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ILINC COMMUNICATIONS INC
Form 10-Q
February 02, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. (20549)

FORM (10)-Q

(MARK ONE)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2006

OR

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

For the transition period from _____ to _____

Commission File Number 1-13725

ILINC COMMUNICATIONS, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction
Of incorporation or organization)

76-0545043
(I.R.S. Employer
Identification No.)

2999 NORTH 44TH STREET, SUITE 650, PHOENIX, ARIZONA
(Address of principal executive offices)

85018
(Zip code)

(602) 952-1200
(Registrant's telephone number, including area code)

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

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

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

The number of shares of Common Stock of the Registrant, par value \$.001
per share, outstanding at February 2, 2007 was 33,405,431 net of shares held in

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treasury.

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FORWARD-LOOKING STATEMENTS

Unless the context requires otherwise, references in this document to "iLinc Communications," "iLinc," the "Company," "we," "us," and "our" refer to iLinc Communications, Inc.

Statements contained in this Quarterly Report on Form 10-Q that involve words like "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," and similar expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. These are statements that relate to future periods and include, but are not limited to, statements as to our ability to: sell our products and services; improve the quality of our software; derive overall benefits of our products and services; introduce new products and versions of our existing products; sustain and increase revenue from existing products; integrate current and emerging technologies into our product offerings; control our expenses; control changes in our customer base; obtain sales or increase revenue; sustain sufficient cash flow; manage liquidity and capital resources; realize positive cash flow from operations; or realize net earnings.

Such forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from anticipated results. These risks and uncertainties include, but are not limited to, our dependence on our products or services, market demand for our products and services, our ability to attract and retain customers and channel partners, our ability to expand our technological infrastructure to meet the demand from our customers, our ability to recruit and retain qualified employees, the ability of channel partners to successfully resell our products, the status of the overall economy, the strength of competitive offerings, the pricing pressures created by market forces, and the risks discussed herein (see "Managements Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors"). All forward-looking statements included in this report are based on information available to us as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein, to reflect any change in our expectations or in events, conditions or circumstances on which any such statement is based. Readers are urged to carefully review and consider the various disclosures made in this report and in our other reports filed with the SEC that attempt to advise interested parties of certain risks and factors that may affect our business. Our reports are available free of charge as soon as reasonably practicable after such material is electronically filed with the SEC and may be obtained through our Web site located at www.ilinc.com.

iLinc, iLinc Communications, iLinc Suite, MeetingLinc, LearnLinc, ConferenceLinc, SupportLinc, iLinc On-Demand, and their respective logos are trademarks or registered trademarks of iLinc Communications, Inc. All other company names and products may be trademarks of their respective companies.

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ITEM 1. FINANCIAL STATEMENTS

ILINC COMMUNICATIONS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) (IN THOUSANDS, EXCEPT SHARE DATA)

	DECEMBER 31, 2006	DECEMBER 31, 2005
	----	----
ASSETS		
Current assets:		
Cash and cash equivalents	\$	
Certificates of deposit		2
Accounts receivable, net of allowance for doubtful accounts of \$96 and \$120, respectively		
Note receivable		
Prepaid and other current assets		
	----	----
Total current assets	4	
Property and equipment, net		
Goodwill		11
Intangible assets, net		1
Other assets		
	----	----
Total assets	\$ 17	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long term debt	\$	
Accounts payable trade		1
Accrued liabilities		1
Current portion of capital lease liabilities		
Deferred revenue		1
	----	----
Total current liabilities	3	
Long term debt, less current maturities, net of discount and beneficial conversion feature of \$1,042 and \$1,493, at December 31, and March 31, 2006, respectively....		7
	----	----
Total liabilities	10	
SHAREHOLDERS' EQUITY:		
Preferred stock series A & B, 10,000,000 shares authorized:		
Series A preferred stock, \$.001 par value, 115,000 and 127,500 shares, respectively, issued and outstanding, liquidation preference of \$1,150,000 and \$1,275,000, respectively		
Series B preferred stock, \$.001 par value, 64,000 and 70,000 shares, respectively, issued and outstanding, liquidation preference of \$640,000 and \$700,000, respectively		
Common stock, \$.001 par value 100,000,000 shares authorized 34,837,843 and 28,923,168 issued, respectively		
Additional paid-in capital		46
Accumulated deficit		(38)
Less: 1,432,412 treasury shares at cost		(1)
	----	----
Total shareholders' equity	6	

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Total liabilities and shareholders' equity \$ 17

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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ILINC COMMUNICATIONS, INC., AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) (IN THOUSANDS, EXCEPT PER SHARE DATA)

	THREE MONTHS ENDED DECEMBER 31,	
	2006	2005
Revenues		
Software licenses	\$ 1,105	\$ 850
Software and audio services	1,831	1,747
Maintenance and professional services	715	677
Total revenues	3,651	3,274
Cost of revenues		
Software licenses	51	40
Software and audio services	884	959
Maintenance and professional services	310	237
Amortization of acquired developed technology	68	82
Total cost of revenues	1,313	1,318
Gross profit	2,338	1,956
Operating expenses		
Research and development	307	351
Sales and marketing	924	701
General and administrative	588	485
Total operating expenses	1,819	1,537
Income from operations	519	419
Interest expense	(244)	(246)
Amortization of beneficial debt conversion	(150)	(213)
Total interest expense	(394)	(459)
Net (loss) gain on settlement of debt and other obligations	--	--
Loss on extinguishment of debt	(160)	--
Interest income (charges) and other	--	177
Gain on sale of assets	--	--
Income (loss) from continuing operations before income		

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taxes	(35)	137
Income taxes	--	--
	-----	-----
Income (loss) from continuing operations	(35)	137
Income (loss) from discontinued operations	--	70
	-----	-----
Net income (loss)	\$ (35)	\$ 207
Series A and B preferred stock dividends	(38)	(40)
Imputed preferred stock dividends	--	--
	-----	-----
Income (loss) available to common shareholders	\$ (73)	\$ 167
	=====	=====
Income (loss) per common share, basic and diluted		
From continuing operations	\$ --	\$ 0.01
From discontinued operations	--	--
	-----	-----
Income (loss) per common share	\$ --	\$ 0.01
	=====	=====
Number of shares used in calculation of income (loss) per share:		
Basic	33,190	27,114
	=====	=====
Diluted	33,190	27,115
	=====	=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ILINC COMMUNICATIONS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED) (IN THOUSANDS)

	CONVERTIBLE PREFERRED STOCK		COMMON STOCK		ADDITIONAL PAID - IN CAPITAL
	SHARES	AMOUNT	SHARES	AMOUNT	
Balances, April 1, 2006	197	\$ --	28,923	\$ 29	\$ 44,228
Warrant grant	--	--	--	--	57
Fair value of unvested warrant issued in agent agreement	--	--	--	--	450
Vesting of restricted stock grant..	--	--	--	--	30
Series A and B preferred stock dividends.....	--	--	--	--	--
Conversion of Series A preferred stock	(12)	--	250	1	(1)
Conversion of Series B preferred stock	(6)	--	240	--	--
Exercise of stock options	--	--	19	--	5
Issuance of common stock in private placement	--	--	5,405	5	1,995
Costs incurred in connection with issuance of common stock in private placement	--	--	--	--	(288)

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Stock option compensation expense	--	--	--	--	76
Net income	--	--	--	--	--
	-----	-----	-----	-----	-----
Balances, December 31, 2006	179	\$ --	34,837	\$ 35	\$ 46,552
	=====	=====	=====	=====	=====

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE INTERIM CONDENSED CONSOLIDATED

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ILINC COMMUNICATIONS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (IN THOUSANDS)

	NINE MONTHS ENDED DECEMBER 31,	
	2006	2005
	-----	-----
Net cash provided by operating activities	\$ 443	\$ 385
	-----	-----
Cash flows from investing activities:		
Investment in certificate of deposit	(768)	--
Capital expenditures	(393)	(52)
Capitalization of software development costs	(295)	--
Acquisitions, net of cash acquired	--	(4)
Acquisitions, royalty earn-out payment to Mentergy	--	(100)
Proceeds from sale of fixed assets	3	20
Repayment of note receivable	14	3
	-----	-----
Net cash used in investing activities	(1,439)	(133)
	-----	-----
Cash flows from financing activities:		
Proceeds from issuance of common stock	2,000	--
Proceeds from issuance of Series B preferred stock	--	150
Payment of Series A and B preferred stock dividends	(118)	(91)
Stock issuance expense	(258)	--
Proceeds from exercise of stock options	5	--
Proceeds from exercise of warrants	--	41
Repayment of long-term debt	(121)	(215)
Repayment of capital lease liabilities	(65)	(109)
Financing costs incurred	(101)	(28)
	-----	-----
Net cash provided by (used in) financing activities	1,342	(252)
	-----	-----
Cash flows from continuing operations	346	--
Cash flows from discontinued operations	(40)	86
	-----	-----
Net change in cash and cash equivalents	306	86
Cash and cash equivalents, beginning of period	466	532
	-----	-----
Cash and cash equivalents, end of period	\$ 772	\$ 618

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Supplemental Schedule of Noncash Investing and Financing Activities

	NINE MONTHS ENDED DECEMBER 31,	
	2006	2005
Conversion of AP to preferred stock	\$ --	\$550
Conversion of convertible notes to common stock	--	531
Fair value of warrants recorded as prepaid	450	--
Conversion of unsecured notes to common stock	--	225
Fair value of warrants issued with preferred dividends	--	55
Conversion of AR to note receivable	54	--
Fair value of warrants recorded as intangible asset	42	--
Deferred maintenance offset by accrued royalty.....	8	--
Conversion of preferred stock to common stock	1	--

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE INTERIM CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS.

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ILINC COMMUNICATIONS, INC. NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. ORGANIZATION AND NATURE OF OPERATIONS

Headquartered in Phoenix, Arizona, iLinc Communications, Inc., a Delaware corporation, is a leading provider of Web conferencing, audio conferencing and collaboration software and services. The Company develops and sells software that provides real-time collaboration and training using Web-based tools. The Company's four-product iLinc Suite, comprised of LearnLinc, MeetingLinc, ConferenceLinc and SupportLinc, is an award winning virtual classroom, Web conferencing and collaboration suite of software. With its Web collaboration, conferencing and virtual classroom products, the Company provides what it believes to be simple, reliable and cost-effective tools for remote presentations, meetings and online events. The Company's software is based on a proprietary architecture and code that finds its origins as far back as 1994, in what it believes to be the beginnings of the Web collaboration industry. Versions of the iLinc Suite have been translated into six languages, and it is currently available in Version 8.01. The Company's customers may choose from several different pricing and licensing options for the iLinc Suite depending upon their needs. Uses for the four-product suite of Web collaboration software include online business meetings, sales presentations, training sessions, product demonstrations and technical support assistance. The Company sells its software solutions to large and medium-sized corporations inside and outside of the Fortune 1000. The Company markets its products using a direct sales force and an indirect distribution channel consisting of agents, distributors, value added resellers and OEM partners. The Company allows its customers to choose between purchasing a perpetual license and subscribing to a term license,

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providing for flexibility in pricing and payment methods. The Company's revenues are a mixture of high margin perpetual licenses of software and monthly recurring revenues from annual maintenance, hosting and support agreements and other products and services.

The Company maintains corporate headquarters in Phoenix, Arizona and has occupied that Class A facility since the Company's inception in 1998. The Phoenix office can accommodate up to 65 employees in approximately 9,100 square feet, and is fully equipped with computer equipment and server facilities. On May 5, 2006, the Company amended the Phoenix lease with the term extended to February 28, 2012. The Phoenix lease requires a monthly rent and operating expenses of approximately \$25,000.

The Company also maintains a 2,500 square foot Class B facility in Troy, New York with an emphasis in that location on research, development and technical support. On July 5, 2006, the Company amended the New York lease that now expires on June 30, 2009. The New York lease requires a monthly rent and operating expenses of approximately \$4,000.

In addition, the Company maintains offices in Springville, Utah, occupying a Class A facility in two adjacent buildings. The first building houses its administrative and IT functions, with 10,000 square feet of space, with the second housing the operator complex and support staff with 6,122 square feet. The Springville lease began in 2003 and has a term of five years. The Springville offices can accommodate up to 100 employees and is fully equipped with computer equipment and server facilities. The facility also provides a fully redundant co-location and server facility for audio conferencing activities and hosted Web conferencing services. The Springville lease requires a monthly rent and operating expenses of approximately \$15,000.

The Company began operations in March of 1998. Its formation included the simultaneous rollup of 50 private businesses and an initial public offering. The Company's initial goals included providing training enhancement services over the Internet using a browser based system. In 2002, the Company began shifting its focus away from its legacy business, settling on its current focus on Web conferencing and audio conferencing and in doing so ultimately changed its name to iLinc Communications, Inc. in February 2004.

The unaudited condensed consolidated financial statements included herein have been prepared by the Company, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Pursuant to such regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The Company believes the presentation and disclosures herein are adequate to make the information not misleading, but does not purport them to be a complete presentation inasmuch as all note disclosures required by generally accepted accounting principles are not included. In the opinion of management, the unaudited condensed consolidated financial statements reflect all elimination entries and normal recurring adjustments that are necessary for a fair statement of the results for the three and nine months ended December 31, 2006 and 2005.

Fiscal operating results for interim periods are not necessarily indicative of the results for full years. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the

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consolidated financial statements of the Company and related notes thereto, and management's discussion and analysis related thereto, all of which are included in the Company's annual report on Form 10-K as of and for the year ended March 31, 2006, as filed with the SEC.

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

The condensed consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

CERTIFICATE OF DEPOSIT

The Company holds various certificates of deposit at financial institutions. These certificates have maturities of seven months from the date of acquisition, which precludes them from being accounted for as a cash equivalent.

