COMPUTERIZED THERMAL IMAGING INC
Form 10QSB
November 14, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2005

[ ] 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: 001-16253

COMPUTERIZED THERMAL IMAGING, INC.
(Exact name of Registrant as specified in its charter)

| NEVADA | 87-0458721 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| 1719 West 2800 South<br>Ogden, Utah | 84401 |
| (Address of principal executive offices) | (Zip Code) |

(801) 776-4700
(Registrant's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the 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 a shell company (as Defined in rule 12b-2 of the Exchange Act). Yes [ ] No [X]

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: Common stock, par value $0.001, of which 114,561,698 shares were issued and outstanding as of October 31, 2005.

Transitional Small Business Disclosure Format (check one):
Yes [ ] No [X]

COMPUTERIZED THERMAL IMAGING, INC.

FORM 10-QSB

QUARTERLY REPORT

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PART I - FINANCIAL INFORMATION
ITEM 1. UNAUDITED FINANCIAL STATEMENTS

COMPUTERIZED THERMAL IMAGING, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

| | September 30, 2005 | June 30, 2005 |
|---|---|---|
| ASSETS | (Unaudited) | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 240,766 | $ 51,688 |
| Accounts Receivable - trade, less allowance for doubtful accounts of $0 on September 30, 2005 | 285 | 40 |
| Inventories | 84,712 | 87,276 |

| | | |
|---|---|---|
| Prepaid expenses | 33,809 | 33,809 |
| Total current assets | 359,572 | 172,813 |
| PROPERTY AND EQUIPMENT, Net | 7,231 | 7,525 |
| INTANGIBLE ASSETS: | | |
| Intellectual property rights, net (less accumulated amortization of accounts of $20,774 and $20,107 for September 30, 2005 and June 30, 2005, respectively | 12,073 | 12,740 |
| TOTAL ASSETS | $ 378,876 | $ 193,078 |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 544,700 | $ 558,045 |
| Accrued liabilities | 548,782 | 555,262 |
| Short-term Note Payable | 666,506 | 333,891 |
| Deferred revenues | 666,859 | 669,991 |
| Total current liabilities | 2,426,847 | 2,117,189 |
| LONG-TERM NOTE PAYABLE | 115,442 | 114,181 |
| TOTAL LIABILITIES | 2,542,289 | 2,231,370 |
| STOCKHOLDERS' EQUITY (DEFICIT): | | |
| Convertible preferred stock, no par value, 3,000,000 shares authorized; issued-none | | |
| Common stock, $.001 par value, 200,000,000 shares authorized, 114,562 issued and outstanding on September 30, 2005 and June 30, 2005 | 114,562 | 114,562 |
| Additional paid-in capital | 95,462,474 | 95,462,474 |
| Deficit accumulated | (97,740,449) | (97,615,328) |
| Total stockholders' equity (deficit) | (2,163,413) | (2,038,292) |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | $ 378,876 | $ 193,078 |

The accompanying notes are an integral part of these consolidated financial statements.



COMPUTERIZED THERMAL IMAGING, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | FOR THE THREE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|
| | 2005 | 2004 |

| | | |
|---|---|---|
| INCOME: | | |
| Product revenues | $ 14,882 | $ 66,609 |
| Service revenues | 7,165 | 9,787 |
| Total Revenues | 22,047 | 76,396 |
| Cost of product revenues | (2,670) | (13,416) |
| Cost of service revenues | (3,654) | -- |
| Total cost of revenues | (6,324) | (13,416) |
| GROSS MARGIN | 15,723 | 62,980 |
| OPERATING EXPENSES: | | |
| Operating, general and administrative | 130,951 | 116,040 |
| Litigation settlements | 1,000 | -- |
| Research and development | -- | 56,802 |
| Marketing | -- | 17,566 |
| Depreciation and amortization | 961 | 5,180 |
| Total operating expenses | 132,912 | 195,588 |
| OPERATING LOSS | (117,189) | (132,608) |
| OTHER INCOME (EXPENSE): | | |
| Interest income | 956 | 4 |
| Interest expense | (8,888) | (4,618) |
| Other | -- | 20 |
| Total other income (expense) | (7,932) | (4,594) |
| NET LOSS | $ (125,121) | $ (137,202) |
| WEIGHTED AVERAGE SHARES OUTSTANDING | 114,561,698 | 114,561,698 |
| BASIC AND DILUTED LOSS PER COMMON SHARE | $ (0.001) | $ (0.001) |

