Interim Financial Reporting", to require disclosure about those effects in interim financial information. We have chosen not to voluntarily change to the fair value based method of accounting for stock-based employee compensation but have adopted the disclosure rules under SFAS 148.

In December 2004, the FASB issued SFAS No. 123R (revised 2004), "Share-Based Payment". For public companies, the cost of employee services received in exchange for equity instruments generally should be measured at fair value at the grant date. The cost of employee services received in exchange for an award of liability instruments should be measured initially at fair value and re-measured subsequently at each reporting date through the settlement date. Publicly traded companies, other than small business issuers, must apply this Standard as of the beginning of the first interim or annual period that begins after June 15, 2005. Public entities that file as small business issuers must comply as of the beginning of the first interim or annual reporting period that begins after December 15, 2005.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29". This amendment to Opinion No. 29 eliminates the fair value exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The Statement is effective for nonmonetary asset exchanges occurring in periods beginning after June 15, 2005.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections - A Replacement of APB Opinion No. 20 and FASB Statement No. 3". This Statement replaces APB Opinion No. 20, "Accounting Changes", and FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

Note 3. Discontinued Operations and Reclassifications

The statements of operations and cash flows for the three and six months ended June 30, 2005 and 2004 account for the discontinued operations of the Photonics Group, consisting of Infinite Photonics, Inc. (IP), which business was suspended in 2002 as a result of the loss of the DARPA contract, and Laser Group (LF), which was sold as discussed below.

On October 30, 2002, IP received a Notice of Termination of its DARPA contract for the government's convenience under the contract provisions entitled Termination, Federal Acquisition Regulation (FAR) 52.249.6. The DARPA contract had provided substantially all of the revenue of the Photonics Group. As of December 31, 2004, the contract termination process was substantially complete. We have been reimbursed for substantially all costs associated with the termination. The termination of the contract had a detrimental effect on the development of our technology. During 2002, all of our Photonics Group employees

were released and the operations of the Photonics Group ceased. We also determined that our Photonics Group intellectual property and property and equipment were impaired, and consequently recorded impairment losses in the fourth quarter of 2002 of approximately $468,000 and $148,000 respectively, which were included in loss on disposal of discontinued operations in the consolidated statement of operations for the year ended December 31, 2002.

On December 31, 2003, the Company and LF entered into an asset purchase agreement with LFI, Inc. ("LFI") relating to the purchase by LFI of certain assets and the assumption of certain liabilities of LF relating to the laser engraving and medical products manufacturing and assembly businesses of LF (the "Purchase Agreement"). The principals of LFI are former employees of LF, including the former chairman and chief executive officer of the Company. The purchase price for the assets was assumed liabilities of LF and the Company. On December 31, 2004, the Company completed the sale of the remaining assets, including the assumption of certain liabilities, to an affiliate of LFI, relating to all the remaining laser businesses of LF. The purchase price was the assumed liabilities of LF plus the issuance of several notes by the buyer to LF. LF recorded a loss on sale of approximately $99,000 for the year ended December 31, 2003. LF reclassified the operating assets and liabilities to assets and liabilities held for sale at December 31, 2003.

In accordance with FASB 144, the disposal of the Photonics and Laser segments have been accounted for as a disposal of business segments and accordingly, the assets and liabilities for IP and LF have been segregated from continuing operations in the accompanying consolidated balance sheets and classified as assets and liabilities of discontinued operations. The operating results for both segments are segregated and reported as discontinued operations in the accompanying consolidated statements of operations and cash flows.