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 judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. The more significant areas requiring use of estimates and judgment relate to revenue recognition, accounts receivable valuation reserves, realizability of intangible assets, realizability of deferred income tax assets and the evaluation of contingencies and litigation. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The results of such estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

BARTER TRANSACTIONS

In accordance with APB Opinion No. 29, ACCOUNTING FOR NONMONETARY TRANSACTIONS, and SFAS No. 153, EXCHANGES ON NONMONETARY ASSETS, for the three and nine months ended December 31, 2006, the Company recorded license sale revenues as a result of certain barter transactions that involved the exchange of hardware or services from various providers. As the exchanges related to either dissimilar assets or were similar but otherwise recognizable assets, thus the exchange was considered a culmination of the earnings process, and therefore the Company recorded the sale of their software as software license revenue at the exchanged fair value of the hardware or services received.

On September 28, 2006, the Company entered into a reciprocal OEM agreement with ThinkEngine Networks, Inc., a provider of TDM and IP capable conferencing bridges and media servers. ThinkEngine purchased a private label OEM license in a barter exchange in which the Company acquired hardware conferencing bridges for use by the Company. The Company recognized \$225,000 of license revenue related to this barter transaction. The Company recorded an asset with a value of \$255,000 during the quarter ending September 30, 2006 and recorded \$17,000 of depreciation expense through December 31, 2006.

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On December 12, 2006, the Company entered into a reciprocal services agreement with Measured Progress, a provider of testing services. Measured Progress purchased iLinc Suite seats and an annual event room license in a barter exchange in which the Company acquired services and access to computer hardware for scale testing of the Company's software. The Company recognized \$60,000 of license revenue during the three month period ending December 31, 2006, and deferred \$75,000 of license revenue and \$17,000 for maintenance and hosting revenue that will be recognized over the following 12 months. The Company recorded a prepaid asset of \$152,000 and will amortize this amount over the 12 month period of the service contract.

On December 29, 2006, the Company entered into a marketing agreement with The Human Capital Institute, a provider of marketing and consulting services for human capital professionals. Human Capital purchased a perpetual named-user license room in a barter exchange in which the Company acquired certain marketing and advertising placements. The Company recognized license revenue of \$56,000 and deferred revenue of \$22,000 for maintenance and hosting. The Company recorded a prepaid asset of \$30,000 and a receivable for \$48,000 for services rendered during the three month period ending December 31, 2006.

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STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, SHARE-BASED PAYMENT ("SFAS 123R"). Under this new standard, companies will no longer be able to account for share-based compensation transactions using the intrinsic method in accordance with APB 25. Instead, companies will be required to account for such transactions using a fair-value method and to recognize the expense over the service period. SFAS 123R is effective for periods beginning after March 31, 2006 and allows for several alternative transition methods. The Company adopted SFAS 123R, effective April 1, 2006, which requires recognition of compensation expense for all stock option or other equity-based awards that vest or become exercisable after the option's effective date. The Company elected the modified prospective application transition method of adoption and, as such, prior period financial statements have not been restated. Under this method, the fair value of all stock options granted or modified after adoption must be recognized in the Condensed Consolidated Statement of Operations and total compensation cost related to non-vested awards not yet recognized, as determined under the original provisions of SFAS 123, must also be recognized in the Condensed Consolidated Statement of Operations as vesting occurs.

Prior to April 1, 2006, the Company accounted for share-based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES, and related interpretations and elected the disclosure option of SFAS No. 123 as amended by SFAS No. 148, ACCOUNTING FOR STOCK-BASED COMPENSATION - COMPENSATION AND DISCLOSURE. SFAS No. 123 requires that companies either recognize compensation expense for grants of stock, stock options and other equity instruments based on fair value, or provide pro forma disclosure of net income and earnings per share in the notes to the financial statements. Accordingly, the Company measured compensation expense for stock options as the excess, if any, of the estimated fair market value of the Company's stock at the date of grant over the exercise price.

Under SFAS 123R, the Company recognized \$33,000 and \$106,000, net of taxes, of compensation expense related to stock options and vesting of stock

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grants in the three months and nine months ended December 31, 2006, respectively. The following table summarizes stock-based compensation expense related to employee stock options and vesting of employee stock grants under SFAS 123R for the three months and nine months ended December 31, 2006, which was allocated by employee among various expense categories as follows (in thousands except per share amounts):

	THREE MONTHS ENDED DECEMBER 31, 2006
Stock-based compensation expense included:	
Cost of sales.....	\$ 3
Research and development.....	3
Sales and marketing.....	11
General and administrative.....	16
Stock-based compensation expense related to employee stock options and employee stock grants included in income from operations.....	33
Tax benefit.....	--
Stock-based compensation expense related to employee stock options and employee stock grants, net of tax.....	\$ 33
Decrease in basic earnings per share.....	\$ --
Decrease in diluted earnings per share.....	\$ --

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations for the third quarter of fiscal 2007 is based on options ultimately expected to vest, it has been reduced for expected forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

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The following table reflects net income and diluted net income per share pro forma information assuming application of SFAS 123 for the three and nine months ended December 31, 2005 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS):

	THREE MONTHS ENDED DECEMBER 31, 2005	NINE MONTHS ENDED DECEMBER 31, 2005
Net income (loss) available to common shareholders, as reported for the prior period (1)	\$ 167	\$ (1,345)
Stock-based employee compensation expense included in		

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reported net loss for the prior period	10	30
Total stock-based employee compensation expense related to employee stock options and vesting of employee stock grants, net of tax	(32)	(140)
Net income (loss) available to common shareholders, including the effect of stock-based compensation expense	\$ 145	\$ (1,455)
Basic income (loss) per common share:		
As reported for the prior period (1)	\$ 0.01	\$ (0.05)
Including the effect of stock-based compensation expense	\$ 0.01	\$ (0.06)
Diluted income (loss) per common share:		
As reported for the prior period (1)	\$ 0.01	\$ (0.05)
Including the effect of stock-based compensation expense	\$ 0.01	\$ (0.06)

- (1) Net loss and net loss per share prior to fiscal 2007 did not include stock-based compensation expense for employee stock options under SFAS 123 because the Company did not adopt the recognition provisions of SFAS 123.

Upon adoption of SFAS 123R, the Company continued to calculate the value of each employee stock option, estimated on the date of grant, using the Black-Scholes model in accordance with SFAS 123R. The weighted average fair value of employee stock options granted during the nine months ended December 31, 2006 and December 31, 2005 was \$0.38 per share and \$0.22 per share, respectively, using the following weighted-average assumptions:

	NINE MONTHS ENDED DECEMBER 31,	
	2006	2005
Risk free interest rate	4.43% - 5.11%	3.89% - 4.30%
Dividend yield	0%	0%
Volatility factors of the expected market price of the Company's common stock	97% - 109%	67% - 89%
Weighted-average expected life of Options	10 years	10 years

Stock options activity for the nine months ended December 31, 2006 was as follows:

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Options outstanding at April 1, 2006.....	2,637,864	\$1.07	
Options granted.....	598,000	\$0.42	
Options exercised.....	(19,270)	\$0.25	
Options forfeited and expired.....	(191,802)	\$0.40	
Options outstanding at December 31, 2006.....	3,024,792	\$0.99	6.24
Options exercisable at December 31, 2006.....	2,229,372	\$1.20	5.21

The aggregate intrinsic value in the table above represents total pretax intrinsic value (the difference between the Company's closing stock price on December 31, 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2006. This amount changes based on the fair market value of the Company's common stock. Total intrinsic value of options exercised for the first nine months of fiscal 2007 was \$4,780. The Company issues new shares of common stock upon the exercise of stock options.

At December 31, 2006, 1,824,570 shares were available for future grants under the Company's amended and restated Stock Compensation Plan (the "Plan").

At December 31, 2006, the Company had approximately \$174,000 of total unrecognized compensation expense, net of estimated forfeitures, related to stock option plans that will be recognized over the weighted average period of 2.46 years.

3. EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for each reporting period presented. Diluted earnings per share are computed similar to basic earnings per share while giving effect to all potential dilutive common stock equivalents that were outstanding during each reporting period. For the three and nine months ended December 31, 2006, options and warrants to purchase 2,233,444 and 2,278,444 of common stock, respectively, were excluded from the computation of diluted earnings per share because of their anti-dilutive effect. For the three months ended December 31, 2005, options and warrants to purchase 5,238,792 of common stock were excluded from the computation of diluted earnings per share because of their anti-dilutive effect and for the nine months ended December 31, 2005, options and warrants to purchase 5,298,792 of common stock were excluded from the computation of diluted loss per share because of their anti-dilutive effect.

Additionally, preferred stock and debt convertible into 9,960,000 and 10,450,000 shares of common stock for the three and nine months ended December 31, 2006 and 2005, respectively, were excluded from the computation of diluted earnings/loss per share because inclusion of such would be antidilutive. Furthermore, a restricted stock grant to James Powers, the Company's CEO, of 450,000 shares has been excluded from the earnings per share calculations for the three and nine months ended December 31, 2006 and 2005 because the measurement date stock price exceeds the average stock price for all periods presented.

4. GOODWILL AND INTANGIBLE ASSETS, NET

Goodwill consisted of the following:

DECEMBER	MARCH 31,
31, 2006	2006

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	(IN THOUSANDS)	
Goodwill.....	\$ 11,206	\$ 11,206
	=====	=====

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Intangible assets consisted of the following:

	DECEMBER 31, 2006			
	WEIGHTED AVERAGE REMAINING LIVES	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	N
	(YEARS)		(IN THOUSANDS)	
AMORTIZED INTANGIBLE ASSETS:				
Deferred financing costs	4.78	\$ 926	\$ (383)	\$
Purchased software	0.42	1,481	(1,370)	
Customer relationships	3.42	1,230	(547)	
Capitalized software development costs	--	295	--	
		\$ 3,932	\$ (2,300)	\$
		=====	=====	

	MARCH 31, 2006			
	WEIGHTED AVERAGE REMAINING LIVES	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	N
	(YEARS)		(IN THOUSANDS)	
AMORTIZED INTANGIBLE ASSETS:				
Deferred financing costs	5.10	\$ 1,080	\$ (493)	\$
Purchased software	1.17	1,481	(1,169)	
Customer relationships	4.17	1,230	(398)	
		\$ 3,791	\$ (2,060)	\$
		=====	=====	

As a result of the debt extension treated as a debt extinguishment in accordance with EITF 96-19 DEBTOR'S ACCOUNTING FOR A MODIFICATION OR EXCHANGE OF DEBT INSTRUMENTS, the Company recorded in December 2006, \$272,000 of gross deferred financing costs and \$232,000 of accumulated amortization of deferred financing costs were written off to loss on extinguishment of debt.

CAPITALIZATION OF SOFTWARE DEVELOPMENT COSTS

In May of 2006, the Company began production of version 9.0 of its Web collaboration software. In accordance with SFAS No. 86 ACCOUNTING FOR THE COSTS OF COMPUTER SOFTWARE TO BE SOLD, LEASED, OR OTHERWISE MARKETED, the Company began capitalizing certain direct and indirect software development costs that included expenses related to employee payroll costs, consultant fees, dedicated computer hardware costs and specialized software license costs associated with

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this project. As of December 31, 2006, the Company capitalized costs totaling \$295,000. When version 9.0 is complete and released to customers then the Company will begin amortization of these capitalized costs, using straight line amortization over a three year period.

5. ACCRUED LIABILITIES

Accrued liabilities consisted of the following:

	DECEMBER 31,
	2006
	(IN THOUSANDS)
Accrued state sales tax.....	\$ 73
Accrued interest.....	280
Amounts related to acquisitions.....	--
Accrued salaries and related benefits.....	365
Amount payable to third party providers.....	309
Amount payable to Interactive Alchemy.....	203
Deferred rent liability.....	7
Liabilities from discontinued operations.....	--
Other.....	40
Total accrued liabilities.....	\$ 1,277

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6. LONG-TERM DEBT

Long-term debt consisted of the following:

	DECEMBER 31,	MAR
	2006	2
	(IN THOUSANDS)	
2002 Convertible redeemable unsecured subordinated notes.....	\$ 5,100	\$ 5
2004 Senior unsecured notes.....	2,962	2
IPO shareholders' notes payable.....	51	
Other notes payable.....	432	
	8,545	8
Less: Current portion of long-term debt.....	(483)	
Discount.....	(521)	
Beneficial conversion feature.....	(521)	
Long-term debt, net of current portion.....	\$ 7,020	\$ 6

In March 2002, the Company completed a private placement offering (the "Convertible Note Offering") raising capital of \$5,775,000 that was used to extinguish an existing line of credit. Under the terms of the Convertible Note Offering, the Company issued unsecured subordinated convertible notes (the "Convertible Notes"). The Convertible Notes bear interest at the rate of 12% per

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annum and require quarterly interest payments, with the principal due at maturity on March 29, 2012. The holders of the Convertible Notes may convert the principal into shares of the Company's common stock at the fixed price of \$1.00 per share. The Company may force redemption by conversion of the principal into common stock at the fixed conversion price, if at any time the 20 trading day average closing price of the Company's common stock exceeds \$3.00 per share. The notes are subordinated to any present or future senior indebtedness. As a part of the Convertible Note Offering the Company also issued warrants to purchase 5,775,000 shares of the Company's common stock for an exercise price of \$3.00 per share. Those warrants expired on March 29, 2005 without exercise. The fair value of the warrants was estimated using a Black-Scholes pricing model with the following assumptions: contractual and expected life of three years, volatility of 75%, dividend yield of 0% and a risk-free rate of 3.87%. A discount to the Convertible Notes of \$1,132,000 was recorded using this value, which is being amortized to interest expense over the 10-year term of the Convertible Notes. As the carrying value of the notes is less than the conversion value, a beneficial conversion feature of \$1,132,000 was calculated and recorded as an additional discount to the notes and is being amortized to interest expense over the 10 year term of the Convertible Notes. Upon conversion, any remaining discount and beneficial conversion feature will be expensed in full at the time of conversion. During fiscal 2004, holders with a principal balance totaling \$150,000 converted their notes into 150,000 common shares of the Company. During fiscal 2006, holders with a principal balance of \$525,000 converted their notes and \$8,000 of accrued interest into 1,971,088 shares of the Company's common stock that had been registered with the SEC at a price of \$0.25, \$0.26 and \$0.30 per share. Since the actual conversion price for the convertible debt was less than the fixed conversion price of \$1.00, the Company recorded conversion expense of \$338,000 for the year ended March 31, 2006. During fiscal 2006, the Company accelerated the amortization of the deferred offering costs and the discount and beneficial conversion feature associated with the debt by expensing \$50,000 and \$137,000, respectively at the time of conversion. No conversion of debt or acceleration of amortization of costs occurred during the three and nine months ended December 31, 2006 for the Convertible Note Offering.

