

NEW MEXICO SOFTWARE, INC  
Form 10QSB/A  
March 24, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB/A

(Mark One)

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

For the quarter ended September 30, 2005

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

*COMMISSION FILE #333-30176*

NMXS.COM, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN CHARTER)

DELAWARE

(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

91-1287406

(IRS EMPLOYER IDENTIFICATION NUMBER)

5021 Indian School Road, Suite 100

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Albuquerque, New Mexico 87110

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)(ZIP CODE)

(505) 255-1999

(REGISTRANT'S TELEPHONE NO., INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR,  
IF CHANGED SINCE LAST REPORT)

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INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES  NO

NUMBER OF SHARES OF THE REGISTRANT'S COMMON STOCK OUTSTANDING AS OF NOVEMBER 11, 2005 IS: 48,417,326.

TRANSFER AGENT AS OF NOVEMBER 11, 2005: Interwest Transfer Company, Inc., 1981 East 4800 South, Suite 100, Salt Lake City, Utah 84117

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**NMXS.com, Inc. and Subsidiaries****Consolidated Balance Sheets****(Rounded to the nearest thousand)****(UNAUDITED)**

|  | <b>September 30,<br/>2005</b> | <b>2004</b> |
|--|-------------------------------|-------------|
| <b>Assets</b>  |                               |             |
| Current assets:  |                               |             |
| Cash and equivalents   | \$ 106,000                    | \$ 89,000   |
| Accounts receivable, net   | 286,000                       | 507,000     |
| Inventory  | 19,000                        | 7,000       |
| Prepaid expenses and other assets  | 569,000                       | 34,000      |
| Total current assets   | 980,000                       | 637,000     |
| Furniture, equipment and improvements, net   | 71,000                        | 100,000     |
| Security deposits  | 11,000                        | 40,000      |
| Prepaid advertising  | 185,000                       |             |
| Goodwill, net  |                               | 75,000      |
|  | \$ 1,247,000                  | \$ 852,000  |
| <b>Liabilities and Stockholders Equity</b>   |                               |             |
| Current liabilities:   |                               |             |
| Accounts payable   | \$ 146,000                    | \$ 67,000   |
| Accrued expenses   | 589,000                       | 412,000     |
| Deferred revenue   | 24,000                        | 15,000      |
| Subscriptions payable  | 118,000                       | 78,000      |
| Notes payable  | 177,000                       | 356,000     |
| Total current liabilities  | 1,054,000                     | 928,000     |
| Stockholders equity/(deficit):   |                               |             |
| Preferred stock, \$0.001 par value, 500,000 shares<br>authorized, 75 and 135 shares issued and outstanding<br>as of 9/30/05 and 9/30/04, respectively                |                               |             |
| Common stock, \$0.001 par value, 50,000,000 shares<br>authorized, 44,216,781 and 31,436,791 shares issued and<br>outstanding as of 9/30/05 and 9/30/04, respectively | 44,000                        | 31,000      |
| Additional paid-in capital   | 10,362,000                    | 9,136,000   |
| Deferred compensation  | (321,000)                     | (159,000)   |
| Accumulated (deficit)  | (9,892,000)                   | (9,084,000) |
| Total stockholders equity/(deficit)  | 193,000                       | (76,000)    |
|  | \$ 1,247,000                  | \$ 852,000  |

The accompanying notes are an integral part of these financial statements



## NMXS.com, Inc. and Subsidiaries

## Consolidated Statements of Operations

(Rounded to the nearest thousand)

(UNAUDITED)

|   | For the three months ended |               | For the nine months ended |               |
|---|----------------------------|---------------|---------------------------|---------------|
|   | September 30,<br>2005      | 2004          | September 30,<br>2005     | 2004          |
| Revenue   |                            |               |                           |               |
| Software sales and maintenance  | \$ 390,000                 | \$ 142,000    | \$ 822,000                | \$ 632,000    |
| Custom programming  | 202,000                    | 5,000         | 270,000                   | 43,000        |
| License fees  | 7,000                      | 15,000        | 22,000                    | 125,000       |
| Scanning services   | 18,000                     | 42,000        | 110,000                   | 130,000       |
| Hardware sales  | 20,000                     | 3,000         | 43,000                    | 53,000        |
| Other   | 3,000                      | 1,000         | 7,000                     | 2,000         |
|   | 640,000                    | 208,000       | 1,274,000                 | 985,000       |
| Operating costs and expenses:   |                            |               |                           |               |
| Cost of services  | 182,000                    | 136,000       | 438,000                   | 311,000       |
| General and administrative  | 231,000                    | 260,000       | 778,000                   | 700,000       |
| Research and development  | 53,000                     | 32,000        | 162,000                   | 91,000        |
| Total operating costs and expenses                                      | 466,000                    | 428,000       | 1,378,000                 | 1,102,000     |
| Net operating income/(loss)   | 174,000                    | (220,000 )    | (104,000 )                | (117,000 )    |
| Other income (expense):   |                            |               |                           |               |
| Interest income   |                            |               |                           |               |
| Interest (expense)  | (125,000 )                 | (12,000 )     | (137,000 )                | (19,000 )     |
| (Loss) on disposal of fixed assets                                      |                            |               |                           |               |
| Total other income (expense)  | (125,000 )                 | (12,000 )     | (137,000 )                | (19,000 )     |
| Net income(loss)  | \$ 49,000                  | \$ (232,000 ) | \$ (241,000 )             | \$ (136,000 ) |
| Earnings per share - basic  | \$ 0.00                    | \$ (0.01 )    | \$ (0.01 )                | \$ (0.00 )    |
| Earnings per share - fully diluted                                      | \$ 0.00                    | \$ (0.01 )    | \$ (0.01 )                | \$ (0.00 )    |
| Weighted average number of<br>common shares outstanding - basic         | 42,131,088                 | 30,953,517    | 38,071,882                | 30,326,246    |
| Weighted average number of<br>common shares outstanding - fully diluted | 45,718,674                 | 30,953,517    | 38,071,882                | 30,326,246    |