The accompanying notes are an integral part of these consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | For the THREE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|
| | 2005 | 2004 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | $(125,121) | $(137,202) |
| Depreciation and amortization | 961 | 5,182 |
| Accounts receivable - trade | (245) | (82,377) |
| Accounts receivable - other | -- | 1,391 |
| Inventories | 2,563 | 8,628 |
| Prepaid expenses | -- | 11,802 |
| Accounts payable | (13,345) | 14,789 |
| Accrued liabilities | 2,397 | (47,467) |
| Deferred revenues | (3,132) | 84,410 |
| Net cash used in operating activities | (135,922) | (140,844) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Net cash provided by (used in) investing activities | -- | -- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from loan | 325,000 | -- |
| Net cash provided by financing activities | 325,000 | -- |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 189,078 | (140,844) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 51,688 | 168,955 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 240,766 | $ 28,111 |

The accompanying notes are an integral part of these consolidated financial statements.



COMPUTERIZED THERMAL IMAGING, INC.
Notes to Condensed Consolidated Financial Statements
September 30, 2005
(UNAUDITED)

NOTE A. UNAUDITED FINANCIAL STATEMENTS AND BASIS OF PRESENTATION

The condensed consolidated financial statements of Computerized Thermal Imaging (the "Company") for the three month periods ended September 30, 2005 and

2004 are unaudited. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's results of operation for the periods presented have been included. These interim statements should be read in conjunction with the audited consolidated financial statements and footnotes thereto contained in the Company's most recent Annual Report on Form 10-KSB for the Year Ended June 30, 2005. The consolidated results of operations for the three-month period ended September 30, 2005 is not necessarily indicative of the results to be expected for the full year.

Certain amounts from the prior period financial statements have been reclassified to conform to current period presentation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions, including for example, accounts receivable allowances, inventory obsolescence reserves, deferred tax valuation allowances, and reserves for pending or threatened litigation. These assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue as a going concern. In it's Annual Report on Form 10-KSB for the Year Ended June 30, 2005, the Company reported that its recurring losses from operations, negative cash flows from operations, the Company's need for additional working capital, and the Company's continuing struggle to obtain FDA approval for its primary product raised substantial doubt about the Company's ability to continue as a going concern. The Company's independent auditors have also expressed their doubts about the Company's ability to continue as a going concern.

In order to pursue its existing plan of operations, the Company will have to secure additional financing through the sale of equity, the incurrence of debt or the sale of assets, including the Company's intellectual property, or some other method. There can be no assurance that capital will be available from any source or, if available, that the terms and conditions associated with such capital will be



acceptable to the Company. If the Company raises equity or debt capital, the sale of these securities could dilute existing shareholders, and borrowings from third parties could result in assets being pledged as collateral and could provide loan terms that could adversely affect the Company's operations and the price of its capital stock.

The accompanying condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary if the Company is unable to continue as a going concern.

NOTE B. REVENUE RECOGNITION

The Company generates revenues from sales of its products and from services provided to its customers. The Company sells its products to independent distributors and to end customers. With the exception of sales

transactions in which a customer may return a defective product, the Company does not provide its customers with other rights to return products. The Company recognizes revenue from its product sales to end customers upon shipment of products when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant Company obligations remain, the fee is fixed or determinable, and collectibility is probable. If these conditions are not met, revenue is deferred until such obligations and conditions are fulfilled. If the Company retains an ongoing obligation under a sales arrangement, revenue is deferred until all of the Company's obligations are fulfilled. The Company has adopted the practice of deferring revenue on shipments to distributors until cash payment from the distributor is received by the Company, which is generally when the product is sold by the distributor to the end customer.

Certain of the Company's products contain software that is not considered incidental to the product. Sales of those products are subject to the provisions of AICPA Statement of Position No. 97-2, SOFTWARE REVENUE RECOGNITION, as amended, which requires the deferral of revenue from certain multiple-element arrangements. The Company defers revenue from multiple-element arrangements until all elements have been delivered.