In April of 2004, the Company completed a private placement offering of unsecured senior notes (the "2004 Senior Note Offering") that provided gross proceeds of \$4.25 million. Under the terms of the 2004 Senior Note Offering, the Company issued \$3,187,000 in unsecured senior notes and 1,634,550 shares of the Company's common stock. The senior notes were issued as a series of notes pursuant to a unit purchase and agency agreement. The senior notes are unsecured. The placement agent received a commission equal to 10% of the gross proceeds together with a warrant for the purchase of 163,455 shares of the Company's common stock with an exercise price equal to 120% of the price paid by investors. The senior notes bear interest at a rate of 10% per annum and accrued interest is due and payable on a quarterly basis beginning July 15, 2004, with principal due at maturity on July 15, 2007. The senior notes are redeemable by the Company at 100% of the principal value at any time after July 15, 2005. The notes and common stock were issued with a debt discount of \$768,000. The fair value of the warrants was estimated and used to calculate a discount of \$119,000

of which \$68,000 was allocated to the notes and \$51,000 was allocated to equity. The total discount allocated to the notes of \$836,000 is being amortized as a component of interest expense over the term of the notes which is approximately 39 months. The senior notes are unsecured obligations of the Company but are senior in right of payment to all existing and future indebtedness of the

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Company. The common stock issued in the 2004 Senior Note Offering was registered with the SEC pursuant to a resale prospectus dated August 2, 2005. Effective August 1, 2005, holders with a principal balance totaling \$225,000 converted their senior notes and accrued interest of \$800 into 903,205 shares of the Company's common stock at a price of \$0.25 per share. Since the actual conversion price for the debt was greater than the market value of the stock at the date of conversion, the Company recorded a gain on conversion of \$9,000 for the period ended December 31, 2005. During fiscal 2006, the Company accelerated the amortization of the deferred offering costs and the discount associated with the debt by expensing \$10,000 and \$35,000, respectively at the time of conversion. On November 9, 2005, placement agent warrants originally issued with an exercise price of \$0.78 per common share were converted to 163,455 common shares at an exercise price of \$0.25 per share, in which the Company received \$41,000 in cash. The transaction resulted in an increase in deferred offering costs of \$7,000 and an adjustment to additional paid-in capital of \$7,000. No conversion of debt to equity or acceleration of amortization of costs related to such conversions occurred during the three and nine months ended December 31, 2006. In December, 2006, the Company negotiated a modification of the terms of the senior notes to extend the maturity date from July 15, 2007 to July 15, 2010. In exchange for the extension, the interest rate increased from 10% per annum to 12% per annum, with the new, increased interest rate to begin to accrue under the amendment on January 16, 2007, and continue thereafter at that rate until maturity or the senior note is fully paid. All other terms and provisions of the senior notes remained unchanged. The placement agent received a commission of \$87,000 together with a warrant of the purchase of 100,000 shares of the Company's common stock with an exercise price of \$0.66 per share. The warrant is effective as of December 15, 2006 and has a three year term. The note agent received an expense reimbursement of \$14,000. In accordance with EITF 96-19, DEBTOR'S ACCOUNTING FOR A MODIFICATION OR EXCHANGE OF DEBT INSTRUMENTS, the debt extension was accounted for as an extinguishment of the existing debt and the creation of the new debt. As a result, the Company recorded a one-time loss on extinguishment of debt of \$160,000 resulting from the acceleration of interest expense accounted for as debt discount and deferred offering costs under the original terms of the senior debt. The direct expenses of \$101,000 and the estimated fair value of the warrant of \$42,000 were recorded as a deferred offering cost and both will be amortized as a component of interest expense over the term of the notes.

The aggregate maturities of long-term debt excluding capital leases for each of the next five years subsequent to December 31, 2006 were as follows (IN THOUSANDS):

2007.....	\$	483
2008.....		--
2009.....		--
2010.....		--
2011.....		2,962
Thereafter.....		5,100

	\$	8,545
		=====

7. CAPITALIZATION

On June 9, 2006, the Company completed a private placement of 5,405,405 unregistered, restricted shares of common stock providing \$2.0 million in gross cash proceeds. The Company intends to use the proceeds for working capital and general corporate purposes. The Company paid its placement agent an underwriting commission of \$185,000 of which \$25,000 was recorded as deferred offering costs, and incurred additional offering expenses of approximately \$103,000. Pursuant to the registration rights agreement between the parties, the Company filed a Registration Statement on Form S-3 to enable the resale of the shares by the

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investors which was declared effective on September 29, 2006.

On September 16, 2003, the Company completed its private placement of series A convertible preferred stock (the "Series A Preferred Stock") with detachable warrants. The Company sold 30 units at \$50,000 each and raised a total of \$1,500,000. Each unit consisted of 5,000 shares of Series A Preferred Stock, par value \$0.001 and a warrant to purchase 25,000 shares of common stock. The Series A Preferred Stock is convertible into the Company's common stock at a price of \$0.50 per share, and the warrants are immediately exercisable at a price of \$1.50 per share with a three-year term. Accordingly, each share of preferred stock is convertible into 20 shares of common stock and retains a \$10 liquidation preference. The Company pays an 8% dividend to holders of the Series A Preferred Stock, and the dividend is cumulative. The Series A Preferred Stock is non-voting and non-participating. The shares of Series A Preferred Stock will not be registered under the Securities Act of 1933, as amended, and were offered

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in a private placement providing exemption from registration. The cash proceeds of the private placement of Series A Preferred Stock were allocated pro rata between the relative fair values of the Series A Preferred Stock and warrants at issuance using the Black-Scholes valuation model for valuing the warrants. The aggregate value of the warrants and the beneficial conversion discount of \$247,000 are considered a deemed dividend in the calculation of loss per share. During the 2005 fiscal year, holders of 22,500 shares of Series A Preferred Stock converted those shares into 450,000 shares of the Company's common stock. During fiscal 2007, holders of 12,500 shares of series A Preferred Stock converted those shares into 250,000 shares of the Company's common stock. The underlying common stock that would be issued upon conversion of the Series A Preferred Stock and upon exercise of the associated warrants have been registered with the SEC and may be sold pursuant to a resale prospectus dated May 24, 2004.

On September 30, 2005, the Company executed definitive agreements with nine investors to issue 70,000 unregistered shares of its Series B Preferred Stock, par value \$0.001 (the "Series B Preferred Stock") and warrants to purchase 700,000 shares of its common stock (the "Warrants") in a private transaction that was exempt from registration under Section 4(2) of the Securities Act of 1933. The Series B Preferred Stock bears an 8% dividend, was sold using a deemed \$10.00 per share issue price, and is convertible into 2,800,000 shares of the Company's common stock using a conversion price of \$0.25 per share. The Warrants that are exercisable at an exercise price equal to \$0.50 per share expire on the third anniversary of the issue date of September 30, 2005. The aggregate value of the warrants of \$55,000 is considered a deemed dividend in the calculation of loss per share. During fiscal 2007, holders of 6,000 shares of series B Preferred Stock converted those shares into 240,000 shares of the Company's common stock

8. INCOME TAX EXPENSE FROM CONTINUING OPERATIONS

There is no tax benefit or provision in the accompanying Condensed Consolidated Statements of Operations during the three and nine months ended December 31, 2006 or 2005 because the Company concluded it is not likely it would be able to recognize the tax asset created due to historical losses. The Company will continue to evaluate the likelihood of the realization of that tax asset as operations continue to improve and profitability rises, and the Company believes that if current profitability trends continue that the Company will

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realize a portion of the net tax asset. At December 31, 2006 and March 31, 2006, the Company has net deferred tax assets of \$15.7 million and \$15.9 million, respectively, with corresponding valuation allowances. The Company's tax assets are scheduled to expire over a period of five to twenty years.

9. STOCK OPTION PLANS AND WARRANTS

The Company grants stock options under its amended and restated Stock Compensation Plan. The Company recognizes stock-based compensation issued to employees at the intrinsic value between the exercise price of options granted and the fair value of stock for which the options may be exercised. However, pro forma disclosures as if the Company recognized stock-based compensation at the fair value of the options themselves are presented below.

Under the Plan, as amended, the Company is authorized to issue 5,500,000 shares of common stock pursuant to "Awards" granted to officers and key employees in the form of stock options.

There were 3,024,792 options outstanding under the Plan at December 31, 2006. The Compensation Committee of the Board of Directors administers the Plan. Stock options granted to employees have a contractual term of 10 years (subject to earlier termination in certain events) and have an exercise price no less than the fair market value of the Company's common stock on the date of grant. The options vest at varying rates over a one to five year period.

Following is a summary of the status of the Company's stock options as of December 31, 2006:

	NUMBER OF SHARES UNDERLYING OPTIONS	WEIGHTED AVERAGE EXERCISE PRICES	WEIGHTED AVERAGE EXERCISE PRICES
Outstanding at March 31, 2006.....	2,637,864	\$1.07	
Granted.....	598,000	\$0.42	
Exercised.....	(19,270)	\$0.25	
Forfeited and expired.....	(191,802)	\$0.40	
Outstanding at December 31, 2006.....	3,024,792	\$0.99	

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

				OPTIONS OUTSTANDING			OPTIONS EXERCISED	
				NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	NUMBER OF SHARES	
\$	0.24	-	\$ 0.36	393,052	\$ 0.25	8.74	196,616	
\$	0.39	-	\$ 0.59	1,438,642	\$ 0.46	6.89	916,242	
\$	0.64	-	\$ 0.96	569,000	\$ 0.74	6.81	496,666	
\$	1.00	-	\$ 1.50	44,125	\$ 1.15	5.98	39,875	
\$	1.94	-	\$ 2.91	490,000	\$ 2.18	2.53	490,000	

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\$	6.13	-	\$	9.19	89,973	\$	7.71	1.67	89,973

					3,024,792				
					=====				

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following assumptions: contractual and expected life of three years, volatility of 125%, dividend yield of 0% and a risk-free rate of 4.83%. On April 1, 2006, the expiration dates of the warrants issued in January 2005 and June 2005 were extended to March 31, 2009. Based on an analysis using the Black-Scholes pricing model, no adjustment was made to the fair value of the two extended warrants.

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On July 1, 2006, the Company issued a warrant for up to 1,000,000 shares of the Company's common stock, par value \$0.001 per share, with an exercise price of \$0.55 per share to an agent of the Company in connection with an agent agreement effective June 30, 2006. The warrant expires on July 1, 2011. The warrant is subject to vesting provisions based on net collected revenue targets achieved through the agent and certain value added resellers over a five-year period. As of December 31, 2006, none of the revenue targets had been achieved. In accordance with EITF 96-18: ACCOUNTING FOR EQUITY INSTRUMENTS THAT ARE ISSUED TO OTHER THAN EMPLOYEES FOR ACQUIRING, OR IN CONJUNCTION WITH SELLING, GOODS AND SERVICES, the Company recorded a prepaid asset and corresponding additional paid-in capital of \$450,000 as the fair value of the 1,000,000 shares at December 31, 2006 using the Black-Scholes pricing model with the following assumptions: contractual and expected life of 4.50 years, volatility of 102%, dividend yield of 0% and a risk-free rate of 4.70%.

10. COMMITMENTS AND CONTINGENCIES

The Company is subject to various commitments and contingencies as described in Note 13 to the condensed consolidated financial statements in the Company's Annual Report on Form 10-K as of and for the year ended March 31, 2006. During the nine-month period ended December 31, 2006, the following changes occurred with respect to certain of the Company's commitments and contingencies:

ROYALTY AGREEMENTS

In conjunction with the acquisition of certain assets from Mentergy, Inc. ("Mentergy"), the Company agreed to provide a royalty earn-out payment that is due upon collection of cash received from the sales of its Web conferencing software. The Company accounts for any such amounts collected as additional purchase consideration in accordance with EITF 95-8: ACCOUNTING FOR CONTINGENT CONSIDERATION PAID TO THE SHAREHOLDERS OF AN ACQUIRED ENTERPRISE IN A PURCHASE BUSINESS COMBINATION at the time such amounts are accrued as revenue. The Company had accrued Mentergy royalties totaling \$186,000 and \$890,000 as of December 31, 2006 and March 31, 2006, respectively. On October 10, 2005, Mentergy and the Company executed a payment agreement that provides, notwithstanding the termination of the royalty accrual, negotiated payment terms that would require an initial payment followed by installment payments and a balloon payment for the entire remaining balance, but with the accrual of additional royalties terminating as originally intended on November 4, 2005. As of December 31, 2006, the Company paid \$951,000, net of interest, and offset maintenance amounts due of \$8,000, to Mentergy and others due a portion of this royalty, in accordance with the payment agreement with the outstanding balance due to Mentergy and others of \$184,000 net of interest.

LEASE COMMITMENTS

On July 5, 2006, the Company amended the lease on its New York location, which had expired December 31, 2005. The new lease term is effective July 1, 2006 through June 30, 2009. Under the terms of the new lease the monthly rent is approximately \$4,000 per month.

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On May 5, 2006, the Company amended the lease on its Phoenix location, which was set to expire February 28, 2007. The term was extended to February 28, 2012, the square footage was reduced to 9,100 and the related rent expense was therefore reduced as a result of the amendment. After this amendment, the Phoenix lease requires a monthly rent and operating expenses of approximately \$25,000.

The lease related to the Springville location expires in January 2, 2008 and requires a monthly rent and operating expenses of approximately \$15,000.

11. DISCONTINUED OPERATIONS

Effective January 1, 2004, the Company discontinued its practice management services segment. In accordance with SFAS 144 ACCOUNTING FOR IMPAIRMENT ON DISPOSAL OF LONG-LIVED ASSETS, the Company has restated its historical results to reflect its practice management service business segment as a discontinued operation. For the three months ended December 31, 2006 and December 31, 2005, the Company had net income of \$0 and \$70,000, respectively. For the nine months ended December 31, 2006 and December 31, 2005, the Company had net income from discontinued operations of \$10,000 and \$82,000, respectively.

