

INSIGNIA SYSTEMS INC/MN  
Form 10-K  
April 02, 2007  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

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

For the year ended December 31, 2006

Commission File Number 1-13471

**INSIGNIA SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of incorporation or organization)

**41-1656308**

(IRS Employer Identification No.)

**6470 Sycamore Court North  
Maple Grove, MN 55369**

(Address of principal executive offices)

**(763) 392-6200**

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class:

Common Stock, \$.01 par value

Name of each exchange on which registered:

The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

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 report(s), and (2) has been

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subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of the last business day of the second quarter (June 30, 2006) was approximately \$26,629,000 based upon the last sale price of the registrant's Common Stock on such date.

Number of shares outstanding of Common Stock, \$.01 par value, as of March 26, 2007, was 15,316,046.

### DOCUMENTS INCORPORATED BY REFERENCE:

Insignia Systems, Inc. Proxy Statement to be filed for the Annual Meeting of Shareholders to be held on May 23, 2007 (Part III Items 10, 11, 12, 13 and 14)

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**Cautionary Statement Regarding Forward-Looking Information**

Statements made in this annual report on Form 10-K, in the Company’s other SEC filings, in press releases and in oral statements to shareholders and securities analysts, which are not statements of historical or current facts are forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results or performance of the Company to be materially different from the results or performance expressed or implied by such forward-looking statements. The words believes, expects, anticipates, seeks and similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. These statements are subject to the risks and uncertainties that could cause actual results to differ materially and adversely from the forward-looking statements. These risks and uncertainties include, but are not limited to, the risks described in Part I, Item 1A.

***PART I.***

Item 1. Business

**General**

Insignia Systems, Inc., (the Company) markets in-store advertising products, programs and services to retailers and consumer packaged goods manufacturers. The Company has been in business since 1990. Since 1998, the Company has been focusing on providing in-store services through the Insignia Point-Of-Purchase Services (POPS) in-store advertising program. Insignia POPS® includes the Insignia POPSign® program.

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Insignia's POPSign is a national, account-specific, in-store, shelf-edge advertising program that has been shown to deliver significant sales increases. Funded by consumer packaged goods manufacturers, the program allows manufacturers to deliver vital product information to consumers at the point-of-purchase. The brand information is combined with each retailer's store-specific prices and is displayed on the retailer's unique sign format. The combining of manufacturer and retailer information produces a complete call to action that gets consumers the information they want and need to make purchasing decisions, while building store and brand equity.

For retailers, Insignia's POPSign program is a source of incremental revenue and is the first in-store advertising program that delivers a complete call to action on a product-specific and store-specific basis, with all participating retail stores updated weekly. For consumer goods manufacturers, Insignia's POPSign program provides access to the optimum retail advertising site for their products—the retail shelf-edge. In addition, manufacturers benefit from significant sales increases, short lead times, micro-marketing capabilities, such as store-specific and multiple language options, and a wide variety of program features and enhancements that provide unique advertising advantages.

The Company's Internet address is [www.insigniasystems.com](http://www.insigniasystems.com). The Company has made available on its Web site all of the reports it files with the SEC. Copies can also be obtained free of charge by requesting them from Insignia Systems, Inc., 6470 Sycamore Court North, Maple Grove, Minnesota 55369-6032; Attention: CFO; telephone 763-392-6200.

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#### **Industry and Market Background**

According to Point-Of-Purchase Advertising International (POPPI), an industry non-profit trade association, more than 70% of brand purchase decisions are being made in-store. As a result, product manufacturers are constantly seeking in-store vehicles to motivate consumers to buy their branded products. Industry studies estimate that manufacturers spend approximately \$19.35 billion annually on retail, point-of-purchase and in-store services. The Company's market studies indicate that the shelf-edge sign represents the final and best opportunity for manufacturers to convince the consumer to buy. In fact, a 2005 industry study concluded that shelf signs are the most effective type of in-store advertising after end-aisle displays and in-store leaflets.

Many consumers seek product information beyond price in order to make educated buying decisions. The Company's marketing studies indicate the most effective sign contains information supplied by the product manufacturer in combination with the retailer's price and design look.

#### **Company Products**

##### *Insignia's POPSign Program*

Insignia's POPSign program is an in-store, shelf-edge, point-of-purchase advertising program that enables manufacturers to deliver product-specific messages quickly and accurately in designs and formats that have been pre-approved and supported by participating retailers. Insignia POPSigns deliver vital product selling information from manufacturers, such as product uses and features, nutritional information, advertising tag lines and product images. The brand information is combined with the retailer's store-specific prices and is displayed on the retailer's unique sign format that includes its logo, headline and store colors. Each sign is displayed directly in front of the manufacturer's product in the participating retailer's stores. Insignia's POPSign program offers special features and enhancements, such as Advantage and Custom Advantage headers that allow manufacturers to add visibility and highlight their brand message at-shelf. Insignia offers Color POPSigns with customizable, image-building full-color graphics. Insignia UltraColor® POPSigns offer 75% more area for the full-color creative than Color

POPSigns.

Utilizing proprietary technology, the Company collects and organizes the data from both manufacturers and retailers, then formats, prints and delivers the signs to retailers for distribution and display. Store personnel place the signs at the shelf for two-week or four-week display cycles. The Company charges manufacturers for the signs placed in stores for each cycle. Retailers are paid a fee to display the signs and for product movement data provided to Insignia.

***The Impulse Retail System and SIGNright Sign System***

Prior to 1996, the Company's primary product offering was the Impulse Retail System, a system developed by an independent product design and development firm (the Developer). In 1996, the Company replaced the Impulse Retail System with the SIGNright Sign System. In 1998, the Company ceased the active domestic sales of the SIGNright Sign System.

Cardstock for the two systems are sold by the Company in a variety of sizes and colors that can be customized to include pre-printed custom artwork, such as a retailer's logo. Approximately 5% of 2006 revenues came from the sale of cardstock. The Company expects this percentage to be lower in the future.

***Stylus Software***

In late 1993, the Company introduced Stylus, a PC-based software application used by retailers to produce signs, labels, and posters. The Stylus software allows retailers to create signs, labels and posters by manually entering the information or by importing information from a database. Approximately 2% of 2006 revenues came from the sale of Stylus products and maintenance. The Company expects this percentage to be lower in the future.

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**Marketing and Sales**

The Company directly markets the Insignia POPSign program to food and drug manufacturers and retailers. By utilizing the Insignia POPSign program, these manufacturers and retailers can easily accomplish what had previously been either impossible or extremely difficult: tailoring national in-store advertising programs to regional and local needs with minimal effort. In addition to the benefits provided to manufacturers and retailers, Insignia's POPSign program provides consumers more information and clearer messages to aid in purchasing decisions. The Company believes its POPSign program is the most complete in-store advertising sign program available, benefiting consumer, retailer, and manufacturer.

On June 12, 2006, the Company entered into an Exclusive Reseller Agreement with Valassis Sales and Marketing Services, Inc. The agreement had an initial term of one year with the objective of increasing the Company's sales of Insignia POPSigns. On December 6, 2006, the Company and Valassis executed Amendment No. 1 to the agreement which finalized certain appendices, made certain other modifications to the agreement and extended the initial term through December 31, 2007. This agreement enables Valassis to sell the Insignia POPSigns programs in addition to its diversified product portfolio and gives the Company broader exposure to consumer packaged goods clients. The financial terms of the agreement vary depending on the type of sale.

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Prior to April 1998, the Company marketed the Impulse Retail System and the SIGNright Sign System through telemarketing by in-house sales personnel and independent sales representatives. In May 1998, the Company discontinued the active marketing of the systems. The Company sells cardstock and supplies related to these systems to U.S. and international customers.

The Company markets its Stylus software in the United States and internationally primarily through resellers that integrate Stylus as an Open Database Connectivity design and publishing component into their retail data and information management software applications.

During 2006, 2005 and 2004, foreign sales accounted for approximately 1% of total net sales each year. The Company expects sales to foreign distributors will be less than 1% of total net sales in 2007.

### **Competition**

#### *Insignia's POPSign Program*

The Insignia POPSign program is competing for the marketing expenditures of branded product manufacturers for at-shelf advertising-related signage. The Insignia POPSign program has two major competitors in its market: News America Marketing In-Store<sup>®</sup>, Inc. (News America) and FLOORgraphics<sup>®</sup>, Inc. (FLOORgraphics).

News America offers a network for in-store advertising, promotion and sales merchandising services. News America has branded its in-store shelf signage products as SmartSource Shelftalk<sup>sm</sup>, SmartSource Shelfvision<sup>sm</sup> and SmartSource Price Pop<sup>®</sup>.

FLOORgraphics offers a network for in-store advertising and promotion programs. FLOORgraphics has branded its advertising shelf signage product SHELFplus!<sup>®</sup>.

We believe the main strengths of the Insignia POPSign program in relation to its competitors are:

- the linking of manufacturers to retailers at a central coordination point
- providing a complete call to action
- supplying product-specific and store-specific messages at the retail shelf
- delivering vital product information and store-specific prices
- short lead times
- significant sales increases

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**Patents and Trademarks**

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The Company has developed and is using a number of trademarks, service marks, slogans, logos and other commercial symbols to advertise and sell its products. The Company owns U.S. registered trademarks for Insignia Systems, Inc.® (and Design), Insignia POPS®, POPS Select®, Insignia Color POPS®, Insignia POPSign®, UltraColor®, Stylus®, Stylus Work Center®, SIGNright®, Impulse®, DuraSign®, I-Care®, and Check This Out.®

The Company is in the process of obtaining trademark registrations in the United States for the trademarks Insignia E-POPS and Insignia ShelfPOPS.

The Company filed a Surrender for Cancellation of Registration for the mark VALUSTIX with the U.S Patent and Trademark Office in October of 2006.

The barcode which the Company uses on the sign cards for the Impulse and SIGNright Sign Systems was also developed by the Developer, which has granted the Company an exclusive worldwide license of its rights to the barcode. The license requires the Company to pay a royalty of 1% of the net sales price received by the Company on cardstock or other supply items that bear the barcode used by the Impulse and SIGNright Sign Systems. Although a patent has been issued to the Developer, which covers the use of the barcode, there is no assurance that the Company will be able to prevent other suppliers of cardstock from copying the barcode used by the Company. However, the Company believes that the number, relatively small size and geographic dispersal of Impulse and SIGNright users, their relationship with the Company and the Company's retention of its customer list as a trade secret will discourage other sign card suppliers from offering bar-coded sign cards for use on the Impulse and SIGNright machines.

Key employees are required to enter into nondisclosure and invention assignment agreements, and customers, vendors and other third parties also must agree to nondisclosure restrictions prior to disclosure of our trade secrets or other confidential or proprietary information.

### **Product Development**

Product development for Insignia's POPSign program has been conducted internally and includes the proprietary data management and operations system, as well as the current offering of point-of-purchase and other advertising products. Ongoing internal systems enhancements, as well as the development of point-of-purchase and other advertising or promotional products, will be conducted utilizing both internal and external resources as appropriate.

