IMPROVENET INC
Form 10QSB
May 20, 2005

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

FORM 10-QSB

(MARK ONE)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

[_] TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM ________ TO ________

COMMISSION FILE NUMBER: 000-29927

IMPROVENET, INC.

(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

DELAWARE	77-0452868
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

10799 NORTH 90TH STREET, SUITE 200, SCOTTSDALE, AZ 85260

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(480) 346-0000

(ISSUER'S TELEPHONE NUMBER)

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 [_]

The number of shares outstanding of the registrant's common stock, $.001 par value, was 54,552,653 as of April 29, 2005.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

IMPROVENET, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	March 31, 2005
	(Unaudited
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents	$ 251,03
Restricted cash and cash equivalents	--
Accounts receivable (net of allowance of approximately $269,000 and $284,000 as of March 31, 2005 and December 31, 2004, respectively)	190,43
Prepaid expenses and other current assets	37,72

Assets of discontinued operations	6,05
Total current assets	485,25
PROPERTY AND EQUIPMENT, NET	243,57
TOTAL ASSETS	$ 728,83
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Accounts payable	$ 404,78
Obligations under capital leases - current portion	16,93
Accrued litigation related costs	60,30
Deferred revenue	35,30
Line of credit	--
Accrued expenses and other current liabilities	22,94
Liabilities of discontinued operations	291,04
TOTAL CURRENT LIABILITIES	831,31
LONG-TERM LIABILITIES:	
Obligations under capital leases - long-term portion	37,50
TOTAL LIABILITIES	868,81
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY:	
Common stock, $0.001 par value; 100,000,000 shares authorized; 54,552,653 shares issued and outstanding as of March 31, 2005; 54,430,332 shares issued and outstanding as of December 31, 2004	54,55
Additional paid-in-capital	2,619,03
Accumulated deficit	(2,813,56
TOTAL SHAREHOLDERS' EQUITY	(139,98
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 728,83

See the accompanying notes to the unaudited condensed consolidated financial state

IMPROVENET, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Revenue	$ 868,853	$ 711,382

Cost of revenue	387,191	276,848
Gross profit	481,662	434,534
Selling, general and administrative expense	828,319	454,616
Loss from operations	(346,657)	(20,082)
Other income (expense)		
Interest income	1,623	607
Interest expense and financing costs	(2,667)	(8,267)
Miscellaneous income	501	9,201
Net loss from continuing operations before income taxes	(347,200)	(18,541)
Provision for income taxes	--	--
Net loss from continuing operations	(347,200)	(18,541)
Income from discontinued operations, net of income taxes	9,709	22,125
Net income (loss) attributable to Common Shareholders	(337,491)	3,584
Basic earnings (loss) per share:		
Continuing operations	$ (0.01)	$ 0.00
Discontinued operations	$ 0.00	$ 0.00
Net loss	$ (0.01)	$ 0.00
Weighted average Common Shares outstanding - basic	54,472,773	39,210,315
Diluted earnings (loss) per share:		
Continuing operations	$ (0.01)	$ 0.00
Discontinued operations	$ 0.00	$ 0.00
Net loss	$ (0.01)	$ 0.00
Weighted average Common Shares outstanding - diluted	54,472,773	40,170,315

See the accompanying notes to the unaudited condensed consolidated financial statements.

4

IMPROVENET, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2005

	Common Stock		Additional Paid-In	Accumulat
	Shares	Amount	Capital	Deficit

Balances, December 31, 2004	54,430,332	$ 54,431	$ 2,604,850	$ (2,476,
Stock-based compensation	122,321	122	14,180	
Net loss	--	--	--	(337,
Balances, March 31, 2005	54,552,653	$ 54,553	$ 2,619,030	$ (2,813,

See the accompanying notes to the unaudited condensed consolidated financial state

5

IMPROVENET, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Mont
	2005
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss from continuing operations	$ (347,20
Adjustments to reconcile net loss to net cash flows	
from operating activities -	
Depreciation	25,28
Non-cash stock-based compensation	14,30
Loss on sale of equipment	1,13
Changes in operating assets and liabilities	
Accounts receivable	(19,72
Prepaid expenses and other current assets	(10,64
Accounts payable	64,66
Accrued litigation related costs	(6,00
Deferred revenue	9,56
Accrued expenses and other current liabilities	7,27
Intercompany receivable	73,02
Cash flows from operating activities	(188,30
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchase of property and equipment	(10,23
Capitalization of software and website development costs	(14,44
Cash flows from investing activities	(24,67
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from sale of equipment	40
Borrowings (repayments) on line of credit	(62,30
Change in restricted cash and cash equivalents	100,00
Principal repayments of capital lease obligations	(77

Cash flows from financing activities	37,32
CASH FLOWS FROM DISCONTINUED OPERATIONS	(129,08
DECREASE IN CASH AND CASH EQUIVALENTS	(304,74
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	555,78
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 251,03
SUPPLEMENTAL CASH FLOW INFORMATION:	
Interest paid	$ 6,31
Income taxes paid	$ --
SUPPLEMENTAL DISCLOSUREES FOR NONCASH INVESTING AND FINANCING ACTIVITIES	
Acquisition of property and equipment under capital lease agreements	$ 55,20

See the accompanying notes to the unaudited condensed consolidated financial state

IMPROVENET, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS

1. ORGANIZATION OF BUSINESS AND BASIS OF PRESENTATION

The consolidated financial statements of ImproveNet, Inc. have been prepared in accordance with accounting principles generally accepted in the United States. The consolidated financial statements include the accounts of ImproveNet and its wholly owned subsidiary, eTechLogix, Inc. ("eTechLogix") (collectively, "ImproveNet", "we", "us", or "our"). All intercompany transactions and balances have been eliminated in consolidation. Certain 2004 financial statement amounts have been reclassified to conform with 2005 presentation.

We are a leading Internet-based home improvement services company that, through our TrueMatch(TM) platform, connects homeowners to local screened home improvement service providers throughout the United States. We commenced operations in January 1996 as a regional contractor matching service. ImproveNet was initially incorporated in California and was reincorporated in Delaware in 1998. We spent the majority of 1996 and 1997 building our database of home improvement service providers, developing our services and technology, recruiting personnel and raising capital. We launched our website, www.ImproveNet.com, and homeowner / home improvement service provider matching service on a national scale in August 1997. During 1999 we completed the acquisition of two regional contractor referral companies: Contractor Referral Services, LLC and the J.L. Price Corporation, both of which were integrated into our operations during 2000. On March 15, 2000, we completed our initial public offering and raised approximately $44.16 million in gross proceeds through the sale of approximately 2.76 million Common Shares. Shares of our Common Stock were initially listed on the NASDAQ National Market System. During the first half of 2000, we spent substantial amounts on marketing and marketing related activities, as well as the development and expansion of our service and operations infrastructure. During 2002 ImproveNet merged with eTechLogix. The merger was accounted for as a reverse merger as the previous owners of eTechLogix received a controlling interest in ImproveNet subsequent to the merger. During the fourth quarter of 2004, the Board of Directors determined that our principal focus going forward would be on ImproveNet's core lead matching service and the products and services that compliment it. This decision was based on a number of factors, which include, but are not limited to, the opportunities in the Internet home improvement industry. Based on this decision, we have actively pursued, during the first quarter of 2005, disposition of substantially all of the operations of eTechLogix. An agreement has been executed with 2020 Technologies International, Inc. for the anticipated disposition and is expected to close in the near future. Accordingly, the operations of eTechLogix, which had been classified as a separate operating segment in previous filings, have been classified as discontinued operations for all periods presented in these financial statements.

These unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. All significant intercompany transactions and accounts have been eliminated. Certain information related to our organization, significant accounting policies and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States has been condensed or omitted. The accounting policies followed in the preparation of these interim condensed consolidated financial statements are consistent with those followed in our annual consolidated financial statements for the year ended December 31, 2004, as filed on Form 10-KSB. In the opinion of management, these unaudited condensed consolidated financial statements contain all material adjustments, consisting only of normal recurring adjustments, necessary to fairly state our financial position, results of operations and cash flows for the periods presented and the presentations and disclosures herein are adequate when read in conjunction with our Form 10-KSB for the year ended December 31, 2004. Certain reclassifications have been made to the prior period financial statement amounts to conform to the current presentation. Operating results for interim periods are not necessarily indicative of the results for full years. These interim financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto appearing in our annual report on Form 10-KSB for the year ended December 31, 2004.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the 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 revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful accounts and credits, liabilities for potential litigation and deferred taxes.

Our financial statements are presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. We have continued to sustain losses for the past several years. We do not have sufficient revenues to cover operating costs, and we have a deficit in our shareholders' equity. We anticipate the need to raise additional capital

through public or private, debt or equity offerings. No assurance can be made that we can raise additional capital on terms that are acceptable to us. The financial statements do not include any adjustments to reflect the possible future effects of the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the uncertainty of our ability to continue as a going concern.

Basic earnings (loss) per share is calculated by dividing income (loss) available to Common Shareholders by the weighted average number of Common Shares outstanding for the period. Diluted earnings (loss) per share is calculated based on the weighted average shares of Common Stock outstanding during the period plus the dilutive effect of Common Stock purchase warrants and stock options using the treasury stock method and the dilutive effects of convertible instruments using the if-converted method. Contingently issuable shares are included in the computation of basic earnings (loss) per share when issuance of the shares is no longer contingent. Dilutive securities not included in the diluted loss per share calculation are as follows (unaudited):

	Three Months Ended March 31,	
	2005	2004
Options to purchase Common Shares	509,060	516,812
Warrants to purchase Common Shares	46,154	449,306
Dilutive securities	555,214	966,118

NEW ACCOUNTING PRONOUNCEMENTS

Statements of Financial Accounting Standards

SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes standards for how an issuer classifies, measures and discloses in its financial statements certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 requires that an issuer classify financial instruments that are within its scope as liabilities, in most circumstances. Such financial instruments include (i) financial instruments that are issued in the form of shares that are mandatorily redeemable, (ii) financial instruments that embody an obligation to repurchase the issuer's equity shares, or are indexed to such an obligation, and that require the issuer to settle the obligation by transferring assets, (iii) financial instruments that embody an obligation that the issuer may settle by issuing a variable number of its equity shares if, at inception, the monetary value of the obligation is predominantly based on a fixed amount, variations in something other than the fair value of the issuer's equity shares or variations inversely related to changes in the fair value of the issuer's equity shares and (iv) certain freestanding financial instruments. SFAS No. 150 was effective for contracts entered into or modified after May 31, 2003, and was otherwise effective at the beginning of the first interim period beginning after June 15, 2003, however, in October 2003, the FASB indefinitely deferred the application of certain provisions of SFAS No. 150 as they apply to mandatorily redeemable minority interests. Adoption of SFAS No. 150 did not have a significant impact on our financial statements.

SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The amendments (i) reflect decisions of the Derivatives Implementation Group, (ii) reflect decisions made by the FASB in conjunction with other projects dealing with financial instruments and (iii) address implementation issues related to the application of the definition of a derivative. SFAS No. 149 also modifies various other existing pronouncements to conform with the changes made to SFAS

No. 133. SFAS No. 149 was effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003, with all provisions applied prospectively. Adoption of SFAS No. 149 did not have a significant impact on our financial statements.

SFAS No. 123, "Share-Based Payment (Revised 2004)." SFAS No. 123R establishes standards for the accounting for transactions in which an entity (i) exchanges its equity instruments for goods or services, or (ii) incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of the equity instruments. SFAS No. 123R eliminates the ability to account for stock-based compensation using APB 25 and requires that such transactions be recognized as compensation cost in the income statement based on their fair values on the date of the grant. SFAS No. 123R is effective for ImproveNet on January 1, 2006. We will transition to fair value based accounting for stock-based compensation using a

modified version of prospective application ("modified prospective application"). Under modified prospective application, as it is applicable to us, SFAS No. 123R applies to new awards and to awards modified, repurchased, or cancelled after January 1, 2006. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered (generally referring to non-vested awards) that are outstanding as of January 1, 2006 must be recognized as the remaining requisite service is rendered during the period of and/or the periods after the adoption of SFAS No. 123R. The attribution of compensation cost for those earlier awards will be based on the same method and on the same grant-date fair values previously determined for the pro forma disclosures required for companies that did not adopt the fair value accounting method for stock-based employee compensation. The adoption of SFAS No. 123R is expected to have a significant impact on the Company's financial statements. The impact of adopting SFAS No. 123R cannot be accurately estimated at this time, as it will depend on the market value and the amount of share-based awards granted in future periods. Future levels of compensation cost recognized related to stock-based compensation awards (including the aforementioned expected costs during the period of adoption) may be impacted by new awards and/or modifications, repurchases and cancellations of existing awards before and after the adoption of this standard.

Financial Accounting Standards Board Interpretations

FIN No. 46, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (Revised December 2003)." FIN 46, establishes accounting guidance for consolidation of variable interest entities (VIE) that function to support the activities of the primary beneficiary. The primary beneficiary of a VIE entity is the entity that absorbs a majority of the VIE's expected losses, receives a majority of the VIE's expected residual returns, or both, as a result of ownership, controlling interest, contractual relationship or other business relationship with a VIE. Prior to the implementation of FIN 46, VIEs were generally consolidated by an enterprise when the enterprise had a controlling financial interest through ownership of a majority of voting interest in the entity. The provisions of FIN 46 were effective immediately for all arrangements entered into after January 31, 2003. If a VIE existed prior to February 1, 2003, FIN 46 was effective at the beginning of the first interim period beginning after June 15, 2003. However, subsequent revisions to the interpretation deferred the implementation date of FIN 46 until the first period ending after December 15, 2003. The adoption of this standard did not have a significant impact on our financial statements.

FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others -- an Interpretation of FASB Statements No. 5, 57 and 107 and Rescission of FASB Interpretation No. 34." FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of FIN 45 were applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements of FIN 45 were effective for financial statements of interim or annual periods ending after December 15, 2002, and were adopted in our financial statements for the year ended December 31, 2002. The adoption of this standard did not have a significant impact on our financial statements.

2. STOCK-BASED COMPENSATION

We have stock-based compensation plans accounted for under the recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25 "Accounting for Stock Issued to Employees," and related interpretations. Pro forma information regarding the impact of stock-based compensation on net income and earnings per share is required by SFAS No. 123 "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." Such unaudited pro forma information, determined as if we had accounted for our employee stock options under the fair value recognition provisions of SFAS No. 123, is illustrated in the following table (unaudited):

	Three Months Ended	
	2005	
Net income (loss) attributable to Common Shareholders as reported	$ (337,491)	$
Stock-based employee compensation expense		
pursuant to SFAS No. 123, net of tax	(63,649)	
Pro forma net loss attributable to Common Shareholders	$ (401,140)	$
Earnings (loss) per share:		
Basic as reported	$ (0.01)	$
Basic Pro forma	$ (0.01)	$
Diluted as reported	$ (0.01)	$
Diluted Pro forma	$ (0.01)	$

The fair value of options granted during the three months ended March 31, 2005 and 2004 were estimated using the Black-Scholes option pricing model using the following assumptions:

THREE MONTHS ENDED
MARCH 31,

	2005	2004
Annual dividend yield	--	--
Weighted-average expected life (years)	10 years	2 years
Risk-free interest rate	3.6%	4%
Volatility	143%	147%

Details of our 1996 Stock Option Plan and 1999 Equity Incentive Plan are described in our consolidated financial statements for the year ended December 31, 2004 as filed on Form 10-KSB. During the three months ended March 31, 2005, 122,321 Common Shares and 1,685,800 options to purchase Common Shares were granted from the 1999 Equity Incentive Plan. As of March 31, 2005, the aggregate number of options outstanding entitled holders to purchase 4,705,959 Common Shares at prices ranging from $.05 to $6.25. The weighted average exercise price for vested options as of March 31, 2005 was $0.28 per share.

3. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	March 31, 2005	December 31, 2004
	(Unaudited)	
Furniture and fixtures	$ 2,138	$ 2,138
Equipment	106,857	54,067
Software and website development costs	159,633	134,955
Leasehold improvements	12,171	12,171
	280,799	203,331
Less: Accumulated depreciation	(37,224)	(22,750)
Property and equipment, net	$ 243,575	$ 180,581

10

ImproveNet capitalizes internally developed software and website development costs in accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" and Emerging Issues Task Force 00-2, "Accounting for Web Site Development Costs." Capitalized costs are amortized on a straight-line basis over the estimated useful life of the software once it is available for use. The ongoing assessment of recoverability of capitalized software development costs requires considerable judgment by management with respect to estimated economic life and changes in software and hardware technologies. During the three months ended March 31, 2005, we capitalized a total of approximately $14,000 of internally developed software and website development costs.

4. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	March 31,	December 31,

	2005 (Unaudited)	2004
Accrued compensation	$ 13,729	$ 15,665
Other current liabilities	9,213	--
Total accrued expenses and other current liabilities	$ 22,942	$ 15,665

5. LINE OF CREDIT

During September 2004 we entered into a line of credit for $100,000 with a national banking association. Interest accrues on all funds advanced on the line of credit at 1/4 point over the bank's prime lending rate. The maturity of the line of credit facility is September 14, 2005, at which time the payment of all outstanding principal and accrued interest is due. There is no penalty for prepayment of outstanding amounts prior to maturity. We had secured our obligation under the line of credit with the pledge of a certificate of deposit, accordingly, $100,000 is classified as restricted cash on the accompanying financial statements as of December 31, 2004. As of December 31, 2004, there was approximately $62,000 outstanding on this line of credit. During the first quarter of 2005, this line of credit was paid off and closed.

6. FINANCING TRANSACTION

During June 2004, ImproveNet raised $1,050,000, from the sale of 10,500,000 Common Shares and three-year warrants to purchase 8,000,000 Common Shares at a strike price of $0.15 per share in a private placement transaction to several accredited investors (collectively, the "Investors"). The issuance was made under applicable registration exemptions from both state and federal securities laws including section 4(2) of the Securities Act of 1933, as amended. The proceeds were allocated to the Common Shares and warrants based on the relative fair value of each security at the time of issuance with $621,500 allocated to the Common Shares and $428,500 allocated to the warrants. Due to the nature of certain potential financial penalties related to registration rights granted to the Investors, the most substantive of which would require ImproveNet to rescind the transaction at the option of the Investors should the applicable registration statement not be declared effective and remain effective by March 1, 2005, the shares of Common Stock were initially classified outside of equity as mezzanine financing and the warrants to purchase Common Stock were initially classified as a liability. During October 2004, the Common Shares and warrants became fully registered, at which time the amounts were reclassified to equity. Prior to the registration statement being declared effective, changes in the fair value of the warrants were recognized as other income in our statement of operations. Changes in the fair value of the warrants resulted in other income of approximately $162,000 recognized during 2004. In connection with the private placement transaction, we granted the right to designate a nominee to our Board of Directors to one of the Investors.

As part of the financing transaction described above, the Investors also purchased 1,500,000 Common Shares from affiliates of three of our officers and directors for an aggregate purchase price of $150,000. Each of these three selling parties entered into a lock-up agreement restricting future sales of their common stock for a specified period, as well as a voting agreement regarding the accredited investor's designated nominee to our Board of Directors.

Separately, during June 2004 holders of $370,000 of principal of our 8.0% convertible promissory notes (the "Converting Investors") elected to convert the then outstanding principal and interest to Common Shares and warrants on similar terms to the private placement offering described above. The conversion resulted in the issuance of 3,707,400 Common Shares and three-year warrants to

purchase 2,466,666 Common Shares at a strike price of $0.15 per share. Due to the modified conversion terms associated with this conversion, we recognized a charge in the amount of approximately $695,000. The remaining $30,000 of the then outstanding principal of the 8.0% convertible promissory notes, which was with affiliates of ImproveNet, was repaid in the second quarter of 2004.