12. BUSINESS COMBINATIONS

As part of the Glyphics acquisition, the Company recorded estimates of assumed liabilities that might necessitate payment to certain Glyphics vendors. After further review and confirmation from certain of those Glyphics vendors, the Company determined during the three months ended September 30, 2005 and the three months ended December 31, 2005, that those liabilities would not be

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realized. Therefore, \$250,000 and \$106,000 were recorded as a one-time elimination of the liabilities and a corresponding reduction in cost of software and audio services revenues was recorded in the second and third quarters of fiscal 2006, respectively. In addition, \$7,000 in consulting fees and \$81,000 in tax liabilities were recorded as a one-time elimination of those liabilities and a corresponding reduction in general and administrative expenses during the second and third quarter of fiscal 2006, respectively. There were no comparable write offs in the current year.

The Company was able to negotiate settlements with the relevant vendors of certain of the assumed liabilities from the Glyphics. As a result, liabilities of \$167,000 were eliminated and the corresponding reduction in costs was recorded as other income as a one-time reduction in costs for the three months ended December 31, 2005. There were no comparable reductions in the current year.

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

STATEMENTS CONTAINED IN THIS QUARTERLY REPORT ON FORM 10-Q THAT INVOLVE WORDS LIKE "ANTICIPATES," "EXPECTS," "INTENDS," "PLANS," "BELIEVES," "SEEKS," "ESTIMATES," AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, THE SECURITIES ACT OF 1933, AS AMENDED, AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE ARE STATEMENTS THAT RELATE TO FUTURE PERIODS AND

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INCLUDE, BUT ARE NOT LIMITED TO, STATEMENTS AS TO OUR ABILITY TO: SELL OUR PRODUCTS AND SERVICES; IMPROVE THE QUALITY OF OUR SOFTWARE; DERIVE OVERALL BENEFITS OF OUR PRODUCTS AND SERVICES; INTRODUCE NEW PRODUCTS AND VERSIONS OF OUR EXISTING PRODUCTS; SUSTAIN AND INCREASE REVENUE; INTEGRATE CURRENT AND EMERGING TECHNOLOGIES; CONTROL OUR EXPENSES; CONTROL CHANGES IN OUR CUSTOMER BASE; CONTROL CHANGES IN OUR EMPLOYEE HEADCOUNT; MANAGE LIQUIDITY AND CAPITAL RESOURCES; REALIZE POSITIVE CASH FLOW FROM OPERATIONS; OR REALIZE NET EARNINGS.

SUCH FORWARD-LOOKING STATEMENTS INVOLVE CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM ANTICIPATED RESULTS. THESE RISKS AND UNCERTAINTIES INCLUDE, BUT ARE NOT LIMITED TO, OUR DEPENDENCE ON OUR PRODUCTS OR SERVICES, MARKET DEMAND FOR OUR PRODUCTS AND SERVICES, OUR ABILITY TO ATTRACT AND RETAIN CUSTOMERS AND CHANNEL PARTNERS, OUR ABILITY TO EXPAND OUR TECHNOLOGICAL INFRASTRUCTURE TO MEET THE DEMAND FROM OUR CUSTOMERS, OUR ABILITY TO RECRUIT AND RETAIN QUALIFIED EMPLOYEES, THE ABILITY OF CHANNEL PARTNERS TO SUCCESSFULLY RESELL OUR PRODUCTS, THE STATUS OF THE OVERALL ECONOMY, THE STRENGTH OF COMPETITIVE OFFERINGS, THE PRICING PRESSURES CREATED BY MARKET FORCES, AND THE OTHER RISKS DISCUSSED HEREIN (SEE ITEM 2 "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS"). ALL FORWARD-LOOKING STATEMENTS INCLUDED IN THIS REPORT ARE BASED ON INFORMATION AVAILABLE TO US AS OF THE DATE HEREOF. WE EXPRESSLY DISCLAIM ANY OBLIGATION OR UNDERTAKING TO RELEASE PUBLICLY ANY UPDATES OR REVISIONS TO ANY FORWARD-LOOKING STATEMENTS CONTAINED HEREIN, TO REFLECT ANY CHANGE IN OUR EXPECTATIONS OR IN EVENTS, CONDITIONS OR CIRCUMSTANCES ON WHICH ANY SUCH STATEMENT IS BASED. READERS ARE URGED TO CAREFULLY REVIEW AND CONSIDER THE VARIOUS DISCLOSURES MADE IN THIS REPORT AND IN OUR OTHER REPORTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION (THE "SEC") THAT ATTEMPT TO ADVISE INTERESTED PARTIES OF CERTAIN RISKS AND FACTORS THAT MAY AFFECT OUR BUSINESS. OUR REPORTS ARE AVAILABLE FREE OF CHARGE AS SOON AS REASONABLY PRACTICABLE AFTER SUCH MATERIAL IS ELECTRONICALLY FILED WITH THE SEC AND MAY BE OBTAINED EITHER FROM THE SEC AT THEIR WEB SITE LOCATED AT WWW.SEC.GOV, OR THROUGH OUR WEB SITE LOCATED AT WWW.ILINC.COM.

OVERVIEW

Headquartered in Phoenix, Arizona, iLinc Communications, Inc. is a leading provider of Web conferencing, audio conferencing and collaboration software and services. We develop and sell software that provides real-time collaboration and training using Web-based tools. Our four-product iLinc Suite, comprised of LearnLinc, MeetingLinc, ConferenceLinc and SupportLinc, is an award winning virtual classroom, Web conferencing and collaboration suite of software. With our Web collaboration, conferencing and virtual classroom products, we provide what we believe to be simple, reliable and cost-effective tools for remote presentations, meetings and online events. Our software is based on a proprietary architecture and code that finds its origins as far back as 1994, in what we believe to be the beginnings of the Web collaboration industry. Versions of the iLinc Suite have been translated into six languages, and it is currently available in Version 8.01. Our customers may choose from several different pricing and licensing options for the iLinc Suite depending upon their needs. Uses for our four-product suite of Web collaboration software include online

business meetings, sales presentations, training sessions, product demonstrations and technical support assistance. We sell our software solutions to large and medium-sized corporations inside and outside of the Fortune 1000. We market our products using a direct sales force and an indirect distribution channel consisting of agents, distributors, value added resellers and OEM partners. We allow customers to choose between purchasing a perpetual license and subscribing to a term license, providing for flexibility in pricing and

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payment methods. Our revenues are a mixture of high margin perpetual licenses of software and monthly recurring revenues from annual maintenance, hosting and support agreements and other products and services.

PRODUCTS AND SERVICES

WEB CONFERENCING AND WEB COLLABORATION

The iLinc Suite is a four-product suite of software that addresses the most common business collaboration needs.

LearnLinc is an Internet-based software that is designed for training and education of remote students. With LearnLinc, instructors and students can collaborate and learn remotely providing an enhanced learning environment that replicates and surpasses traditional instructor-led classes. Instructors can create courses and classes, add varied agenda items, enroll students, deliver live instruction and deliver content that includes audio, video and interactive multimedia. In combination with TestLinc, LearnLinc permits users to administer comprehensive tests, organize multiple simultaneous breakout sessions and record, edit, play back and archive entire sessions for future use.

MeetingLinc is an online collaboration software designed to facilitate the sharing of documents, PowerPoint(TM) presentations, graphics and applications between meeting participants without leaving their desks. MeetingLinc allows business professionals, government employees and educators to communicate more effectively and economically through interactive online meetings using Voice-over IP technology to avoid the expense of travel and long distance charges. MeetingLinc allows remote participants to give presentations, demonstrate their products and services, annotate on virtual whiteboards, edit documents simultaneously and take meeting participants on a Web tour. Like all of the Web collaboration products in the Suite, MeetingLinc includes integrated voice and video conferencing services.

ConferenceLinc is a presentation software designed to deliver the message in a one-to-many format providing professional management of Web conferencing events. ConferenceLinc manages events such as earnings announcements, press briefings, new product announcements, corporate internal mass communications and external marketing events. ConferenceLinc is built on the MeetingLinc software platform and code to combine the best interactive features with an easy-to-use interface providing meaningful and measurable results to presenters and participants alike. Its design includes features that take the hassle out of planning and supporting a hosted Web seminar. ConferenceLinc includes automatic email invitations, "one-click join" capabilities, online confirmations, update notifications and customized attendee registration. With ConferenceLinc, presenters may not only present content, but may also gain audience feedback using real-time polling, live chat, question and answer sessions and post-event assessments. The entire presentation is easily recordable for viewing offline and review after the show with the recorder capturing the content and the audio, video and participant feedback.

SupportLinc is an online technical support and customer sales support software designed to give customer service organizations the ability to provide remote hands-on support for products, systems or software applications. SupportLinc manages the support call volume and enhances the effectiveness of traditional telephone-based customer support systems. SupportLinc's custom interface is designed to be simple to use so as to improve the interaction and level of support for both customers and their technical support agents.

Our Web collaboration software is sold on a perpetual license or periodic license basis. A customer may choose to acquire a one-time perpetual license (the "Purchase Model") or may rent our software on a periodic basis on either a per-seat, per-month or per-minute basis (the "Subscription Model").

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Should they choose to acquire the software using the Purchase Model, then they may either elect to host our software behind their own firewall or they may choose to have iLinc host it for them, depending upon their preferences, budget and IT capabilities. Customers who select the Purchase Model, whether hosted by iLinc or the customer, may also subscribe for ongoing customer support and maintenance and software upgrade services, using a support and maintenance

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contract with terms from one to five years. The annual maintenance and support fee charged is initially based upon a percentage of the purchase price that varies between 12% and 18% of the purchase license fee paid for the perpetual licenses, with the percentage depending upon the contractual length and pre-payment of the annual maintenance and support agreement. If a customer chooses to have iLinc host their Purchase Model licenses, then the customer is also charged an annual hosting fee equal to 10% of the Purchase Model License fee that was paid for the perpetual license.

During fiscal 2006, iLinc launched its Enterprise Unlimited perpetual licensing model that enables customers to pay a one-time up-front fee for unlimited, organization-wide Web conferencing, as well as a named-user model that permits a host to subscribe for a limited use room. Those customers who qualify for the iLinc Enterprise Unlimited site license may subscribe to an unlimited use license. The initial iLinc Enterprise Unlimited license fee is determined based upon the number of employees within the customer's organization and various other factors. The annual maintenance and support fees and hosting fees associated with an iLinc Enterprise Unlimited license are then based upon a fixed rate per-seat license that is active on each annual anniversary of the iLinc Enterprise Unlimited license agreement. Customers may expand the number of active seats available to them at any time with a corresponding increase in annual maintenance and hosting fees being charged.

Customers choosing the Subscription Model pay per seat (concurrent connection) on either a per-month or per-year basis depending upon the length and term of the subscription agreement. Hosting and maintenance are included as a part of the monthly or annual rental fees. Customers may also obtain Web conferencing and audio conferencing on a per-minute basis using the iLinc On-Demand product. Those choosing the iLinc On-Demand product pay on a monthly basis typically without contractual commitment.

AUDIO CONFERENCING

The Company also delivers comprehensive audio conferencing solutions that help businesses provide virtual meetings, corporate events, distance learning programs and daily conference calls. Our audio conferencing offering includes a wide array of services and products that include the following:

- o AUDIO ON-DEMAND (NO RESERVATIONS NEEDED): With pre-established calling accounts for each user, you can create or participate in conference calls with no advance notice, 24/7;
- o RESERVED AUTOMATED: The solution for recurring calls, each participant has a permanent number and passcode;
- o OPERATOR ASSISTED: For important calls, this service includes an iLinc conference operator to host, monitor and coordinate the call; and,

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- o **ONLINE SEMINARS:** High-quality event services that include invitation and user management, scripting, presentation preparation, post show distribution and dedicated operator assistance from iLinc.

Customers may purchase our audio conferencing products and services without an annual contract commitment on a monthly recurring usage basis, and often subscribe for a fixed per-minute rate.

iLinc expects to launch version 8.5 of the iLinc Suite(TM) in mid February as a fully integrated voice and Web conferencing system allowing customers to manage all aspects of the audio and Web session, including the audio conferencing aspect of the conference as a result of a deeper integration with an audio conferencing bridge using its API. With this integration, iLinc customers will be able to choose between use of traditional telephone conferencing or voice-over-IP (VOIP) conferencing.

OTHER PRODUCTS AND SERVICES

In addition to the iLinc Suite of products and services, we offer to our customers an array of e-Learning and training products and services. We offer training software products that, like iLinc, promote online collaboration with products that integrate with our LearnLinc software. These include: TestLinc which is an assessment and quizzing tool that allows for formal testing and evaluation of students and i-Canvas, which is a training content development software that allows non-technical training professionals to create Web-based

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training courses without programming. i-Canvas is sold on an individual user perpetual license basis. We offer custom content development services through a subcontractor relationship. We also offer a library of online courses focused upon the training of executives on essential business topics. Our off-the-shelf online library of content includes an online mini-MBA program co-developed with the Tuck School of Business at Dartmouth College.

INDUSTRY TRENDS

Industry analyst Frost and Sullivan in their recent World Web Conferencing Market report separates the Web conferencing vendor community into distinct groups that include: service providers ("Service Providers") and software providers ("Software Providers"). The difference between Service Providers and Software Providers is that the Service Providers effectively only offer Web conferencing as a service or rental model basis. However, Software Providers offer Web conferencing as a solution that can be purchased and owned by customers (whether the software is installed internally by customers or hosted by the software provider). iLinc is one of the only providers that effectively competes in both the Service Provider and Software Provider markets. While we also offer our iLinc Suite on a subscription or per-minute service, the predominate licensing arrangement selected by our customer base remains the Purchase Model. The Web conferencing software market is the faster growing segment, representing about \$227 million of the current Web conferencing market. A Frost and Sullivan forecast projects a 40% Compound Annual Growth Rate ("CAGR") between 2002 and 2010 (as compared with the service provider market which is projected to grow at a 22% CAGR for the same time period). The Software Provider market, based upon its higher growth rate, is expected to outgrow the

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Service Provider market by the end of 2009.