Product development on the SIGNright Sign System was primarily conducted by the Developer on a contract basis. The Company continues to introduce complementary products such as new cardstock formats, styles and colors.

The Stylus software product line remains a viable application for the Company's retailer customers. The Company performs development to keep Stylus current and updated to meet industry requirements.

### **Customers**

Nestle Co. and Kellogg Company accounted for 26% and 10% of the Company's total net sales for the year ended December 31, 2006. Nestle Co. and Kellogg Company accounted for 16% and 17% of the Company's total net sales for the year ended December 31, 2005. Nestle Co., Kellogg Company and SC Johnson accounted for 16%, 11% and 11% of the Company's total net sales for the year ended December 31, 2004.

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**Backlog**

Sales backlog at February 28, 2007 was approximately \$14.7 million, of which \$11.8 million is for delivery during 2007 and \$2.9 million is for delivery during 2008 through 2010. The orders are believed to be firm but there is no assurance that all of the backlog will actually result in revenues. Sales backlog at February 28, 2006 was approximately \$11 million.

**Seasonality**

The Company's results of operations have fluctuated from quarter to quarter due to variations in net sales and operating expenses. Before 2003, the Company generated a significant portion of operating income in the fourth quarter of the fiscal year because of seasonal events that affected when customers purchased Insignia POPSign programs. However, the pattern has varied since 2002 and it is unclear whether there will be a consistent seasonality pattern in the future.

Any factor that negatively affects net sales or increases operating expenses could negatively affect annual results of operations, and in particular, quarterly results. As a result of the variability of the business, the Company may incur losses in a given quarter and fluctuations in working capital. In certain quarters the Company may realize strong sales, but due to increased sales promotion activities and investments in growing the business, we may experience reduced operating income. The results of operations fluctuate from quarter to quarter as a result of the following:

- The timing of seasonal events for customers;
- Variations in the specific products which customers choose to advertise;
- Variations in the number of retailers in the Company's network;
- Minimum program level commitments to retailers (called retailer guarantees), and
- Professional fees related to litigation.

**Employees**

As of February 28, 2007, the Company had 88 employees, including all full-time and part-time employees.

## Segment Reporting

The Company operates in a single reportable segment.

## Item 1A. Risk Factors

Our business faces significant risks, including the risks described below. Additional risks that we do not yet know of or that we currently believe are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks occurs, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

### **We Have Had Significant Losses In Recent Periods**

Although we had net income of \$2,396,000 for the year ended December 31, 2006, we experienced net losses of \$3,308,000 and \$4,858,000 for the years ended December 31, 2005 and 2004. There can be no assurance that we will be profitable on a quarterly or annual basis. If we are unable to generate net income from operations our business will be adversely affected and our stock price will likely decline.

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### **We Are Involved In Major Litigation**

In August 2000, News America Marketing In-Store, Inc. (News America), brought suit against the Company in U.S. District Court in New York, New York. The case was settled in November 2002. The terms of the settlement agreement are confidential. The settlement did not impact the Company's operating results.

In October 2003, News America brought suit against the Company in U.S. District Court in New York, New York, alleging that the Company has engaged in deceptive acts and practices, has interfered with existing business relationships with retailers and prospective economic advantage, and has engaged in unfair competition. The suit sought unspecified damages and injunctive relief. In February 2007 the U.S. District Court in New York transferred this action to Minnesota where the claims will become part of the lawsuit the Company filed against News America and Albertson's Inc.

On September 23, 2004, the Company brought suit against News America and Albertson's Inc. in Federal District Court in Minneapolis, Minnesota, for violations of federal and state antitrust and false advertising laws, alleging that News America has acquired and maintained monopoly power through various wrongful acts designed to harm the Company in the in-store advertising and promotion products and services market. The suit seeks injunctive relief sufficient to prevent further antitrust injury and an award of treble damages to be determined at trial for the harm caused to the Company. On June 30, 2006 the Court denied the motions of News America and Albertson's to dismiss the suit. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the Minnesota case. The parties are now engaged in pre-trial discovery. In December 2006 News America filed counterclaims similar to the claims in its New York action against Insignia and one of its officers. Motions to dismiss the counterclaims are pending with oral argument scheduled in mid-April 2007. Management believes that the allegations of the counterclaims are without merit. An evaluation of the likelihood

of an unfavorable outcome and estimate of the potential liability cannot be rendered at this time.

Management currently expects the amount of legal fees that will be incurred in connection with the ongoing lawsuit to be significant throughout 2007. During the years ended December 31, 2006, 2005 and 2004, the Company incurred legal fees of \$935,000, \$1,085,000 and \$2,527,000 related to the News America lawsuits and expects to continue to incur significant expenses until the litigation is concluded. Also, if we are required to pay a significant amount in settlement or damages, it will have a material adverse effect on our operations and financial condition. In addition, a negative outcome of this litigation could affect long-term competitive aspects of our business. Continuing litigation with a retailer could also have a negative impact on our business.

#### **We Are Dependent On Our Contracts With Retailers And Our Ability To Renew Those Contracts When Their Terms Expire**

On an ongoing basis, we negotiate renewals of various retailer contracts. Some of our retailer contracts require us to guarantee minimum payments to our retailers. If we are unable to offer guarantees at the required levels in the new contracts, and the contracts are not renewed because of that or because of other reasons, it will have a material adverse effect on our operations and financial condition.

Our POPS business and results of operations could be adversely affected if the number of retailer partners decreases significantly or if the retailer partners fail to continue to provide good service including performing their duties in placing and maintaining POPSigns at the shelf in their stores and providing product movement data to us.

#### **We May Need Additional External Financing In The Future Which May Not Be Available**

The Company has implemented various initiatives to improve its operating performance through the reduction of cost of sales expenses, operating expenses and legal fees. Management believes it will be able to continue to fund operations through cash saved as a result of the implementation of these

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initiatives. However, there can be no assurance that additional external financing will not be needed or that the Company will be able to secure such financing if and when needed.

#### **Our Results Of Operations May Be Subject To Significant Fluctuations Which May Result In A Decrease In Our Stock Price**

Our quarterly and annual operating results have fluctuated in the past and may vary in the future due to a wide variety of factors including:

the loss of contracts with retailers;  
the continued impact of significant litigation on our business;  
the timing of seasonal events for customers or the loss of customers;  
the timing of new retail stores being added;  
the timing of additional selling, marketing and general and administrative expenses; and  
competitive conditions in our industry.

Due to these factors, our quarterly net sales, expenses and results of operations could vary significantly in the future and this could adversely affect the market price of our common stock.

#### **We Have Significant Competitors**

We face significant competition from other providers of at-shelf advertising or promotional signage. Some of these competitors have significantly greater financial resources that can be used to market their products. Should our competitors succeed in obtaining more of the at-shelf advertising business from our current customers, our revenues and related operations would be adversely affected.

#### **Our Results Are Dependent On The Success Of Our Insignia POPS Program Which Represents A Very Significant Part Of Our Business**

We are largely dependent on our POPS program, which represented approximately 88%, 84% and 83% of total net sales for fiscal 2006, 2005 and 2004, respectively. We expect the POPS program to continue to represent a higher percentage in fiscal 2007 and future periods. Should brand manufacturers no longer perceive value in the POPS program, our business and results of operations would be adversely affected due to our heavy dependence on this program.

#### **Our Results Are Dependent On The Level Of Spending By Branded Product Manufacturers For Advertising And Promotional Expenditures**

We are largely dependent on the net sales from our POPSigs, which are purchased by branded product manufacturers. Changes in economic conditions could result in reductions in advertising and promotional expenditures by branded product manufacturers. Should these reductions occur, our revenues and related results of operations would be adversely affected.

#### **Our Results Are Dependent On Our Manufacturer Partners Continuing To Achieve Sales Increases**

Our product manufacturer customers use our POPS program to motivate consumers to buy their branded products. Use of our POPS program has historically resulted in sales increases for that particular product. If our POPS program does not continue to result in these product sales increases, our marketing success and sales levels could be adversely affected.

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**Our Stock Price Has Been And May Continue To Be Volatile**

During 2006 our common stock has traded between \$3.91 and \$0.53 per share. The market price of our common stock may continue to be volatile and may be significantly affected by:

- the loss or addition of contracts with major retailers;
- the continued impact of significant litigation on our business;
- actual or anticipated fluctuations in our operating results;
- announcements of new services by us or our competitors;
- developments with respect to conditions and trends in our industry or in the industries we serve;
- general market conditions; and
- other factors, many of which are beyond our control.

**Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

The Company leases approximately 47,000 square feet of office and warehouse space in suburban Minneapolis, Minnesota, under a lease effective until January 2010. During 2005, the Company sublet approximately 10,000 square feet of this space. The Company believes that the remaining occupied square footage of approximately 37,000 square feet will meet the Company's current and foreseeable needs.

**Item 3. Legal Proceedings**

In August 2000, News America Marketing In-Store, Inc. (News America), brought suit against the Company in U.S. District Court in New York, New York. The case was settled in November 2002. The terms of the settlement agreement are confidential. The settlement did not impact the Company's operating results.

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On September 23, 2004, the Company brought suit against News America and Albertson's Inc. in Federal District Court in Minneapolis, Minnesota, for violations of federal and state antitrust and false advertising laws, alleging that News America has acquired and maintained monopoly power through various wrongful acts designed to harm the Company in the in-store advertising and promotion products and services market. The suit seeks injunctive relief sufficient to prevent further antitrust injury and an award of treble damages to be determined at trial for the harm caused to the Company. On June 30, 2006 the Court denied the motions of News America and Albertson's to dismiss the suit. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the Minnesota case. The parties are now engaged in pre-trial discovery. In December 2006 News

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America filed counterclaims similar to the claims in its New York action against Insignia and one of its officers. Motions to dismiss the counterclaims are pending with oral argument scheduled in mid-April 2007. Management believes that the allegations of the counterclaims are without merit. An evaluation of the likelihood of an unfavorable outcome and estimate of the potential liability cannot be rendered at this time.

During the year ended December 31, 2006, the Company incurred legal fees of \$935,000 related to the News America lawsuits and expects to continue to incur significant expenses until the litigation is concluded.

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

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2006.

### Item 4A. Executive Officers of the Registrant

The names, ages and positions of the Company's executive officers are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Scott F. Drill	54	President, Chief Executive Officer, Secretary –and Director
Justin W. Shireman	56	Vice President of Finance, Chief Financial Officer and Treasurer
Scott J. Simcox	54	Senior Vice President of Marketing Services
A. Thomas Lucas	57	Vice President of Operations

Scott F. Drill has been President and Chief Executive Officer of the Company since February 24, 1998. From 1996 to December 2002, he was also a partner in Minnesota Management Partners (MMP), a venture capital firm located in Minneapolis, Minnesota. Mr. Drill co-founded Varitronic Systems, Inc. in 1983, and was its President and CEO until it was sold in 1996. Prior to starting Varitronics, Mr. Drill held senior management positions in sales and marketing at Conklin Company and Kroy, Inc.