7. COMMITMENTS AND CONTINGENCIES

LEGAL PROCEEDINGS

From time to time, we may be involved in litigation relating to claims arising out of, or incidental to, our operations. We are currently engaged in various legal proceedings that are incidental to our business that could materially affect our business should an adverse judgment be entered against us. We intend to vigorously defend these claims and expect to prevail in all cases. In connection with the defense of these claims and the settlement of previous claims, we have accrued approximately $60,000 and $66,000 as of March 31, 2005 and December 31, 2004, respectively, which represents our best estimate of future costs associated with these claims.

One arbitration matter in Phoenix, Arizona involved First Systech International, Inc., a predecessor to eTechLogix, our wholly-owned subsidiary. This proceeding concerns the 1998 sale of an Enterprise Resource Planning software product to a former client who demanded a refund of the purchase price. The matter was before an arbitrator who entered an award against First Systech for $116,886 plus simple interest at 10% per year. First Systech International reached agreement with Friedman Corporation ("Friedman") pursuant to terms and conditions of a Repayment and Security Agreement effective May 25, 2004 (the "Agreement") which finalizes a payment plan for First Systech International's obligations for the arbitration award that Friedman has paid. The final amount owed under the Agreement is approximately $182,000 with interest accruing at 8% per annum from April 2, 2004 and attorney's fees incurred by Friedman in the minimum amount of $4,500 and not to exceed $10,000 as set forth therein. Payments of $5,000 per month commenced June 20, 2004, increased to $10,000 per month on November 20, 2004 and are scheduled to increase to $12,500 per month during June 2005. Following the June 2005 increase, payments will remain at $12,500 per month until the balance is paid in full. Pursuant to provisions of the Agreement, First Systech International has granted a security interest and lien on all of its assets to secure performance of its obligations under the Agreement. First Systech International continues to maintain ownership of all of the assets that it has pledged. As of March 31, 2005, a total of approximately $118,000 was due under the terms of this agreement and is included in "Liabilities of discontinued operations" on the accompanying balance sheets.

OTHER CONTRACTUAL ARRANGEMENTS

During September 2004 we entered into an exclusive licensing agreement for the use of the phone number and website domain name related to "1-800-Contractor" (the "Licensed Property"). The licensor receives a percentage of the gross revenue collected from our use of the Licensed Property, payable on a monthly basis during the term of the licensing agreement, which is subject to annual minimum payments to the licensor. Improvenet also has an option to purchase the Licensed Property. The term of the licensing agreement is for 100 years subject to the following early termination provisions: ImproveNet may terminate the licensing agreement at our election or upon exercise of our option to purchase the Licensed Property. The licensor may terminate the licensing agreement for (i) ImproveNet's failure to make required payments timely, (ii) ImproveNet's failure to comply with its obligations under the licensing agreement after written notice of such failure or (iii) the proper revocation or suspension of ImproveNet's authority to do business in its state of incorporation or the state where our principal office is located.

8. CUSTOMER CARE CENTER SERVICE AGREEMENT

ImproveNet entered into an agreement with a third party service provider to operate and manage our customer care center including the home improvement service provider matching operation of our Home Improvement Information Services Segment. The agreement was effective on December 23, 2002, had a term of two years and was cancelable by ImproveNet with 90 days written notice or by the service provider with 180 days written notice. The agreement called for us to remit, on a weekly basis, 25% of collected revenues related to the home improvement service provider matching function that the service provider managed and operated. On a monthly basis, we were required to reconcile total revenue related to the service agreement. We were required to pay the service provider an additional 2.5% of monthly revenues in excess of $400,000 but less than $500,000 and an additional 5% of revenues greater than $500,000. In January 2004, the service provider provided written notice to us of termination of the services agreement. We staffed our Scottsdale, Arizona offices for the customer care call center operations, and in March 2004 we transitioned our customer service operations in-house.

In March 2004, we initiated litigation in Nova Scotia, Canada against the Canadian corporation that had been operating our customer care center and operations for the home improvement service provider matching service to enforce and protect our rights under the services agreement regarding our proprietary material. During March 2004, the Canadian court entered an order prohibiting the Canadian corporation from utilizing, in any way, ImproveNet's proprietary materials and from soliciting or contacting any ImproveNet home improvement service provider for a specified period of time, which expired in June 2004.

9. DISCONTINUED OPERATIONS

During the fourth quarter of 2004, the Board of Directors determined that our principal focus going forward would be on ImproveNet's core lead matching service and the products and services that compliment it. This decision was based on a number of factors, which include, but are not limited to, the opportunities in the Internet home improvement industry. Based on this decision, we have entered into an agreement during the first quarter of 2005 to dispose of substantially all of the operations of eTechLogix. An agreement has been executed with a third party for the anticipated disposition and is expected to close in the near future. Accordingly, the operations of eTechLogix, which had been classified as a separate operating segment in previous filings, have been classified as discontinued operations for all periods presented in these financial statements. The assets and liabilities of eTechLogix are presented in the Balance Sheets under the captions "Assets of discontinued operation" and "Liabilities of discontinued operations." The carrying amounts of the major classes of these assets and liabilities as of March 31, 2005 and December 31, 2004 are summarized as follows:

	2005	2004
Assets:		
Cash and cash equivalents	$ 72	$ --
Accounts receivable, net	4,000	21,156

Property and equipment, net	1,984	14,107
Assets of discontinued operations	$ 6,056	$ 35,263
Liabilities:		
Accounts payable	$ --	$ 28,222
Accrued litigation related costs	187,446	214,724
Line of credit	57,984	60,081
Deferred revenue	33,342	49,992
Obligations under capital leases	6,275	18,401
Other accrued expenses	6,000	4,679
Liabilities of discontinued operations	$ 291,047	$ 376,099

Summarized statement of operations data for eTechLogix for the three months ended March 31, 2005 and 2004 is as follows:

	2005	2004
Revenue	$ 62,478	$ 168,625
Operating income	12,867	26,632
Net income	9,709	22,125

eTechLogix recognizes revenue in accordance with SOP 97-2, "Software Revenue Recognition." This SOP provides guidance on revenue recognition of software transactions. eTechLogix recognizes revenue principally from the development and licensing of its software and from consulting and maintenance services rendered in connection with such development and licensing activities. Maintenance contract revenue is recognized on a straight-line basis over the life of the respective contract. eTechLogix also derives revenue from the sale of third party hardware and software which is recognized based on the terms of each contract. Consulting revenue is recognized when the services are rendered. No revenue is recognized prior to obtaining a binding commitment from the customer. Revenue from fixed price software development contracts, which require significant modification to meet the customer's specifications, is recognized on the percentage-of-completion method using the units-of-work-performed method to measure progress towards completion. Revisions in cost estimates and recognition of losses on these contracts are reflected in the accounting period in which the facts become known. Revenue from software package license agreements without significant vendor obligations is recognized upon delivery of the software. Contract terms may provide for billing schedules that differ from revenue recognition and

give rise to costs and estimated earnings in excess of billings on uncompleted software contracts, and billings in excess of costs and estimated earnings on uncompleted software contracts.