Another important trend in the industry is the convergence of communication technologies such as audio and Web conferencing and the increase in demand for a single source for both of these capabilities. Frost and Sullivan has noted, in a separate report on audio conferencing, that the demand for integrated audio, Web, and video conferencing solutions continues to surge as end user needs for easy-to-use, single-source solutions swell. Developing and providing a truly converged user environment and experience, including the integration of audio, Web and video conferencing technologies, is essential. With the addition of audio conferencing capabilities, we have been able to provide a single source for deeply integrated Web, audio, video as well as Voice-over IP. Increasingly, the option a vendor chooses for Web conferencing determines their selection for audio conferencing. We believe we have already made significant progress in selling audio conferencing to the iLinc customer base and we actively cross sell all of our products and services to all customers. We believe that another benefit of the integrated conferencing approach is customer retention. According to the same Frost and Sullivan report, when Web conferencing and audio conferencing are sold together as an integrated package there is a significant increase in retention of the audio conferencing service. We are continuing to create incentives for our audio customers to be both Web and audio customers to drive this retention.

MARKET POSITION - DIFFERENTIATORS

We view our position in the market as the best solution for the enterprise-wide buyer that has already adopted Web conferencing, as well as organizations that believe their usage of Web conferencing will grow quickly. As mentioned earlier, a growing number of these organizations are using four or more different vendors for Web or audio conferencing services and, therefore, not realizing the economies of scale that consolidating to one or two vendors for these services can provide. There are also other important considerations revolving around Web conferencing such as security and bandwidth availability that are forcing the buying decision for Web and audio conferencing out of the business units and into the IT department. We believe that our solution uniquely maps to critical IT requirements among these mature buyers in four important areas.

First, we offer WEB CONFERENCING SOFTWARE WITH FLEXIBLE LICENSING OPTIONS that allows organizations to pay a one-time license fee to install the software inside of their environment, or to purchase perpetual licenses and have those licenses hosted in our co-location facility. We find this flexibility to be an important differentiator to address the needs of customers that are ready to make an enterprise-wide decision as well as customers that think their usage may grow throughout their organization. We believe this licensing structure also enables us to maintain a consistent revenue stream of smaller sized purchases while also winning larger enterprise-wide deals that help substantially increase revenue growth.

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Second, we believe we offer the HIGHEST LEVEL OF DATA SECURITY commercially available. We believe that we are the only Web conferencing provider that offers a customer-hosted solution with a purchase license option and true point-to-point security with our unique combination of Advanced Encryption Standard and secure socket layer (SSL). All information within a session can be transmitted between meeting attendees securely without any

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reduction in performance. We believe this aspect of our software has been extremely attractive to government, military and financial organizations, as well as to the companies that supply to these entities. We also believe that this solution, combined with other aspects of our software, enables us to be a more reliable solution than our Web conferencing software competitors.

Third, our solution is SUITABLE AND SCALABLE FOR ENTERPRISE-WIDE DEPLOYMENT. The iLinc Suite contains four modes that address the most common needs for business collaboration within the enterprise. We offer virtual classroom software with our LearnLinc mode, presentation and sales demonstration capabilities with MeetingLinc, customer support with SupportLinc, and a mode for Web casts and marketing events with ConferenceLinc. Each of these modes shares a common interface enabling users of one mode to easily understand any of our other modes. We believe this reduces the learning curve for Web conferencing enterprise-wide roll out and we believe increases adoption success. All users can have access to all four modes of the suite. This is an important differentiation because our competition typically charges separate licensing fees for the use of separate modes. Giving users access to the full suite supports the natural migration of Web conferencing usage from department to department. Each of the modes has functionality built specifically for a particular type of activity.

Fourth, we provide what we believe to be an EXCEPTIONAL "TOTAL COST OF OWNERSHIP" VALUE. Our software and services are competitively priced but, unlike our competitors, a customer's installation of our product is a very short and non-labor intensive process. Maintenance of our software also requires minimal attention from an IT perspective. We believe most of our Web conferencing software competitors require very complex and costly implementations.

We believe that all of these factors make our solution compelling to organizations that have already adopted the practice of Web conferencing as a best practice as well as companies that are just starting to use Web conferencing, but anticipate that their usage will grow quickly. We recognize that in order to grow our market share we need to develop products that are easy to implement and that scale with our customer needs.

SALES AND MARKETING FOCUS

To leverage these advantages, our organization continually creates new marketing and sales campaigns that focus in four target markets.

- o We sell to prospects that are using other Web conferencing service providers that are ready to migrate to Web conferencing software. We find that these organizations appreciate the cost and feature advantages that our technology offers.
- o We target organizations that have a natural fit for highly secure Web conferencing software such as government, military and financial organizations, as well as the companies that supply to these entities.
- o We target organizations looking to deploy live, Web-based training. Our software was originally built for training and we have maintained a competitive technology advantage in this area.
- o We continue to cross sell all of our products and services to our large database of existing customers.
- o We look to expand distribution and gain market share by leveraging the sales and distribution capabilities of our partners, distributors, value added resellers and OEM partners.

RESULTS OF OPERATIONS

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The operations of the Company involve many risks, which, even through a combination of experience, knowledge, and careful evaluation, may not be overcome. These risks include the fact that the market for Web conferencing products and services is in the early stages of development and may not grow to a sufficient size or at a sufficient rate to sustain our business. We also face intense competition from other Web conferencing and audio conferencing providers and may be unable to compete successfully. Many of our existing and potential competitors have longer operating histories and significantly greater financial, technical and other resources and therefore may be able to more quickly respond to changing opportunities or customer requirements. Please read also the section entitled "Risk Factors."

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REVENUES FROM CONTINUING OPERATIONS

Total revenues generated from continuing operations for the three months ended December 31, 2006 and December 31, 2005 were \$3.7 million and \$3.3 million, respectively, an overall increase of approximately \$377,000. Of this amount, software license revenues increased \$255,000, software and audio services revenues increased \$84,000 and maintenance and professional services revenues increased \$38,000. The overall increase was primarily the result of planned growth in software license revenues, as well as maintenance revenues from renewals as our customer base continues to grow. Also contributing to the growth in the quarter were software license fees from certain off-the-shelf content and OEM licensing fees from new distribution partners. Specifically, during the quarter the Company entered into an OEM agreement with an IP based PBX distributor that includes the ability to offer the named-user subscription model on a private labeled basis to its customers. For the three months ended December 31, 2006, software license revenues were 30% of total revenue, software and audio services revenues were 50% of total revenue and maintenance and professional services revenues were 20% of the total revenue, as compared to 26%, 53% and 21%, respectively, for the same three month period last year. We expect software license revenues and indirect subscription license revenue to continue to become a larger percentage of total revenues as total revenues increase given our focus on the software purchase model and indirect sales model.

Total revenues generated from continuing operations for the nine months ended December 31, 2006 and December 31, 2005 were \$10.7 million and \$9.0 million, respectively, an overall increase of \$1.8 million. This increase was the result of an increase of \$1.1 million in license revenues, an increase of \$282,000 in software and audio services in combination with an increase of \$341,000 in maintenance and professional services revenues. The overall increase was primarily the result of planned growth in software license revenues. Also contributing to the growth were software license fees from certain off-the-shelf content and OEM licensing fees from new distribution partners. For the nine months ended December 31, 2006 license revenues were 30%, software and audio service revenues were 51% and service and maintenance revenues were 19% of total revenues, as compared to 24% for license revenues, 57% for software and audio services revenues and 19% for service and maintenance revenues for the same nine months ended December 31, 2005.

COST OF REVENUES FROM CONTINUING OPERATIONS

Cost of software license revenue is driven by the number of software

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licenses sold. It consists of royalty fees paid on certain off-the-shelf products, if any sold, and sales rebates to distribution partners on the sale of certain product software licenses as well as a small amount for the cost of fulfillment and materials. Cost of software license revenues for the three months ended December 31, 2006 and December 31, 2005 were \$51,000 and \$40,000, respectively. Cost of license revenues for the nine months ended December 31, 2006 and December 31, 2005 was \$132,000 and \$72,000, respectively, an increase of \$60,000 that was primarily the result of an increase in royalty fees arising from the sale of certain off-the-shelf courseware. Cost of license revenue will remain a small fraction of license revenue because the remaining royalty due is associated only with our off-the-shelf courses. We expect the cost of software license revenue to remain a very small fraction of total software license revenue, which will arise only from royalties which may be due from the sale of off-the-shelf courses.

Cost of software and audio services revenue uses a fully allocated overhead method that includes an allocation of salaries and allocable expenses resulting from the delivery of our hosted Web conferencing services, together with all expenses associated with the delivery of our audio conferencing services. Expenses related to our audio conferencing services that are accrued as cost of revenues include salaries and allocable expenses of our telephone operators, allocated facilities costs, allocated technical support costs for support services, together with all direct telecommunication expenses for long distance and local dial tone connectivity, and finally, allocable depreciation and amortization expense related to our audio conferencing assets. Cost of software and audio services for the three months ended December 31, 2006 and December 31, 2005 were \$884,000 and \$959,000, respectively, a decrease of \$75,000. This decrease is primarily a result of the complete depreciation of certain audio conferencing and computer equipment. This decrease was partially offset by an increase in office expenses of \$106,000 due primarily to a one-time elimination of liabilities associated with the Glyphics acquisition. Cost of software and audio services for the nine months ended December 31, 2006 and December 31, 2005 was \$2.7 million and \$2.8 million, respectively, a decrease of \$111,000. The decrease was primarily attributable to the elimination of depreciation of certain audio conferencing and computer equipment, providing a decrease in depreciation expense of \$64,000 per month, or \$446,000 for the nine-month period. The decrease in costs were partially offset by increases office expenses in part as a result of the one-time Glyphics liability

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elimination, increases in salaries expenses of \$36,000, telecommunications costs of \$294,000, professional services of \$27,000, advertising and marketing of \$14,000 and travel and entertainment expenses of \$11,000. Overall we expect the cost of audio conferencing services to rise with increases in audio conferencing revenue, but decline as a percentage of audio conferencing revenue as we are successful in driving down telecommunications costs.

Cost of maintenance and professional services revenue included an allocation of technical support personnel and facilities costs allocable to those service revenues consisting primarily of a portion of our facilities costs, communications and depreciation expenses. However, by far the largest and most variable component of the cost of maintenance and professional services arises from the amount due to our third-party custom content subcontractor that supports our custom content revenue. The amount due to our third-party subcontractor is a fixed proportion of the custom content revenue earned. The cost of maintenance and professional services for the three months ended

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December 31, 2006 and December 31, 2005 were \$310,000 and \$237,000, respectively, an increase of \$73,000. The increase or decrease will vary proportionately and directly with the amount of revenue earned in a quarter. The cost of maintenance and professional services for the nine months ended December 31, 2006 and December 31, 2005 was \$710,000 and \$535,000, respectively, an increase of \$175,000 that was primarily a change in the amount of custom content revenue earned in that period.

Amortization of acquired developed technology consists of amortization of software and identified intangible technology that was acquired in the Quisic, Mentergy and Glyphics acquisitions. Amortization of acquired technology for the three months ended December 31, 2006 and December 31, 2005 was \$68,000 and \$82,000, respectively, a decrease of \$14,000. Amortization of acquired technology for the nine months ended December 31, 2006 and December 31, 2005 was \$202,000 and \$309,000, respectively, a decrease of \$107,000 which was related primarily to the full amortization of the software assets acquired from Mentergy.

OPERATING EXPENSES FROM CONTINUING OPERATIONS

Total operating expenses consist of research and development expenses, sales and marketing expenses and general and administrative expenses. We incurred total operating expenses from continuing operations for the three months ended December 31, 2006 and December 31, 2005 of \$1.8 million and \$1.5 million, respectively, an increase of \$282,000. Total operating expenses for the nine months ended December 31, 2006 and December 31, 2005 were \$5.3 million and \$4.9 million, respectively, an increase of \$406,000.

Research and development expenses represent expenses incurred in connection with the continued development and enhancement of our software products and new versions. Those costs consist primarily of salaries and benefits, telecommunication allocations, rent allocations, computer equipment allocations and allocated depreciation and amortization expense. Research and development expenses from continuing operations for the three months ended December 31, 2006 and December 31, 2005 were \$307,000 and \$351,000, respectively, a decrease of \$44,000. The decrease was primarily a result of salaries and benefits expenses which decreased by \$21,000 and professional services expenses which decreased by \$48,000. The increase was partially offset by an increase in office expenses of \$23,000. During the three months ended June 30, 2006, we began capitalizing identified direct expenses associated with a specific software development upon achieving technological feasibility for version 9.0 of our Web collaboration software in accordance with SFAS No. 86 ACCOUNTING FOR THE COSTS OF COMPUTER SOFTWARE TO BE SOLD, LEASED, OR OTHERWISE MARKETING. We will continue to capitalize those direct costs until the new software product is ready for distribution and sale to our customers. Once the product is released, we will amortize these software development costs over a three year period. Most of the decrease in the December quarter in research and development costs was attributable to the capitalization of those software development costs that would otherwise have been expensed. Taking into account the decrease from the capitalization of 9.0 software costs and the increase from amortization of those costs, we expect research and development costs to remain relatively flat in fiscal 2007. Research and development expenses from continuing operations for the nine months ended December 31, 2006 and December 31, 2005 were \$905,000 and \$1.1 million, respectively, a decrease of \$150,000. The decrease was primarily a result of a decrease in salaries and benefits expenses and professional services of \$110,000 and \$74,000, respectively, a result of the capitalized research and development costs. The decrease was partially offset by an increase in office expenses of \$41,000.

