INFINITE GROUP INC
Form 10QSB
November 14, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

Commission File Number 0-21816

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

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

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

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

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

Yes |X| No | |

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

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

1

INFINITE GROUP INC.
FORM 10-QSB REPORT

Infinite Group Inc.

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report on Form 10-QSB are "forward-looking statements" within the meaning of Section 21E of the Securities and Exchange Act of 1934 regarding the plans and objectives of management for future operations and market trends and expectations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the continued expansion of our business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. The terms "we", "our", "us", or any derivative thereof, as used herein refer to Infinite

Group Inc., a Delaware corporation.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

INFINITE GROUP, INC.

Consolidated Balance Sheets

	September 30, 2005 (unaudited)	Decem 2 (aud
ASSETS		
Current assets:		
Cash	$ 79,521	$
Restricted cash	--	
Accounts receivable, net of allowance of $56,202 ($25,000 - 2004)	1,759,265	1,0
Current portion of notes receivable	4,449	2
Inventories	23,239	
Other current assets	40,771	
Assets of discontinued operations	--	2
Total current assets	1,907,245	1,6
Property and equipment, net	293,126	2
Other assets:		
Note receivable	79,824	1,9
Other assets	16,703	
Intangible assets, net	--	
Total other assets	96,527	1,9
Total assets	$ 2,296,898	$ 3,9
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Notes payable:		
Bank	--	
Other	249,166	1
Related parties	184,906	
Accounts payable	678,540	5
Accrued expenses	708,256	5
Current maturities of long-term obligations	11,725	2,1
Current maturities of long-term obligations-related party	44,000	
Liabilities of discontinued operations	--	2
Total current liabilities	1,876,593	3,6

Long-term obligations:		
Bank notes payable	54,341	
Notes payable-related parties	1,100,124	1,1
Accrued pension expense	2,091,387	2,1
Total liabilities	5,122,445	7,0
Commitments and contingencies		
Stockholders' deficiency:		
Common stock, $.001 par value, 20,000,000 shares authorized; 19,206,965 (17,561,965 in 2004) shares issued and outstanding	19,207	
Additional paid-in capital	28,455,803	28,3
Common stock authorized, not issued	40,800	
Accumulated deficit	(28,585,466)	(28,7
Accumulated other comprehensive loss	(2,755,891)	(2,7
Total stockholders' deficiency	(2,825,547)	(3,0
Total liabilities and stockholders' deficiency	$ 2,296,898	$ 3,9

See notes to consolidated financial statements

INFINITE GROUP, INC.

Consolidated Statements of Operations (Unaudited)

	Nine Months Ended September 30,		Th
	2005	2004	2005
Sales	$ 6,370,558	$ 3,840,603	$ 2,236,
Cost of goods and services	4,467,602	2,579,607	1,581,
Gross profit	1,902,956	1,260,996	654,
Costs and expenses:			
General and administrative	1,208,061	854,043	420,
Depreciation and amortization	31,593	19,875	7,
Write-off of capitalized financing costs	44,857	--	
Selling	371,500	4,364	231,
Research and development	240,347	214,486	78,
Total costs and expenses	1,896,358	1,092,768	738,
Operating income (loss)	6,598	168,228	(83,
Other income (expense):			
Interest income	66,255	--	
Interest expense:			
Related parties	(68,331)	(57,187)	(23,

Other	(81,149)	--	(11,
	(149,480)	(57,187)	(35,
Gain on settlement with terminated employee	191,739	--	191,
Gain on sale of equipment	8,452	--	8,
Total other income (expense)	116,966	(57,187)	164,
Income from continuing operations before income tax expense	123,564	111,041	80,
Income tax expense	(1,300)	(350)	
Income from continuing operations	122,264	110,691	80,
Discontinued operations:			
Income (loss) from discontinued operations	12,233	(90,370)	
Net income	$ 134,497	$ 20,321	$ 80,
Net income (loss) per share-basic:			
Income from continuing operations	$ .01	$ .01	$
Income (loss) from discontinued operations	.00	(.01)	
Net income	$ .01	$ .00	$
Net income (loss) per share-diluted:			
Income from continuing operations	$ .01	$ .01	$
Income (loss) from discontinued operations	.00	(.01)	
Net income	$ .01	$ .00	$
Weighted average number of shares outstanding:			
Basic	18,946,141	14,321,335	19,206,
Diluted	20,504,570	15,279,074	21,087,

See notes to consolidated financial statements.