The following is a summary of financial position at June 30, 2005 and December 31, 2004 and results of operations for the three and six months ended June 30, 2005 and 2004 for the disposed Photonics (IP) and Laser (LF) segments:

Financial Position	June 30, 2005	December 31, 2004
Current assets and total assets of discontinued operations	$ --	$ 205,921
Liabilities of discontinued operations:		
Accounts payable and accrued expenses	$ --	$ 212,300
Unsecured note payable	--	5,000
Total liabilities of discontinued operations	$ --	$ 217,300

Results of Operations	Three Months Ended June 30, 2005	2004
Revenue from discontinued operations	$ --	$ 821,648
Income (loss) from discontinued operations	$ 4,979	$ 13,938

Results of Operations	Six Months Ended June 30, 2005	2004
Revenue from discontinued operations	$ --	$ 1,492,158
Income (loss) from discontinued operations	$ 12,233	$ (74,731)

Certain other amounts in the 2004 financial statements have been reclassified to conform with the 2005 financial statements.

Note 4. Stock Option Plan and Stock Warrants

As of June 30, 2005 the Company's Stock Option Plans (the "Plan"), as approved by shareholders, provided for the grant of incentive or non-qualified stock options for the purchase of common stock for up to approximately 1,840,000 shares to employees, directors and consultants. The Company's board of directors has approved the grant of incentive stock options for the purchase of common stock for up to 4,000,000 shares to employees, directors and consultants, which is subject to approval by shareholders. The Plan is administered by the compensation committee established by the Company's board of directors, which determines the terms of options including the exercise price, expiration date, number of shares, and vesting provisions.

A summary of all stock option activity for the six months ended June 30, 2005 is as follows:

	Number Of Options	Exercise Price	Weighted Average Exercise Price
Outstanding at December 31, 2004	1,895,482	$ .01 - $2.50	$ .13
Options issued	2,428,000	$ .09 - $.25	$ .18
Options expired	(676,982)	$ .09 - $2.50	$ .42
Outstanding at June 30, 2005	3,646,500	$ .01 - $.25	$ .11
Exercisable at June 30, 2005	3,646,500	$ .01 - $ .25	$ .11

At December 31, 2004, the Company had 425,000 warrants outstanding at an average

exercise price of $2.50 per share. During the six months ended June 30, 2005, 350,000 warrants expired. At June 30, 2005, the Company had 75,000 warrants outstanding at an average exercise price of $2.40.

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123 -"Accounting for Stock-Based Compensation, " and, accordingly, does not recognize compensation cost for stock option grants under fixed awards. If the Company had elected to recognize compensation costs based on the fair value of the options granted at grant date as prescribed by SFAS No.123, net income (loss) and income (loss) per share from continuing operations would have changed as follows:

	Three Months Ended June 30,	
Results of Operations	2005	2004
Net income (loss)-as reported (000's)	$ (67)	$ 35
Total stock based employee compensation expense determined under the fair value method for all awards (000's)	$ (119)	$ (8)
Net income (loss) - pro forma (000's)	$ (186)	$ 27
Income (loss) per share as reported-basic and diluted	$ (.00)	$ .00
Income (loss) per share pro forma-basic and diluted	$ (.01)	$ .00

	Six Months Ended June 30,	
Results of Operations	2005	2004
Net income (loss)-as reported (000's)	$ 54	$ (211)
Total stock based employee compensation expense determined under the fair value method for all awards (000's)	$ (251)	$ (15)
Net loss- pro forma (000's)	$ (197)	$ (226)
Income (loss) per share as reported-basic and diluted	$ .00	$ (.02)

Loss per share pro forma-basic and diluted	$ (.01)	$ (.02)

Note 5. Business Segments

Prior to 2002, our business was organized, managed and internally reported as three segments. The segments were determined based on differences in products, production processes and internal reporting. During the fourth quarter of 2002, our contract with DARPA was terminated and as a result of the termination, management decided to suspend the activities of the Photonics Group in 2002 and liquidate the remaining assets. During the fourth quarter of the year ended December 31, 2003, we approved the sale of the assets and certain liabilities of our Laser Fare, Inc. subsidiary, referred to as the Laser Group. As a result, in accordance with FASB 144, the disposal of the Plastics, Photonics, and Laser segments have been accounted for as disposals of business segments and accordingly, the respective assets and liabilities have been segregated from continuing operations and classified as assets and liabilities of discontinued operations and the operating results for all three segments are segregated and reported as discontinued operations.