10. RELATED PARTY TRANSACTIONS

Research and development

We subcontract a portion of our research and development to companies wholly owned by two of our officers. We incurred costs of approximately $21,000 and $29,000 relative to these subcontracted services during the three months ended

March 31, 2005 and 2004, respectively. $12,000 and $27,000 have been included in discontinued operations for the three months ended March 31, 2005 and 2004, respectively.

Credit card use

To facilitate payments to certain vendors, we utilize credit cards held personally by certain of our executive officers. ImproveNet has agreed to indemnify these officers from any obligations arising from the use of these credit cards for ImproveNet's business.

11. CAPITAL LEASE OBLIGATIONS

Capital lease obligations

During the first quarter of 2005, we entered into various capital and operating lease agreements for computers and computer equipment. A summary of future minimum lease payments under these leases is as follows:

FOR THE YEAR ENDED MARCH 31,	CAPITAL LEASES	OPERATING LEASES	TOTAL
2006	$ 16,932	$ 6,983	$ 23,915
2007	16,932	6,983	23,915
2008	16,932	5,238	22,170
2009	14,062	--	14,062
2010	12,600	--	12,600
Total future minimum lease payments	77,458	$ 19,204	$ 96,662
Less: amounts representing interest	23,025		
Present value of net minimum lease payments	$ 54,433		

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

The following discussion should be read in conjunction with the Unaudited Condensed Consolidated Financial Statements and Notes thereto included elsewhere herein as well as our annual report on Form 10-KSB for the year ended December 31, 2004, as filed with the Securities and Exchange Commission, including the factors set forth in the section titled "Factors That Might Affect Future Results" under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations."

OVERVIEW

HOME IMPROVEMENT INFORMATION SERVICES SEGMENT

We are a leading web-based home improvement services company that provides matching services to homeowners and local screened home improvement service providers throughout the United States. We were recognized by Money Magazine as "Best of the Web" in 2003 under the Home Improvement Category and have been featured nationally on the Today Show, MSNBC, CNNfn, CBS Marketwatch and locally on many news networks and in newspapers. ImproveNet has been connecting homeowners with local screened home improvement service providers since 1996.

Our website, www.improvenet.com, includes over 50,000 pages of content

and serves both homeowner and home improvement service providers including architects, designers, builders and contractors to assist with the completion of home improvement projects from start to finish. Our website also features management tools, product showcases, visualizers, advice from experts and active message boards targeting home improvement content.

SOURCES OF REVENUE

HOME IMPROVEMENT INFORMATION SERVICES SEGMENT

During the third quarter of 2004, we implemented a new subscription-based pricing model for new home improvement service providers joining our service provider membership network. The model currently offers three different levels that home improvement service providers can choose from to accommodate their financial and professional needs. Benefits of some levels include email (for example, name@improvenetpro.com), a website, online advertisements with ImproveNet affiliates, a personal toll free number with immediate access to a dedicated customer care representative, screened and verified home improvement leads, an online console to manage the user's profile and home improvement project lead management.

These three levels currently consist of: (i) Standard membership - no monthly fee; (ii) Professional membership - $29.99 monthly fee and (iii) Master membership - $199.00 monthly fee. We charge our home improvement service providers a fee for each lead that is provided through our service. Lead fees currently charged to our home improvement service providers for each level of membership are summarized as follows:

Project Lead Budget Range	Standard	Professional	Master
$0 - $999	$ 10.00	$ 7.00	$ 5.00
$1,000 - $4,999	15.00	10.00	8.00
$5,000 - $9,999	32.00	25.00	16.00
$10,000 - $24,999	65.00	50.00	32.00
$24,000 - $50,000	100.00	75.00	50.00
Over $50,000	120.00	100.00	60.00

Home improvement service providers who were part of our network prior to our implementation of the subscription based pricing model and who have elected to remain on our previous plan continue to utilize our service with no monthly fee, however, these service providers are subject to "win" fees on all home improvement projects obtained through the use of our services. These win fees are based on a percentage of the total home improvement project value. Lead fees and win fees currently charged for these service providers are summarized as follows:

Project Lead Budget Range	Lead Fee	Win Fee
$0 - $999	$ --	7.0%
$1,000 - $4,999	10.00	5.0%
$5,000 - $9,999	25.00	2.0%
$10,000 - $24,999	50.00	2.0%
$25,000 - $50,000	75.00	2.0%
Over $50,000	100.00	2.0%

We believe that the subscription based pricing structure will result in a more consistent cash flow stream as we will generate a flat monthly fee from many of the home improvement service providers using our service while continuing to generate revenue based on the quantity of leads sold. Additionally, we are collecting payments from service providers participating in the subscription based pricing model via credit card or ACH charges, which differs from the previous model whereby we billed service providers for leads sold and win fees earned and collected these charges at a later date. We believe charging our customers at the time of sale will have a positive impact on collections and will decrease the number of days our sales are outstanding. We plan to convert all home improvement service providers that are part of our network to the subscription model over the next two quarters.

SOFTWARE DEVELOPMENT AND SALES SEGMENT

During the fourth quarter of 2004, the Board of Directors determined that our principal focus going forward would be on ImproveNet's core lead matching service and the products and services that compliment it. This decision was based on a number of factors, which include, but are not limited to, the opportunities in the Internet home improvement industry discussed elsewhere in this document. Based on this decision, we have actively pursued, during the first quarter of 2005, disposition of substantially all of the operations of eTechLogix. An agreement has been executed with 2020 Technologies International, Inc. for the anticipated disposition and is expected to close in the near future. Accordingly, the operations of eTechLogix, which had been classified as a separate operating segment in previous filings, have been classified as discontinued operations for all periods presented in the financial

statements included in this filing and in any financial data presented elsewhere herein.

ADDITIONAL PLANNED SOURCES OF REVENUE

During the third quarter of 2004, we commenced development of two new initiatives that are aimed at augmenting our home improvement information services segment. These initiatives include a project known as "AdServe" and the development of the 1-800-Contractor telephone number and corresponding 1800Contractor.com website. We currently plan to go live with both AdServe and 1-800-Contractor over the next two to three quarters. Information on these initiatives is summarized as follows:

ADSERVE

During the first half of 2005, we intend to offer a highly targeted advertising program known as "AdServePRO" to businesses searching to promote their products and services to consumers and service providers in the home improvement industry. Advertisers will have the ability to feature their products and services as paid listings in their choice of ImproveNet's marketing channels, such as emails, newsletters and the web pages of ImproveNet.com, ImproveNetPro.com and 1800Contractor.com. Each month ImproveNet reaches hundreds of thousands of homeowners and home improvement service providers. Through our touch points, businesses can strategically position their products and services in front of their target buying groups during the time the consumer or service provider is searching for, or ready to purchase, home improvement products and services. AdServePRO's technology is intended to be a user-friendly web-based application that will allow advertisers to manage their accounts online, from setting up their campaign, creating the message, choosing their target audience and setting the amount they wish to invest in their advertising program.