Sales and marketing expenses consist primarily of sales and marketing salaries and benefits, and also include allocated travel and entertainment costs, allocated advertising and other marketing expenses. Sales and marketing

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expenses from continuing operations for the three months ended December 31, 2006 and December 31, 2005 were \$924,000 and \$701,000,

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respectively, an increase of \$223,000. The increase was a result of increased expenses in advertising and marketing of \$204,000, in salaries and benefits of \$38,000. We expect sales and marketing expenses to increase in amount as revenues increase, but that the percentage of sales and marketing expenses incurred in relation to total revenue to remain consistent through fiscal 2007. Sales and marketing expense from continuing operations for the nine months ended December 31, 2006 and December 31, 2005 was \$2.5 million and \$2.3 million, respectively, an increase of \$283,000. The increase was partially the result of an accrued rebate and sales incentives expense due to a new distributor of our products in accordance with the distributor agreement of \$29,000 in the three months ended June 30, 2006. In addition, advertising and marketing expenses increased by \$344,000, salaries and benefits decreased by \$36,000, professional services increased by \$35,000, office expenses increased by \$35,000 and travel and entertainment increased by \$17,000. These increases were partially offset by a decrease in the occupancy expenses allocated to sales and marketing of \$113,000.

General and administrative expenses consist of company-wide expenses that are not directly related to research and development or sales and marketing, with the bulk of those general and administrative expenses comprised of salaries, rent and the costs associated with being a public company, including accounting costs, legal costs and fees directly associated with being a public company. General and administrative expenses from continuing operations for the three months ended December 31, 2006 and December 31, 2005 were \$588,000 and \$485,000, respectively, an increase of \$103,000. Salaries and benefits increased \$36,000, telecommunications increased by \$11,000, and office expenses by \$51,000 when comparing December 31, 2006 to December 31, 2005. In addition, other taxes increased by \$106,000 primarily as a result of a reduction in tax liability of \$81,000 for the three months ended December 31, 2005 related to the release of a tax liability that was recorded as an estimate as part of the Glyphics acquisition. The increase in general and administrative was partially offset by decreases in professional services of \$24,000, accounting fees of \$4,000, legal fees of \$17,000, board and investor relations of \$23,000 and bad debt expense of \$25,000. General and administrative expenses from continuing operations for the nine months ended December 31, 2006 and December 31, 2005 were \$1.9 million and \$1.6 million, respectively, an increase of \$273,000. This increase included an increase in salaries and benefits to executives and other administrative staff of \$167,000, telecommunications expenses of \$46,000, office expenses of \$97,000 and travel and entertainment of \$24,000. In addition, other tax expense increased by \$115,000 due primarily to the one-time liability elimination in the nine months ended December 31, 2005. These increases were partially offset by a decrease of \$70,000 in professional services, a decrease of \$56,000 in legal fees, a reduction in costs associated with premises of \$10,000 and an overall decrease in bad debt expense of \$36,000 over the nine month period. We expect general and administrative expenses to remain at this level and relatively flat through fiscal 2007.

EARNINGS FROM OPERATIONS

For the three months ended December 31, 2006, we reported earnings from operations of \$519,000 as compared to earnings from operations of \$419,000 for the three months ended December 31, 2005, an increase in earnings from

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operations of \$100,000. We expect to continue to hold down costs where appropriate while we continue to invest in research and development and likewise sales and marketing in order to increase revenues. We posted income from operations for the nine months ended December 31, 2006 and December 31, 2005 of \$1.6 million and \$273,000, a positive change of \$1.3 million.

INTEREST EXPENSE FROM CONTINUING OPERATIONS

Interest expense from continuing operations paid on outstanding debt instruments for the three months ended December 31, 2006 and December 31, 2005 was \$244,000 and \$246,000, respectively, a decrease of \$2,000. Non-cash interest expense, arising from the beneficial conversion feature of our debt, for the three months ended December 31, 2006 and December 31, 2005 was \$150,000 and \$213,000, respectively, a decrease of \$63,000. Interest expense from continuing operations paid on outstanding debt instruments for the nine months ended December 31, 2006 and December 31, 2005 was \$741,000 and \$773,000, respectively, a decrease of \$32,000 as a result of the reduction in overall debt. We incurred non-cash interest expense for the nine months ended December 31, 2006 and December 31, 2005 of \$451,000 and \$705,000, respectively, a decrease of \$254,000 due to the conversion of certain notes in September 2005.

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INCOME TAX EXPENSE FROM CONTINUING OPERATIONS

There is no tax benefit or provision on our Condensed Consolidated Statements of Operations during the three and nine months ended December 31, 2006 or 2005 because we concluded it is not likely we would be able to recognize the tax asset created due to historical losses. We will continue to evaluate the likelihood of realization of that tax asset as operations continue to improve and profitability rises. At December 31, 2006 and March 31, 2006, we had net deferred tax assets of \$15.7 million and \$15.9 million, respectively, with corresponding valuation allowances. Our tax assets are scheduled to expire over a period of five to twenty YEARS.

GAIN ON THE SALE OF ASSETS

We recorded gains on the sale of assets for the nine months ended December 31, 2006 and 2005, in the amount of \$3,000 and \$40,000, respectively as the result of the sale of office furniture to our subcontractor and the sale of a portion of our off-the-shelf course library that we had acquired in the Quisic acquisition.

LOSS ON EXTINGUISHMENT OF DEBT

In December, 2006, the Company negotiated a modification of the terms of the senior notes to extend the maturity date from July 15, 2007 to July 15, 2010. In exchange for the extension, the interest rate increased from 10% per annum to 12% per annum, with the new, increased interest rate to begin to accrue under the amendment on January 16, 2007, and continue thereafter at that rate until maturity or the senior note is fully paid. All other terms and provisions of the senior notes remained unchanged. The placement agent received a commission of \$87,000 together with a warrant of the purchase of 100,000 shares of the Company's common stock with an exercise price of \$0.66 per share. The warrant is effective as of December 15, 2006 and has a three year term. The note agent received an expense reimbursement of \$14,000. In accordance with EITF96-19, DEBTOR'S ACCOUNTING FOR A MODIFICATION OR EXCHANGE OF DEBT

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INSTRUMENTS, the debt extension was accounted for as an extinguishment of the existing debt and the creation of the new debt. As a result, the Company recorded a one-time loss on extinguishment of debt of \$160,000 resulting from the acceleration of interest expense accounted for as debt discount and deferred offering costs under the original terms of the senior debt. The direct expenses of \$101,000 and the estimated fair value of the warrant of \$42,000 were recorded as a deferred offering cost and both will be amortized as a component of interest expense over the term of the notes.

RESULTS OF DISCONTINUED OPERATIONS

Effective January 1, 2004, we discontinued our legacy practice management business. Results of operations from this segment are presented as discontinued operations for the three and nine months ended December 31, 2006 and 2005 in accordance with SFAS 146. We do not expect to recognize further income or incur further expenses related to our discontinued legacy practice management business.

ACCOUNTING FOR COSTS ASSOCIATED WITH EXIT OR DISPOSAL ACTIVITIES.

Net income from discontinued operations for the three months ended December 31, 2006 and December 31, 2005 was \$0 and \$70,000, respectively. Net income from discontinued operations for the nine months ending December 31, 2006 and 2005 was \$10,000 and \$82,000, respectively. Cash flows used in discontinued operations were \$40,000 for the nine months ended December 31, 2006. Cash flows provided by discontinued operations were \$86,000 for the nine months ended December 31, 2005.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006, we had a working capital surplus of \$558,000. Current assets included \$772,000 in cash, \$768,000 held in certificates of deposit that mature in January 2007, \$2.1 million in net accounts receivable, \$52,000 in notes receivable and \$788,000 in prepaids and other assets. Current liabilities consisted of \$1.1 million of deferred revenue, current maturities of long-term debt of \$483,000 and \$2.4 million in accounts payable and accrued liabilities.

In June 2006, we raised \$2,000,000 of gross proceeds in a private placement of 5.4 million shares of common stock. A portion of our plan to address our working capital needs include further reductions in overhead and continued development, marketing and licensing of our iLinc suite of products and services through internal sales efforts and external channel partnerships.

Cash provided by operating activities from continuing operations was \$443,000 during the nine months ended December 31, 2006 while cash provided by operating activities from continuing operations was \$385,000 during the nine months ended December 31, 2005. Cash provided by operating activities from continuing operations during the nine months ended December 31, 2006 was primarily attributable to decreases in accounts payable and accrued expenses of \$1.0 million, increases in accounts receivable of \$48,000, and increases in prepaid expenses and other assets of \$310,000. These items were partially offset by net income from continuing operations of \$245,000, increases in deferred revenue of \$166,000 and non-cash expenses and revenues of \$1.4 million. Cash provided by operating activities from continuing operations during the nine

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months ended December 31, 2005 was primarily attributable to a net loss of \$1.3 million, decreases in accounts payable of \$671,000, increases in prepaid expenses of \$118,000 and decreases in deferred revenue of \$150,000. These items were partially offset by non-cash expenses and revenues of \$2.3 million and decreases in accounts receivable of \$340,000.

Cash used in investing activities from continuing operations was \$1.4 million for the nine months ended December 31, 2006, while cash used in investing activities from continuing operations was \$133,000 for the nine months ended December 31, 2005. Cash used in investing activities during the nine months ended December 31, 2006 was due to an investment in a 7-month certificate of deposit of \$768,000, capital expenditures of \$393,000 and capitalization of software development costs of \$295,000. The proceeds from the sale of fixed assets of \$3,000 and the repayment on notes receivable of \$14,000 provided cash during the nine months ended December 31, 2006. Cash used in investing activities during the nine months ended December 31, 2005 was due to capital expenditures of \$52,000, payment on the Mentergy royalty earn-out of \$100,000 and acquisition related expenses of \$4,000, partially offset by \$20,000 in proceeds from the sale of software and by \$3,000 in collection on notes receivable.

Cash provided by financing activities from continuing operations was \$1.3 million during the nine months ended December 31, 2006, while cash used in financing activities from continuing operations was \$252,000 during the nine months ended December 31, 2005. Cash provided by financing activities during the nine months ended December 31, 2006 was attributable to proceeds from the issuance of common stock of \$2.0 million partially offset by stock issuance expenses of \$258,000, the repayment of debt and capital leases totaling \$186,000, payment of preferred dividends of \$118,000, payment of financing costs of \$101,000 and additional proceeds from the exercise of stock options of \$5,000. Cash used in financing activities during the nine months ended December 31, 2005 was attributable to the repayment of debt and capital leases totaling \$324,000, payment of preferred dividends of \$91,000 and financing costs of \$28,000, offset by \$150,000 in proceeds from the issuance of Series B preferred stock and \$41,000 proceeds from the exercise of outstanding warrants.

INFORMATION RELATED TO ACQUISITIONS AND CAPITAL RAISE ACTIVITIES

In March 2002, the Company completed a private placement offering (the "Convertible Note Offering") raising capital of \$5,775,000 that was used to extinguish an existing line of credit. Under the terms of the Convertible Note Offering, the Company issued unsecured subordinated convertible notes (the "Convertible Notes"). The Convertible Notes bear interest at the rate of 12% per annum and require quarterly interest payments, with the principal due at maturity on March 29, 2012. The holders of the Convertible Notes may convert the principal into shares of the Company's common stock at the fixed price of \$1.00 per share. The Company may force redemption by conversion of the principal into common stock at the fixed conversion price, if at any time the 20 trading day average closing price of the Company's common stock exceeds \$3.00 per share. The notes are subordinated to any present or future senior indebtedness. As a part of the Convertible Note Offering the Company also issued warrants to purchase 5,775,000 shares of the Company's common stock for an exercise price of \$3.00 per share. Those warrants expired on March 29, 2005 without exercise. The fair value of the warrants was estimated using a Black-Scholes pricing model with the following assumptions: contractual and expected life of three years, volatility of 75%, dividend yield of 0% and a risk-free rate of 3.87%. A discount to the Convertible Notes of \$1,132,000 was recorded using this value, which is being amortized to interest expense over the 10-year term of the Convertible Notes. As the carrying value of the notes is less than the conversion value, a beneficial conversion feature of \$1,132,000 was calculated and recorded as an additional discount to the notes and is being amortized to interest expense over the 10 year term of the Convertible Notes. Upon conversion, any remaining discount and

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beneficial conversion feature will be expensed in full at the time of conversion. During fiscal 2004, holders with a principal balance totaling \$150,000 converted their notes into 150,000 common shares of the Company. During fiscal 2006, holders with a principal balance of \$525,000 converted their notes and \$8,000 of accrued interest into 1,971,088 shares of the Company's common stock that had been registered with the SEC at a price of \$0.25, \$0.26 and \$0.30 per share. Since the actual conversion price for the convertible debt was less

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than the fixed conversion price of \$1.00, the Company recorded conversion expense of \$338,000 for the year ended March 31, 2006. During fiscal 2006, the Company accelerated the amortization of the deferred offering costs and the discount and beneficial conversion feature associated with the debt by expensing \$50,000 and \$137,000, respectively at the time of conversion. No conversion of debt or acceleration of amortization of costs occurred during the three and nine months ended December 31, 2006 for the Convertible Note Offering.

On September 16, 2003, the Company completed its private placement of series A convertible preferred stock (the "Series A Preferred Stock") with detachable warrants. The Company sold 30 units at \$50,000 each and raised a total of \$1,500,000. Each unit consisted of 5,000 shares of Series A Preferred Stock, par value \$0.001 and a warrant to purchase 25,000 shares of common stock. The Series A Preferred Stock is convertible into the Company's common stock at a price of \$0.50 per share, and the warrants are immediately exercisable at a price of \$1.50 per share with a three-year term. Accordingly, each share of preferred stock is convertible into 20 shares of common stock and retains a \$10 liquidation preference. The Company pays an 8% dividend to holders of the Series A Preferred Stock, and the dividend is cumulative. The Series A Preferred Stock is non-voting and non-participating. The shares of Series A Preferred Stock will not be registered under the Securities Act of 1933, as amended, and were offered in a private placement providing exemption from registration. The cash proceeds of the private placement of Series A Preferred Stock were allocated pro rata between the relative fair values of the Series A Preferred Stock and warrants at issuance using the Black-Scholes valuation model for valuing the warrants. The aggregate value of the warrants and the beneficial conversion discount of \$247,000 are considered a deemed dividend in the calculation of loss per share. During the 2005 fiscal year, holders of 22,500 shares of Series A Preferred Stock converted those shares into 450,000 shares of the Company's common stock. During fiscal 2007, holders of 12,500 shares of series A Preferred Stock converted those shares into 250,000 shares of the Company's common stock. The underlying common stock that would be issued upon conversion of the Series A Preferred Stock and upon exercise of the associated warrants have been registered with the SEC and may be sold pursuant to a resale prospectus dated May 24, 2004.