The accompanying notes are an integral part of these financial statements



**NMXS.com, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(Rounded to the nearest thousand)****(UNAUDITED)**

|  | <b>For the nine months ended</b> |              |
|--|----------------------------------|--------------|
|  | <b>September 30,</b>             |              |
|  | <b>2005</b>                      | <b>2004</b>  |
| <b>Cash flows from operating activities</b>  |                                  |              |
| Net income   | \$ (241,000)                     | \$ (136,000) |
| Adjustments to reconcile net (loss) to net cash provided (used) by operating activities: |                                  |              |
| Common stock issued for salaries   | 403,000                          | 98,000       |
| Common stock issued for services   | 99,000                           | 48,000       |
| Common stock issued for interest   | 6,000                            |              |
| Depreciation and amortization  | 34,000                           | 58,000       |
| Changes in operating assets and liabilities:   |                                  |              |
| Accounts receivable  | 147,000                          | (57,000)     |
| Inventory  | (12,000)                         | (4,000)      |
| Prepaid expenses and other assets  | (728,000)                        | (13,000)     |
| Security deposits  | -                                | (1,000)      |
| Accounts payable   | 24,000                           | (55,000)     |
| Accrued expenses   | 150,000                          | (53,000)     |
| Deferred revenue   | (62,000)                         | (55,000)     |
| Net cash (used) by operating activities  | (180,000)                        | (170,000)    |
| <b>Cash flows from investing activities</b>  |                                  |              |
| Acquisition of fixed assets  | (20,000)                         | (17,000)     |
| Disposal of fixed assets   | -                                | -            |
| Net cash (used) by investing activities  | (20,000)                         | (17,000)     |
| <b>Cash flows from financing activities</b>  |                                  |              |
| Proceeds from notes payable  | -                                | 105,000      |
| Repayment of note payable  | (24,000)                         | (25,000)     |
| Net proceeds from the issuance of common stock   | 289,000                          | 185,000      |
| Net proceeds from warrants/options exercised   | 41,000                           | -            |
| Net cash provided by financing activities  | 306,000                          | 265,000      |
| Net increase (decrease) in cash equivalents  | 106,000                          | 78,000       |
| Cash equivalents - beginning   | -                                | 11,000       |
| Cash equivalents - ending  | \$ 106,000                       | \$ 89,000    |
| <b>Supplemental disclosures:</b>   |                                  |              |
| Interest paid  | \$ 7,000                         | \$ 7,000     |

The accompanying notes are an integral part of these financial statements





**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

**NOTE A BASIS OF PRESENTATION**

The interim consolidated financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim consolidated financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2004 and notes thereto included in the Company's Form 10-KSB. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim periods are not indicative of annual results.

**NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

[1] Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material inter-company accounts and transactions have been eliminated.

[2] Revenue recognition:

Our revenues are generally classified into three main categories: software license revenue, custom software development revenue, and maintenance and hosting revenue. The Company recognizes revenue in accordance with Statement of Position 97-2 Software Revenue Recognition .

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Revenue from proprietary software sales that does not require further commitment from the company is recognized upon shipment. These sales are generally direct purchases of a software product and there is no other involvement by the Company.

The Company offers with certain sales of its software products a software maintenance, upgrade and support arrangement. These contracts may be elements in a multiple-element arrangement or may be sold in a stand-alone basis. Revenues from maintenance and support services are recognized ratably on a straight-line basis over the term that the maintenance service is provided. Maintenance contracts typically provide for 12-month terms with maintenance contracts. The Company typically charges 17% to 21% of the software purchase price for a 12-month contract with discounts available for longer-term agreements. Charges for hosting are likewise spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 12 months, with renewal on an annual basis.