Beginning in 2003, we revised our business strategy and began operating our newly formed IT Services Group.

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All of our business segments operate entirely within the United States. Revenues from customers in foreign countries are minimal. Transactions between reportable segments are recorded at cost. We rely on inter-segment cooperation and management does not represent that these segments, if operated independently, would report the results shown. A summary of selected consolidated information for our industry segments during the periods ended June 30, 2005 and 2004, respectively, is set forth as follows.

	Photonics Group	Laser Group	IT Services Group	Consolidated
Three Months ended June 30, 2004				
Sales to unaffiliated customers	$ --	$ --	$ 1,269,388	$ 1,269,388
Operating income	$ --	$ --	$ 40,233	$ 40,233
Income (loss) from discontinued operations	$ (19,752)	$ 33,690	$ --	$ 13,938
Three Months ended June 30, 2005				
Sales to unaffiliated customers	$ --	$ --	$ 2,009,823	$ 2,009,823
Operating (loss)	$ --	$ (46,486)	$ (1,395)	$ (47,881)
Income (loss) from				

discontinued operations	$ 4,979	$ --	$ --	$ 4,979

	Photonics Group	Laser Group	IT Services Group	Consolidated
Six Months ended June 30, 2004				
Sales to unaffiliated customers	$ --	$ --	$ 1,829,823	$ 1,829,823
Operating loss	$ --	$ --	$ (98,917)	$ (98,917)
Income (loss) from discontinued operations	$ (59,930)	$ (14,801)	$ --	$ (74,731)
Six Months ended June 30, 2005				
Sales to unaffiliated customers	$ --	$ --	$ 4,134,550	$ 4,134,550
Operating income (loss)	$ --	$ (48,087)	$ 138,453	$ 90,366
Income (loss) from discontinued operations	$ 12,233	$ --	$ --	$ 12,233

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Note 6. Supplemental Cash Flow Information

Non-cash investing and financing transactions, including non-monetary exchanges, consist of the following:

	Six Months Ended June 30,	
	2005	2004
Conversion of accounts payable to common stock	$ 2,250	$ --
Common stock authorized not issued, transferred to issued	$ --	$ 75,000
Purchase of equipment through long-term lease obligation	$ --	$ 45,120

Note 7. Earnings Per Share

Basic income per share is based on the weighted average number of common shares outstanding during the periods presented. Diluted income per share is based on the weighted average number of common shares outstanding, as well as dilutive potential common shares which, in our case, comprise shares issuable under the stock options and stock warrants. 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 exercised. In a loss year, the calculation for basic and diluted earnings per share is considered to be the same, as the impact of potential common shares is anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share for those periods with net income from continuing operations as follows:

	Six Months Ended June 30, 2005	Three Months Ended June 30, 2004
Numerator:		
Income available to common stockholders from continuing operations	$ 53,790	$ 20,668
Weighted average shares outstanding	18,910,805	13,769,822
Denominator for diluted income per share:		
Weighted average shares outstanding	18,910,805	13,769,822
Common stock options and stock warrants	1,270,778	1,037,397
Weighted average shares and conversions	20,181,583	14,807,219

For the three months ended June 30, 2005 and six months ended June 30, 2004 all outstanding stock options and warrants have not been considered common stock equivalents because their assumed exercise would be anti-dilutive.

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

On January 3, 2003, our former president and chief executive officer, Clifford G. Brockmyre II, resigned and was replaced by Michael S. Smith, one of our board members. At the same time, we moved our corporate headquarters from Rhode Island to Rochester, New York. On May 6, 2003, Dr. Allan Robbins and Paul Delmore were appointed to fill two existing vacancies on our board. Mr. Brockmyre remained on our board of directors until October 30, 2003 at which time he resigned. On March 15, 2004, Brian Corridan resigned from our board.