1-800-CONTRACTOR

During September 2004 we entered into an exclusive licensing agreement for the use of the phone number and website domain name related to "1-800-Contractor" (the "Licensed Property"). The licensor receives a percentage of the gross revenue collected from our use of the Licensed Property, payable on a monthly basis during the term of the licensing agreement, which is subject to annual minimum payments to the licensor. Improvenet also has an option to purchase the Licensed Property. The term of the licensing agreement is for 100 years subject to the following early termination provisions: ImproveNet may terminate the licensing agreement at our election or upon exercise of our option to purchase the Licensed Property. The licensor may terminate the licensing agreement for (i) ImproveNet's failure to make required payments timely, (ii) ImproveNet's failure to comply with its obligations under the licensing agreement after written notice of such failure or (iii) the proper revocation or suspension of ImproveNet's authority to do business in its state of incorporation or the state where our principal office is located.

Through the licensing of the 1800Contractor.com web property (domain names), the 1-800-Contractor (1-800-266-8722) telephone number and associated service marks, we intend to launch a new division of ImproveNet that will compliment the existing ImproveNet home improvement information services segment by supplementing the online home improvement service provider lead generation service with an online and offline resource for homeowners to find and research local repair and installation contractors via the internet or telephone.

During December 2004, we launched a new division of ImproveNet through the licensing of the 1-800-Contractor (1-800-266-8722) telephone number, the 1800Contractor.com web property (domain names) and associated service marks. This division will compliment our existing ImproveNet home improvement information services by supplementing the online home improvement lead generation service with an online and offline resource for homeowners to find and research local contractors via the Internet or telephone.

Following the launch of 1-800-Contractor, service providers joining the ImproveNet network in 2005 pay an additional flat monthly fee to be listed in the 1-800-Contractor directory in addition to the monthly subscription fees discussed above in the "Home Improvement Information Services" segment. ProPLUS and Pro 1-800-Contractor members are able to purchase leads at the ImproveNet Professional rates shown above, while Standard 1-800-Contractor members are offered leads at the Standard rates shown above in the "Home Improvement Information Services" segment. New service providers joining the ImproveNet network and 1-800-Contractor directory in 2005 pay monthly subscription fees as follows:

Standard	$ 9.99
Pro	39.99
ProPlus	79.99
Master (ProPlus status in the 1-800-Contractor directory	199.99

COST OF REVENUE STRUCTURE

HOME IMPROVEMENT INFORMATION SERVICES

Our cost of revenue primarily includes the cost of procuring leads and costs associated with lead qualification. We procure home improvement leads by use of the following methods: (i) Homeowners visiting our ImproveNet.com website and submitting a home improvement project lead; (ii) Search engines including Google and Overture; (iii) Lead generator service providers; (iv) Utilization of affiliate programs with other home improvement related websites and (v) Search engine optimization ("SEO") partners. We do not incur any costs related to homeowner submissions made directly to our ImproveNet.com website. We pay fees to search engines based on the number of times internet users click on a paid advertising link to the ImproveNet.com website. Fees paid to lead generator service providers, affiliates and SEO partners are based on the quantity and quality of leads provided.

The lead qualification process includes an analysis of the information provided from the homeowner to ensure that the information is correct. For larger home improvement project submissions, this process includes verbally confirming the information relative to the project directly with the homeowner.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE STRUCTURE

Our selling, general and administrative expense primarily consists of payroll and related costs and, prior to bringing our customer care center in-house during March 2004, included the cost of outsourcing our sales, collections and new member recruiting functions. Selling, general and administrative expense also includes bad debt charges, rent, travel, recruiting, professional and advisory services, marketing and advertising, depreciation and other general overhead expenses.

FACTORS THAT MIGHT AFFECT FUTURE RESULTS

As discussed above, we are in the process of developing AdServe and the 1-800-Contractor telephone number and corresponding website. We intend to make a significant investment in both of these initiatives. If these initiatives are not positively accepted by the marketplace or if we are unable to support both or either of these initiatives, it would have a material adverse impact on our operations and available cash flow.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2005 AND 2004

Our consolidated results of operations for the three months ended March 31, 2005 and 2004 is as follows:

	Three months ended March 31,				
	2005		2004		C
Revenue	$ 868,853	100.0%	$ 711,382	100.0%	$
Cost of revenue	387,191	44.6%	276,848	38.9%	
Gross profit	481,662	55.4%	434,534	61.1%	
Selling, general and administrative expense	828,319	95.3%	454,616	63.9%	
Loss from operations	$ (346,657)	(40.0%)	$ (20,082)	(2.8%)	$ (

17

REVENUE

A summary of our revenue for the three months ended March 31, 2005 and 2004 is as follows:

	Year ended March 31,				
	2005		2004		C
Lead fees	$ 664,845	76.6%	$ 528,112	74.2%	$
Subscription fees	121,610	14.0%	--		
Win fees	62,016	7.1%	172,670	24.3%	(
Marketing and other revenue	20,382	2.3%	10,600	1.5%	
	$ 868,853	100.0%	$ 711,382	100.0%	$

Revenue was approximately $869,000 and $711,000 for the three months ended March 31, 2005 and 2004, respectively, an increase of $158,000 or 22.1%. The increase in revenue for the three months ended March 31, 2005, as compared to the same period in the prior year, is due to increased lead sales and subscription fees from the subscription based pricing model, offset by a decline in win fees. We anticipate win fees to continue to decline as a percentage of revenue and subscription fees to increase as a percentage of revenue in the future as more new contractors are established, and existing contractors are converted to the subscription based pricing model.

Overall, there was little impact on lead revenue as a result of lead pricing changes associated with our adoption of the subscription based pricing model in the third quarter of 2004. Fluctuations in lead revenue on a period over period basis are primarily the result of net lead revenue sales volume increases.

COST OF REVENUE

Cost of revenue was approximately $387,000 and $277,000 for the three months ended March 31, 2005 and 2004, respectively, an increase of $110,000 or 39.9%. As a percentage of revenue, cost of revenue was 44.6% and 38.9% for the three months ended March 31, 2005 and 2004, respectively. The increase in cost of revenue as a percentage of revenue is due to higher costs associated with procuring leads from lead generators. The overall increase in cost of revenue for the three months ended March 31, 2005, as compared to the same period in the prior year was due to increased costs related to lead generators and affiliates of 45.7% and increased costs of qualifying leads internally of 9.8%, offset by decreased costs associated with leads procured from search engines of 6.8% and a decrease in costs from our previous customer care service provider of 8.8%.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE

Consolidated selling, general and administrative expense was approximately $828,000 and $455,000 for the three months ended March 31, 2005 and 2004, respectively, an increase of $373,000 or 82.2%. Since the time of the move of our customer care center operations to our office in Scottsdale, Arizona in late March 2004, we have increased personnel, made enhancements to our infrastructure and expended other resources to support those operations. Much of this increase is reflected in our selling, general and administrative expenses in the areas of payroll expense, office overhead, professional services, IT facilities maintenance, and programming expense from personnel employed with our wholly owned subsidiary, eTechLogix. In addition our bad debt expense has increased. The increase in payroll expense and bad debt expense was approximately $321,000 during the three months ended March 31, 2005 versus the same period in the previous year. Increases in payroll expense and bad debt expense increased selling, general and administrative expense 60.8% and 9.7%, respectively.