Justin W. Shireman has been Vice President of Finance, Chief Financial Officer and Treasurer since April 2005. From April 2003 to March 2005, he was the Company's Controller. From 2000 to 2002, he was the Controller for Learningbyte International, Inc., a developer of e-learning solutions. From 1994 to 2000 Mr. Shireman held several positions, including Controller and Director of Finance, with LecTec Corporation, a medical device manufacturer.

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Scott J. Simcox has been Senior Vice President of Marketing Services since August 2006. Mr. Simcox has been with the Company since inception in January 1990, initially as Director of Business Development until May 1991 and then as Director of Marketing until July 1998. From July 1998 to July 2006, he was the Company's Vice President of Marketing, POPS Division. From August 1988 through December 1989, Mr. Simcox was with Varitronic Systems in various sales and marketing roles. From 1978 to 1988 Mr. Simcox held several marketing and senior management positions at Conklin Company including Vice President of Marketing.

Thomas Lucas has been Vice President of Operations since August, 2004. Mr. Lucas has been with the Company since 1992. From 1998 to 2004 he was Vice President of Operations, POPS Division, and from 1992 to 1998 he was Manager and Director of Customer Services. Prior to 1992, Mr. Lucas held a variety of management and leadership positions within the United States Air Force and the Joint Chiefs of Staff.

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## ***PART II.***

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### **Market Information**

The Company's common stock trades on the NASDAQ Capital Market® under the symbol ISIG. The following table sets forth the range of high and low bid prices reported on the Nasdaq System. These quotations represent prices between dealers and do not reflect retail mark-ups, mark-downs or commissions.

<b>2006</b>	<b>High</b>	<b>Low</b>	<b>2005</b>	<b>High</b>	<b>Low</b>
First Quarter	\$ 1.38	\$ 0.65	First Quarter	\$ 2.31	\$ 1.25
Second Quarter	2.52	0.51	Second Quarter	1.46	0.76
Third Quarter	3.90	2.15	Third Quarter	1.01	0.46
Fourth Quarter	3.71	2.20	Fourth Quarter	0.90	0.25

#### **Approximate Number of Holders of Common Stock**

As of February 28, 2007, the Company had one class of Common Stock beneficially held by approximately 2,074 owners.

#### **Dividends**

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The Company has never paid cash dividends on its common stock. The Board of Directors presently intends to retain all earnings for use in the Company's business and does not anticipate paying cash dividends in the foreseeable future.

The following graph compares the cumulative total shareholder return on the Company's Common Stock for the five fiscal years beginning December 31, 2001 and ending December 31, 2006, with the cumulative total return on the NASDAQ Stock Market -- U.S. Index and the Russell 2000 Index over the same period (assuming the investment of \$100 in the Company's Stock, the NASDAQ Stock Market -- U. S. Index and the Russell 2000 Index on December 31, 2001 and the reinvestment of all dividends).

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### Item 6. Selected Financial Data

(In thousands, except per share amounts.)

#### **For the Years Ended**

<b>December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
Net sales	\$21,894	\$19,598	\$20,992	\$26,138	\$24,821
Operating income (loss)	2,314	(3,331 )	(4,875 )*	(4,324 )**	410
Net income (loss)	2,396	(3,308 )	(4,858 )	(4,252 )	333
Net income (loss) per share:					
Basic	\$0.16	\$(0.22 )	\$(0.38 )	\$(0.35 )	\$.03
Diluted	\$0.15	\$(0.22 )	\$(0.38 )	\$(0.35 )	\$.03
Shares used in calculation of net income (loss) per share:					
Basic	15,093	15,002	12,687	12,259	10,872
Diluted	15,556	15,002	12,687	12,259	11,800
Working capital	\$5,017	\$2,592	\$4,813	\$5,797	\$7,324
Total assets	8,583	6,673	9,921	11,676	16,722
Total shareholders' equity	4,862	2,072	5,333	7,822	11,258

\*Includes a \$960 impairment of goodwill more fully described in Note 3 to the financial statements.

\*\*Includes a \$2,133 impairment of goodwill more fully described in Note 3 to the financial statements.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the financial statements and the related notes included in this Report. This Report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those in such forward-looking statements as a result of many factors, including those discussed in Cautionary Statements Regarding Forward-Looking Information and elsewhere in this Report.

**Results of Operations**

The following table sets forth, for the periods indicated, certain items in the Company's Statements of Operations as a percentage of total net sales.

<b>Year ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Net sales	100.0 %	100.0 %	100.0 %
Cost of sales	45.9	63.9	62.2
Gross profit	54.1	36.1	37.8
Operating expenses:			
Selling	22.1	29.1	27.7
Marketing	4.8	5.8	5.2
General and administrative	16.6	18.2	23.5
Impairment of goodwill			4.6
Total operating expenses	43.5	53.1	61.0
Operating income (loss)	10.6	(17.0 )	(23.2 )
Other income	0.3	0.1	0.1
Net income (loss)	10.9 %	(16.9 )%	(23.1 )%

**Critical Accounting Policies**

Our discussion of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. During the preparation of these financial statements, we are

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required to make estimates and assumptions that affect the reported amounts of assets, liabilities, net revenues, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowance for doubtful accounts, income taxes, and stock-based compensation expense. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and the impact of such differences may be material to our consolidated financial statements.

We believe that the following critical accounting policies affect our more significant judgements and estimates used in the preparation of our financial statements:

**Revenue Recognition.** The Company recognizes revenue from Insignia POPSigns ratably over the period of service, which is either a two-week or four-week display cycle. We recognize revenue related to equipment, software and sign card sales at the time the products are shipped to customers. Revenue associated with maintenance agreements is recognized ratably over the life of the contract. Revenue that has been billed and not yet recognized is reflected as deferred revenue on our balance sheet.

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**Allowance for Doubtful Accounts.** An allowance is established for estimated uncollectible accounts receivable. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, the condition of the general economy and the industry as a whole and other relevant facts and circumstances. Unexpected changes in the aforementioned factors could result in materially different amounts.

**Income Taxes.** The Company records income taxes using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. A valuation allowance is established when management determines it is more likely than not that a deferred tax asset is not realizable in the foreseeable future. At December 31, 2006, all of the Company's net deferred tax assets were offset with a valuation allowance, which amounted to approximately \$9 million. The Company cannot be certain that it will be more likely than not that these deferred tax assets will be realized in future years.

**Stock-Based Compensation.** Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. We use the Black-Scholes option pricing model to determine the weighted average fair value of options and employee stock purchase plan rights. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as by assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

The expected terms of the options and employee stock purchase plan rights are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on historical and expected future volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to in the future. SFAS 123R requires forfeitures to be estimated at the time of the grant and revised, if necessary, in subsequent periods if actual forfeitures differ from estimates.

If factors change and we employ different assumptions in the application of SFAS 123R to grants in future periods, the compensation expense that we record under SFAS 123R may differ significantly from what we have recorded in the current periods.

## Acquisition

In December 2002, the Company acquired all of the assets comprising the VALUSTix business from Paul A. Richards, Inc., a New York company ( PAR ), for \$3,000,000 in cash, plus a five-year royalty based on annual net sales over a threshold amount, pursuant to an Asset Purchase Agreement between the Company and PAR.

The Company was not successful in integrating the VALUSTix business into the POPS program during 2003 and 2004 based on a number of factors and therefore made a decision to de-emphasize that business. Utilizing discounted cash flows to determine the fair value of the VALUSTix business, the Company determined that the carrying amount of goodwill exceeded the fair value of the business. As a result, the Company wrote-off the goodwill associated with the acquisition of \$2,133,000 in the fourth quarter of 2003 and \$960,000 in the second quarter of 2004. The primary factor leading to the impairment was the continued inability of the VALUSTix acquisition to generate positive cash flow from operations. As of December 31, 2004, there is no goodwill remaining associated with the VALUSTix acquisition.

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In September 2005, the Company brought a suit against PAR and Paul Richards in Federal District Court in Minneapolis, Minnesota asking that the acquisition be rescinded and all parties restored to their pre-acquisition status. The suit was settled in June 2006 with terms including mutual releases and payment of \$100,000 to the Company in exchange for certain assets. In October 2006, the Company filed a Surrender for Cancellation of Registration for the mark VALUSTIX with the U.S. Patent and Trademark Office and ceased all activities related to the VALUSTix business.

## Fiscal 2006 Compared to Fiscal 2005

**Net Sales.** Net sales for the year ended December 31, 2006 increased 11.7% to \$21,894,000 compared to \$19,598,000 for the year ended December 31, 2005.

Service revenues from our POPSign programs for the year ended December 31, 2006 increased 16.9% to \$19,219,000 compared to \$16,445,000 for the year ended December 31, 2005. The increase was primarily due to a change in the sales mix towards higher-priced custom POPSign programs sold to customers during the year combined with an increase in the number of programs sold.

Product sales for the year ended December 31, 2006 decreased 15.2% to \$2,675,000 compared to \$3,153,000 for the year ended December 31, 2005. The decrease was due to general decreasing demand for our products from our customers.

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**Gross Profit.** Gross profit for the year ended December 31, 2006 increased 67.3% to \$11,840,000 compared to \$7,079,000 for the year ended December 31, 2005. Gross profit as a percentage of total net sales increased to 54.1% for 2006 compared to 36.1% for 2005.

Gross profit from our POPSign program revenues for the year ended December 31, 2006 increased 90.5% to \$10,725,000 compared to \$5,630,000 for the year ended December 31, 2005. The increase was primarily due to the effect of reduced retailer expense and other cost reductions. Gross profit as a percentage of POPSign program revenues increased to 55.8% for 2006 compared to 34.2% for 2005, due to the factors discussed above.

Gross profit from our product sales for the year ended December 31, 2006 decreased 23.1% to \$1,115,000 compared to \$1,449,000 for the year ended December 31, 2005. Gross profit as a percentage of product sales decreased to 41.7% for 2006 compared to 46.0% for 2005. The decreases were primarily due to decreases in sales of higher margin products and the effect of fixed costs on decreased sales.

### *Operating Expenses*

**Selling.** Selling expenses for the year ended December 31, 2006 decreased 15.1% to \$4,838,000 compared to \$5,697,000 for the year ended December 31, 2005, primarily due to sales force reductions in December of 2005 and decreased third-party compliance costs which were partially offset by increased sales commissions due to increased sales. Selling expenses as a percentage of total net sales decreased to 22.1% in 2006 compared to 29.1% in 2005, primarily due to the factors described above, combined with the effect of increased sales.

**Marketing.** Marketing expenses for the year ended December 31, 2006 decreased 7.4% to \$1,051,000 compared to \$1,135,000 for the year ended December 31, 2005, primarily due to reductions in staff, decreased out-sourced data analysis and reduced advertising expense. Marketing expenses as a percentage of total net sales decreased to 4.8% in 2006 compared to 5.8% in 2005, primarily due to the factors described above, combined with the effect of higher net sales.