Should the sale of its software involve an arrangement with multiple elements (for example, the sale of a software license along with the sale of maintenance and support to be delivered over the contract period), the Company allocates revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. The fair value of the separate elements is determined from vendor-specific objective evidence (VSOE), which is based on the price charged for each element when it is sold separately. The Company defers revenue from the arrangement equivalent to the fair value of the undelivered elements and recognizes the remaining amount at the time of the delivery of the product or when all other revenue recognition criteria have been met.

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

For contracts and revenues related exclusively to custom software development services, the Company recognizes revenue and profit as work progresses on custom content service contracts using the percentage-of-completion method. This method relies on estimates of total expected contract revenue and costs as each job progresses throughout the relevant contract period. The Company follows this method since reasonably dependable estimates of the costs applicable to various stages of a custom content service contract can be made.

From time to time, the Company effects sales of its enterprise-level software in return for barter credits for advertising. The software is valued at the same price it would have been valued if it had been sold for cash. The revenue is recognized when the software is transferred to the customer, along with a corresponding receivable for the barter credits. The advertising expense is recognized as the ads are placed. The value of any remaining barter credits is reviewed at the end of each fiscal year for possible impairment, and any such impairment loss is recorded at that time. During the fiscal year ended December 31, 2004, the Company recognized \$135,000 in revenue from barter transactions. At December 31, 2004, the Company had \$135,000 in barter credits receivable.

The Company also derives revenue from the sale of third party hardware and software. Revenue from installation, training and consulting services is recognized when the services are rendered.

Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

Due to uncertainties inherent in the estimation process it is at least reasonably possible that completion costs for contracts in progress will be further revised in the near-term.

The cost of services, consisting of staff payroll, outside services, equipment rental, communication costs and supplies, is expensed as incurred.

[3] Cash and cash equivalents:

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents.

[4] Inventory:

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Inventory, which is composed of component parts and finished goods, is valued at cost on a specific identity basis for those items with serial numbers. The remainder of the inventory is valued at the lower of first-in-first-out (FIFO) cost or market. On a quarterly basis, management compares the inventory on hand with our records to determine whether write-downs for excess or obsolete inventory are required.

[5] Furniture, equipment and improvements:

Furniture, equipment and improvements are recorded at cost. The cost of maintenance and repairs is charged against results of operations as incurred. Depreciation is charged against results of operations using the straight-line method over the estimated economic useful life. Leasehold improvements are amortized on a straight-line basis over the life of the related lease.

[6] Income taxes:

The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined on the basis of the differences between the tax basis of assets and liabilities and their respective financial reporting amount ( temporary differences ) at enacted tax rates in effect for the years in which the differences are expected to reverse.

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

[7] Per share data:

The basic and diluted per share data has been computed on the basis of the net loss available to common stockholders for the period divided by the historic weighted average number of shares of common stock. All potentially dilutive securities have been excluded from the computations since they would be antidilutive, however, these dilutive securities could potentially dilute earnings per share in the future. Options and warrants exercisable for 1,567,000 shares of common stock have been excluded from the diluted loss per share calculation for the nine months ended September 30, 2005, because inclusion of such would be antidilutive.

[8] Research and development expenses:

Costs of research and development activities are expensed as incurred.

[9] Advertising expenses:

The Company expenses advertising costs which consist primarily of direct mailings, promotional items and print media, as incurred. Advertising expenses amounted to \$12,000 and \$7,000 for the nine months ended September 30, 2005 and 2004, respectively.

[10] Use of estimates:

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 amount 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.

[11] Stock-based compensation:

Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ) allows companies to either expense the estimated fair value of stock options and warrants, or to continue following the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ) but disclose the pro forma effects on net loss had the fair

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value of the options and warrants been expensed. The Company has elected to apply APB 25 in accounting for grants to employees under its stock based incentive plans. Equity instruments issued to non-employees are measured based on their fair values.

Statement of Financial Accounting Standards No. 148 Accounting for Stock-Based Compensation Transition and Disclosure ( SFAS 148 ) provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation.

Common stock:

During the nine-month period ended September 30, 2005, the Company effected the following stock transactions:

The Company issued a total of 1,325,000 shares of its \$0.001 par value common stock to Brian McGowan as part of a five year consulting agreement in the amount of \$79,000. The entire amount is considered deferred compensation. During the nine months ended September 30, 2005, \$45,000 of the compensation was earned.

The Company issued a total of 1,280,000 shares of its \$0.001 par value common stock to Brian McGowan as part of a separate seven year consulting agreement in the amount of \$166,000. The entire amount is considered deferred compensation. During the nine months ended September 30, 2005, \$40,000 of the compensation was earned.

The Company issued a total of 3,130,917 shares of the Company's \$0.001 par value common stock to employees in lieu of salary, which was valued at \$403,000.