In April of 2004, the Company completed a private placement offering of unsecured senior notes (the "2004 Senior Note Offering") that provided gross proceeds of \$4.25 million. Under the terms of the 2004 Senior Note Offering, the Company issued \$3,187,000 in unsecured senior notes and 1,634,550 shares of the Company's common stock. The senior notes were issued as a series of notes pursuant to a unit purchase and agency agreement. The senior notes are unsecured. The placement agent received a commission equal to 10% of the gross proceeds together with a warrant for the purchase of 163,455 shares of the Company's common stock with an exercise price equal to 120% of the price paid by investors. The senior notes bear interest at a rate of 10% per annum and accrued interest is due and payable on a quarterly basis beginning July 15, 2004, with

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principal due at maturity on July 15, 2007. The senior notes are redeemable by the Company at 100% of the principal value at any time after July 15, 2005. The notes and common stock were issued with a debt discount of \$768,000. The fair value of the warrants was estimated and used to calculate a discount of \$119,000 of which \$68,000 was allocated to the notes and \$51,000 was allocated to equity. The total discount allocated to the notes of \$836,000 is being amortized as a component of interest expense over the term of the notes which is approximately 39 months. The senior notes are unsecured obligations of the Company but are senior in right of payment to all existing and future indebtedness of the Company. The common stock issued in the 2004 Senior Note Offering was registered with the SEC pursuant to a resale prospectus dated August 2, 2005. Effective August 1, 2005, holders with a principal balance totaling \$225,000 converted their senior notes and accrued interest of \$800 into 903,205 shares of the Company's common stock at a price of \$0.25 per share. Since the actual conversion price for the debt was greater than the market value of the stock at the date of conversion, the Company recorded a gain on conversion of \$9,000 for the period ended December 31, 2005. During fiscal 2006, the Company accelerated the amortization of the deferred offering costs and the discount associated with the debt by expensing \$10,000 and \$35,000, respectively at the time of conversion. On November 9, 2005, placement agent warrants originally issued with an exercise price of \$0.78 per common share were converted to 163,455 common shares at an exercise price of \$0.25 per share, in which the Company received \$41,000 in cash. The transaction resulted in an increase in deferred offering costs of \$7,000 and an adjustment to additional paid-in capital of \$7,000. No conversion of debt to equity or acceleration of amortization of costs related to such conversion occurred during the three and nine months ended December 31, 2006. In December, 2006, the Company negotiated a modification of the terms of the senior notes to extend the maturity date from July 15, 2007 to July 15, 2010. In exchange for the extension, the interest rate increased from 10% per annum to 12% per annum, with the new, increased interest rate to begin to accrue under the amendment on January 16, 2007, and continue thereafter at that rate until maturity or the senior note is fully paid. All other terms and provisions of the senior notes remained unchanged. The placement agent received a commission of \$87,000 together with a warrant of the purchase of 100,000 shares of the Company's

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common stock with an exercise price of \$0.66 per share. The warrant is effective as of December 15, 2006 and has a three year term. The note agent received an expense reimbursement of \$14,000. In accordance with EITF96-19, DEBTOR'S ACCOUNTING FOR A MODIFICATION OR EXCHANGE OF DEBT INSTRUMENTS, the debt extension was accounted for as an extinguishment of the existing debt and the creation of the new debt. As a result, the Company recorded a one-time loss on extinguishment of debt of \$160,000 resulting from the acceleration of interest expense accounted for as debt discount and deferred offering costs under the original terms of the senior debt. The direct expenses of \$101,000 and the estimated fair value of the warrant of \$42,000 were recorded as a deferred offering cost and both will be amortized as a component of interest expense over the term of the notes.

On September 30, 2005, the Company executed definitive agreements with nine investors to issue 70,000 unregistered shares of its Series B Preferred Stock, par value \$0.001 (the "Series B Preferred Stock") and warrants to purchase 700,000 shares of its common stock (the "Warrants") in a private transaction that was exempt from registration under Section 4(2) of the Securities Act of 1933. The Series B Preferred Stock bears an 8% dividend, was

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sold using a deemed \$10.00 per share issue price, and is convertible into 2,800,000 shares of the Company's common stock using a conversion price of \$0.25 per share. The Warrants that are exercisable at an exercise price equal to \$0.50 per share expire on the third anniversary of the issue date of September 30, 2005. The aggregate value of the warrants of \$55,000 is considered a deemed dividend in the calculation of loss per share. During fiscal 2007, holders of 6,000 shares of series B Preferred Stock converted those shares into 240,000 shares of the Company's common stock

On June 9, 2006, the Company completed a private placement of 5,405,405 unregistered, restricted shares of common stock providing \$2.0 million in gross cash proceeds. The Company intends to use the proceeds for working capital and general corporate purposes. The Company paid its placement agent an underwriting commission of \$185,000 of which \$25,000 was recorded as deferred offering costs and incurred additional offering expenses of approximately \$102,000. Pursuant to the registration rights agreement between the parties, the Company filed a Registration Statement on Form S-3 to enable the resale of the shares by the investors which was declared effective on September 29, 2006.

CONTRACTUAL OBLIGATIONS

The following schedule details all of the Company's indebtedness and the required payments related to such obligations at December 31, 2006 (in thousands):

	TOTAL	DUE IN LESS THAN ONE YEAR	DUE IN YEAR TWO	DUE IN YEAR THREE
Long term debt obligations	\$ 8,545	\$ 483	\$ --	\$ --
Interest expense	4,510	1,007	968	967
Operating lease obligations	2,062	587	387	352
Base salary commitments under employment agreements	1,057	575	482	--
Total contractual obligations....	\$16,174	\$ 2,652	\$ 1,837	\$ 1,319

OFF BALANCE SHEET TRANSACTIONS

There are no off-balance sheet transactions, arrangements, obligations (including contingent obligations) or other relationships of the Company with unsolicited entities or other persons that have or may have a material effect on financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources of the Company.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements in conformity with accounting principles generally accepted

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in the United States of America requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. The more significant areas requiring use of estimates relate to revenue recognition, accounts receivable and notes receivable valuation reserves, realizability of intangible assets, realizability of deferred income tax assets and the evaluation of contingencies and litigation. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. The results of such estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

Our critical accounting policies and estimates are included in the Company's annual report on Form 10-K for the year ended March 31, 2006 as filed with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The following discusses our exposure to market risk related to changes in interest rates, equity prices and foreign currency exchange rates. Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument as a result of fluctuations in interest rates and market prices. We have not traded or otherwise bought and sold derivatives nor do we expect to in the future. We also do not invest in market risk sensitive instruments for trading purposes.

We provide our products and services to customers in the United States, Europe and elsewhere throughout the world. Sales are predominately made in U.S. Dollars, however, we have sold products that were payable in Euros and Canadian Dollars. A strengthening of the U.S. Dollar could make our products and services less competitive in foreign markets.

The primary objective of our investment activity is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents in a variety of money market funds.

As of December 31, 2006, the carrying value of our outstanding convertible redeemable subordinated notes and unsecured senior notes was approximately \$8.1 million at fixed interest rates of 10% to 12%. In certain circumstances, we may redeem this long-term debt. Our other components of indebtedness of \$483,000 bear interest rates of 6% to 10.25%. Increases in interest rates could increase the interest expense associated with future borrowings, if any. We do not hedge against interest rate increases.

ITEM 4. CONTROLS AND PROCEDURES

The Company evaluated the design and operation of its disclosure controls and procedures to determine whether they are effective in ensuring that it discloses the required information in a timely manner and in accordance with the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the rules and forms of the Securities and Exchange Commission. Management, including its principal executive officer and principal financial officer, supervised and participated in the evaluation. The principal executive officer and principal financial officer concluded, based on their review, that its disclosure controls and procedures, as defined by Exchange Act Rules 13a-15(e) and 15d-15(e), are effective and ensure that (i) it discloses the required information in reports that it files under the Exchange Act and that the filings are recorded, processed, summarized and reported within the time periods specified in

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Securities and Exchange Commission rules and forms and (ii) information required to be disclosed in reports that it files under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure.

During the third quarter ended December 31, 2006, no changes were made to its internal controls over financial reporting that materially affected or were reasonably likely to materially affect these controls subsequent to the date of their evaluation.

PART II--OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

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ITEM 1A. RISK FACTORS

You should carefully consider the risks described below. The risks and uncertainties described below are not the only ones we face. If any of the following risks actually occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could be adversely affected.

WE HAVE A LIMITED OPERATING HISTORY, WHICH MAKES IT DIFFICULT TO EVALUATE OUR BUSINESS.

We acquired our Web conferencing software and business in November of 2002 and we acquired our audio conferencing business in June of 2004. Therefore, we have a limited operating history in the Web conferencing and audio conferencing business. While the organizations that we have acquired have been engaged in their respective businesses for over five years, we only recently acquired those assets and have undertaken to integrate their assets into our operations at varying levels. Since the acquisition of these businesses, we have made significant changes to our product mix and service mix, our growth strategies, our sales and marketing plans, and other operational matters. Given our recent investment in technology, we cannot be certain that our business model and future operating performance will yield the results that we intend. In addition, the competitive and rapidly changing nature of the Web conferencing and audio conferencing markets makes it difficult for us to predict future results. Our business strategy may be unsuccessful and we may be unable to address the risks we face.

WE FACE RISKS INHERENT IN INTERNET-RELATED BUSINESSES AND MAY BE UNSUCCESSFUL IN ADDRESSING THESE RISKS.

We face risks frequently encountered by companies in new and rapidly evolving markets such as Web conferencing and audio conferencing. We may fail to adequately address these risks and, as a consequence, our business may suffer. To address these risks among others, we must successfully introduce and attract new customers to our products and services; successfully implement our sales and marketing strategy to generate sufficient sales and revenues to sustain operations; foster existing relationships with our customers to provide for

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continued or recurring business and cash flow; and successfully address and establish new products and technologies as new markets develop. We may not be able to sufficiently address and overcome risks inherent in our business strategy.

OUR QUARTERLY OPERATING RESULTS ARE UNCERTAIN AND MAY FLUCTUATE SIGNIFICANTLY.

Our operating results have varied significantly from quarter to quarter and are likely to continue to fluctuate as a result of a variety of factors, many of which we cannot control. Factors that may adversely affect our quarterly operating results include: the dependence upon software purchase license sales as opposed to the more ratable subscription model, the size and timing of product orders; the mix of revenue from custom services and software products; the market acceptance of our products and services; our ability to develop and market new products in a timely manner; the timing of revenues and expenses relating to our product sales; and revenue recognition rules. Expense levels are based, in part, on expectations as to future revenue and to a large extent are fixed in the short term. To the extent we are unable to predict future revenue accurately, we may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall.

WE HAVE LIMITED FINANCIAL RESOURCES AND MAY NOT REMAIN PROFITABLE.

We have incurred substantial operating losses and have limited financial resources at our disposal. We have long-term obligations that we will not be able to satisfy without additional debt and/or equity capital and/or ultimately generating profits and cash flows from our Web conferencing and audio conferencing operations. If we are unable to remain profitable, we will face increasing demands for capital. We may not be successful in raising additional debt or equity capital and may not remain profitable. As a result, we may not have sufficient financial resources to satisfy our obligations as they come due in the short term.

LISTING QUALIFICATIONS MAY NOT BE MET.

The American Stock Exchange's continued listing standards require that we maintain stockholders' equity of at least \$4.0 million if we have losses from continuing operations or net losses in three of our four most recent fiscal years. We have sustained losses in three of our four most recent fiscal years and therefore must maintain stockholders' equity of at least \$4.0 million. If

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now or in the future, we fail to maintain a sufficient level of stockholders' equity in compliance with those and other listing standards of the American Stock Exchange, then we would be required to submit a plan to the American Stock Exchange describing how we intended to regain compliance with the requirements. In the event that our shares of common stock are de-listed, the liquidity and price per share of our common stock may be adversely affected.

DILUTION TO EXISTING STOCKHOLDERS WILL OCCUR UPON ISSUANCE OF SHARES WE HAVE RESERVED FOR FUTURE ISSUANCE.

On December 31, 2006, 34,837,843 shares of our common stock were issued, of which 1,432,412 were held in treasury, leaving 33,405,431 issued and outstanding. An additional 16,184,956 shares of our common stock were reserved for issuance that would be issued as the result of the exercise of warrants or

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the conversion of convertible notes and/or convertible preferred stock. The issuance of these additional shares will reduce the percentage ownership of our existing stockholders. The existence of these reserved shares coupled with other factors, such as the relatively small public float, could adversely affect prevailing market prices for our common stock and our ability to raise capital through an offering of equity securities.

THE LOSS OF THE SERVICES OF OUR SENIOR EXECUTIVES AND KEY PERSONNEL WOULD LIKELY CAUSE OUR BUSINESS TO SUFFER.

Our success depends to a significant degree on the performance of our senior management team. The loss of any of these individuals could harm our business. We do not maintain key person life insurance for any officers or key employees other than on the life of James M. Powers, Jr., our Chairman, President and CEO, with that policy providing a death benefit to the Company of \$1.0 million. Our success also depends on the ability to attract, integrate, motivate and retain additional highly skilled technical, sales and marketing, and professional services personnel. To the extent we are unable to attract and retain a sufficient number of additional skilled personnel, our business will suffer.

OUR INTELLECTUAL PROPERTY MAY BECOME SUBJECT TO LEGAL CHALLENGES, UNAUTHORIZED USE OR INFRINGEMENT, ANY OF WHICH COULD DIMINISH THE VALUE OF OUR PRODUCTS AND SERVICES.