Service revenue is derived from non-destructive testing of turbine blades and other items as well as service of medical equipment previously sold but not covered by warranty. Service revenue is recognized upon the completion of the services provided. The Company offers extended warranties on certain of its products. Warranty revenue is recognized ratably over the period of the agreement as services are provided.

NOTE C. DEFERRED REVENUE

Deferred revenues at September 30, 2005 was approximately $666,859, and consisted of $660,000 of deferred revenues with a manufacturing/licensing agreement between the Company and NanDa Thermal Medical Technology, Inc. ("NanDa") and $6,859 of deferred warranty revenues.



| DEFERRED REVENUES | SEPTEMBER 30 | JUNE 30, 2005 |
|---|---|---|
| | 2005 | 2004 |
| Nanda Licensing | 660,000 | 660,000 |
| Warranty Revenues | 6,859 | 9,991 |
| | $ 666,859 | $ 669,991 |

The Company's Manufacturing License Agreement with NanDa (the "NanDa Agreement") is billed in stages. The Company has billed NanDa $660,000 to date and received payment for $660,000. The NanDa Agreement obligates the Company to provide training services for NanDa employees in the United States and in China. The Company has provided the training services for NanDa employees in the United States, but, has yet to train in China. Therefore, according to the Company's revenue recognition policy, the Company will not recognize any revenue from the NanDa Agreement until all its obligations are performed or the NanDa Agreement is deemed to be complete.

NOTE D. INVENTORIES

Inventories are stated at the lower-of-cost or market with cost determined using the first-in first-out method of accounting. As of the dates set forth below, the Company's inventories consisted of the following:

| | SEPTEMBER 30, 2005 | JUNE 30, 2005 |
|---|---|---|
| Raw materials | $ 535,837 | $ 536,053 |
| Inventory Reserve | (639,664) | (639,664) |
| Work in Process | - | - |
| Finished Goods | 188,539 | 190,887 |
| Total | $ 84,712 | $87,276 |

Finished goods inventory at September 30, 2005 consisted of approximately $189 thousand of finished goods ready for sale, $0 in the manufacturing process and $536 thousand of raw materials. The Company has impaired its inventory by 88% due to the company's ability to continue as a going concern. The impairment is held in a reserve account.

The Company has in the past reserved for excess and obsolete inventory by comparing inventory on hand to estimated consumption during the next twelve months. Consumption is estimated by annualizing trailing three or six -month sales volumes, adjusting those volumes for known activities and trends, then comparing forecast consumption to quantity on hand. However, the Company evaluates all inventories to determine if the total impaired book value could be recovered if liquidation becomes necessary. The Company felt no need to impair additional inventory in the quarter ended September 30, 2005



NOTE E. INCOME TAXES

The Company accounts for income taxes using the liability method. Under this method, the Company records deferred income taxes to reflect future year tax consequences of temporary differences between the tax basis of assets and liabilities and their financial statement amounts. The Company has reviewed its net deferred tax assets, together with net operating loss carry-forwards, and has provided a valuation allowance to reduce its net deferred tax assets to their net realizable value. Due to uncertainty regarding the Company's volatility to continue as a going concern, there are no deferred tax assets.

NOTE F. CONTINGENCIES

SEC INVESTIGATION

In December 2002, the Company was requested to provide certain documents to the SEC and the U.S. Department of Justice in connection with an investigation regarding possible violations of the insider trading prohibitions found in the federal securities laws. The Company responded to the Commission's requests for copies of documentation, and members of the Company's management have provided testimony to the Commission. To date, the Company has incurred

approximately $650,000 in legal costs in complying with these requests. The Company also may be required to indemnify its officers and directors in connection with fees incurred in connection with these investigations. The Company's efforts to respond to the Commission's requests has required, and in the future may require, significant additional legal expenses, may make fund raising more difficult if not impossible, and will divert management's attention away from the Company's day-to-day operations.

INDEMNIFICATION

Under its bylaws and contractual agreements, the Company may be required to indemnify its current and former officers and directors who are parties to litigation or other proceedings by providing legal defense through the Company's attorneys (or reimbursing the parties for their own attorneys) and covering all damages the parties may suffer if the plaintiffs are successful.