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

The Company issued a total of 115,715 shares the Company s \$0.001 par value common stock to outside contractors in exchange for services rendered of \$14,000.

The Company issued a total of 520,517 shares of the Company s \$0.001 par value common stock which were related to the exercise of options/warrants in exchange for \$42,000 cash.

The Company issued a total of 912,108 shares of the Company s \$0.001 par value common stock which were related to the conversion of 60 shares of Series A convertible preferred stock.

The Company issued a total of 313,621 shares of the Company s \$0.001 par value common stock in repayment of a short-term note plus interest in the amount of \$36,000.

The Company issued a total of 3,784,445 shares of the Company s \$0.001 par value common stock for cash in the amount of \$385,000.

**Warrants:**

During the nine-month period ended September 30, 2005 there were 110,000 warrants issued and none exercised.

The following is a summary of warrants outstanding as of September 30, 2005:

| <u>Number of Warrants</u> | <u>Exercise Price</u> | <u>Expiration Date</u> |
|---------------------------|-----------------------|------------------------|
| 1,161,545                 | \$0.21                | July 24, 2012          |
| 110,000                   | \$0.25                | July 23, 2008          |

**Stock options:**

Disclosures required by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123 ), including pro forma operating results had the Company prepared its financial statements in accordance with the fair value based method of



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accounting for stock-based compensation prescribed therein are shown below. Exercise prices and weighted-average contractual lives of stock options outstanding as of September 30, 2005 are as follows:

| Options Outstanding |             | Weighted Average      | Weighted        | Options Exercisable |                |
|---------------------|-------------|-----------------------|-----------------|---------------------|----------------|
| Exercise Prices     | Number      | Remaining Contractual | Average         | Number              | Weighted       |
|                     | Outstanding | Life                  | Exercise Prices | Exercisable         | Average        |
|                     |             |                       |                 |                     | Exercise Price |
| \$0.10-\$0.30       | 3,914,500   | 5.50                  | \$0.06          | 3,310,167           | \$0.06         |
| \$0.31-\$0.50       | 160,000     | 3.63                  | \$0.36          | 160,000             | \$0.36         |
| \$0.54-\$0.83       | 60,000      | .58                   | \$0.61          | 60,000              | \$0.61         |

**NMXS.com, INC. AND SUBSIDIARIES**

## Notes to Consolidated Financial Statements

## Summary of Options Granted and Outstanding:

|                                     | For the nine months ended September 30, |                                       |           |                                       |
|-------------------------------------|---|---------------------------------------|-----------|---------------------------------------|
|                                     | 2005                                    |                                       | 2004      |                                       |
|                                     | Shares                                  | Weighted<br>Average<br>Exercise Price | Shares    | Weighted<br>Average<br>Exercise Price |
| Options:                            |   |                                       |           |                                       |
| Outstanding at beginning<br>of year | 4,183,030                               | \$0.08                                | 6,042,824 | \$0.12                                |
| Granted                             | -                                       | \$ -                                  | -         | \$ -                                  |
| Cancelled                           | (48,530)                                | \$0.06                                | (337,049) | \$0.26                                |
| Exercised                           | -                                       | -                                     | -         | -                                     |
| Outstanding at end of year          | 4,134,500                               | \$0.08                                | 5,705,775 | \$0.12                                |

The following table summarizes the pro forma operating results of the Company for the nine months ended September 30, 2005 and 2004 had compensation costs for the stock options granted to employees been determined in accordance with the fair value based method of accounting for stock based compensation as prescribed by SFAS No. 123.

|   | 2005      | 2004      |
|---|-----------|-----------|
| Net income as reported                        | (241,000) | (136,000) |
| Pro forma effects of stock-based compensation | (16,000)  | (24,000)  |
| Net (loss) pro forma                          | (257,000) | (160,000) |
| (Loss) per share as reported                  | (\$0.01)  | \$0.00    |
| Pro forma effects of stock-based compensation | -         | -         |
| (Loss) per share pro forma                    | (\$0.01)  | \$0.00    |

As of September 30, 2005, the Company has reserved 1,000,000 shares of its common stock for issuance upon exercise of stock options and warrants.