In the fourth quarter of 2003, we decided to dispose of our Laser Fare, Inc. subsidiary (LF) and to restructure our business. We sold a portion of the business of LF (primarily the medical and engraving business) as of December 31, 2003 and the remaining business as of December 31, 2004, although we continued to operate the business during the disposal process.

The purchase price for the assets consisted of LFI's assumption of certain of

our liabilities in the aggregate amount of approximately $358,000. On December 31, 2004, we sold the remaining assets of LF to Rolben Acquisition Corporation (Rolben), a company affiliated with LFI. The purchase price for the remaining assets consisted of Rolben's assumption of substantially all of the liabilities of LF and the delivery of promissory notes in the aggregate amount of approximately $2.1 million. Because certain required consents were not yet obtained at December 31, 2004, we remained obligated under several notes to UPS Capital Business Credit (UPS) and the Rhode Island Industrial Facilities Corporation (RIIFC) in the same amounts as the notes from Rolben. In May 2005, the UPS and RIIFC notes were paid in full and we were released from all of our obligations thereunder. At the same time, the notes from Rolben to us terminated.

During the second quarter of 2003, we commenced providing services in the field of information technology (IT) consulting services through our IT Services Group. We provide business and technology integration and systems support to government clients. We focus on aligning business processes with technology for delivery of solutions meeting the client's exact needs.

Results of Operations

Comparison of Three Months ended June 30, 2005 and 2004

We commenced the operations of our IT services Group in the second quarter of 2003. The trends suggested by the following table are not necessarily indicative of future operating results due to the startup nature of our IT Services Group.

	Three Months Ended June			
	2005	As a % of Net Revenues	2004	As
Sales	$ 2,009,823	100.0%	$ 1,269,388	
Cost of sales	1,371,147	68.2	833,965	
Gross profit	638,676	31.8	435,423	
General and administrative	399,711	19.9	310,775	
Depreciation and amortization	12,568	0.6	5,911	
Write-off of capitalized financing costs	44,857	2.2	--	
Selling	139,178	6.9	4,195	
Research and development	90,243	4.5	74,309	
Total operating expenses	686,557	34.2	395,190	
Operating income(loss)	(47,881)	(2.4)	40,233	
Other income (expense) and income taxes, net	(24,172)	(1.2)	(19,565)	
Income (loss) from continuing operations	(72,053)	(3.6)	20,668	
Income from discontinued operations	4,979	0.2	13,938	
Net income (loss)	$ (67,074)	(3.3)%	$ 34,606	

Sales

Sales for the three months ended June 30, 2005 were $2,009,823 which was a substantial increase of $740,435 or 58.3% as compared to sales for the three months ended June 30, 2004 of $1,269,388. The increase was due to the continued development of our IT Services Group, which began operations in the second quarter of 2003. We realized sales increases in 2005 from new and expanded contracts with prime contractors for the U.S. Government.

Cost of Sales and Gross Profit

Cost of sales represents the cost of employee services related to the IT Services Group. Cost of sales for the three months ended June 30, 2005 was $1,371,147 or 68.2% of sales as compared to $833,965 or 65.7% of sales for the three months ended June 30, 2004. Gross profit was $638,676 or 31.8% of sales for the three months ended June 30, 2005 compared to $435,423 or 34.3% of sales from the three months ended June 30, 2004. We experienced a decrease in gross profit margin as a percent of sales due to the competitive nature of our business, which generally provides for lower gross profit margins on larger sales volume contracts. As the mix of different projects changes, our gross profit margin changes. In the future we may submit bids on new work with lower gross profit margins to generate opportunities for long-term, larger volume contracts and more stable sales.

General and Administrative Expenses

General and administrative expenses include corporate overhead such as compensation and benefits for administrative and finance personnel, rent, insurance, professional fees, travel, and office expenses. General and administrative expenses for the three months ended June 30, 2005 were $399,711 which was an increase of $88,938 or 28.6% as compared to $310,775 for the three months ended June 30, 2004. As a percentage of sales, general and administrative expenses were 19.9 % for the three months ended June 30, 2005 as compared to 24.5% for the three months ended June 30, 2004. We anticipate that general and administrative expenses will increase as we continue to grow our business and incur travel and other expenses associated with managing a larger business. We also experienced increases in accounting and legal expenses in 2005 due to our focus on completing audits of our financial statements and related regulatory filings.