INFINITE GROUP, INC.

Consolidated Statements of Cash Flows (Unaudited)

	For the
	2005

Operating activities:	
Net income	$ 134,497
Adjustments to reconcile net income to net cash provided by (used in) operating activities:	
(Income) loss from discontinued operations	(12,233
Gain on sale of equipment	(8,450
Expenses satisfied with common stock	40,800
Depreciation and amortization and write-off of capitalized financing costs	76,450
Gain on settlement with terminated employee	(191,739
(Increase) decrease in:	
Accounts receivable, net	(704,642
Inventories	(23,239
Other current assets	436
Other assets	(16,703
Increase (decrease) in:	
Accounts payable	193,203
Accrued expenses	166,189
Accrued pension obligations	89,100
Net cash used in operating activities of continuing operations	(256,331
Net cash provided by operating activities of discontinued operations	854
Net cash used in operating activities	(255,477
Investing activities:	
Decrease (increase) in restricted funds	30,327
Purchase of property and equipment	(81,768
Proceeds from notes receivable	2,138,006
Net cash provided by (used in) investing activities	2,086,565
Financing activities:	
Net repayments of bank notes payable	(50,207
Net borrowings of notes payable-other	72,982
Net borrowings of notes payable-related parties	175,000
Proceeds from issuance of long-term obligations-related parties	--
Repayment of notes payable-related parties	--
Repayments of long-term obligations	(2,126,639
Proceeds from issuance of common stock, net of costs	80,000
Net cash provided by (used in) financing activities	(1,848,864
Net increase (decrease) in cash	(17,776
Cash - beginning of period	97,297
Cash - end of period	$ 79,521
Supplemental disclosure:	
Cash paid for:	
Interest	$ 119,165
Income taxes	$ 1,300

See notes to consolidated financial statements.

INFINITE GROUP INC.

Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of Infinite Group Inc. ("Infinite Group Inc." or the "Company"), included herein have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. The accompanying unaudited consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and footnotes for the year ended December 31, 2004 and the notes thereto included in the Company's Annual report on Form 10-KSB filed with the United States Securities and Exchange Commission. Results of consolidated operations for the nine months ended September 30, 2005 are not necessarily indicative of the operating results to be attained in the year ending December 31, 2005. The consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiaries. All material inter-company accounts and transactions have been eliminated.

Note 2. Summary of Significant Accounting Policies

Critical Accounting Policies and Estimates

There are several accounting policies that we believe are significant to the presentation of our consolidated financial statements. These policies require management to make complex or subjective judgments about matters that are inherently uncertain. Note 3 to our audited consolidated financial statements at December 31, 2004 presents a summary of significant accounting policies. The most critical accounting policies follow.

Inventories

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

Revenue Recognition

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

Stock-Based Compensation

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

Effect of New Accounting Pronouncements

In February 2003, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation: A Comparison of FASB Statement No. 123, Accounting for Stock-Based Compensation, and Its Related Interpretations, and IASB Proposed IFRS, Share-based Payments." SFAS 148 amends SFAS 123 to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based compensation. The statement also amends APB Opinion No. 28, "Interim Financial Reporting", to require disclosure about those effects in interim financial information. We have chosen not to voluntarily change to the fair value based method of accounting for stock-based employee compensation but have adopted the disclosure rules under SFAS 148.