During March 2004, we staffed our Scottsdale, Arizona office to operate all customer care call center functions including lead qualification, service provider support and collections. Prior to this, these functions had been performed by a third party service provider.

OTHER INCOME (EXPENSE)

Other income (expense) is summarized as follows:

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Interest income	$ 1,623	$ 607
Interest expense and financing costs	(2,667)	(8,267)
Miscellaneous income	501	9,201
	$ (543)	$ 1,541

Interest income

Interest income increased for the three months ended March 31, 2005 versus the same period in the prior-year due to higher amounts of interest bearing investments during the current period.

Interest expense and financing costs

Interest expense and financing costs decreased during the three months ended March 31, 2005 versus the same period in the prior year as a result of higher interest expense associated with the 8% convertible promissory notes in the first quarter 2004.

Miscellaneous income

Miscellaneous income decreased for the three months ended March 31, 2005 versus the same period in the prior-year as the result of fewer non-operating activities.

LIQUIDITY AND CAPITAL RESOURCES

Our principal capital requirements are to fund capital expenditures, which includes expenditures related to the development and implementation of AdServe and 1-800-Contractor, which were discussed previously herein. The significant source of liquidity is cash on hand. Net working capital was approximately negative $346,000 versus approximately $3,000, including restricted cash, as of March 31, 2005 and December 31, 2004, respectively. The decrease in working capital was primarily attributable to a decrease in cash and cash equivalents.

Due to the significant level of current liabilities and the history of operating losses, there is no assurance that our available cash resources will be sufficient to meet our anticipated needs for operations and capital expenditures during the next 12 months. We will strive to make ongoing realignments, if required, to achieve positive cash flow with our existing cash resources. If results of operations for 2005 do not meet our expectations we may need to raise additional funds, to develop new or enhance existing services, to respond to competitive pressures, or to acquire complementary businesses, services or technologies. If we raise additional funds by selling equity securities, the percentage ownership of our stockholders will be reduced. We cannot be sure that additional financing will be available on terms favorable to us, or at all. If adequate funds were not available on acceptable terms, our ability to fund expansion, react to competitive pressures, or take advantage of unanticipated opportunities would be substantially limited. If this occurred, our business would be significantly harmed. We will continue to evaluate our needs for funds based on our assessment of access to public or private capital markets and the timing of our need for funds. We may seek to raise these additional funds through private or public debt or equity financings.

FINANCING TRANSACTION

During June 2004, ImproveNet raised $1,050,000, from the sale of 10,500,000 Common Shares and three-year warrants to purchase 8,000,000 Common Shares at a strike price of $0.15 per share in a private placement transaction to several accredited investors (collectively, the "Investors"). The proceeds were allocated to the Common Shares and warrants based on the relative fair value of each security at the time of issuance with $621,500 allocated to the Common Shares and $428,500 allocated to the warrants. Due to the nature of certain potential financial penalties related to registration rights granted to the Investors, the most substantive of which would require ImproveNet to rescind the transaction at the option of the Investors should the applicable registration statement not be declared effective and remain effective by March 1, 2005. Initially, the shares of Common Stock were classified outside of equity as mezzanine financing and the warrants to purchase Common Stock were classified as a liability. The Common Shares and warrants continued to be classified in such manner until such registration statement was declared effective on October 26, 2004, at which time the amounts were reclassified to equity. Prior to the registration statement being declared effective, changes in the fair value of the warrants were recognized as other income or expense in our statement of operations. We recognized additional other income during

the fourth quarter of 2004 of approximately $75,000 as a result of changes in the fair value of the warrants during the fourth quarter of 2004 prior to the registration statement being declared effective. In connection with the sale, we granted the right to designate a nominee to our Board of Directors to one of the Investors.

As part of the financing transaction described above, the Investors also purchased 1,500,000 Common Shares from affiliates of three of our officers and directors for an aggregate purchase price of $150,000. Each of these three selling parties entered into a lock-up agreement restricting future sales of their common stock for a specified period as well as a voting agreement regarding the accredited investor's designated nominee to our Board of Directors.

Separately, during June 2004 holders of $370,000 of principal of our 8.0% convertible promissory notes (the "Converting Investors") elected to convert the then outstanding principal and interest to Common Shares and warrants on similar terms to the private placement offering described above. The conversion resulted in the issuance of 3,707,400 Common Shares and three-year warrants to purchase 2,466,666 Common Shares at a strike price of $0.15 per share. Due to the modified conversion terms associated with this conversion, we recognized a charge in the amount of approximately $695,000. The remaining $30,000 of the then outstanding principal of the 8.0% convertible promissory notes, which was with affiliates of ImproveNet, was repaid in the second quarter of 2004.

LINE OF CREDIT

During September 2004 we entered into a line of credit for $100,000 with a national banking association. Interest accrues on all funds advanced on the line of credit at 1/4 point over the bank's prime lending rate. The maturity of the line of credit facility is September 14, 2005, at which time the payment of all outstanding principal and accrued interest is due. There is no penalty for prepayment of outstanding amounts prior to maturity. We have secured our obligations under the line of credit with the pledge of a certificate of deposit. As of December 31, 2004, there was approximately $62,000 outstanding on this line of credit. During the first quarter of 2005, this line of credit was paid off and closed.

EQUITY ISSUANCE

The following table summarizes ImproveNet's Common Share issuances during the three months ended March 31, 2005:

	Number of Common Shares
Stock based compensation of consultants, employees and directors	122,321
Common Shares issued during the three months ended March 31, 2005	122,321

CASH FLOWS

The following discussion relates to the major components of the changes in cash flows for the three months ended March 31, 2005 and 2004.

CASH FLOW USED IN OPERATING ACTIVITIES

Cash flow used in operating activities was approximately $188,000 for the three months ended March 31, 2005 and 2004, respectively. The cash used in operating activities in the current quarter reflects the changes in the operating assets and liabilities.