**NOTE C - FURNITURE, EQUIPMENT, AND IMPROVEMENTS**

Furniture, equipment, and improvements as of September 30, 2005 consisted of the following:

|           |            |
|-----------|------------|
| Computers | \$ 315,000 |
|-----------|------------|

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|                                   |                  |
|-----------------------------------|------------------|
| Furniture, fixtures and equipment | 112,000          |
| Automobiles                       | 38,000           |
| Leasehold improvements            | <u>12,000</u>    |
|                                   | 477,000          |
| Accumulated depreciation          | <u>(406,000)</u> |
|                                   | \$ 71,000        |

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**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

**NOTE D - NOTE PAYABLE**

During January 2001, the Company borrowed \$300,000. The loan is collateralized by substantially all of the Company's assets and personally guaranteed by an officer of the Company. Additional collateral was provided by a letter of credit issued by a then unrelated third party. The letter of credit expired on January 19, 2002. The note was renewed with a due date of July 24, 2002 at a current interest rate of 7%. On July 24, 2002, the Company paid \$50,000 of principal and \$10,525 of interest. The remaining \$250,000 of principal was extended to October 24, 2002 at a current interest rate of 7%. On October 24, 2002 the Company paid \$25,000 of principal and \$4,555 of interest. The remaining \$225,000 of principal was extended until April 24, 2003 at a current interest rate of 7%. On April 24, 2003, the Company paid \$12,224 of principal and \$12,768 of interest. The remaining \$212,776 of principal was extended until October 15, 2003 at a current interest rate of 7%. On October 20, 2003, the Company negotiated a payment of \$25,000 in principal and \$7,500 in interest and extended the note to April 23, 2004. On March 27, 2004, the Company received a notice from the bank to extend the note to October 15, 2004 upon payment of an additional \$25,000 of principal and approximately \$6,000 of accrued interest, which was paid on April 5, 2004. On October 8, 2004, the Company paid \$25,000 of principal and \$6,000 of interest, and the remaining \$138,168 was extended until April 15, 2005. In May 2005, the Company paid \$25,000 of principal and \$5,000 of interest, and the remaining \$114,112 was extended until October 15, 2005. As of September 30, 2005, the Company had a balance due of \$114,000 plus accrued interest of \$3,000.

On April 22, 2002, the Company borrowed \$50,000. The loan was due on April 23, 2003 at a current interest rate of 10% per annum. This note is secured by 500,000 shares of the Company's \$0.001 par value common stock. As of September 30, 2005, the Company is in default and is negotiating with the note holder.

In April 2002, the Company borrowed \$12,500. The loan is due on demand and bears no interest. As of September 30, 2005, the Company had a balance due of \$12,500.

On March 1, 2003, the Company borrowed \$25,000. The loan was due on September 30, 2003 at a current interest rate of 7% per annum until the due date and 18% per annum thereafter. On August 29, 2003, the note was extended to December 31, 2003. On December 31, 2003, the note was extended to April 15, 2004. On April 15, 2004, the note was extended to June 30, 2004. On May 21, 2004, the Company borrowed an additional \$50,000. The loan was due on demand at a current interest rate of 8% per annum. The loans were secured by 400,000 shares of NMXS.com, Inc. common stock owned by the Company's President/CEO. On January 12, 2005, the Company received a letter requesting payment of the loans. On March 31, 2005, the Company elected to surrender the 400,000 shares owned by the President/CEO as payment in full of the loan and accumulated interest of approximately \$9,000. The Board of Directors has approved the issuance of 400,000 shares of restricted common stock to the President/CEO to replace the shares surrendered. As of September 30, 2005 these shares have not been issued, and approximately \$84,000 is included in subscriptions payable on the balance sheet.

**NOTE E - RELATED PARTY TRANSACTIONS**

Consulting agreement:

The Company entered into a consulting agreement with Brian McGowan to advise the CEO on business strategy and to formulate marketing ideas. The term of the employment agreement is for approximately five years commencing on July 1, 2003 and terminating on December 31, 2008. Mr. McGowan will receive a total of 5,500,000 shares of the Company's \$0.001 par value common stock valued at \$330,000. As of September 30, 2005, he was paid a total of 5,500,000 shares of common stock, but he has earned only 2,250,000 shares and the difference of 3,250,000 shares is considered deferred compensation. During the nine-month period ended September 30, 2005, the Company has expensed \$45,000 in consulting fees.

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

On January 27, 2005, the Company entered into a second consulting agreement with Brian McGowan to assist the Company's CEO in the structure, formation, marketing and growth of two joint venture partnerships involving the Company's consumer products division and the Company's wholly-owned subsidiary (Working Knowledge, Inc.). The term of the employment agreement is for approximately seven years commencing on January 27, 2005 and terminating on December 31, 2011. Mr. McGowan will receive a total of 3,220,000 shares of the Company's \$0.001 par value common stock valued at \$419,000. As of September 30, 2005, the shareholder was paid a total of 1,280,000 shares of common stock, but he has earned only 308,000 shares and the difference of 972,000 shares is considered deferred compensation. During the nine-month period ended September 30, 2005, the Company has expensed \$40,000 in consulting fees.

**NOTE F- MAJOR CUSTOMERS**

During the nine-month period ended September 30, 2005, two customers accounted for 60% of the Company's revenue. The Company recognized \$600,000 as revenue and \$0 as expense from barter agreements for the nine-month period ended September 30, 2005.

As of September 30, 2005, balances due from two customers comprised 62% of total accounts receivable.