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

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

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

Note 3. Discontinued Operations and Reclassifications

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

On October 30, 2002, IPI received a Notice of Termination of its DARPA contract for the government's convenience under the contract provisions entitled Termination, Federal Acquisition Regulation (FAR) 52.249.6. The DARPA contract had provided substantially all of the revenue of the Photonics Group. As of December 31, 2004, the contract termination process was substantially complete. We have been reimbursed for substantially all costs associated with the termination. The termination of the contract had a detrimental effect on the development of our technology. During 2002, all of our Photonics Group employees were released and the operations of the Photonics Group ceased. We also determined that our Photonics Group patents and property and equipment were impaired, and consequently recorded impairment losses in the fourth quarter of 2002 of approximately $468,000 and $148,000 respectively, which were included in loss on disposal of discontinued operations in the consolidated statement of operations for the year ended December 31, 2002.

7

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

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

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

	September 30, 2005	December 31, 2004
Financial Position		
Current assets and total assets of discontinued operations	$ --	$ 205,921

Liabilities of discontinued operations:		
Accounts payable and accrued expenses	$ --	$ 212,300
Unsecured note payable	--	5,000
Total liabilities of discontinued operations	$ --	$ 217,300

	Three Months Ended September 30, 2005	2004
Results of Operations		
Revenue from discontinued operations	$ --	$ 738,384
Loss from discontinued operations	$ --	$ (15,640)

	Nine Months Ended September 30, 2005	2004
Results of Operations		
Revenue from discontinued operations	$ --	$2,230,542
Income (loss) from discontinued operations	$ 12,233	$ (90,370)

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

8

Note 4. Stock Option Plan and Stock Warrants

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

A summary of incentive stock option activity for the nine months ended September 30, 2005 follows:

Weighted

	Number Of Options	Exercise Price	Average Exercise Pric
Outstanding at December 31, 2004	1,895,482	$ .01 - $2.50	$ .13
Options issued	2,640,000	$ .09-$.35	$ .18
Options expired	(692,982)	$ .01 - $2.50	$ .41
Outstanding at September 30, 2005	3,842,500	$ .01 -$.35	$ .13
Exercisable at September 30, 2005	3,842,500	$ .01 -$ .35	$ .13

At December 31, 2004, the Company had 425,000 warrants outstanding at an average exercise price of $2.50 per share. During the nine months ended September 30, 2005, 350,000 warrants expired. At September 30, 2005, the Company had 75,000 warrants outstanding at an average exercise price of $2.40.

At December 31, 2004 under the outside directors' stock option plan, there were 42,000 options outstanding to directors at an average exercise price of $1.15 per share. During the nine months ended September 30, 2005, 500 options expired. At September 30, 2005, there were 41,500 options outstanding to directors under this plan at an average exercise price of $1.05.

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

	Three Months Ended September 30, 2005	2004
Results of Operations		
Net income - as reported (000's)	$ 81	$ 231
Total stock based employee compensation expense determined under the fair value method for all awards (000's)	$ (35)	$ (2)
Net income - pro forma (000's)	$ 46	$ 229
Income per share as reported-basic and diluted	$ .00	$ .02
Income per share pro forma-basic and diluted	$ .00	$ .02

	Nine Months Ended September 30, 2005	2004
Results of Operations		
Net income - as reported (000's)	$ 134	$ 20
Total stock based employee compensation expense determined under the fair value method for all awards (000's)	$(284)	$ (17)
Net income (loss) - pro forma (000's)	$(150)	$ 3
Income per share as reported-basic and diluted	$ .01	$ .00
Income (loss) per share pro forma-basic and diluted	$(.01)	$ .00

Note 5. Business Segments

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

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

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

	Photonics Group	Laser Group	IT Services Group	Consol
Three Months ended September 30, 2004				
Sales to unaffiliated customers	$ --	$ --	$ 2,010,780	$ 2,0
Operating income	$ --	$ --	$ 267,146	$ 2