General and administrative expenses include expenses (including professional services and interest costs) associated with the Osley & Whitney defined benefit retirement plan of approximately $48,000 and $54,000 for the three months ended June 30, 2005 and 2004, respectively.

Depreciation and Amortization

Depreciation and amortization expense was $12,568 for the three months ended June 30, 2005 compared to $5,911 for the three months ended June 30, 2004. This increase is due to depreciation of equipment and software that were added in 2004 and 2005.

Write-off of Capitalized Closing Costs

In the second quarter of 2005, the buyer of the assets and businesses of LF obtained new bank financing. The buyer paid all of its notes receivables to us, which proceeds were used to pay off all of LF's bank promissory notes and LF's

capital lease obligation. As a result we wrote off the balance of LF's capitalized financing costs of $44,857.

Selling Expenses

For the three months ended June 30, 2005 we incurred selling expenses of $139,178 associated with growing business in our IT Services Group as compared to $4,195 for the three months ended June 30, 2004. We added new employees and changed the work assignment of one employee in the second quarter of 2005 to focus on generating new sales leads and new contract opportunities. We expect that selling expenses will increase as we devote more resources to increasing our sales.

Research and Development

For the three months ended June 30, 2005 we continued to incur research and development expenses associated with growing business in our IT Services Group related to our biometrics applications and recorded $90,243 of expense compared to $74,309 for the three months ended June 30, 2004. These expenses are principally related to the development of an access control terminal and related software called TouchThru(TM). TouchThru(TM) is a self-contained terminal enabling physical access control using biometric identification. It incorporates fingerprint matching technology licensed from Ultra-Scan Corporation, a private technology company headquartered in Buffalo, New York. TouchThru(TM) will be the first biometric product we introduce, and we intend to be in a position to market and sell that product beginning in 2006. We plan to market and sell TouchThru(TM) in a variety of industries and markets, including the federal, state and local government, health care, travel and general security, and access control.

Operating Income (Loss)

The non-recurring write off of capitalized financing costs of $44,857 recorded in the three months ended June 30, 2005 had a significant impact in the reduction of net operating income from $40,233 for the three months ended June 30, 2004 to a net operating loss of $47,881 for the three months ended June 30, 2005. For the three months ended June 30, 2005, we experienced increases in operating expenses of $291,367 as discussed above, offset in part by an improvement in gross margin of $203,253.

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Other Income (Expense)

Other income and expense consists of interest expense on indebtedness for the three months ended June 30, 2005. Interest expense was $56,365 (including $32,193 of interest expense on notes payable of LF) for the three months ended June 30, 2005 compared to interest expense of $19,565 for the three months ended June 30, 2004, which was an increase of $36,800. This increase is principally offset by $32,193 of interest income from the notes receivable due from the buyer of LF's businesses.

Income (Loss) from Discontinued Operations

We recorded income from discontinued operations of $4,979 for the three months ended June 30, 2005 compared to income of $13,938 for the three months ended June 30, 2004. The income is the result of the Laser Group and the Photonics Group which were reclassified as discontinued operations.

Net Income (Loss)

For the three months ended June 30, 2005, we recorded a loss from continuing operations of $72,053 or breakeven per share, and a net loss of $67,074 or breakeven per share. This compares to net income from continuing operations of $20,668 or breakeven per share and a net income of $34,606, or breakeven per share for the three months ended June 30, 2004. The decrease in profitability is attributable to the write off of capitalized financing costs of $44,857 and increases in other expenses, especially selling expenses during the three months ended June 30, 2005.