**General and Administrative.** General and administrative expenses for the year ended December 31, 2006 increased 1.6% to \$3,637,000 compared to \$3,578,000 for the year ended December 31, 2005, primarily due to increased employed and temporary staffing costs in 2006, increased public relations expense in

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2006, and stock-based compensation costs recognized in 2006 due to the adoption of SFAS 123R, which were partially offset by decreased legal costs in 2006. General and administrative expenses as a percentage of total net sales decreased to 16.6% in 2006 compared to 18.2% in 2005, primarily due to the factors described above, combined with the effect of increased sales. Legal fees were \$1,143,000 for the year ended December 31, 2006 compared to \$1,352,000 for the year ended December 31, 2005. The legal fees in each year were incurred primarily in connection with two News America lawsuits described elsewhere herein. In February 2007 the New York lawsuit was transferred to Minnesota. We currently expect the amount of legal fees that will be incurred in connection with the ongoing lawsuit to be significant throughout 2007 as both parties are now engaged in pre-trial discovery. Also, if the Company is required to pay a significant amount in settlement or damages, it will have a material adverse effect on its operations and financial condition. In addition, a negative outcome of this litigation could affect long-term competitive aspects of the Company's business.

**Other Income (Expense).** Other income (net) for the year ended December 31, 2006 was \$82,000 compared to other income (net) of \$23,000 for the year ended December 31, 2005. Other income (net) in 2006 included \$100,000 from the sales of certain assets per the terms of the settlement agreement with Paul Richards and his company (see Note 3 to the financial statements). Higher interest income of \$123,000 for the year ended December 31, 2006 versus interest income of \$71,000 for the year ended December 31, 2005 was the result of higher interest rates and higher cash balances during the 2006 period. Interest expense of \$146,000 in 2006 versus \$53,000 in 2005 was primarily due to interest expense in 2006 related to an agreement reached with a retailer effective December 31, 2005, for the deferred payment of certain obligations.

**Income Taxes.** The Company recorded no income tax expense for the year ended December 31, 2006, primarily due to the deduction for tax purposes in 2006 of the remaining unamortized goodwill associated with the VALUSTix acquisition. For financial statement purposes the goodwill was determined to be impaired in 2003 and 2004 and was written-off during those periods. During 2006, the Company ceased all business activities related to VALUSTix and abandoned the VALUSTIX trademark.

**Net Income (Loss).** Net income for the year ended December 31, 2006 was \$2,396,000 compared to a net loss of \$(3,308,000) for the year ended December 31, 2005.

#### **Fiscal 2005 Compared to Fiscal 2004**

**Net Sales.** Net sales for the year ended December 31, 2005 decreased 6.6% to \$19,598,000 compared to \$20,992,000 for the year ended December 31, 2004.

Service revenues from our POPSign programs for the year ended December 31, 2005 decreased 5.2% to \$16,445,000 compared to \$17,341,000 for the year ended December 31, 2004. The decrease was primarily due to a significant reduction in the number of POPSign programs contracted by customers (consumer packaged goods manufacturers) during the fourth quarter of 2005. Our POPSign revenues during the first two quarters of 2005 exceeded revenues during the first two quarters of 2004 and third quarter revenues for both years were comparable. However, 2005 fourth quarter POPSign revenues decreased 37.9% to \$3,169,000 compared to \$5,104,000 for the fourth quarter of 2004. Historically, POPSign revenues have fluctuated significantly quarter to quarter as the volume of POPSign programs and the customers' buying habits vary.

Product sales for the year ended December 31, 2005 decreased 13.6% to \$3,153,000 compared to \$3,651,000 for the year ended December 31, 2004. The decrease was due to the loss of a printing customer in 2005, a one-time printing order in 2004 and general decreasing demand for our products from our customers.

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**Gross Profit.** Gross profit for the year ended December 31, 2005 decreased 10.7% to \$7,079,000 compared to \$7,930,000 for the year ended December 31, 2004. Gross profit as a percentage of total net sales decreased to 36.1% for 2005 compared to 37.8% for 2004.

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Gross profit from our POPSign program revenues for the year ended December 31, 2005 decreased 9.3% to \$5,630,000 compared to \$6,205,000 for the year ended December 31, 2004. The decrease was primarily due to the effect of fixed costs on lower POPS program revenues partially offset by reduced payments to retailers. Gross profit as a percentage of POPSign program revenues decreased to 34.2% for 2005 compared to 35.8% for 2004, due to the factors discussed above. Gross profit from our POPSign revenues fluctuated significantly quarter to quarter during 2005. The fluctuations were due to a number of factors including level of revenues and related levels of guaranteed payments to retailers, as well as average price per sign.

Gross profit from our product sales for the year ended December 31, 2005 decreased 16.0% to \$1,449,000 compared to \$1,725,000 for the year ended December 31, 2004. Gross profit as a percentage of product sales decreased to 46.0% for 2005 compared to 47.2% for 2004. The decreases were primarily due to changes in product mix.

### *Operating Expenses*

**Selling.** Selling expenses for the year ended December 31, 2005 decreased 1.9% to \$5,697,000 compared to \$5,809,000 for the year ended December 31, 2004, primarily due to a decrease in the number of sales related employees and reduced compliance audit costs, which were partially offset by severance costs due to staff reductions in December 2005. Selling expenses as a percentage of total net sales increased to 29.1% in 2005 compared to 27.7% in 2004, due to the effect of decreased net sales partially offset by the cost decreases described above.

**Marketing.** Marketing expenses for the year ended December 31, 2005 increased 3.7% to \$1,135,000 compared to \$1,095,000 for the year ended December 31, 2004, primarily due to increased data acquisition and advertising costs. Marketing expenses as a percentage of total net sales increased to 5.8% in 2005 compared to 5.2% in 2004, due to the effect of lower net sales and increased costs discussed above.

**General and Administrative.** General and administrative expenses for the year ended December 31, 2005 decreased 27.6% to \$3,578,000 compared to \$4,941,000 for the year ended December 31, 2004, primarily due to decreased legal fees. General and administrative expenses as a percentage of total net sales decreased to 18.2% in 2005 compared to 23.5% in 2004, primarily due to decreased legal fees which more than offset the effect of lower net sales. Legal fees were \$1,352,000 for the year ended December 31, 2005 compared to \$2,712,000 for the year ended December 31, 2004. The legal fees in each year were incurred primarily in connection with two News America lawsuits described elsewhere herein.

**Impairment of Goodwill.** The Company recorded an impairment charge of \$960,000 during 2004, writing off the remaining goodwill related to the 2002 acquisition of VALUSTix (see discussion under Acquisition).

**Other Income (Expense).** Other income (net) for the year ended December 31, 2005 was \$23,000 compared to other income (net) of \$17,000 for the year ended December 31, 2004. Other income (net) in 2005 included \$53,000 of interest expense related to the line of credit as compared to \$13,000 of interest expense in 2004 related to the line of credit which was put in place in September 2004. Included in other income (net) in 2004 was a \$45,000 one-time fee to move to the Nasdaq Capital Market.

**Net Loss.** Our net loss for the year ended December 31, 2005 was \$(3,308,000) compared to \$(4,858,000) for the year ended December 31, 2004.

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Table of Contents**Liquidity and Capital Resources**

The Company has financed its operations with proceeds from public and private stock sales and sales of its services and products. At December 31, 2006, working capital was \$5,017,000 compared to \$2,592,000 at December 31, 2005. During the same period total cash and cash equivalents increased \$1,074,000 to \$3,785,000.

Net cash provided by operating activities during 2006 was \$1,361,000, primarily due to net income during the period of \$2,396,000 partially offset by the payment of retailer obligations which were recorded at December 31, 2005, and other changes in working capital items. Accounts receivable increased \$600,000 during 2006 due to higher net sales in the last two months of 2006, as compared to net sales in the last two months of 2005. Accounts payable and accrued liabilities decreased \$557,000 during 2006 primarily as a result of the payment of retailer obligations which were recorded at December 31, 2005. The Company expects accounts receivable and accounts payable to fluctuate during future periods depending on the level of quarterly POPSign revenues.

Net cash of \$275,000 was used in investing activities in 2006 due to the purchase of property and equipment, primarily the purchase of two previously leased digital printers and information technology hardware and software expenditures. The Company expects that the level of 2007 capital expenditures will be comparable to 2006.

Net cash of \$12,000 was used in financing activities, including the payment of \$201,000 of principal on long-term liabilities to a retailer offset partially by \$54,000 of additional advances on the line of credit and \$135,000 of proceeds from the issuance of common stock, net of expenses. The issuance of common stock was related to the Employee Stock Purchase Plan and the exercise of employee stock options.

On September 16, 2004, the Company entered into a Financing Agreement, Security Agreement and Revolving Note (collectively, the Credit Agreement ) with Itasca Business Credit, Inc. that initially provided for borrowings up to \$1,500,000 for twelve months, subject to collateral availability. The borrowings are secured by all of the Company's assets. The Credit Agreement provides that borrowings will bear interest at 2.5% over prime, with a minimum monthly interest charge of \$2,500, and an annual fee of 1% of the Revolving Note payable. The Credit Agreement includes various other customary terms and conditions. On November 22, 2004, the Company entered into an amendment to the Credit Agreement to extend the term to April 30, 2006, and on May 8, 2006, the Company entered into a second amendment to the Credit Agreement to extend the term to April 30, 2007. The Company has decided not to seek further extensions of the Credit Agreement nor seek other financing agreements at the present time. There were borrowings of \$186,000 outstanding as of December 31, 2006.

The Company believes that based upon current business conditions, its existing cash balance and future cash from operations will be sufficient for its cash requirements during 2007. However, there can be no assurances that this will occur or that the Company will be able to secure additional financing from public or private stock sales or from other financing agreements if needed.

**New Accounting Pronouncements**

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### Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements

In September 2006, the U.S. Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 eliminates the diversity of practice regarding how public companies quantify financial statement misstatements. It establishes an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. SAB 108 must be

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applied to annual financial statements for their first fiscal year ending after November 15, 2006. SAB 108 did not have a material impact on our financial condition or results of operations.

### Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not to be sustained upon audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We have reviewed our accounting for income taxes in light of the provisions of FIN 48 and do not expect that adoption will materially affect our financial statements.

### **Contractual Obligations**

The following table summarizes the Company's contractual obligations and commercial commitments as of December 31, 2006:

#### **Payments due by Period**

	<b>Total</b>	<b>Less than 1 Year</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>After 5 years</b>
Contractual Obligations:					
Operating leases, excluding operating costs	\$ 1,698,000	\$ 527,000	\$ 1,146,000	\$ 25,000	\$
Payments to retailers*	11,581,000	3,766,000	5,495,000	2,320,000	
Purchase commitments	53,000	53,000			
Total contractual obligations	\$ 13,332,000	\$ 4,346,000	\$ 6,641,000	\$ 2,345,000	\$

\*On an ongoing basis, the Company negotiates renewals of various retailer agreements, some of which provide for minimum annual program levels. If these minimums are not met, the Company is required to pay the contractual difference to the retailers. Upon the completion of

renewals, the annual commitment amounts could be in excess of the amounts above.