Income (loss) from discontinued operations	$ (34,651)	$ 19,011	$ --	$ (
Three Months ended September 30, 2005				
Sales to unaffiliated customers	$ --	$ --	$ 2,236,008	$ 2,2
Operating (loss)	$ --	$ --	$ (83,768)	$ (
Income from discontinued operations	$ --	$ --	$ --	$

10

	Photonics Group	Laser Group	IT Services Group	Consolid
Nine Months ended September 30, 2004				
Sales to unaffiliated customers	$ --	$ --	$ 3,840,603	$ 3,840
Operating income	$ --	$ --	$ 168,228	$ 168
Income (loss) from discontinued operations	$ (94,581)	$ 4,211	$ --	$ (90
Nine Months ended September 30, 2005				
Sales to unaffiliated customers	$ --	$ --	$ 6,370,558	$ 6,370
Operating income	$ --	$ --	$ 6,598	$ 6
Income from discontinued operations	$ 12,233	$ --	$ --	$ 12

Note 6. Supplemental Cash Flow Information

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

	Nine Months Ended September 30, 2005	2004
Conversion of accounts payable to common stock	$ 2,250	$ --

Common stock received in connection with settlement agreement with terminated employee	$ 175,000	$ --
Common stock contributed to Osley & Whitney Retirement Plan which reduced the balance of accrued pension expense obligation	$ 175,000	$ --
Common stock authorized not issued, transferred to issued	$ --	$ 75,000
Purchase of vehicle through long-term obligations	$ --	$ 45,120
Conversion of long-term obligation and related accrued interest and fees to common stock, net of capitalized costs written off	$ --	$ 5,000

Note 7. Earnings Per Share

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

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

	Nine Months ended September 30, 2005	Three Months ended September 30, 2005
Numerator:		
Income available to common stockholders from continuing operations	$ 122,264	$ 80,707
Weighted average shares outstanding	18,946,141	19,206,965
Denominator for diluted income per share:		
Weighted average shares outstanding	18,946,141	19,206,965
Common stock options and stock warrants	1,558,429	1,880,534
Weighted average shares and conversions	20,504,570	21,087,499

	Nine Months ended September 30, 2004	Three Months ended September 30, 2004
Numerator:		
Income available to common stockholders from continuing operations	$ 110,691	$ 246,612
Weighted average shares outstanding	14,321,335	14,439,201
Denominator for diluted income per share:		
Weighted average shares outstanding	14,321,335	14,439,201
Common stock options and stock warrants	957,739	1,195,861
Weighted average shares and conversions	15,279,074	15,635,062

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

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

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

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

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

Results of Operations

Comparison of Three Months ended September 30, 2005 and 2004

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

	Three Months Ended Septe		
	2005	As a % of Net Revenues	2004
Sales	$2,236,008	100.0%	$2,010,780
Cost of sales	1,581,574	70.7	1,385,657
Gross profit	654,434	29.3	625,123
General and administrative	420,507	18.8	279,088
Depreciation and amortization	7,844	0.4	7,358
Selling	231,428	10.4	--
Research and development	78,423	3.5	71,531
Total operating expenses	738,202	33.0	357,977
Operating income (loss)	(83,768)	(3.7)	267,146
Gain on settlement with terminated employee	191,739	8.6	--
Other income (expense) and income taxes, net	(27,264)	(1.2)	(20,534)
Income from continuing operations	80,707	3.6	246,612
Loss from discontinued operations	--	0.0	(15,640)
Net income	$ 80,707	3.6%	$ 230,972

Sales

Sales for the three months ended September 30, 2005 were $2,236,008 which was an increase of $225,228 or 11.2% as compared to sales for the three months ended September 30, 2004 of $2,010,780. The increase was due to more billable hours in our IT Services Group in 2005 from expanded contracts with prime contractors for the U.S. Government.