Comparison of Six Months ended June 30, 2005 and 2004

The following table compares our statements of operations data for the first six months of 2005 and 2004. We commenced the operations of our IT Services Group in the second quarter of 2003. The trends suggested by this table are not indicative of future operating results due to the startup nature of our IT Services Group, our termination of the DARPA contract and our decision to sell the business of our Laser Group and focus on our IT Services Group.

	Six Months Ended June		
	2005	As a % of Net Revenues	2004
Sales	$ 4,134,550	100.0%	$ 1,829,823
Cost of sales	2,886,028	69.8	1,193,950
Gross profit	1,248,522	30.2	635,873
General and administrative	787,554	19.0	574,954
Depreciation and amortization	23,749	0.6	12,517
Write-off of capitalized financing costs	44,857	1.1	--
Selling	140,072	3.4	4,364
Research and development	161,924	3.9	142,955
Total operating expenses	1,158,156	28.0	734,790
Operating income (loss)	90,366	2.2	(98,917)
Other income (expense) and income taxes, net	(48,809)	(1.2)	(37,003)
Income (loss) from continuing operations	41,557	1.0	(135,920)
Income (loss) from discontinued operations	12,233	0.3	(74,731)
Net income (loss)	$ 53,790	1.3%	$ (210,651)

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Sales

Sales for the six months ended June 30, 2005 increased substantially by $2,304,727 or 126% to $4,134,550 as compared to sales for the six months ended June 30, 2004 of $1,829,823. The increase was due to the continued development of our IT Services Group, which began operations in the second quarter of 2003. We realized sales increases from new and expanded contracts with prime

contractors for the U.S. Government.

Cost of Sales and Gross Profit

Cost of sales represents the cost of employee services related to the IT Services Group. Cost of sales for the six months ended June 30, 2005 was $2,886,028 or 69.8% of sales as compared to $1,193,950 or 65.2% of sales for the six months ended June 30, 2004. Gross profit was $1,248,522 or 30.2% of sales for the six months ended June 30, 2005 compared to $635,873 or 34.8% of sales for the six months ended June 30, 2004. We experienced a decrease in gross profit margin as a percent of sales due to the competitive nature of our business, which generally provides for lower gross profit margins on larger sales volume contracts. As the mix of different projects changes, our gross profit margin changes. In the future we may submit bids on new work with lower gross profit margins to generate opportunities for long-term, larger volume contracts and more stable sales.

General and Administrative Expenses

General and administrative expenses include corporate overhead such as compensation and benefits for administrative and finance personnel, rent, insurance, professional fees, travel, and office expenses. General and administrative expenses for the six months ended June 30, 2005 increased by $212,600 or 37.0% due to the increases in employee compensation and related fringe benefits expenses as well as increased operating expenses as we manage a larger volume of business. As a percentage of sales, general and administrative expense was 19.0% for the six months ended June 30, 2005 and 31.4% for the six months ended June 30, 2004. We anticipate that general and administrative expenses will increase as we continue to implement our business strategy and incur travel and other expenses associated with managing a larger business. We experienced increases in accounting and legal expenses in 2005 due to our focus on completing audits of our financial statements and related regulatory filings.

General and administrative expenses include expenses (including professional services and interest costs) associated with the Osley & Whitney defined benefit retirement plan of approximately $123,000 and $108,000 for the six months ended June 30, 2005 and 2004, respectively.

Depreciation and Amortization

Depreciation and amortization expense was $23,949 for the six months ended June 30, 2005. Beginning in the second quarter of 2003, we purchased equipment related to our Rochester headquarters office, acquired a technology license and capitalized software development costs related to our TouchThru TM products. The increase is due to depreciations and amortization of these assets.

Write-off of Capitalized Closing Costs

In the second quarter of 2005, the buyer of the assets and businesses of LF obtained new bank financing. The buyer paid all of its notes receivable to us, which proceeds were used to pay off all of LF's bank promissory notes and LF's capital lease obligation. As a result we wrote off the balance of LF's capitalized financing costs of $44,857.