**Off-Balance Sheet Transactions**

None.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

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**Item 8. Financial Statements and Supplementary Data**

**INDEX TO FINANCIAL STATEMENTS**

The following are included on the pages indicated:

Report of Independent Registered Public Accounting Firm	22
Balance Sheets as of December 31, 2006 and 2005	23
Statements of Operations for the years ended December 31, 2006, 2005 and 2004	24
Statements of Shareholders' Equity for the years ended December 31, 2006, 2005 and 2004	25
Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004	26

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To the Board of Directors and Shareholders

Insignia Systems, Inc.

We have audited the accompanying balance sheets of Insignia Systems, Inc. as of December 31, 2006 and 2005 and the related statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Insignia Systems, Inc. as of December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the Company adopted Financial Accounting Standards Board Statement No. 123(R), Share-Based Payments (SFAS 123R) effective January 1, 2006.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule II is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ Grant Thornton LLP

Minneapolis, Minnesota

March 23, 2007

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#### **Insignia Systems, Inc.**

#### **BALANCE SHEETS**

<b>As of December 31</b>	<b>2006</b>	<b>2005</b>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 3,785,000	\$ 2,711,000
Accounts receivable net of \$10,000 allowance in 2006 and \$50,000 in 2005	2,925,000	2,294,000
Inventories	452,000	448,000
Prepaid expenses and other	888,000	811,000
Total Current Assets	8,050,000	6,264,000
<b>Other Assets:</b>		
Property and equipment, net	477,000	409,000

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Other	56,000	
<b>Total Assets</b>	<b>\$ 8,583,000</b>	<b>\$ 6,673,000</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current Liabilities:</b>		
Line of credit	\$ 186,000	\$ 132,000
Current maturities of long-term liabilities	241,000	201,000
Accounts payable	1,345,000	1,770,000
Accrued liabilities		
Compensation	468,000	496,000
Employee stock purchase plan	98,000	35,000
Legal	105,000	92,000
Retailer guarantees		271,000
Other	154,000	63,000
Deferred revenue	436,000	612,000
Total Current Liabilities	3,033,000	3,672,000
<b>Long-Term Liabilities, less current maturities</b>	<b>688,000</b>	<b>929,000</b>
<b>Commitments and Contingencies</b>		
<b>Shareholders Equity:</b>		
Common stock, par value \$.01:		
Authorized shares 40,000,000 in 2006		
and 20,000,000 in 2005		
Issued and outstanding shares 15,152,000 in 2006		
and 15,002,000 in 2005		
	152,000	150,000
Additional paid-in capital	29,557,000	29,165,000
Accumulated deficit	(24,847,000 )	(27,243,000 )
Total Shareholders Equity	4,862,000	2,072,000
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 8,583,000</b>	<b>\$ 6,673,000</b>

See accompanying notes to financial statements.

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**Insignia Systems, Inc.**

**STATEMENTS OF OPERATIONS**

<b>Year Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Services revenues	\$ 19,219,000	\$ 16,445,000	\$ 17,341,000
Products sold	2,675,000	3,153,000	3,651,000
Total Net Sales	21,894,000	19,598,000	20,992,000
Cost of services	8,494,000	10,815,000	11,136,000

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Cost of goods sold	1,560,000	1,704,000	1,926,000
Total Cost of Sales	10,054,000	12,519,000	13,062,000
Gross Profit	11,840,000	7,079,000	7,930,000
<b>Operating Expenses:</b>			
Selling	4,838,000	5,697,000	5,809,000
Marketing	1,051,000	1,135,000	1,095,000
General and administrative	3,637,000	3,578,000	4,941,000
Impairment of goodwill			960,000
Total Operating Expenses	9,526,000	10,410,000	12,805,000
Operating Income (Loss)	2,314,000	(3,331,000 )	(4,875,000 )
<b>Other Income (Expense):</b>			
Interest income	123,000	71,000	67,000
Interest expense	(146,000 )	(53,000 )	(13,000 )
Other income (expense)	105,000	5,000	(37,000 )
Total Other Income	82,000	23,000	17,000
<b>Net Income (Loss)</b>	<b>\$2,396,000</b>	<b>\$(3,308,000 )</b>	<b>\$(4,858,000 )</b>
Net income (loss) per share:			
Basic	\$0.16	\$(0.22 )	\$(0.38 )
Diluted	\$0.15	\$(0.22 )	\$(0.38 )
Shares used in calculation of net income (loss) per share:			
Basic	15,093,000	15,002,000	12,687,000
Diluted	15,556,000	15,002,000	12,687,000

See accompanying notes to financial statements.

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**Insignia Systems, Inc.**

**STATEMENTS OF SHAREHOLDERS' EQUITY**

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount			
<b>Balance at December 31, 2003</b>	12,412,000	\$ 124,000	\$26,775,000	\$(19,077,000)	\$7,822,000
Issuance of common stock, net	2,562,000	26,000	2,343,000		2,369,000
Net loss				(4,858,000 )	(4,858,000 )
<b>Balance at December 31, 2004</b>	14,974,000	150,000	29,118,000	(23,935,000)	5,333,000
Issuance of common stock, net	28,000		47,000		47,000
Net loss				(3,308,000 )	(3,308,000 )

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<b>Balance at December 31, 2005</b>	15,002,000	150,000	29,165,000	(27,243,000)	2,072,000
Issuance of common stock, net	150,000	2,000	133,000		135,000
Value of stock-based compensation			259,000		259,000
Net income				2,396,000	2,396,000
<b>Balance at December 31, 2006</b>	15,152,000	\$ 152,000	\$29,557,000	\$(24,847,000)	\$4,862,000

*See accompanying notes to financial statements.*

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**Insignia Systems, Inc.**

**STATEMENTS OF CASH FLOWS**

<b>Year Ended December 31</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Operating Activities:</b>			
Net income (loss)	\$ 2,396,000	\$ (3,308,000 )	\$ (4,858,000 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	207,000	239,000	296,000
Provision for bad debt expense	(31,000 )	14,000	(88,000 )
Stock-based compensation	259,000		
Impairment of goodwill			960,000
Changes in operating assets and liabilities:			
Accounts receivable	(600,000 )	(74,000 )	1,094,000
Inventories	(4,000 )	47,000	215,000
Prepaid expenses and other	(133,000 )	(295,000 )	293,000
Accounts payable	(425,000 )	(159,000 )	(163,000 )
Accrued liabilities	(132,000 )	(52,000 )	1,010,000
Deferred revenue	(176,000 )	320,000	(341,000 )
Net cash provided by (used in) operating activities	1,361,000	(3,268,000 )	(1,582,000 )
<b>Investing Activities:</b>			
Purchases of property and equipment	(275,000 )	(128,000 )	(84,000 )

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Net cash used in investing activities	(275,000 )	(128,000 )	(84,000 )
<b>Financing Activities:</b>			
Net change in line of credit	54,000	(96,000 )	228,000
Payment of long-term liabilities	(201,000 )		
Proceeds from issuance of common stock, net	135,000	47,000	2,369,000
Net cash provided by (used in) financing activities	(12,000 )	(49,000 )	2,597,000
Increase (decrease) in cash and cash equivalents	1,074,000	(3,445,000 )	931,000
Cash and cash equivalents at beginning of year	2,711,000	6,156,000	5,225,000
Cash and cash equivalents at end of year	\$ 3,785,000	\$ 2,711,000	\$ 6,156,000
<b>Non-cash transaction:</b>			
Accrued liabilities (retailer guarantees) converted to long-term liabilities (see Note 5)	\$	\$ 1,130,000	\$
<b>Supplemental disclosures for cash flow information:</b>			
Cash paid during the year for interest	\$ 103,000	\$ 52,000	\$ 11,000

See accompanying notes to financial statements.

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies.**

**Description of Business.** Insignia Systems, Inc. (the Company) markets in-store advertising products, programs and services to retailers and consumer packaged goods manufacturers. The Company's products include the Insignia Point-of-Purchase Services (POPS) in-store advertising program, thermal sign card supplies for the Company's SIGNright and Impulse systems, Stylus software and laser printable cardstock and label supplies.

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**Revenue Recognition.** The Company recognizes revenue from Insignia POPSigns ratably over the period of service. The Company recognizes revenue related to equipment, software and sign card sales at the time the products are shipped to customers. Revenue associated with maintenance agreements is recognized ratably over the life of the contract. Revenue that has been billed and not yet earned is reflected as deferred revenue on the Balance Sheet.

**Cash Equivalents.** The Company considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value. At December 31, 2006, \$980,000 was invested in an overnight repurchase account, \$2,800,000 was invested in certificates of deposit and \$5,000 was invested in a short-term money market account. At December 31, 2005, \$1,684,000 was invested in an overnight repurchase account, \$700,000 was invested in certificates of deposit and \$327,000 was invested in a short-term money market account.

**Fair Value of Financial Instruments.** The financial statements include the following financial instruments: cash and cash equivalents, accounts receivable, line of credit, accounts payable and long-term liabilities. The fair value of the long-term liabilities is estimated based on the use of discounted cash flow analysis using interest rates for other debt offered to the Company. The Company estimates the carrying value of the long-term liabilities approximates fair value. All other financial instruments approximate fair value because of the short-term nature of these instruments.

**Accounts Receivable.** The majority of the Company's accounts receivable are due from companies in the consumer packaged goods industry. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are due within 30-60 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts receivable outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Changes in the Company's allowance for doubtful accounts are as follows:

<b>December 31</b>	<b>2006</b>	<b>2005</b>
Beginning balance	\$ 50,000	\$ 50,000
Bad debt provision (recovery)	(31,000 )	14,000
Accounts written-off	(9,000 )	(14,000 )
Ending balance	\$ 10,000	\$ 50,000

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

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**Inventories.** Inventories are primarily comprised of parts and supplies for Impulse and SIGNright machines, sign cards, and rollstock. Inventory is valued at the lower of cost or market using the first-in, first-out (FIFO) method, and consists of the following:

December 31	2006	2005
Raw materials	\$ 162,000	\$ 164,000
Work-in-process	8,000	14,000
Finished goods	282,000	270,000
	\$ 452,000	\$ 448,000

**Property and Equipment.** Property and equipment is recorded at cost. Significant additions or improvements extending asset lives are capitalized, while repairs and maintenance are charged to expense when incurred. Depreciation is provided in amounts sufficient to relate the cost of assets to operations over their estimated useful lives. The straight-line method of depreciation is used for financial reporting purposes and accelerated methods are used for tax purposes. Estimated useful lives of the assets are as follows:

Production tooling	1-3 years
Machinery and equipment	5-10 years
Office furniture and fixtures	3 years
Computer equipment and software	3 years

Leasehold improvements are amortized over the shorter of the remaining term of the lease or estimated life of the asset.

**Impairment of Long-Lived Assets.** The Company records impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. Impaired assets are then recorded at their estimated fair market value.

**Income Taxes.** Income taxes are accounted for under the liability method. Deferred income taxes are provided for temporary differences between the financial reporting and tax basis of assets and liabilities. Deferred taxes are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment.