**NOTE G - REPORTABLE SEGMENTS**

Management has identified the Company's reportable segments based on separate legal entities. On January 1, 2005, the Company reorganized its segments to more clearly reflect the Company's direction and growth. In addition to having a variety of products and services available, management has formulated a business strategy for the next two years that will take advantage of opportunities to market these products. The current business strategy is to form up to twenty joint venture projects over the next two to three years. These joint venture projects would be formed to develop, market and distribute various digital lifecycle management applications built around our core Roswell technology.

In the past, Working Knowledge, Inc. provided data maintenance services related to the NMS digital asset management system. The data maintenance services have been absorbed into New Mexico Software, and Working Knowledge, Inc. has been redefined to include those product divisions for which joint venture projects are being formed. Therefore, at this time, Working Knowledge, Inc. includes the healthcare division and the Sox Advisors division. These divisions are centered around the products XR-EXpress and SOXtrac. Information related to the Company's reportable segments for the nine months ended September 30, 2005 is as follows:

|                            | NMS          | WKI       | Total        |
|----------------------------|--------------|-----------|--------------|
| Revenue                    | \$ 1,244,000 | \$ 30,000 | \$ 1,274,000 |
| Cost of services           | 397,000      | 41,000    | 438,000      |
| General and administrative | 767,000      | 11,000    | 778,000      |

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|                          |              |           |              |
|--------------------------|--------------|-----------|--------------|
| Research and development | 160,000      | 2,000     | 162,000      |
| Operating income (loss)  | (80,000)     | (24,000)  | (104,000)    |
| Total assets             | \$ 1,209,000 | \$ 38,000 | \$ 1,247,000 |

WKI revenue consists primarily of software maintenance and diagnostic reports for XR-EXpress customers.

A reconciliation of the segments' operating loss to the consolidated net loss/comprehensive loss is as follows:

|  |                     |
|--|---------------------|
| Segment's operating income               | <u>\$ (104,000)</u> |
| Other expense                            | <u>(137,000)</u>    |
| Consolidated net loss/comprehensive loss | \$ (241,000)        |

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

Prior to acquisition of Working Knowledge, Inc., in April 2000, the Company operated within one business segment.

For the nine months ended September 30, 2005, amortization and depreciation expense amounted to \$34,000 and \$0 for NMS and WKI, respectively. Also, total fixed asset additions amounted to \$19,000 and \$1,000 for NMS and WKI, respectively, while fixed asset disposals amounted to \$8,000 and \$0 for NMS and WKI, respectively.

**NOTE H COMMITMENTS AND CONTINGENCIES**

Leases:

The Company leases office space in New Mexico and California. Future minimum lease payments as of September 30, 2005 are as follows:

| <u>Year</u> | <u>Amount</u> |
|-------------|---------------|
| 2005        | \$ 24,000     |
| 2006        | \$ 73,000     |
| 2007        | \$ 60,000     |
| 2008        | \$ 60,000     |
| 2009        | \$ 20,000     |

Rent expense for the nine months ended September 30, 2005 and 2004 amounted to \$58,000 and \$53,000, respectively.

Employment agreement:

The Company entered into an employment and non-competition agreement with a stockholder to act in the capacity of President and Chief Executive Officer (CEO). The term of the employment agreement is for three years commencing on January 1, 2003. The agreement allows for a one-year renewal option unless terminated by either party. Base salary is \$44,000 per annum with available additional cash compensation as defined in the agreement. Compensation under this agreement of \$33,000 is included in general and administrative expenses for the nine months ended September 30, 2005. The non-competition agreement commences upon the termination of the employment agreement for a period of one year. As of September 30, 2005, there was a total of \$113,000 in accrued payroll for this executive.



Outstanding Payroll Taxes:

The Company has unpaid Federal and State payroll taxes totaling approximately \$348,000 as of September 30, 2005, including estimated penalties and interest. The Company has accrued \$108,000 in penalties and interest on the Federal tax obligation based on a notice received from the IRS as of August 31, 2005.

On June 1, 2003, the Company settled with the State of New Mexico and agreed to pay \$1,000 per month of past due payroll taxes plus the current amount due. During the nine months ended September 30, 2005, the Company paid a total of \$9,000 of past due payroll taxes.

On September 1, 2005, the Company negotiated a final settlement with the IRS and agreed to pay \$25,000 per month of past due payroll taxes plus the current amount due. During the nine months ended September 30, 2005, the Company paid a total of \$70,000 of past due payroll taxes.