CASH FLOW USED IN INVESTING ACTIVITIES

Cash flow used in investing activities was approximately $25,000 and $12,000 for the three months ended March 31, 2005 and 2004, respectively. The increase in cash used in investing activities is primarily due to the development and enhancement of our existing software systems and the purchase of equipment and development of software to implement AdServe. We intend to finance expenditures related to the AdServe and 1-800-Contractor initiatives through currently available cash on hand and the issuance of additional debt and / or equity securities if necessary.

CASH FLOW FROM FINANCING ACTIVITIES

Cash flow provided by financing activities was approximately $37,000 and $0 for the three months ended March 31, 2005 and 2004, respectively. The increase in cash flow from financing activities is due to the change in restricted cash and cash equivalents, offset by payments to the line on credit.

OFF-BALANCE SHEET FINANCING

We have no off-balance sheet debt or similar obligations nor do we have any transactions or obligations with related parties that are not disclosed, consolidated into or reflected in our reported results of operations or financial position. We do not guarantee any third party debt.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-Q contains certain "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934. Some of these forward-looking statements include forward-looking phrases such as "anticipates," "believes," "could," "estimates," "expects," "foresees," "intends," "may," "should" or "will continue," or similar expressions or the negatives thereof or other variations on these expressions, or similar terminology, or discussions of strategy, plans or intentions. These statements also include descriptions in connection with, among other things our anticipated implementation of the AdServe and 1-800-Contractor initiatives, as well as the conversion of all home improvement service providers to the subscription based pricing model.

Such statements reflect our current views regarding future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause the actual results, performance or achievements to be materially different from any future results, performance or achievements that forward-looking statements may express or imply, including, among others:

o changes in inflation;

o changes in regulations affecting our business and costs of compliance;

o the outcome of pending legal claims against us;

o our ability to implement our corporate strategy;

o changes in the economic conditions and competition in the markets that we conduct business in;

o changes in general business and economic conditions and in the financial markets; and

o changes in accounting standards or pronouncements.

Some of these factors are discussed in more detail in our annual report on Form 10-KSB, as filed with the Securities and Exchange Commission for the year ended December 31, 2004, including those under Item 1. of the annual report, "Description of Business -- Factors Affecting Future Performance, Results of Operation and Financial Condition," as well as those factors discussed in our Form SB-2 filed on October 26, 2004 with the Securities and Exchange Commission under the heading "Risk Factors." If one or more of these risks or uncertainties affects future events and circumstances, or if underlying assumptions do not materialize, actual results may vary materially from those described in this Form 10-QSB and our annual report as anticipated, believed, estimated or expected, and this could have a material adverse effect on our business, financial condition and the results of our operations. Further, any forward-looking statement speaks only as of the date on which it is made, and except as required by law we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made or to reflect the occurrence of anticipated or unanticipated events or circumstances.

ITEM 3. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES/EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were adequate and

21

effective and designed to ensure that material information relating to us (including our consolidated subsidiary) required to be disclosed by us in the reports we file under the Exchange Act is recorded, processed, summarized and reported within the required time periods.

CHANGES IN INTERNAL CONTROLS

During the period covered by this filing, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we may be involved in litigation relating to claims arising out of, or incidental to, our operations. We are currently engaged in various legal proceedings that are incidental to our business that could materially affect our business should an adverse judgment be entered against us. We intend to vigorously defend these claims and expect to prevail in all cases.

One arbitration matter in Phoenix, Arizona involved First Systech International, Inc., a predecessor to eTechLogix, our wholly-owned subsidiary. This proceeding concerns the 1998 sale of an Enterprise Resource Planning software product to a former client who demanded a refund of the purchase price. The matter was before an arbitrator who entered an award against First Systech for $116,886 plus simple interest at 10% per year. First Systech International reached agreement with Friedman Corporation ("Friedman") pursuant to terms and conditions of a Repayment and Security Agreement effective May 25, 2004 (the "Agreement") which finalizes a payment plan for First Systech International's obligations for the arbitration award that Friedman has paid. The final amount owed under the Agreement is approximately $182,000 with interest accruing at 8% per annum from April 2, 2004 and attorney's fees incurred by Friedman in the minimum amount of $4,500 and not to exceed $10,000 as set forth therein. Payments of $5,000 per month commenced June 20, 2004, increased to $10,000 per month on November 20, 2004 and are scheduled to increase to $12,500 per month during June 2005. Following the June 2005 increase, payments will remain at $12,500 per month until the balance is paid in full. Pursuant to provisions of the Agreement, First Systech International has granted a security interest and lien on all of its assets to secure performance of its obligations under the Agreement. First Systech International continues to maintain ownership of all of the assets that it has pledged.

ITEM 2. CHANGES IN SECURITIES AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY

SECURITIES

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS --

Exhibit 31.1 -- Section 302 Certification of Jeffrey I. Rassas, Chief Executive Officer

Exhibit 31.2 -- Section 302 Certification of Homayoon J. Farsi, Acting Chief Financial Officer

Exhibit 32.1 -- Section 1350 Certification of Jeffrey I. Rassas, Chief Executive Officer

Exhibit 32.2 -- Section 1350 Certification of Homayoon J. Farsi, Acting Chief Financial Officer

(b) REPORTS ON FORM 8-K DURING THE QUARTER ENDED MARCH 31, 2005:

On January 25, 2005, we filed a current report on Form 8-K to announce the resignation of Ronald B. Cooper from ImproveNet's Board of Directors. No appointment or election of a replacement for Mr. Cooper has been made.

On March 25, 2005, we filed a current report on Form 8-K to announce the resignation of James R. Schroepfer as ImproveNet's Chief Financial Officer. Homayoon J. Farsi, ImproveNet's President and a director, assumed the duties of Acting Chief Financial Officer while the Company actively seeks a permanent Chief Financial Officer.

On April 8, 2005, we filed a current report on Form 8-K to announce execution of a sales agreement between eTechLogix, Inc., our wholly owned subsidiary, and 2020 Technologies International, Inc. for the intangible assets and certain property and assets of Etech, including its SmartFusion software line and contracts and service and support agreements relative thereto which are held by Etech along with the obligation to provide some limited knowledge transfer services to 2020 for the software.

SIGNATURES

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

Date: May 20, 2005

By: /s/ JEFFREY I RASSAS

Jeffrey I Rassas
CHIEF EXECUTIVE OFFICER

By: /s/ HOMAYOON J. FARSI

Homayoon J. Farsi
ACTING CHIEF FINANCIAL OFFICER

23

EXHIBIT INDEX

EXHIBIT NO.		DESCRIPTION
Exhibit 31.1	--	Section 302 Certification of Jeffrey I. Rassas, Chief Executive Officer
Exhibit 31.2	--	Section 302 Certification of Homayoon J. Farsi, Acting Chief Financial Officer
Exhibit 32.1	--	Section 1350 Certification of Jeffrey I. Rassas, Chief Executive Officer
Exhibit 32.2	--	Section 1350 Certification of Homayoon J. Farsi, Acting Chief Financial Officer