OTHER LEGAL PROCEEDINGS

The Company is involved in certain other litigation matters in the normal course of business which management currently believes are not likely to result in any material adverse effects on the Company's financial position, results of operations, or net cash flows.

NOTE G. RECENT DEVELOPMENTS

On June 30, 2004 the Company filed a "Citizen Petition" with the FDA contending that consideration of the Company's application for pre-market approval was severely and improperly prejudiced because of pervasive bias against the Company by the FDA staff reviewers who improperly undermined the review of the Company's application and ultimately caused the FDA to reject that application. The Company is seeking internal documents within the FDA to determine the basis for the FDA staff's behavior.



ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

FORWARD-LOOKING STATEMENTS CONCERNING THE COMPANY'S BUSINESS

The following discussion should be read in conjunction with the Company's Condensed Consolidated Financial Statements, the notes thereto and the other information included in this Report. Certain statements in this "Management's Discussion and Analysis or Plan of Operation" are forward-looking statements. When used in this document, the words "expects," "anticipates," "intends," "plans," "may," "believes," "seeks," "estimates," and similar expressions generally identify forward-looking statements. The forward-looking statements contained herein are based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward-looking statements. For a more detailed discussion of these and other business risks, see "Factors that May Affect Future Results."

OVERVIEW

The company's mission is to improve the quality of life by raising the performance standards of infrared thermal imaging technology for both the medical device and industrial markets. The Company designs, manufactures and markets thermal imaging devices and provides services used for clinical

diagnosis, pain management and industrial non-destructive testing. The Company provides inspection services and designs and builds non-destructive test systems for industrial customers.

The Company's current products are the BCS 2100, Photonic Stimulator, Thermal Image Processor ("TIP") and the company's TBIS. The Company has historically marketed its products with an internal sales force and through independent distributors. At present, however, due to troubled financial condition, the Company is not actively marketing products with the exception of the Company's web page (www.cti-net.com). To date, revenues have been generated principally from the sale of the Company's Photonic Stimulator, TIP, TBIS and services provided in connection with the TBIS.

Given the Company's inability to market its principal product unless it secures FDA pre-market approval, the Company's need to raise capital to fund its operations, history of losses ($97.7 million since inception), and the pending or future litigation, the Company's independent auditor's opinion dated October 2005 contains a "going concern qualification," meaning that the Company's independent auditors have indicated that there is substantial doubt as to the Company's ability to continue as a going concern. The Company's efforts to raise additional funds to date have been only marginally successful. Since the FDA's rejection of the Company's application for pre-market approval of the BCS 2100 in December 2002, the company has raised approximately $500 thousand in advances under an equity line of credit with Beach Boulevard, $1.32 million through a private issuance of restricted stock, $660 thousand from the NanDa Agreement and $645 thousand from short-term notes. The Company has pursued additional financing transactions, but, as of the date of this Report, the Company has been unsuccessful in their efforts to raise additional capital. Regardless of the FDA's ultimate decision regarding the Company's application for pre-market approval of the BCS2100, the Company will require additional capital to execute its operating plan, which may include more clinical trials, research and development, marketing into Canada and marketing and manufacturing expenses.



The following discussion and analysis of the Company's consolidated financial condition and results of operations should be read in conjunction with the Company's audited condensed consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-KSB for the fiscal year ended June 30, 2005.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires the Company to estimate the effect of various matters that are inherently uncertain as of the date of the financial statements. Each of these required estimates varies in regard to the level of judgment involved and its potential impact on the Company's reported financial results. Estimates are deemed critical when a different estimate could have reasonably been used or where changes in the estimate are reasonably likely to occur from period to period, and would materially impact the Company's financial condition or results of operations. The Company's significant accounting policies are discussed in Note 1 of the Notes to Condensed Consolidated Financial Statements. Critical estimates inherent in these accounting policies are discussed in the following paragraphs. The Company's management has discussed the development and selection of these critical accounting policies with the Audit Committee of the Companies Board of Directors.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents include cash in checking accounts and short-term highly liquid investments with an original maturity of one year or less.