Cost of Sales and Gross Profit

Cost of sales represents the cost of employee services related to the IT Services Group. Cost of sales for the three months ended September 30, 2005 was $1,581,574 or 70.7% of sales as compared to $1,385,657 or 68.9% of sales for the three months ended September 30, 2004. Gross profit was $654,434 or 29.3% of sales for the three months ended September 30, 2005 compared to $625,123 or 31.1% of sales from the three months ended September 30, 2004. We experienced a decrease in gross profit margin as a percent of sales due to the competitive nature of our business, which generally provides for lower gross profit margins on larger sales volume contracts. As the mix of different projects changes, our gross profit margin changes. In the future we may submit bids on new work with lower gross profit margins to generate opportunities for long-term, larger volume contracts and more stable sales.

General and Administrative Expenses

General and administrative expenses include corporate overhead such as compensation and benefits for administrative and finance personnel, rent, insurance, professional fees, travel, and office expenses. General and administrative expenses for the three months ended September 30, 2005 were $420,507 which was an increase of $141,419 or 50.7% as compared to $279,088 for the three months ended September 30, 2004. Approximately 62% of this increase is due to the increases in employee compensation and related fringe benefits expenses. We also incurred increased operating expenses as we manage a larger volume of business.

We experienced increases in accounting and legal expenses of approximately $42,000 for the three months ended September 30, 2005 principally due to our focus on completing audits of our financial statements and related regulatory filings, which were completed and filed with the Securities and Exchange Commission in July 2005.

General and administrative expense includes expenses (including professional services and interest costs) associated with the Osley & Whitney defined benefit retirement plan, increased by approximately $11,100 from approximately $41,500 for the three months ended September 30, 2004 to approximately $51,600 for the three months ended September 30, 2005.

As a percentage of sales, general and administrative expense was 18.8 % for the three months ended September 30, 2005 as compared to 13.9 % for the three months ended September 30, 2004. We anticipate that the amount of general and administrative expenses will increase as we continue to grow our business and incur travel and other expenses associated with managing a larger business. We expect that legal and accounting expenses will decrease in the future since our public filings for several years were brought current.

Depreciation and Amortization

Depreciation and amortization expense was relatively unchanged at $7,844 for the three months ended September 30, 2005 compared to $7,358 for the three months ended September 30, 2004.

Selling Expenses

For the three months ended September 30, 2005 we incurred selling expenses of $231,428 associated with growing business in our IT Services Group as compared to no expenses for the three months ended September 30, 2004. Beginning in the second quarter of 2005, we added new employees and changed the work assignment of one employee and added sales consultants to focus on generating new sales leads and new contract opportunities. We engaged the services of a sales consultant in the three months ended September 2005. The consultant earned and we therefore expensed $40,800 in fees, payable in shares of our common stock. We expect that selling expenses, consisting principally of salaries, benefits, sales consultants, and travel expenses will increase as we devote more resources to increasing our sales.

Research and Development

For the three months ended September 30, 2005 we continued to incur research and development expenses associated with growing business in our IT Services Group related to our biometrics applications and recorded $78,423 of expense compared to $71,531 for the three months ended September 30, 2004. These expenses are principally related to the development of an access control terminal and related software called TouchThru(TM). TouchThru(TM) is a self-contained terminal enabling physical access control using biometric identification. It incorporates fingerprint matching technology licensed from Ultra-Scan Corporation, a private technology company headquartered in Buffalo, New York. TouchThru(TM) will be the first biometric product we introduce, and we intend to be in a position to market and sell that product beginning in 2006. We plan to market and sell TouchThru(TM) in a variety of industries and markets, including the federal, state and local government, health care, travel and general security, and access control.

Income (Loss) From Operations

For the three months ended September 30, 2005 our operating loss was $83,768 compared to net income of $267,146 for the comparable period of 2004. For the three months ended September 30, 2005, we experienced increases in operating expenses of $380,225 offset in part by an improvement in gross margin of $29,311.

Other Income (Expense)

Other income and expense consists of three components for the three months ended September 30, 2005.