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

**NOTE I BARTER TRANSACTIONS**

During the nine months ended September 30, 2005, the Company had two barter transactions totaling \$600,000 for the sale of software to Forbes.com in return for advertising credits. In these barter transactions customized software was transferred to the customer in return for print advertising. The software and customization was valued at the same price it would have been valued if it had been sold for cash, so no impairment was recorded before the asset was transferred. The revenue was recognized when the software was transferred to the customer in accordance with paragraph 8 of SOP 97-2, and a corresponding receivable for the barter credits was recorded at that time. During the third quarter of 2005, the receivable was reclassified as prepaid advertising. The advertising expense will be recognized as the ads are placed. The value of any remaining barter credits will be reviewed at the end of each fiscal year for possible impairment, and any such impairment loss will be recorded at that time.

**NOTE J LEGAL PROCEEDINGS**

Grossman Lawsuit: Kurt Paul Grossman and Ann Grossman filed a complaint for Breach of Contract on a Promissory Note against us on November 25, 2003, in the Superior Court of California, Orange County Division, case # 03CC14074. There was a question of whether the complaint was properly served and whether the California courts have jurisdiction over us. The Grossmans filed an Application for Writ of Attachment which was denied on January 30, 2004. The Grossmans asked for \$55,000 (\$50,000 on the promissory note plus \$5,000 interest); \$304.40 in costs; and \$24,000 in attorney's fees. The Grossmans, through a separate entity, Doctors Telehealth Network, purchased software from us, and it has not been paid for. We filed a motion to quash the service of summons for lack of personal jurisdiction and to vacate a default judgment against us. The court tentatively ruled in favor of the Grossmans. However, after our oral argument on April 23, 2004, the court withdrew its tentative ruling and ruled in favor of us. Specifically, the court ruled that we do not have sufficient contact with California to warrant the exercise of personal jurisdiction. Mr. Grossman appealed this ruling on the issue of the quashing of service on jurisdictional grounds. After the case was fully briefed to the Appellate Court, the Appellate Court affirmed the decision of the trial court, in favor of us, finding that there was no jurisdiction in California for this matter. The Appellate Court also stated that the Company shall recover its costs on appeal. Because of the Appellate Court's ruling, the Grossman action is no longer pending against us.

Internal Revenue Service Payments: In October 2003 we entered into an interim agreement with the Internal Revenue Service concerning the repayment of federal tax deposits which we failed to pay for the six operating quarters ended September 30, 2003. We agreed to pay and did pay \$5,000 per month toward the past due tax obligation beginning November 1, 2003. On September 1, 2005 we negotiated a final settlement with the IRS. We agreed to pay \$25,000 per month until the total balance of \$358,000 has been paid.

Manhattan Scientifics Lawsuit: On March 9, 2004, our legal counsel received a letter from an attorney representing Manhattan Scientifics. The letter threatened litigation against us for alleged breach of contract and against Richard Govatski for alleged tortious interference with contract. This is based on the fact that we were alleged to have declined to honor Manhattan Scientifics' request for a cashless exercise of 150,000 of our Common Stock Purchase Warrants (the Warrants) allegedly issued to Manhattan Scientifics. It is our position that the Warrants, among other things, were issued in a transaction that was not an arms-length transaction and therefore, the Warrants should be cancelled, and that in any event, the alleged cashless exercise was not properly done and itself is a nullity. In May 2004, Manhattan Scientifics filed a suit in Federal Court in New York against us and Mr. Govatski for damages in this matter. The case was dismissed by the Federal Court due to a lack of diversity jurisdiction. On June 25, 2004, we were served with a complaint filed in the Supreme Court of the State New York, County of New York, Index

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No. 601793/04, asserting the same claims. Manhattan Scientifics seeks damages against us for an alleged breach of contract for failure to allow the cashless exercise, in an amount of \$1.5 million, and alleges a tortious interference claim against Mr. Govatski.

**NMXS.com, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

We served our Answer to the Complaint on August 16, 2004. Mr. Govatski is seeking dismissal of the claim against him for lack of personal jurisdiction and for failure to state a claim. Mr. Govatski's motion to dismiss has been fully submitted to the court, but has not yet been decided. Along with our Answer, we are asserting Counterclaims against Manhattan Scientifics for monies owed by Manhattan Scientifics and for a declaratory judgment, and against a former Company Director, Marvin Maslow for fraud and breach of fiduciary duty due to his persuading the Company to enter into the Warrant transaction with Manhattan Scientifics, which we contend was done for the benefit of Maslow and Manhattan Scientifics, and not for the benefit of the Company. We believe that due to the fact that Mr. Maslow and a second former Company director (Scott Bach), were also Directors of Manhattan Scientifics at the time of the transactions in dispute, and constituted two of the Company's three Directors at the time, Mr. Maslow and Mr. Bach should have excused themselves from participating in negotiating and voting on the issue of whether to approve the Warrants. Messrs. Maslow and Bach resigned as our Directors in December 2002. It is our position that such financial conflicts include Mr. Maslow's causing the Company to pay for third-party consulting services provided to Manhattan Scientifics, while stating that such services would be provided to, and were needed by, the Company as part of the transaction. It is our position that Mr. Maslow also misrepresented the fairness of the transaction in dispute at the time to us, which we contend was being done for the benefit of Mr. Maslow and Manhattan Scientifics, to the detriment of the Company. In our counterclaims, we are seeking, among other relief, a determination that the Warrants should be declared null and void from inception, plus damages against Mr. Maslow. It is further our position that even if the Warrants were properly issued (we contend they were not), the Warrants were never properly exercised by Manhattan Scientifics. Manhattan Scientifics and Mr. Maslow have moved to dismiss certain of our Counterclaims alleged against them. That motion too has been fully submitted to the court, but not yet decided.