REVENUE RECOGNITION - Revenue recognition is a significant business process that requires management to make estimates and assumptions. The Company recognizes revenue from product sales after shipment when persuasive evidence of an agreement exists, delivery of the product has occurred, no significant obligations remain, the price or fee is fixed or determinable, and collection is probable. If these conditions are not met, revenue is deferred until such obligations and conditions are fulfilled.

The Company's standard domestic terms for medical products sold to end-user customers are "prepaid," and the Company's standard international terms for its medical products require payment in cash or placement of a letter of credit before shipment. On occasion, the Company offers extended payment terms beyond its normal business practices, usually in connection with providing an initial order of demonstration equipment to a new domestic distributor. The Company considers fees on these extended terms agreements not fixed and collectibility less than probable and defer the revenue until receipt of payment. The Company sells separate extended warranty contracts for its TIP and Photonic Stimulator and recognize revenue from those arrangements ratably over the contract life. The Company does not offer rights or return privileges in sales agreements.

RESEARCH AND DEVELOPMENT EXPENSES - The Company expenses as incurred the direct, indirect and purchased research and development costs associated with their products. The Company believes this method is conservative given the product and market acceptance risk inherent to the Company's products and reduces administrative burden and cost.

IMPAIRMENT OF LONG-LIVED ASSETS - The Company follows the provisions of Financial Accounting Standards Board ("FASB") SFAS No. 141, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, which requires that if the sum of the future cash flows expected to result from the assets, undiscounted and without interest charges, is less than a company's



reported value of the assets, the asset is not recoverable and the company must recognize impairment. The amount of impairment to be recognized is the excess of the reported value of the assets over the fair value of those assets and is recorded as impairment expense on the company's statements of operations. In estimating impairments, management makes assumptions about future cash flows and fair value that are inherently uncertain, can significantly affect the results and may differ from actual future results.

INVENTORY RESERVES - The Company has in the past reserved for excess and obsolete inventory by comparing inventory on hand to estimated consumption during the next twelve months. Consumption is estimated by annualizing trailing three or six month sales volumes, adjusting those volumes for known activities and trends, and then compare forecast consumption to quantity on hand. However, the Company evaluates all inventories to determine if the total impaired book value could be recovered if liquidation is necessary. The Company felt no need to impair additional inventory during the quarter ended September 30, 2005.

TRENDS/UNCERTAINTIES AFFECTING CONTINUING OPERATIONS

The Company is exposed to the opportunities and risks usually associated with marketing and manufacturing novel products, including staff retention and recruiting, market acceptance of the Company's products, product warranty, bad debts and inventory obsolescence. The Company expects to earn revenues from the sale of its products, but there is no guarantee that these revenues will recover all the costs of marketing, selling and manufacturing of the products.

The Company has only Internet marketing efforts at present due to the Company's current lack of resources. If the Company is able to acquire additional capital, of which there can be no assurance, the Company hope to be able to resume marketing efforts by building relationships with manufacturers, medical equipment dealers, physicians and clinical investigators; communicating with the Company's target markets by attending trade shows and conferences, making direct sales calls, and sponsoring clinics in which the Company could introduce and demonstrate its products. The Company believes marketing medical products through trade shows, conference presentations, direct mail and inside sales, augmented with dealers, provides a low-cost, high-leverage approach to diagnostic imaging and pain management practitioners.

If resources permit, the Company hopes to be able to organize clinical studies with institutions and practitioners to obtain user feedback and to secure technical papers for training and marketing purposes. These strategies represent a significant investment of time and resources and in the past have provided useful information; however, there can be no guarantee that these strategies will lead to market acceptance of the Company's products.

To date, the Company has had limited operating revenues from the sale of its products and services ($4 million in total revenues since inception). The Company cannot provide any assurance that it will achieve profitability in the future. The Company's immediate priority is to produce revenue by selling existing TIP and Photonic Stimulator inventory, then, to expand the Company's market in Canada where the Company has obtained the necessary licenses for, current product offerings to pursue the U.S. market for its TIP and Photonic Stimulator; and to reconcile issues presented to the FDA in the Company's Citizens Petition. At this time, the Company is unsure how much time and additional financing will be required to resolve issues with the FDA. The Company can offer no assurance that it will ever be able to resolve those FDA issues. The Company is also unsure about their ability to raise additional financing that will be required to continue the business operations. These uncertainties, among others, raise doubts about the Company's ability to continue as a going concern.