**Accrued Retailer Guarantees.** The Company has contracts with many retailers that provide for the retailer to be paid on a per sign basis for the services rendered by the retailer to hang POPSigns in their respective stores. Some of the retailer contracts provide for minimum annual payment amounts. If those minimum levels are not met based upon the annual activity with those retailers, the Company is obligated to pay the contractual difference to the retailers. Excess amounts to be paid are computed and recorded on a monthly basis and paid on either a monthly, quarterly or annual basis. These amounts are included as expense within Cost of Services and thus affect the Company's gross profit margin.

**Stock-Based Compensation.** Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. We use the Black-Scholes option pricing model to determine the weighted average fair value of options and employee stock purchase plan rights. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as by assumptions regarding a

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**Insignia Systems, Inc.****NOTES TO FINANCIAL STATEMENTS**

number of highly complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

The expected terms of the options and employee stock purchase plan rights are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on historical and expected future volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to in the future. SFAS 123R requires forfeitures to be estimated at the time of the grant and revised, if necessary, in subsequent periods if actual forfeitures differ from estimates.

If factors change and we employ different assumptions in the application of SFAS 123R to grants in future periods, the related compensation expense that we record under SFAS 123R may differ significantly from what we have recorded in the current periods.

**Advertising Costs.** Advertising costs are charged to operations as incurred. Advertising expenses were approximately \$9,000, \$69,000 and \$9,000 during the years ended December 31, 2006, 2005 and 2004.

**Net Income (Loss) Per Share.** Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average shares outstanding and excludes any dilutive effects of options, warrants and convertible securities. Diluted net income per share gives effect to all diluted potential common shares outstanding during the year. Options and warrants to purchase approximately 1,086,000, 1,737,000 and 1,629,000 shares of common stock with weighted average exercise prices of \$6.29, \$4.92 and \$5.72 were outstanding at December 31, 2006, 2005 and 2004 and were not included in the computation of common stock equivalents because their exercise prices were higher than the average fair market value of the common shares during the reporting periods.

For the years ended December 31, 2005 and 2004, the effect of options and warrants was anti-dilutive due to the net losses incurred during the periods. Had net income been achieved, approximately 17,000 and 41,000 of common stock equivalents would have been included in the computation of diluted net income per share for the years ended December 31, 2005 and 2004.

Weighted average common share outstanding for the years ended December 31, 2006, 2005 and 2004 were as follows:

Year ended December 31	2006	2005	2004
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Denominator for basic net income (loss) per share weighted average shares	15,093,000	15,002,000	12,687,000
Effect of dilutive securities: Stock options	460,000		
Denominator for diluted net income (loss) per share adjusted weighted average shares	15,556,000	15,002,000	12,687,000

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

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#### **Insignia Systems, Inc.**

#### **NOTES TO FINANCIAL STATEMENTS**

*Reclassifications.* Certain 2005 and 2004 amounts have been reclassified to conform to the presentation in the 2006 financial statements.

#### *New Accounting Pronouncements.*

*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements:* In September 2006, the U.S. Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 eliminates the diversity of practice regarding how public companies quantify financial statement misstatements. It establishes an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. SAB 108 must be applied to annual financial statements for their first fiscal year ending after November 15, 2006. SAB 108 did not have a material impact on our financial condition or results of operations.

*Accounting for Uncertainty in Income Taxes:* In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not to be sustained upon audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We have reviewed our accounting for income taxes in light of the provisions of FIN 48 and do not expect that adoption will materially affect our financial statements.

2. **Property and Equipment.** Property and equipment consists of the following at December 31:

	2006	2005
<b>Property and Equipment:</b>		
Production tooling, machinery and equipment	\$ 1,792,000	\$ 1,657,000

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Office furniture and fixtures	191,000	191,000
Computer equipment and software	661,000	564,000
Leasehold improvements	341,000	327,000
	2,985,000	2,739,000
Accumulated depreciation and amortization	(2,508,000)	(2,330,000)
Net Property and Equipment	\$ 477,000	\$ 409,000

3. **Acquisition.** In December 2002, the Company acquired all of the assets comprising the VALUSTix business from Paul A. Richards, Inc., a New York company ( PAR ), for \$3,000,000 in cash, plus a five-year royalty based on annual net sales over a threshold amount, pursuant to an Asset Purchase Agreement between the Company and PAR.

The Company was not successful in integrating the VALUSTix business into the POPS program during 2003 and 2004 based on a number of factors and therefore made a decision to de-emphasize that business. Utilizing discounted cash flows to determine the fair value of the VALUSTix business, the Company determined that the carrying amount of goodwill exceeded the fair value of the business. As a result, the Company wrote-off goodwill associated with the acquisition of \$2,133,000 in the fourth quarter of 2003 and \$960,000 in the second quarter of 2004. The primary factor leading to the impairment was the continued inability of the VALUSTix acquisition to generate positive cash flow from operations. As of December 31, 2004, there was no goodwill remaining associated with the VALUSTix acquisition.

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#### **Insignia Systems, Inc.**

#### **NOTES TO FINANCIAL STATEMENTS**

In September 2005, the Company brought a suit against PAR and Paul Richards in Federal District Court in Minneapolis, Minnesota asking that the acquisition be rescinded and all parties restored to their pre-acquisition status. The suit was settled in June 2006 with terms including mutual releases and payment of \$100,000 to the Company in exchange for certain assets.

4. **Line of Credit.** On September 16, 2004, the Company entered into a Financing Agreement, Security Agreement and Revolving Note (collectively, the Credit Agreement ) with Marquette Business Credit, Inc. that initially provided for borrowings up to \$1,500,000 for twelve months, subject to collateral availability. The borrowings are secured by all of the Company's assets. The Credit Agreement provides that borrowings will bear interest at 2.5% over prime, with a minimum monthly interest charge of \$2,500, and an annual fee of 1% of the Revolving Note payable. The Credit Agreement includes various other customary terms and conditions. On November 22, 2004 the Company entered into an amendment to the Credit Agreement to extend the term to April 30, 2006, and on May 8, 2006, the Company entered into a second amendment to the Credit Agreement to extend the term to April 30, 2007. Borrowings of \$186,000 and \$132,000 were outstanding with an effective rate of 10.75% and 9.75% as of December 31, 2006 and 2005.
5. **Long-Term Liabilities.** Effective December 31, 2005 the Company reached an agreement with a retailer for the deferred payment of certain obligations on an interest-free basis. These obligations are recorded as long-term liabilities with an imputed annual interest rate of 10.0%.

<b>December 31</b>	<b>2006</b>	<b>2005</b>
Uncollateralized three year liability, payable in monthly installments	\$ 531,000	\$ 732,000
Uncollateralized liability, due December 31, 2009	179,000	179,000
Uncollateralized liability, due December 31, 2010	219,000	219,000

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Total	929,000	1,130,000
Less current maturities	(241,000 )	(201,000 )
	\$ 688,000	\$ 929,000

### 6. Commitments and Contingencies.

**Operating Leases.** The Company conducts its operations in a leased facility. The operating lease is effective until January 2010. During 2005 the Company entered into an agreement to sub-lease a portion of its facility through September 2008. The Company also leases equipment under operating lease agreements effective through September 2009. Rent expense under all of these leases, net of sub-lease rental income, was approximately \$527,000, \$1,070,000 and \$1,170,000 for the years ended December 31, 2006, 2005 and 2004.

Minimum future lease obligations under these leases, net of sub-lease rental income and excluding operating costs, are approximately as follows for the years ending December 31:

2007	\$ 527,000
2008	546,000
2009	600,000
2010	25,000
Thereafter	

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### **Insignia Systems, Inc.**

### **NOTES TO FINANCIAL STATEMENTS**

**Legal.** In August 2000, News America Marketing In-Store, Inc. (News America), brought suit against the Company in U.S. District Court in New York, New York. The case was settled in November 2002. The terms of the settlement agreement are confidential. The settlement did not impact the Company's operating results.

In October 2003, News America brought suit against the Company in U.S. District Court in New York, New York, alleging that the Company has engaged in deceptive acts and practices, has interfered with existing business relationships with retailers and prospective economic advantage, and has engaged in unfair competition. The suit sought unspecified damages and injunctive relief. In February 2007 the U.S. District Court in New York transferred this action to Minnesota where the claims will become part of the lawsuit the Company filed against News America and Albertson's Inc.

On September 23, 2004, the Company brought suit against News America and Albertson's Inc. in Federal District Court in Minneapolis, Minnesota, for violations of federal and state antitrust and false advertising laws, alleging that News America has acquired and maintained monopoly power through various wrongful acts designed to harm the Company in the in-store advertising and promotion products and services market. The suit seeks injunctive relief sufficient to prevent further antitrust injury and an award of treble damages to be determined at trial for the harm caused to the Company. On June 30, 2006 the Court denied the motions of News America and Albertson's to dismiss the suit. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the Minnesota case. The parties are now engaged in pre-trial discovery. In December 2006 News America filed counterclaims similar to the claims in its New York action against Insignia and one of its officers. Motions to dismiss the counterclaims are pending with oral argument scheduled in mid-April 2007. Management believes that the allegations of the counterclaims are without merit. An evaluation of the likelihood of an unfavorable outcome and estimate of the potential liability cannot be rendered at this time.

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Management currently expects the amount of legal fees that will be incurred in connection with the ongoing lawsuit to be significant throughout 2007. During the years ended December 31, 2006, 2005 and 2004, the Company incurred legal fees of \$935,000, \$1,085,000 and \$2,527,000 related to the News America litigation. Legal fees are expensed as incurred.

The Company is subject to various other legal proceedings in the normal course of business. Management believes the outcome of these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

**Retailer Agreements.** The Company has contracts in the normal course of business with various retailers, some of which provide for minimum annual program levels. If those minimum levels are not met, the Company is obligated to pay the contractual difference to the retailers. During the year ended December 31, 2006 the Company recorded no expense related to these minimums as the Company had met the minimum requirements. During the years ended December 31, 2005 and 2004 the Company incurred approximately \$2,131,000 and \$2,701,000 of costs related to these minimums. The amounts were recorded in Cost of Services in the Statements of Operations.

Aggregate minimum commitment amounts under agreements with retailers are approximately as follows for the years ending December 31:

2007	\$ 3,766,000
2008	3,280,000
2009	2,215,000
2010	2,320,000

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#### **Insignia Systems, Inc.**

#### **NOTES TO FINANCIAL STATEMENTS**

On an ongoing basis the Company negotiates renewals of various retailer agreements. Upon the completion of future contract renewals, the annual commitment amounts for 2007 and thereafter could be in excess of the amounts above.

#### **7. Shareholders' Equity.**

**Private Placements and Warrants.** On December 3, 2004, the Company closed a private placement of \$2,490,000 of common stock to a small group of accredited investors at a price of \$1.00 per share, pursuant to a Securities Purchase Agreement. The price represented a 15% discount from the average closing bid price of the Company's common stock over the five days prior to the closing. The Company registered the shares sold in this private placement with an effective date of January 21, 2005.