Selling Expenses

For the six months ended June 30, 2005 we incurred selling expenses of $140,072 associated with growing business in our IT Services Group compared to $4,364 for

the six months ended June 30, 2004. We expect that selling expenses will increase in the future as we hire additional personnel and expand our development of new contract opportunities. We added new employees and changed the work assignment of one employee in the second quarter of 2005 to focus on generating new sales leads and new contract opportunities.

Research and Development

For the six months ended June 30, 2005 we continued to incur research and development expenses associated with growing business in our IT Services Group related to our biometrics applications and recorded $161,924 of expense compared to $142,955 for the six months ended June 30, 2004. These expenses are principally related to the development of an access control terminal and related software called TouchThru(TM). TouchThru(TM) is a self-contained terminal enabling physical access control using biometric identification. It incorporates fingerprint matching technology licensed from Ultra-Scan Corporation, a private technology company headquartered in Buffalo, New York. TouchThru(TM) will be the first biometric product we introduce, and we intend to be in a position to market and sell that product beginning in 2006. We plan to market and sell TouchThru(TM) in a variety of industries and markets, including the federal, state and local government, health care, travel and general security, and access control.

Operating Income (Loss)

For the six months ended June 30, 2005 our operating income was $90,366 compared to a $98,917 loss from operations in the comparable period of 2004. This is primarily attributable to our focus on our new IT Services Group and the growth of IT sales which provided gross profit of $1,248,522, an increase of $612,649 over the six months ended June 30, 2004, to fund research and development, general and administrative expenses and interest expenses. Operating expenses were $1,158,156, for the six months ended June 30, 2005, an increase of $423,366 over the six months ended June 30, 2004.

Other Income (Expense)

Other income and expense consists of interest expense on indebtedness for the six months ended June 30, 2005. Interest expense was $113,764 (including $66,255 of interest expense on notes payable of LF) for the six months ended June 30, 2005 compared to $36,653 for the six months ended June 30, 2004. The increase of $77,111 is principally offset by $66,255 of interest income from the notes receivable due from the buyer of LF's business. Interest expense for notes payable to related parties increased by $7,680 to $44,333 due to an increase in the average outstanding principal balance of notes payable to related parties.

Income (Loss) from Discontinued Operations

We recorded income from discontinued operations of $12,233 for the six months ended June 30, 2005 compared to a loss of $74,731 for the six months ended June 30, 2004. These results are from the Laser Group and the Photonics Group which were reclassified as discontinued operations.

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Net Income (Loss)

For the six months ended June 30, 2005, we recorded income from continuing operations of $41,557, or breakeven per share and net income of $53,790 or breakeven per share. This compares to a net loss from continuing operations of $135,920 or $(.01) per share and a net loss of $210,651 or $(.02) per share (the

difference of $(.01) per share is from discontinued operations) for the six months ended June 30, 2004. The improvement in profitability is attributable to growth of sales and gross profit from our expanding IT Services which allowed us to fund our research and development, general and administrative, and interest expenses.

Liquidity and Capital Resources

As of June 30, 2005 we had unrestricted cash of $338,205, which is available for working capital and property and equipment acquisitions. Approximately $220,000 of this cash was used to fund June 2005 payroll accruals which were paid in July 2005.

At June 30, 2005 we had working capital of $97,843. In previous periods we reported a working capital deficit. The improvement from a deficit of $1,972,840 at December 31, 2004 is a result of the buyer of the assets and businesses of LF obtaining new bank financing and paying off all of LF's notes receivable, which proceeds were used to pay off LF's bank promissory notes and capital lease obligation (which were all classified as current liabilities due to violations of certain loan covenants).

We have financed the activity of our new IT Services Group through the issuance of notes payable to related parties, private placements of common stock and financing of our accounts receivable. In the future, we may issue additional debt or equity securities to satisfy our cash needs. Any debt incurred or issued may be secured or unsecured, at a fixed or variable interest rates and may contain other terms and conditions that our board of directors deems prudent. Any sales of equity securities may be at or below current market prices. We cannot assure you that we will be successful in generating sufficient capital to adequately fund our working capital needs.