One component of other income (expense) for the three months ended September 30, 2005 is a gain on settlement with a terminated employee of $191,739, which consists of the return to us of 500,000 shares of our common stock less legal expenses that we incurred in connection with the settlement. The shares were valued at the fair value on the date the settlement agreement was executed.

Interest expense was $35,716 for the three months ended September 30, 2005 compared to expense of $20,534 for the three months ended September 30, 2004, an increase of $15,182. This increase is principally due to an increase in short-term borrowings to finance accounts receivable of approximately $10,100 and increased borrowings from a related party. The principal balance due to this related party was $175,000 at September 30, 2005 versus zero at September 30, 2004.

Another component of other income (expense) for the three months ended September 30, 2005 consists of a gain on the sale of office equipment of $8,452 in connection with the relocation and sublease of office space in the Washington, D.C. area.

Income (Loss) from Discontinued Operations

We recorded a loss from discontinued operations of $15,640 for the three months ended September 30, 2004 compared with none for the three months ended September 30, 2005. The loss is the result of the Laser Group and the Photonics Group which were reclassified as discontinued operations.

Net Income

For the three months ended September 30, 2005, we recorded income from continuing operations and net income of $80,707 or $.00 per share. This compares to net income from continuing operations of $246,612 or $.02 per share and net income of $230,972, or $.02 per share for the three months ended September 30, 2004. The decrease in profitability is attributable to increases in operating expenses of $380,225, especially selling expenses, offset in part by the gain on settlement with a terminated employee of $191,739 for the three months ended September 30, 2005.

Comparison of Nine Months ended September 30, 2005 and 2004

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

	Nine Months Ended Septemb		
	2005	As a % of Net Revenues	2004
Sales	$ 6,370,558	100.0%	$ 3,840,603
Cost of sales	4,467,602	70.1	2,579,607
Gross profit	1,902,956	29.9	1,260,996
General and administrative	1,208,061	19	854,043
Depreciation and amortization	31,593	0.5	19,875
Write-off of capitalized financing costs	44,857	0.7	--
Selling	371,500	5.8	4,364
Research and development	240,347	3.8	214,486
Total operating expenses	1,896,358	29.8	1,092,768
Operating income	6,598	0.1	168,228
Gain on settlement with terminated employee	191,739	3.0	--
Other income (expense) and income taxes, net	(76,073)	(1.2)	(57,537)
Income from continuing operations	122,264	1.9	110,691
Gain (loss) from discontinued operations	12,233	0.2	(90,370)
Net income	$ 134,497	2.1%	$ 20,321

Sales

Sales for the nine months ended September 30, 2005 increased substantially by $2,529,955 or 65.9% to $6,370,558 as compared to sales for the nine months ended September 30, 2004 of $3,840,603. The increase was due to the continued development of our IT Services Group, which began operations in the second quarter of 2003. We realized sales increases from new and expanded contracts with prime contractors for the U.S. Government.

Cost of Sales and Gross Profit

Cost of sales represents the cost of employee services related to the IT Services Group. Cost of sales for the nine months ended September 30, 2005 was $4,467,602 or 70.1% of sales as compared to $2,579,607 or 67.2% of sales for the nine months ended September 30, 2004. Gross profit was $1,902,956 or 29.9% of sales for the nine months ended September 30, 2005 compared to $1,260,996 or 32.8% of sales for the nine months ended September 30, 2004. We experienced a decrease in gross profit margin as a percent of sales due to the competitive nature of our business, which generally provides for lower gross profit margins on larger sales volume contracts. As the mix of different projects changes, our gross profit margin changes. In the future we may submit bids on new work with lower gross profit margins to generate opportunities for long-term, larger volume contracts and more stable sales.

General and Administrative Expenses

General and administrative expenses include corporate overhead such as compensation and benefits for administrative and finance personnel, rent, insurance, professional fees, travel, and office expenses. General and administrative expenses for the nine months ended September 30, 2005 increased by $354,018 or 41.5%. Approximately half of this increase is due to the increases in employee compensation and related fringe benefits expenses. We also incurred increased operating expenses as we manage a larger volume of business.