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On December 18, 2002, the Company closed a private placement of \$7,500,000 of common stock to a small group of accredited investors at a price of \$9.19 per share, pursuant to a Securities Purchase Agreement. The price represented a 15% discount from the average closing bid price of the Company's common stock over the five days prior to the closing. As part of this offering, the Company also issued warrants to the investors entitling them to purchase an additional 244,827 shares of the Company's common stock at an initial exercise price of \$12.44 per share for a five-year period. Additionally, a warrant to purchase 40,805 shares with the same terms was issued to the Placement Agent. The warrant agreements were amended, effective December 29, 2003, to adjust the exercise price of the warrants to \$2.75 per share in exchange for certain terms of the warrant agreement being deleted in their entirety. The warrants were all exercisable at December 31, 2006.

**Stock Options.** At December 31, 2002 the Company had a stock option plan (the 1990 Plan ) for its employees and directors under which substantially all of the shares reserved for issuance had been issued. During May 2003, the Company's shareholders approved the 2003 Incentive Stock Option Plan (the 2003 Plan ) and an aggregate of 350,000 shares of common stock were reserved for issuance. The shareholders approved an additional 650,000 shares for issuance in May of 2004 and an additional 625,000 shares for issuance in May of 2005. The 2003 Plan replaced the 1990 Plan. Options granted under the 1990 Plan will remain in effect until they are exercised or expire according to their terms. All current option grants are made under the 2003 Plan.

Under the terms of the stock option plans, the Company grants incentive or non-qualified stock options to employees and directors generally at an exercise price at or above 100% of fair market value at the close of business on the date of grant. The stock options expire five or ten years after the date of grant and generally vest over three years.

## Insignia Systems, Inc.

## NOTES TO FINANCIAL STATEMENTS

The following table summarizes activity under the Option Plans:

	Plan Shares Available for Grant	Plan Options Outstanding	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
Balance at December 31, 2003	110,300	1,306,347	6.57	
Reserved	650,000			
Granted	(504,400 )	504,400	1.44	
Exercised		(23,000 )	1.18	\$ 21,000
Cancelled 2003 Plan	102,200	(102,200 )	3.50	
Cancelled 1990 Plan		(213,551 )	5.39	
Balance at December 31, 2004	358,100	1,471,996	5.33	
Reserved	625,000			
Granted	(578,300 )	578,300	0.91	
Cancelled 2003 Plan	158,566	(158,566 )	1.74	
Cancelled 1990 Plan		(32,401 )	7.63	
Balance at December 31, 2005	563,366	1,859,329	\$ 4.22	
Reserved				
Granted	(615,100 )	615,100	\$ 1.24	
Exercised		(113,331 )	\$ 1.52	\$ 179,000
Cancelled 2003 Plan	252,934	(252,934 )	\$ 2.44	
Cancelled 1990 Plan		(61,066 )	\$ 7.66	
Balance at December 31, 2006	201,200	2,047,098	\$ 3.59	

The numbers of options exercisable under the Option Plans were:

December 31, 2004	946,672
December 31, 2005	1,207,131
December 31, 2006	1,242,487

The following table summarizes information about the stock options outstanding at December 31, 2006:

Ranges of Exercise Prices	Number Outstanding	Options Outstanding	Weighted Average Exercise Price Per Share	Options Exercisable
		Weighted Average Remaining Contractual Life		Number Exercisable
\$0.58 \$ 0.95	212,068	6.53 years	\$ 0.77	118,529 \$ 0.79
0.96 1.31	971,001	8.62 years	1.16	291,929 1.20
1.32 1.95	69,700	7.14 years	1.95	69,700 1.95
1.96 3.32	32,000	5.33 years	3.15	

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		Options Outstanding			Options Exercisable		
3.33	4.28	92,297	3.29 years	4.24	92,297	4.24	
4.29	5.80	98,699	6.25 years	5.76	98,699	5.76	
5.81	8.90	351,333	3.89 years	7.80	351,333	7.80	
8.91	11.36	220,000	4.87 years	9.67	220,000	9.67	
\$0.58	\$11.36	2,047,098	6.73 years	\$ 3.59	1,242,487	\$ 5.15	

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

Options outstanding under the Option Plans expire at various dates during the period February 2009 through December 2016. Options outstanding at December 31, 2006 had a weighted average remaining life of 6.73 years and an aggregate intrinsic value of \$2,395,000. Options exercisable at December 31, 2006 had a weighted average remaining life of 5.37 years and an aggregate intrinsic value of \$886,000.

At December 31, 2006, a total of 201,200 shares were available for grant under the Option Plans.

**Employee Stock Purchase Plan.** The Company has an Employee Stock Purchase Plan (the Plan) that enables employees to contribute up to 10% of their compensation toward the purchase of the Company's common stock at 85% of market value. During the years ended December 31, 2006, 2005 and 2004, employees purchased 57,460, 28,231 and 48,506 shares under the Plan. At December 31, 2006, 359,617 shares are reserved for future employee purchases of common stock under the Plan. For the year ended December 31, 2006, the Company recognized \$49,000 of stock-based compensation expense related to the Plan.

**Stock-Based Compensation.** The Company's stock-based compensation plans are administered by the Compensation Committee of the Board of Directors, which selects persons to receive awards and determines the number of shares subject to each award and the terms, conditions, performance measures and other provisions of the award.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123R is being applied on the modified prospective basis. Prior to the adoption of SFAS 123R, the Company accounted for its stock-based compensation plans under the intrinsic value method of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and accordingly, recognized no compensation expense related to the stock-based plans where the exercise price of options granted equaled the market value of the underlying common stock on the date of grant.

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Under the modified prospective approach, SFAS 123R applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized beginning in the first quarter of fiscal 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested on January 1, 2006, and compensation cost for all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Prior periods were not restated to reflect the impact of adopting the new standard.

As a result of the adoption of SFAS 123R, our financial results were lower than under our previous accounting method for stock-based compensation by the following amounts:

	<b>Three Months Ended</b>	<b>Year Ended</b>
	<b>December 31, 2006</b>	<b>December 31, 2006</b>
Income from operations before income taxes	\$ 68,000	\$ 259,000
Income from operations	\$ 68,000	\$ 259,000
Net income	\$ 68,000	\$ 259,000
Earnings per share:		
Basic	\$	\$ 0.02
Diluted	\$	\$ 0.02

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#### **Insignia Systems, Inc.**

#### **NOTES TO FINANCIAL STATEMENTS**

The following table summarizes the stock-based compensation expense which was recognized in the Statements of Operations for the three months and year ended December 31, 2006:

	<b>Three Months Ended</b>	<b>Year Ended</b>
	<b>December 31, 2006</b>	<b>December 31, 2006</b>
Cost of sales	\$ 18,000	\$ 61,000
Selling	15,000	55,000
Marketing	9,000	32,000
General and administrative	26,000	111,000
	\$ 68,000	\$ 259,000

The following table illustrates the effect on net loss and net loss per share had the Company accounted for stock-based compensation in accordance with SFAS 123R for the years ended December 31, 2005 and 2004:

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Year Ended December 31	2005	2004
Net loss, as reported	\$(3,308,000 )	\$(4,858,000 )
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards	(480,000 )	(1,062,000 )
Pro forma net loss	\$(3,788,000 )	\$(5,920,000 )
Basic and diluted net loss per share:		
As reported	\$(0.22 )	\$(0.38 )
Pro forma	\$(0.25 )	\$(0.47 )

The Company uses the Black-Scholes option-pricing model to estimate fair value of stock-based awards with the following weighted average assumptions:

	2006	2005	2004
<i>Stock Options:</i>			
Expected life (years)	2.64	3.00	3.00
Expected volatility	63 %	73 %	57 %
Dividend yield	0 %	0 %	0 %
Risk-free interest rate	4.91 %	3.77 %	2.92 %

The expected terms of the options and employee stock purchase plan rights are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on historical and expected future volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to in the future.

As of December 31, 2006, there was \$227,000 of total unrecognized compensation costs related to the outstanding stock options which is expected to be recognized over a weighted average period of 1.35 years.

8. **Income Taxes.** At December 31, 2006, the Company had net operating loss carryforwards of approximately \$23,000,000, which are available to offset future taxable income. These carryforwards are subject to the limitations of Internal Revenue Code Section 382. This Section provides limitations on the

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#### **Insignia Systems, Inc.**

#### **NOTES TO FINANCIAL STATEMENTS**

availability of net operating losses to offset current taxable income if an ownership change has occurred as defined by Internal Revenue Code Section 382. These carryforwards will begin expiring in 2009.

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The Company has established a valuation allowance due to uncertainties regarding the realization of deferred tax assets based on the Company's lack of historical earnings.

The Company will continue to assess the valuation allowance and to the extent it is determined that said allowance is no longer required, the tax benefit of the remaining deferred tax assets will be recognized in the future. Included as part of the Company's net operating loss carryforwards are approximately \$2,900,000 in tax deductions that resulted from the exercise of stock options. When these loss carryforwards are realized the corresponding changes in the valuation allowance will be recorded as additional paid-in capital.

The actual tax expense attributable to income from continuing operations differs from the expected tax expense (benefit) computed by applying the U.S. federal corporate income tax rate of 34% to the net income (loss) as follows:

Year Ended December 31	2006		2005		2004	
Federal statutory rate	34.0	%	(34.0)	)%	(34.0)	)%
Change in federal valuation allowance	(48.2	)	22.2		33.8	
Expiration of carryforwards	13.3		11.5			
Stock options	0.5				(0.1	)
Other	0.4		0.3		0.3	
Effective federal income tax rate	0.0	%	0.0	%	0.0	%

Significant components of the deferred taxes are as follows:

As of December 31	2006	2005
<b>Deferred Tax Assets:</b>		
Net operating loss carryforwards	\$ 8,508,000	\$ 8,813,000
Goodwill		914,000
Accrued expenses	300,000	348,000
Inventory reserve	35,000	40,000
Accounts receivable allowance	4,000	18,000
Other	175,000	165,000
Deferred tax assets	9,022,000	10,298,000
Less valuation allowance	(9,022,000 )	(10,298,000 )
Net deferred taxes	\$	\$

9. **Employee Benefit Plans.** The Company has a Retirement Profit Sharing and Savings Plan under Section 401(k) of the Internal Revenue Code. The plan allows employees to defer up to 50% of their wages, subject to Federal limitations, on a pre-tax basis through contributions to the plan. During the years ended December 31, 2006, 2005 and 2004 the Company made no matching contributions.

#### 10. Concentrations.

**Major Customers.** During the year ended December 31, 2006, two customers accounted for 26% and 10% of the Company's total net sales. At December 31, 2006, these two customers represented 20% and 14%

**Insignia Systems, Inc.****NOTES TO FINANCIAL STATEMENTS**

of the Company's total accounts receivable. During the year ended December 31, 2005, two customers accounted for 17% and 16% of the Company's total net sales. At December 31, 2005, these two customers represented 24% and 31% of the Company's total accounts receivable and one other customer represented 10% of the Company's total accounts receivable.

Although there are a number of customers that the Company sells to, the loss of a major customer could cause a delay in and possible loss of sales, which would adversely affect operating results.

**Export Sales.** Export sales accounted for approximately 1% of total net sales during the years ended December 31, 2006, 2005 and 2004.