FACTORS THAT MAY AFFECT FUTURE RESULTS

The Company's operating results and financial condition are subject to substantial risks and uncertainties. These risks and uncertainties include, but are not limited to, the following:

- The Company expects to continue to incur losses, deficits, and deficiencies in liquidity for the foreseeable future. Unless the Company is able to finalize agreements for additional capital investments.

- A failure to raise additional capital could cause the Company

to severely curtail operations, which would likely result in immediate and substantial dilution to the Company shareholders, or cease operations entirely, which would likely eliminate any value in the Company's common stock.

- The volatility in the market price of the Company's common stock could continue and adversely affect shareholder value.

- The Company can issue preferred stock or sell other securities or other financing instruments, including convertible debt, which would result in significant dilution to existing shareholders.

- If the Company is unsuccessful in preventing others from using its intellectual property, the Company could lose a competitive advantage. If the Company's intellectual property infringes the rights of other parties, it could incur damages or be forced to cease using marketing or selling those products.

- The Company does not have product liability insurance; if the Company is made subject to a products liability claim, whether or not the claim is meritorious, the Company's results of operation and financial condition may be adversely affected.

OTHER FACTORS THAT MAY AFFECT FUTURE RESULTS.

The foregoing factors should be read in conjunction with the Company's audited condensed consolidated financial statements, notes thereto and risk factors set forth in the Company's Annual Report on Form 10-KSB for the fiscal year ended June 30, 2005 (the "Form 10-KSB"). Many of the risks identified above are discussed in greater detail in the Form 10-KSB.

RESULTS OF OPERATIONS

QUARTER ENDED SEPTEMBER 30, 2005, COMPARED TO QUARTER ENDED SEPTEMBER 30, 2004

REVENUES



Total revenues for the three months ended September 30, 2005 decreased $54 thousand, down to $22 thousand from $76 thousand in September 2004. This represents a 71% reduction in revenues. Fifteen thousand dollars of the Company's revenues resulted from product sales and $7 from services provided in the period ending September 30, 2005. During this same period in 2004 product revenues were $67 thousand with service revenues coming in at $10 thousand. The decrease in revenue was primarily attributed to the reduction in sales force and other resources.

There were no unfilled orders as of September 30, 2005. The Company has not had any foreign sales in the past 3 months.

COSTS AND EXPENSES

Gross margins for the three months ended September 30, 2005 were $15 thousand compared to gross margins of $63 thousand for the same period of the

prior year or a 75% decrease. Total cost of revenues for September 30, 2005 was $6 thousand, compared to $13 thousand for the same period last year: a 53% decrease.

The increase in gross margin resulted primarily from the significant reduction in the Company's cost of goods sold. Cost of goods declined for several principal reasons. First, operations were dramatically reduced, which has resulted in significantly lower revenues, and has also has reduced cost of goods. Second, in part as a result of the reduced level of operations, the Company has experienced lower costs of servicing equipment. Third, a change in mix of revenue from product sales to service most recently, service revenue tending to bring higher margins.

The Company is currently in the process of developing a revised business structure that the Company believe will enhance revenue through leasing of its products and providing services to the Company's customers rather than direct sales.

General and administrative expenses for the three months ended September 30, 2005 were $131 thousand compared to $116 thousand for the same period last year, an increase of $15 thousand. The increase primarily reflects the accrual of the CEO's salary. This past quarter the Company's CEO, RV Secord, has taken a minimal salary and the balance has been accrued.

Depreciation and amortization expense for the three month period ended September 30, 2005 decreased $4 thousand from $5 thousand to $1 thousand or an 81% decrease, compared to the same periods of the prior year. There was no additional impairments in the three month period ended September 30, 2005.

OPERATING INCOME / LOSS

The Company recorded an operating loss of $117 thousand for the three months ended September 30, 2005, compared to an operating loss of $132 ended September 30, 2004. The operating loss improvement of approximately $15 thousand for three months was due principally to the Company's receipt of revenues resulting from an existing customers need for repairs and service on previously purchased products, sale of the Company's Photonic Stimulator and reduction of costs due to the Company's current lack of sales and capital funding.