General and administrative expenses include increases in accounting and legal expenses for the nine months ended September 30, 2005 of approximately $148,000 principally due to our focus on completing audits of our financial statements and related regulatory filings, which were completed and filed with the Securities and Exchange Commission in July 2005.

General and administrative expenses include expenses (including professional services and interest costs) associated with the Osley & Whitney defined benefit retirement plan, which increased by approximately $26,700 from approximately $149,100 for the nine months ended September 30, 2004 to approximately $175,800 for the nine months ended September 30, 2005.

As a percentage of sales, general and administrative expense was 19.0% for the nine months ended September 30, 2005 and 22.2% for the nine months ended September 30, 2004. We anticipate that the amount of general and administrative expenses will increase as we continue to implement our business strategy and incur travel and other expenses associated with managing a larger business. We expect that legal and accounting expenses will decrease in the future since our public filings for several years were brought current in the quarter ended September 30, 2005.

Depreciation and Amortization

Depreciation and amortization expense was $31,593 for the nine months ended September 30, 2005 compared to $19,875 for the nine months ended September 30, 2004. Beginning in the second quarter of 2003, we purchased equipment related to our Rochester headquarters office, acquired a technology license and capitalized software development costs related to our TouchThru TM products. We have continued to acquire office equipment such as personal computers as we hire additional personnel. We relocated our Washington, D.C. office in the third quarter of 2005 and acquired additional office equipment. The increase is due to depreciations and amortization of these recently acquired assets.

Write-off of Capitalized Closing Costs

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

Selling Expenses

For the nine months ended September 30, 2005 we incurred selling expenses of $371,500 associated with growing business in our IT Services Group compared to $4,364 for the nine months ended September 30, 2004. Beginning in the second quarter of 2005, we added new employees and changed the work assignment of one employee and added sales consultants to focus on generating new sales leads and new contract opportunities. We engaged the services of a sales consultant in the three months ended September 2005. The consultant earned and we therefore expensed $40,800 in fees, payable in shares of our common stock. We expect that selling expenses, consisting principally of salaries, benefits, sales consultants, and travel expenses will increase as we devote more resources to increasing our sales.

17

Research and Development

For the nine months ended September 30, 2005 we continued to incur research and development expenses associated with growing business in our IT Services Group related to our biometrics applications and recorded $240,347 of expense compared to $214,486 for the nine months ended September 30, 2004. These expenses are principally related to the development of an access control terminal and related software called TouchThru(TM). TouchThru(TM) is a self-contained terminal enabling physical access control using biometric identification. It incorporates fingerprint matching technology licensed from Ultra-Scan Corporation, a private technology company headquartered in Buffalo, New York. TouchThru(TM) will be the first biometric product we introduce, and we intend to be in a position to market and sell that product beginning in 2006. We plan to market and sell TouchThru(TM) in a variety of industries and markets, including the federal, state and local government, health care, travel and general security, and access control.

Income (Loss) From Operations

For the nine months ended September 30, 2005 our operating income was $6,598 compared to a $168,228 for the comparable period of 2004. This is attributable to our focus on our new IT Services Group and the growth of IT sales which provided gross profit of $1,902,956, an increase of $641,960 over the nine months ended September 30, 2004, to fund research and development, general and administrative expense and interest expenses. Operating expenses were $1,896,358, for the nine months ended September 30, 2005, an increase of $803,590 over the nine months ended September 30, 2004.

Other Income (Expense)

Other income and expense consists of three components for the nine months ended September 30, 2005.

One component of other income (expense) for the three months ended September 30, 2005 is a gain on settlement with a terminated employee of $191,739, which consists of his return to us of 500,000 shares of our common stock less legal expense that we incurred in connection with the settlement. The shares were valued at the fair value on the date the settlement agreement was executed.