**11. Quarterly Financial Data.** (Unaudited)

Quarterly data for the years ended December 31, 2006 and 2005 was as follows:

<b>Year Ended December 31, 2006</b>	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Net sales	\$ 5,422,000	\$ 5,853,000	\$ 5,112,000	\$ 5,507,000
Gross profit	2,974,000	3,232,000	2,600,000	3,034,000
Net income	639,000	949,000	228,000	580,000
Net income per share:				
Basic	\$ 0.04	\$ 0.06	\$ 0.02	\$ 0.04
Diluted	0.04	0.06	0.01	0.04
<b>Year Ended December 31, 2005</b>	<b>1<sup>st</sup> Quarter</b>	<b>2<sup>nd</sup> Quarter</b>	<b>3<sup>rd</sup> Quarter</b>	<b>4<sup>th</sup> Quarter</b>
Net sales	\$ 4,972,000	\$ 5,396,000	\$ 5,285,000	\$ 3,945,000
Gross profit	1,732,000	2,108,000	1,980,000	1,259,000
Net loss	(1,057,000 )	(508,000 )	(432,000 )	(1,311,000 )
Net loss per share:				
Basic and diluted	\$(0.07 )	\$(0.03 )	\$(0.03 )	\$(0.08 )

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosures**

Not applicable.

**Item 9A. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

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The Company's management carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer (principal financial officer), of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of December 31, 2006, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and the Company's Chief Financial Officer (principal financial officer) concluded that the Company's disclosure controls and procedures as of December 31, 2006 are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic filings under the Exchange Act.

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#### (b) Changes in Internal Control Over Financial Reporting

No changes in the Company's internal control over financial reporting have occurred during the fourth quarter of 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### Item 9B. Other Information

None.

## ***PART III.***

### Item 10. Directors, Executive Officers and Corporate Governance

Information concerning Executive Officers of the Company is included in this Annual Report in Item 4A under the caption "Executive Officers of the Registrant." The information required by Item 10 concerning the directors of the Company and corporate governance is incorporated herein by reference to the Company's proxy statement for its 2007 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

### Item 11. Executive Compensation

The information required by Item 11 is incorporated herein by reference to the Company's proxy statement for its 2007 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 is incorporated herein by reference to the Company's proxy statement for its 2007 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

### Item 13. Certain Relationships and Related Transactions and Director Independence

The information required by Item 13 is incorporated herein by reference to the Company's proxy statement for its 2007 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

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### Item 14. Principal Accounting Fees and Services

The information required by Item 14 is incorporated herein by reference to the Company's proxy statement for its 2007 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

### Item 15. Exhibits and Financial Statement Schedules

The following financial statements of Insignia Systems, Inc. are included in Item 8:

- Report of Independent Registered Public Accounting Firm
- Balance Sheets as of December 31, 2006 and 2005
- Statements of Operations for the years ended December 31, 2006, 2005 and 2004
- Statements of Shareholders' Equity for the years ended December 31, 2006, 2005 and 2004
- Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004
- Notes to Financial Statements

The following schedule of Insignia Systems, Inc. is included in Item 15:

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### Schedule II. Valuation and Qualifying Accounts

(a) Exhibits

Exhibit

Number	Description	Incorporation By Reference To
2	Asset Purchase Agreement dated December 23, 2002 between Insignia Systems, Inc. and Paul A. Richards, Inc.	Exhibit 2 of the Registrant's Form 8-K filed December 31, 2002
3.1	Articles of Incorporation of Registrant, as amended to date	Exhibit 3.1 of the Registrant's Registration Statement on Form S-18, Reg. No. 33-40765C
3.2	Bylaws, as amended to date	Exhibit 3.1 of the Registrant's Form 8-K filed February 23, 2007
4.1	Specimen Common Stock Certificate of Registrant	Exhibit 4.1 of the Registrant's Registration Statement on Form S-18, Reg. No. 33-40765C
4.2	Securities Purchase Agreement dated December 18, 2002 among Insignia Systems, Inc. and the Purchasers	Exhibit 4.1 of the Registrant's Form 8-K filed December 31, 2002
4.3	Registration Rights Agreement dated December 18, 2002 among Insignia Systems, Inc. and the Purchasers	Exhibit 4.2 of the Registrant's Form 8-K filed December 31, 2002
4.4	Form of Warrant dated December 18, 2002 between Insignia Systems, Inc. and the Holders	Exhibit 4.3 of the Registrant's Form 8-K filed December 31, 2002
4.5	Amendment to Warrant dated December 29, 2003 between Insignia Systems, Inc. and the Holders	Exhibit 4.5 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003

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Exhibit

Number	Description	Incorporation By Reference To
10.1	Employment Agreement dated December 23, 2002 between Insignia Systems, Inc. and Paul A. Richards	Exhibit 10.1 of the Registrant's Form 8-K filed December 31, 2002
10.2	Royalty Agreement dated December 23, 2002 between Insignia Systems, Inc. and Paul A. Richards, Inc.	Exhibit 10.2 of the Registrant's Form 8-K filed December 31, 2002
10.3	The Company's 1990 Stock Plan, as amended	Exhibit 10.3 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001

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	Lease Agreement between Insignia Systems, Inc. and the Landlord , dated October 31, 2002	Exhibit 10.6 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2002
10.5	Sublease Agreement between Insignia Systems, Inc. and the Sublessee dated March 31, 2005	Exhibit 10.2 of the Registrants Form 10-Q for the quarterly period ended March 31, 2005
10.6	License Agreement between Thomas and Lawrence McGourty and Insignia Systems, Inc. dated January 23, 1990, as amended	Exhibit 10.1 of the Registrant s Registration Statement on Form S-18, Reg. No. 33-40765C
10.7	Barcode License and Support Agreement between Thomas and Lawrence McGourty and Insignia Systems, Inc. dated January 23, 1990	Exhibit 10.2 of the Registrant s Registration Statement on Form S-18, Reg. No. 33-40765C
10.8	Employee Stock Purchase Plan, as amended	Exhibit 4.1 of the Registrants Registration Statement on Form S-8, Reg. No. 333-136591
10.9	The Company s 2003 Incentive Stock Option Plan, as amended	Exhibit 4.1 of the Registrant s Registration Statement on Form S-8, Reg. No. 333-127606
10.10	Amended Change in Control Severance Agreement with Scott F. Drill dated December 20, 2005	Exhibit 10.10 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005
10.11	Amended Change in Control Severance Agreement with Justin W. Shireman dated December 20, 2005	Exhibit 10.11 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005
10.12	Financing Agreement between Itasca Business Credit, Inc. and the Company dated September 16, 2004	Exhibit 10.1 of the Registrant s Form 8-K filed September 22, 2004
10.13	Security Agreement between Itasca Business Credit, Inc. and the Company dated September 16, 2004	Exhibit 10.2 of the Registrant s Form 8-K filed September 22, 2004
10.14	Revolving Note between Itasca Business Credit, Inc. and the Company dated September 16, 2004	Exhibit 10.3 of the Registrant s Form 8-K filed September 22, 2004

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#### Exhibit

Number	Description	Incorporation By Reference To
10.15	Amendment to Financing Agreement between Itasca Business Credit, Inc. and the Company dated November 22, 2004	Exhibit 10.17 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004
10.16	Restated Revolving Note between Itasca Business Credit, Inc. and the Company dated November 22, 2004	Exhibit 10.18 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004
10.17	Consulting Agreement, effective February 1, 2006, between Gary L. Vars and the Company	Exhibit 4.1 of the Registrant s Form 8-K filed February 1, 2006

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10.18	Nonqualified Stock Option Agreement, effective February 1, 2006, between Gary L. Vars and the Company	Exhibit 4.2 of the Registrant's Form 8-K filed February 1, 2006
10.19	Second Amendment to Financing Agreement between Itasca Business Credit, Inc. and the Company dated May 8, 2006	Exhibit 10.1 of the Registrant's Form 10-Q for the quarterly period ended March 31, 2006
10.20	Second Restated Revolving Note between Itasca Business Credit, Inc. and the Company dated May 8, 2006	Exhibit 10.2 of the Registrant's Form 10-Q for the quarterly period ended March 31, 2006
10.21	Exclusive Reseller Agreement between Valassis Sales & Marketing Services, Inc. and the Company entered into as of June 12, 2006	Exhibit 10.1 of the Registrant's Form 10-Q for the quarterly period ended June 30, 2006
10.22	Settlement and Mutual Release Agreement between Paul Richards, Paul A. Richards, Inc. and the Company effective June 22, 2006	Exhibit 10.2 of the Registrant's Form 10-Q for the quarterly period ended June 30, 2006
10.23	2007 CEO Bonus Plan	Exhibit 10.1 of the Registrant's Form 8-K filed January 4, 2007
10.24	Amended Change in Control Severance Agreement with Scott J. Simcox dated February 20, 2007	Exhibit 10.1 of the Registrant's Form 8-K filed February 23, 2007
10.25	2007 Executive Incentive Plan dated February 20, 2007	Filed herewith
14	Code of Ethics	Exhibit 14 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003
23.1	Consent of Independent Registered Public Accounting Firm	Filed herewith
31.1	Certification of Principal Executive Officer	Filed herewith
31.2	Certification of Principal Financial Officer	Filed herewith
32	Section 1350 Certification	Filed herewith

Table of Contents**SCHEDULE II. Valuation and Qualifying Accounts**

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions Describe	Balance at End of Period
<b>Year ended December 31, 2006</b>				
Allowance for doubtful accounts	\$ 50,000	\$ (31,000)	\$ 9,000 (1)	\$ 10,000
Provision for inventory lower of cost or market adjustment	107,000	11,000	(23,000) (2)	95,000
<b>Year ended December 31, 2005</b>				
Allowance for doubtful accounts	\$ 50,000	\$ 14,000	\$ 14,000 (1)	\$ 50,000
Provision for inventory lower of cost or market adjustment	113,000	(6,000)	(2)	107,000
<b>Year ended December 31, 2004</b>				
Allowance for doubtful accounts	\$ 140,000	\$ (88,000)	\$ 2,000 (1)	\$ 50,000
Provision for inventory lower of cost or market adjustment	73,000	60,000	20,000 (2)	113,000

(1) Uncollectible accounts written off, net of recoveries.

(2) Inventory scrapped and disposed of.

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Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Scott F. Drill  
Scott F. Drill  
President and CEO

Dated: March 30, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Scott F. Drill Scott F. Drill	President, Chief Executive Officer (principal executive officer) Secretary and Director	March 30, 2007
/s/ Justin W. Shireman Justin W. Shireman	Vice President of Finance, Chief Financial Officer (principal financial officer and accounting officer) and Treasurer	March 30, 2007
/s/ Donald J. Kramer Donald J. Kramer	Director	March 30, 2007
/s/ W. Robert Ramsdell W. Robert Ramsdell	Director	March 30, 2007
/s/ Gordon F. Stofer Gordon F. Stofer	Director	March 30, 2007
/s/ Gary L. Vars Gary L. Vars	Director	March 30, 2007
/s/ Peter V. Derycz Peter V. Derycz	Director	March 30, 2007

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