OTHER INCOME

Net interest and other expense for the three months ended September 30, 2005 increased $3 thousand from the same period of 2004, from $5 thousand to a net expense of $8 thousand. Interest expense is primarily an accrual of imputed interest on five loans of $100 thousand, $200 thousand, $20 thousand, $100 thousand and $325 thousand, all to related parties. There was virtually no interest income due to the lack of cash.

NET INCOME/(LOSS)

The Company recognized no extraordinary gains or losses during the three months ended September 30, 2005, therefore, net income and operating income were identical. The Company also recorded no income taxes or income tax benefit due to the going concern opinion issued by the Company auditors. Because the Company's future as an on going business is in question the Company's ability to take advantage of a booked tax benefit is also in question.

Therefore, no benefit has been recognized. However, the Company does hope to be able to, in the future, obtain a profitable operational status at which time the Company could then take advantage of a net operating loss carry-forward for tax purposes.

The net income and loss for the three month period ended September 30, 2005 resulted in a per share income loss of less than $0.001 and loss of less than $0.001 ended September 30, 2004.

LIQUIDITY AND CAPITAL RESOURCES

SOURCES AND USES OF LIQUIDITY

The Company's sources of funds used for operations has historically come from selling common stock, as well as the issuance and exercise of options and warrants, revenues generated from operations, sales of marketable securities, interest earned from marketable securities available for sale and debt assumption.

For the three month period ended September 30, 2005 the Company's sole source of cash was from product sales. The Company is pursuing additional financial transactions and has received $325 thousand as debt proceeds. As of the date of this report - none have been finalized.

The Company's cash requirements include, but are not limited to, general corporate expenses including employee salaries and benefits, lease payments on office space, legal and accounting fees for litigation and public reporting requirements, procurement of inventory and supply expenses associated with the Company's efforts to manufacture and market it's medical and industrial applications. The Company has reduced many of these costs in an effort to preserve cash; however, most of these costs are attributable to activities that are necessary to continue the Company's operations.

Net cash used in operating activities for the three months ended September 30, 2005 was $136 thousand, compared to $140 thousand of cash for the three months ended September 30, 2004. The decrease in cash used in operating activities was primarily a result of the Company's efforts to decrease its expenses and cash outlays and is affected by fluctuations in accounts payable and accrued expense balances.



As of November 1, 2005, the Company's current monthly expense rate is approximately $40 thousand; the Company's monthly expense rate at former full operational level was approximately $1.1 million.

The Company has no contractual obligations or commitments as of September 30, 2005. All rentals and leases are on a month-to-month basis.

CAPITAL REQUIREMENTS/PLAN OF OPERATION

The Company's capital requirements have varied significantly from the Company's estimates and will likely continue to vary from those estimates. The capital requirements depend upon numerous factors including, but not limited to: a) FDA approval process; b) results of pre-clinical and clinical testing; c) costs of technology; d) time and costs involved in obtaining other regulatory approvals; e) costs of filing, defending and enforcing any patent claims and other intellectual property rights; f) the economic impact of developments in

competing technology and its markets; g) competing technological and market developments; h) the terms of any new collaborative, licensing and other arrangements that the Company may establish; i) litigation costs; and j) costs the Company incurs in responding to inquiries and investigations conducted by the SEC and other governmental entities.

Since inception, the Company has generated significant losses from operations ($97.7 million), but only limited revenues ($4 million). The Company has taken actions to reduce Company expenses and cash consumption; however, the Company expect to incur additional operating losses for the indefinite future. The Company's working capital requirements in the foreseeable future will depend on a variety of factors and assumptions. In particular, the Company will need to obtain additional financing through additional equity and/or debt financings or through the sale of assets (including its intellectual property) during fiscal year 2005. If the Company raises additional funds through the issuance of equity securities or other financing instruments which are convertible for equity securities, the Company shareholders may experience significant dilution that would aversely affect the price of the Company common stock. Furthermore, there can be no assurance that additional financing will be available when needed or at all, or that if available, such financing will be on terms favorable to the Company or the Company shareholders. If financing is not available when required or is not available on acceptable terms, the Company may be required to curtail its operating plan and will likely not be able to continue operations as a going concern.