Risk Factors

You should consider the risk factors included in our annual report on Form 10-KSB for the year ended December 31, 2004 in evaluating our business and us. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or that are similar to those faced by other companies in our industry or business in general, such as competitive conditions, may also impair our business operations. If any of the results of the risks occur, our business, financial condition, or results of operations could be materially adversely affected.

Item 3. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 (the "Exchange Act") Rules 13a-15(e) and 15-d-15(e)) as of the end of the period covered by this report (the "Evaluation Date"). Based upon that evaluation, the chief executive officer and chief financial officer concluded that, as of the Evaluation Date, our disclosure controls and procedures are effective, providing them with material information relating to the company as required to be disclosed in the reports we file or submit under the Exchange Act on a timely basis.

Changes in Internal Control over Financial Reporting. There were no changes in our internal controls over financial reporting, known to our chief executive

officer and chief financial officer, that occurred during our fiscal second quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1: Legal Proceedings.

We are the plaintiff in a lawsuit filed in the Superior Court, State of Rhode Island on August 13, 1999 captioned Infinite Group, Inc. vs. Spectra Science Corporation and Nabil Lawandy. In the action, we assert that by fraud and in breach of fiduciary duties owed, Spectra and its president, Nabil Lawandy, caused us to sell to Spectra shares of Spectra's Series A Preferred stock at a substantial discount to fair market value. We allege that in entering into the transaction we relied on various representations made by Spectra and Mr. Lawandy, which were untrue at the time they were made. In the action, we seek compensatory damages in the amount of $500,000 plus statutory interest, punitive damages as well as an award of attorney's fees and costs. One of Spectra's counterclaims was dismissed by the court in response to our motion for summary judgment. The trial was completed in February 2005. The jury returned a verdict and judgment in our favor in the amount of approximately $600,000. We have filed a notice of appeal with respect to the damages portion of the verdict. On June 1, 2005, Spectra voluntarily dismissed with prejudice its remaining pending counterclaim against us. We have entered into an escrow agreement with the defendants pursuant to which approximately $600,000, representing the amount of the judgment has been deposited. Withdrawal of the funds will be permitted only upon the date that judgment, in the matter, becomes a final non-appealable decision, or earlier upon the written agreement of all parties.

We are the respondent in an arbitration proceeding filed on December 10, 2002 captioned J. Terrence Feeley v. Infinite Group, Inc. Claimant, a former employee and former member of our board of directors, alleges that the parties entered into a consulting agreement dated June 27, 2002 relative to the early termination of claimant's employment requiring certain cash payments to be made. Claimant alleges that we have failed or refused to make such cash payments and have breached the agreement and seeks all monies owed to him, said amount alleged to be approximately $130,000. We answered the claim by admitting that a letter agreement was entered into but denied all of the remaining allegations. We also filed a counterclaim in the arbitration proceeding. We filed a related claim against Mr. Feeley in the Superior Court, State of Rhode Island on September 5, 2003. We claim that he breached certain provisions of his employment agreement, breached fiduciary duties he owed to us and violated several provisions of the June 27, 2002 letter agreement. We seek compensatory damages in amounts to be shown at trial, and preliminary and permanent injunctive relief and other relief as may be appropriate.

Mr. Feeley's arbitration claims are pending before the American Arbitration Association and an arbitrator selected by the parties. Our claims against Mr. Feeley are pending in the Rhode Island Superior Court. In January of 2004, the parties agreed to stay arbitration proceedings and to mediate all the disputes under procedures available through the Superior Court. To date, neither party has initiated mediation proceedings.

Other than the foregoing proceeding, we are not a party to any material legal proceeding.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

a. Exhibits:

Exhibit No.	Description
31.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Infinite Group Inc.

(Registrant)

Date: August 11, 2005

/s/ Michael S. Smith

Chief Executive Officer

Date: August 11, 2005

/s/ Michael S. Smith

Chief Financial Officer

(Principal Financial Officer)