Interest expense was $149,480 (including $66,255 of interest expense on notes payable of LF) for the nine months ended September 30, 2005 compared to $57,187 for the nine months ended September 30, 2004. The increase of $92,293 is offset by $66,255 of interest income from the notes receivable due from the buyer of LF's business for a net increase of $26,038. This net increase is principally due to (i) an increase in interest on notes payable to related parties of $11,144 due to an increase in the average outstanding principal balance of notes payable to related parties; (ii) an increase in interest to others of $10,100, which is interest on short-term notes to finance accounts receivable; and (iii) an increase in interest on equipment loans.

Another component of other income (expense) for the three months ended September 30, 2005 consists of a gain on the sale of office equipment of $8,452 in connection with the relocation and sublease of office space in the Washington, D.C. area.

Income (loss) from Discontinued Operations

We recorded income from discontinued operations of $12,233 for the nine months ended September 30, 2005 compared to a loss of $90,370 for the nine months ended September 30, 2004. These results are from the Laser Group and the Photonics Group which were reclassified as discontinued operations.

Net Income (Loss)

For the nine months ended September 30, 2005, we recorded income from continuing operations of $122,264, or $.01 per share and net income of $134,497 or $.01 per share. This compares to net income from continuing operations of $110,691 or $.01 per share and a net income of $20,321 or $.00 per share (the difference of $(.01) per share is from discontinued operations) for the nine months ended September 30, 2004. The improvement in profitability is attributable to an increase in gross profit of $641,960 and a gain on settlement with a terminated employee of $191,739 which offset increases in operating expenses of $803,590, especially selling expenses, for the nine months ended September 30, 2005. We also recorded a gain from discontinued operations of $12,233 for the nine months ended September 30, 2005 versus a loss of $90,370 for the comparable period of 2004.

18

Liquidity and Capital Resources

As of September 30, 2005 we had unrestricted cash of $79,521, which is available for working capital and property and equipment acquisitions.

At September 30, 2005 we had working capital of $30,652. Prior to June 30, 2005 we reported a working capital deficit. The improvement from a deficit of $1,972,840 at December 31, 2004 is a result of the buyer of the assets and businesses of LF obtaining new bank financing and paying off all of LF's notes receivable, which proceeds were used to pay off LF's bank promissory notes and capital lease (which were all classified as current liabilities due to violations of certain loan covenants).

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

We have used our common stock to provide compensation to certain employees and consultants and to fund liabilities.

During the three months ended September 30, 2005, one consultant provided services to us valued at $40,800. Those services are payable in 149,916 shares of common stock.

During the three months ended September 30, 2005, we made a contribution to the Osley & Whitney defined benefit retirement plan of 500,000 shares of our common stock, which was valued at $175,000.

Risk Factors

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

Item 3. Controls and Procedures

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

Changes in Internal Control over Financial Reporting. There were no changes in our internal controls over financial reporting, known to our chief executive officer and chief financial officer, that occurred during our fiscal second quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1: Legal Proceedings.

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

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

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

During the three months ended September 30, 2005, we completed settlement negotiations with a former employee. The parties agreed to settle all claims to avoid the expense and time of litigation. The parties executed mutual releases. The former employee surrendered 500,000 shares of our common stock that he owned to us, which was recorded at fair value at the date of the settlement agreement.

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

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

Recent Sales of Unregistered Securities.

During the three months ended September 30, 2005, we received services from a consultant and are obligated to issue 149,916 restricted shares of common stock valued at $40,800, based on the value of the services provided. The shares were accounted for as common stock authorized, not issued at September 30, 2005. We will issue the shares in the quarter ending December 31, 2005.

Item 3. Defaults Upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

a. Exhibits:

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

SIGNATURES

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

Infinite Group, Inc.

(Registrant)

Date November 11, 2005

/s/ Michael S. Smith

Chief Executive Officer

Date November 11, 2005

/s/ Michael S. Smith

Chief Financial Officer

(Principal Financial Officer)