The Company does not have sufficient capital to cover: 1) the expected costs of additional clinical studies currently required by the FDA; or 2) the anticipated expense of funding the Company's business plan over the next year. The Company will not be able to continue its business operations unless it can obtain additional capital immediately. This capital, if obtained, could be generated through issuance of securities, assumption of loans, sale of assets (including the Company's intellectual property); however, the Company has only limited commitments for any capital infusion, and can give no assurance that the Company will be able to raise any such capital. Furthermore, the Company's troubled financial condition, as well as the lack of FDA pre-market approval of the BCS2100 have made it difficult if not impossible to raise capital needed to continue its operations. If the Company is not successful in quickly raising additional capital, the Company will have to scale back its business plan or discontinue operations.



As of September 30, 2005, the Company believed that the Company had sufficient liquidity to sustain the current level of limited operations for the next six months. The Company's monthly expense rate at that time averaged $40 thousand. The Company had cash, marketable securities and pre-paid expenses of approximately $241 thousand and current liabilities (excluding the debenture and deferred revenue) of approximately $1.5 million. On a short-term basis, the Company believed it would be able to fund the current level of limited operations with cash on hand and the proceeds of receivables and current sales activities; however, to fund the Company operations over the long term (more than 6 months) the Company believes it will need to raise additional capital or curtail its operations.

Overall, the Company has reduced monthly cash consumption to under $40 thousand, which the Company currently believes will be adequate to sustained its curtailed operations only through March 2006. The Company has systematically reduced expenses by eliminating all expenditures except for those necessary to

fill orders, file regulatory reports, and seek funding. If the Company is unable to secure additional capital, the Company will likely be forced to discontinue operations entirely.

ITEM 3. CONTROLS AND PROCEDURES

(a) Based on the evaluation of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) required by paragraph (b) of Rules 13a-15 or 15d-15, the Company's President and Acting Chief Financial officer have concluded that, as of September 30, 2005, the Company's disclosure controls and procedures were effective.

(b) The Company is not presently required to conduct quarterly evaluations of the Company's internal control over financial reporting pursuant to paragraph (d) of Rules 13a-15 or 15d-15 promulgated under the Exchange Act. The Company is, however, in the process of designing, evaluating and implementing internal controls in anticipation of the date when the Company will become subject to such evaluation requirements.

PART II -- OTHER INFORMATION

ITEM 4. LEGAL PROCEEDINGS

SEC INVESTIGATION

In December 2002, the Company was requested to provide certain documents to the SEC and the U.S. Department of Justice in connection with an investigation regarding possible violations of the insider trading prohibitions found in the federal securities laws. The Company responded to the Commission's requests for copies of documentation, and members of the Company management have provided testimony to the Commission. To date, the Company has incurred approximately $650,000 in legal costs in complying with these requests. The Company also may be required to indemnify its officers and directors in connection with fees incurred in connection with these investigations. The Company's efforts to respond to the Commission's requests have required, and in the future may require, significant additional legal expenses, may make fund raising more difficult if not impossible, and will divert management from the Company day-to-day operations.

INDEMNIFICATION



Under the Company's bylaws and contractual agreements, the Company may be required to indemnify its current and former officers and directors who are parties to litigation or other proceedings by providing legal defense through the Company attorneys (or reimbursing the parties for their own attorneys) and covering all damages the parties may suffer if the plaintiffs are successful.

OTHER LEGAL PROCEEDINGS

The Company is involved in certain other litigation matters in the normal course of business which management currently believes are not likely to result in any material adverse effects on the Company's financial position, results of operations, or net cash flows.

ITEM 5. EXHIBITS

| | | |
|---|---|---|
| 31.1 | Certification of Chief Executive Officer |
| 31.2 | Certification of Chief Financial Officer |
| 32.1 | Certification of Chief Executive Officer |
| 32.2 | Certification of Chief Financial Officer |



SIGNATURES

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

COMPUTERIZED THERMAL IMAGING, INC.
(Registrant)

/s/Richard V. Secord
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Dated November 14, 2005
Richard V. Secord
Chairman & Chief Executive Officer