Our success depends in large part on our proprietary technology. If we fail to successfully enforce our intellectual property rights, the value of these rights, and consequently, the value of our products and services to our customers, could diminish substantially. It may be possible for third parties to copy or otherwise obtain and use our intellectual property or trade secrets without our authorization, and it may also be possible for third parties to independently develop substantially equivalent intellectual property. Currently, we do not have patent protection in place related to our products and services. Litigation may be necessary in the future to enforce our intellectual property rights, to protect trade secrets or to determine the validity and scope of the proprietary rights of others. While we have not received any notice of any claim of infringement of any of our intellectual property, from time to time we may receive notice of claims of infringement of other parties' proprietary rights. Such claims could result in costly litigation and could divert management and technical resources. These types of claims could also delay product shipment or require us to develop non-infringing technology or enter into royalty or licensing agreements, which agreements, if required, may not be available on reasonable terms, or at all.

COMPETITION IN THE WEB CONFERENCING AND AUDIO CONFERENCING SERVICES MARKET IS INTENSE AND WE MAY BE UNABLE TO COMPETE SUCCESSFULLY.

The markets for Web conferencing and audio conferencing products and services are relatively new, rapidly evolving and intensely competitive. Competition in our market will continue to intensify and may force us to reduce our prices, or cause us to experience reduced sales and margins, loss of market share and reduced acceptance of our services. Many of our competitors have larger and more established customer bases, longer operating histories, greater name recognition, broader service offerings, more employees and significantly greater financial, technical, marketing, public relations, and distribution resources than we do. We expect that we will face new competition as others enter our market to develop Web conferencing and audio conferencing services. These current and future competitors may also offer or develop products or services that perform better than ours. In addition, acquisitions or strategic partnerships involving our current and potential competitors could harm us in a number of ways.

FUTURE REGULATIONS COULD BE ENACTED THAT EITHER DIRECTLY RESTRICT OUR BUSINESS OR INDIRECTLY IMPACT OUR BUSINESS BY LIMITING THE GROWTH OF INTERNET-BASED BUSINESS AND SERVICES.

As commercial use of the Internet increases, federal, state, and foreign agencies could enact laws or adopt regulations covering issues such as user privacy, content, and taxation of products and services. If enacted, such laws or regulations could limit the market for our products and services. Although they might not apply to our business directly, we expect that laws or rules regulating personal and consumer information could indirectly affect our business. It is possible that such legislation or regulation could expose us to liability which could limit the growth of our Web conferencing and audio conferencing products and services. Such legislation or regulation could dampen the growth in overall Web conferencing usage and decrease the Internet's acceptance as a medium of communications and commerce.

WE DEPEND LARGELY ON ONE-TIME SALES TO GROW REVENUES WHICH MAKE OUR REVENUES DIFFICULT TO PREDICT.

While audio conferencing provides a more recurring revenue base, a high percentage of our revenue is attributable to one-time purchases by our customers rather than long-term, recurring, conferencing subscription type contracts. As a result, our inability to continue to obtain new agreements and sales may result in lower than expected revenue, and therefore, harm our ability to achieve or sustain operations or profitability on a consistent basis, which could also cause our stock price to decline. Further, because we face competition from larger, better-capitalized companies, we could face increased downward pricing pressure that could cause a decrease in our gross margins. Additionally, our sales cycle varies depending on the size and type of customer considering a purchase. Potential customers frequently need to obtain approvals from multiple decision makers within their company and may evaluate competing products and services before deciding to use our services. Our sales cycle, which can range from several weeks to several months or more, combined with the license purchase model makes it difficult to predict future quarterly revenues.

OUR OPERATING RESULTS MAY SUFFER IF WE FAIL TO DEVELOP AND FOSTER OUR VALUE ADDED RESELLER OR DISTRIBUTION RELATIONSHIPS.

We have an existing channel and distribution network that provides growing revenues and contributes to our high margin software sales. These distribution partners are not obligated to distribute our services at any minimum level. As a result, we cannot accurately predict the amount of revenue we will derive from our distribution partners in the future. The inability or unwillingness of our distribution partners to sell our products to their customers and increase their distribution of our products could result in significant reductions in our revenue, and therefore, harm our ability to achieve or sustain profitability on a consistent basis.

SALES IN FOREIGN JURISDICTIONS BY OUR INTERNATIONAL DISTRIBUTOR NETWORK AND US MAY RESULT IN UNANTICIPATED COSTS.

We continue to expand internationally through our value added reseller network and OEM partners. We have limited experience in international operations and may not be able to compete effectively in international markets. We face certain risks inherent in conducting business internationally, such as:

- o our inability to establish and maintain effective distribution channels and partners;
- o the varying technology standards from country to country;
- o our inability to effectively protect our intellectual property rights or the code to our software;
- o our inexperience with inconsistent regulations and unexpected changes in regulatory requirements in foreign jurisdictions;
- o language and cultural differences;
- o fluctuations in currency exchange rates;
- o our inability to effectively collect accounts receivable; or
- o our inability to manage sales and other taxes imposed by foreign jurisdictions.

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THE GROWTH OF OUR BUSINESS SUBSTANTIALLY DEPENDS ON OUR ABILITY TO SUCCESSFULLY DEVELOP AND INTRODUCE NEW SERVICES AND FEATURES IN A TIMELY MANNER.

With our focus on our web and audio conferencing products and services, our growth depends on our ability to continue to develop new features, products, and services around that software and product line. We may not successfully identify, develop, and market new products and features in a timely and cost-effective manner. If we fail to develop and maintain market acceptance of our existing and new products to offset our continuing development costs, then our net losses will increase and we may not be able to achieve or sustain profitability on a consistent basis.

IF WE FAIL TO OFFER COMPETITIVE PRICING, WE MAY NOT BE ABLE TO ATTRACT AND RETAIN CUSTOMERS.

Because the Web conferencing market is relatively new and still evolving, the prices for these services are subject to rapid and frequent changes. In many cases, businesses provide their services at significantly reduced rates, for free or on a trial basis in order to win customers. Due to competitive factors and the rapidly changing marketplace, we may be required to significantly reduce our pricing structure, which would negatively affect our revenue, margins and our ability to achieve or sustain profitability on a consistent basis. We have an existing channel and distribution network that provides growing revenues and contributes to our high margin software sales. These distribution partners are not obligated to distribute our services at any particular minimum level. As a result, we cannot accurately predict the amount of revenue we will derive from our distribution partners in the future. The inability of our distribution partners to sell our products to their customers and increase their distribution of our products could result in significant reductions in our revenue, and, therefore, harm our ability to achieve or sustain profitability on a consistent basis.

IF WE ARE UNABLE TO COMPLETE OUR ASSESSMENT AS TO THE ADEQUACY OF OUR INTERNAL CONTROLS OVER FINANCIAL REPORTING AS REQUIRED BY SECTION 404 OF THE SARBANES-OXLEY ACT OF 2002, INVESTORS COULD LOSE CONFIDENCE IN THE RELIABILITY OF OUR FINANCIAL STATEMENTS, WHICH COULD RESULT IN A DECREASE IN THE VALUE OF OUR COMMON STOCK.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission adopted rules requiring non-accelerated public companies to include in their annual reports on Form 10-K for fiscal

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years ending after December 15, 2007 a report of management on their company's internal control over financial reporting, including management's assessment of the effectiveness of their company's internal control over financial reporting as of the company's fiscal year end. In addition, the accounting firm auditing a public company's financial statements must also attest to and report on management's assessment of the effectiveness of the company's internal control over financial reporting as well as the operating effectiveness of the company's internal controls for fiscal years ending after December 15, 2008. There is a risk that we may not comply with all of its requirements. If we do not timely complete our assessment or if our accounting firm determines that our internal controls are not designed or operating effectively as required by Section 404, our accounting firm may either disclaim its opinion as it is related to management's assessment of the effectiveness of its internal controls or may issue a qualified opinion on the effectiveness of our internal controls. If our accounting firm disclaims its opinion or qualifies its opinion as to the effectiveness of our internal controls, then investors may lose confidence in the reliability of our financial statements, which could cause the market price of our common stock to decline.

WE MAY ACQUIRE OTHER BUSINESSES THAT COULD NEGATIVELY AFFECT OUR OPERATIONS AND FINANCIAL RESULTS AND DILUTE EXISTING STOCKHOLDERS.

We may pursue additional business relationships through acquisitions which may not be successful. We may have to devote substantial time and resources in order to complete acquisitions and we therefore may not realize the benefits of those acquisitions. Further, these potential acquisitions entail risks, uncertainties and potential disruptions to our business. For example, we may not be able to successfully integrate a company's operations, technologies, products and services, information systems, and personnel into our business. These risks could harm our operating results and could adversely affect prevailing market prices for our common stock.

OUR CURRENT STOCK COMPENSATION EXPENSE NEGATIVELY IMPACTS OUR EARNINGS, AND WHEN WE ARE REQUIRED TO REPORT THE FAIR VALUE OF EMPLOYEE STOCK OPTIONS AS AN EXPENSE IN CONJUNCTION WITH THE NEW ACCOUNTING STANDARDS, OUR EARNINGS WILL BE ADVERSELY AFFECTED, WHICH MAY CAUSE OUR STOCK PRICE TO DECLINE.

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Under our current accounting practice, stock compensation expense is recorded on the date of the grant only if the current market price of the underlying stock exceeds the exercise price. Beginning with the fiscal quarter April 1, 2006, we will be required to report all employee stock options as an expense based on a change in the accounting standards and our earnings will be negatively impacted, which could adversely affect prevailing market prices for our common stock and increase our anticipated net losses.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS OF SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

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None

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

(a) EXHIBITS

EXHIBIT NUMBER -----	DESCRIPTION OF EXHIBITS -----
3.1(1)	Restated Certificate of Incorporation of the Company
3.2(1)	Bylaws of the Company
3.3(2)	Restated Certificate of Incorporation of the Company
3.4(2)	Amendment of Bylaws of the Company
3.5(3)	Restated Certificate of Incorporation of the Company
3.6(9)	Certificate of Designations of Series A Preferred Stock
3.7(10)	Certificate of Amendment of Restated Certificate of Incorporation of the Company
3.8	Revised Certificate of Designations of Series B Preferred Stock
4.1(1)	Form of certificate evidencing ownership of Common Stock of the Company
4.6(2)	Form of certificate evidencing ownership of Common Stock of the Company
4.7(3)	Form of Convertible Redeemable Subordinated Note
4.9(9)	Form of Redeemable Warrant (2003 Private Placement Offering)
*10.1(14)	The Company's amended and restated stock compensation plan
*10.9(2)	Employment Agreement dated November 12, 2000 between the Company and James M. Powers, Jr.
*10.11(15)	Employment Agreement dated February 15, 2001 between the Company and James L. Dunn, Jr. with Amendments
10.16(6)	Asset Purchase Agreement by and among the Company and Quisic Corporation. Common Stock Purchase Agreement by and between the Company and investors
10.17(7)	Asset Purchase Agreement by and among the Company, and Mentergy, Inc.
10.18(16)	Subcontractor Agreement between the Company and Interactive Alchemy, Inc. with Amendments 10.20(12) Note Purchase Agreement dated February 12, 2004 between the Company and certain creditors
10.21(12)	Unit Purchase and Agency Agreement dated April 19, 2004 between the Company and Cerberus Financial, Inc.
10.22(12)	Placement Agency Agreement dated March 10, 2004 between the Company and Peacock, Hislop, Staley, and Given, Inc.
10.23(11)	Asset Purchase Agreement and Plan of Reorganization by and between the Company and Glyphics Communications, Inc.
*10.24(13)	Employment Agreement dated June 1, 2004 between the Company and Gary L. Moulton, as amended
10.25(16)	Securities Purchase Agreements effective June 9, 2006
10.26(16)	Registration Rights Agreements effective June 9, 2006
10.27(17)	Amendment to Unit Purchase and Agency Agreement
14.1(13)	Code of Ethics
16(8)	Letter re Change in Certifying Accountant
+31.1	Chief Executive Officer Section 302 Certification
+31.2	Principal Financial Officer Section 302 Certification

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+32.1 Chief Executive Officer Section 906 Certification
+32.2 Principal Financial Officer Section 906 Certification

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- (1) Previously filed as an exhibit to iLinc's Registration Statement on Form S-1 (No. 333-37633), and incorporated herein by reference.
 - (2) Previously filed as an exhibit to iLinc's Annual Report on Form 10-K for the year ended March 31, 2001.
 - (3) Previously filed as an exhibit to iLinc's Annual Report on Form 10-K for the year ended March 31, 2002.
 - (4) Previously filed as an exhibit to iLinc's Form 8-K filed October 16, 2001.
 - (5) Previously filed as an exhibit to iLinc's Form 8-K filed January 30, 2002.
 - (6) Previously filed as an exhibit to iLinc's Form 8-K filed July 2, 2002.
 - (7) Previously filed as an exhibit to iLinc's Form 8-K filed December 20, 2002.
 - (8) Previously filed as an exhibit to iLinc's Form 8-K filed April 3, 2003.
 - (9) Previously filed as an exhibit to iLinc's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003.
 - (10) Previously filed as an exhibit to iLinc's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003.

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- (11) Previously filed as an exhibit to iLinc's Form 8-K filed June 14, 2004.
 - (12) Previously filed as an exhibit to iLinc's Annual Report on Form 10-K for the year ended March 31, 2004.
 - (13) Previously filed as an exhibit to iLinc's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2004.
 - (14) Previously filed as an exhibit to iLinc's Annual Proxy Statement dated July 14, 2005.
 - (15) Previously filed as an exhibit to iLinc's Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2005.
 - (16) Previously filed as an exhibit to iLinc's Annual Report on Form 10-K for the year ended March 31, 2006.
 - (17) Previously filed as an exhibit to iLinc's Form 8-K filed December 12, 2006.
- * Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to the requirements of Item 15 of Form 10-K.
- + Furnished herewith as an Exhibit

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant, iLinc Communications, Inc., has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ILINC COMMUNICATIONS, INC.

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Dated: February 2, 2007

By: /s/ James M. Powers, Jr.

Chairman of the Board, President and
Chief Executive Officer

By: /s/ James L. Dunn, Jr.

Senior Vice President & Chief Financial
Officer