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

OVERVIEW

New Mexico Software develops a variety of products centered around the concept of digital lifecycle management systems. The digital lifecycle is the IT (information technology) strategy that associates database information with both paper and digital files including text, email, images, audio, graphics, video and animation files, and coordinates access to a common repository of these processes and files. The digital lifecycle encompasses creation, approval, sharing, storage, retrieval, usage, capture and archiving of the database information. Our core product, Roswell, is an enterprise-level platform that manages digital files. It manages assets by creating folders, or groups of files, catalog hierarchies, users, user groups, and user permissions. The files are managed by a database that maintains both the membership of the file in a folder(s) and information about the file. Roswell's main user interface is a web browser, which makes it accessible and more intuitive to a greater number of users. It can be used on Windows, Macintosh or Linux operating systems.

In addition to developing the software itself, New Mexico Software also provides services such as web hosting, data storage, custom programming, technical support, database development, image scanning and other support services. Since our core technology is based on internet browsers and the majority of our services are either Internet-based or performed via the Internet, the market conditions surrounding the Internet industry directly impact our business.

One of the most significant issues affecting our type of business is that the Internet as a commercial industry is less than ten years old. Therefore, the entire industry is subject to intense competition and rapidly changing conditions, causing uncertainty and inconsistencies for the individual companies operating within that industry. According to the Standard & Poors Industry Survey Computers: Consumer Services & The Internet dated March 3, 2005, two key factors used to analyze Internet-related companies are: 1 - because many Internet-related companies do not generate consistent and substantial earnings, and some have only a small base of revenues, such firms often are valued largely on their prospects for future growth, and 2 - for Internet-related companies qualitative assessments are crucial in helping to determine the competitive position, growth opportunities, and value of an Internet company. According to Standard & Poors, some of the qualitative items investors should look at in addition to financial statement analysis are business models, competitive positioning, management's vision and execution, diversification of revenue streams, capital requirements, ability to recruit and retain skilled software programmers, ability to convert new ideas into saleable offerings quickly, ability to capitalize on the unique benefits offered by the Internet, and the ability to generate new ideas, market new products and foster an entrepreneurial and innovative corporate structure. We believe that these subjects apply to New Mexico Software.

We have spent the last two years positioning our business for future growth. Our focus has been on creating a stable team of software engineers, completing the development of our core product (Roswell), streamlining our expenses and clearing up old obligations on the balance sheet.

Although the development of our core technology has taken several years, its adaptability to any industry provides us with numerous opportunities for growth and market penetration as more creative applications are discovered and developed from within our core intellectual property (Roswell). These new applications will have low capital requirements and provide additional revenue diversification.

One of the challenges of operating in this industry is creating a balance between sustaining a consistent vision and business strategy and yet maintaining the flexibility required to adapt to the rapidly changing market conditions. We believe that our product structure allows us to do that. Since our core technology is useful to literally any company that manages digital assets and has access to browser and search functions, it is the backbone of our product framework. As such, it provides the consistency and stability aspect of the business strategy. The next generation of our products primarily consists of derivative products, new technological combinations, and enhancements to the core product. These have the advantage of taking less than a year to develop into a marketable product, thus providing the flexibility necessary to be able to respond quickly to new market opportunities.

Some challenges we face in the next year are continuing to develop a sales force and distribution channels in order to market our products, as well as educating potential customers about the benefits of digital lifecycle systems. We have hired two executive managers to focus on marketing XR-EXpress, and we have hired a manager to focus on the consumer products division. These executive managers are known as SME s (Subject Matter Experts) who have had the experience to understand the broad range of requirements needed to successfully manage complex IT structures, technology, client relationships and products.

Another possible opportunity for our business can be found in the current expansion of the open-source software market. The growth in this market was discussed in a May 10, 2004 article in Business Week Online entitled "Software Shift". According to this article, the market for software products using open source programming is expanding beyond the Linux operating system to include software products such as databases, search engines, programming tools and desktop PC software. Since our products have all been developed with open source code, we may be in a position to take advantage of this expansion by identifying opportunities to integrate our software with some of the newly emerging open source products.

We presently realize revenues from four primary sources: (i) software sales, maintenance and hosting; (ii) custom programming services; (iii) license fees; and (iv) scanning and other services. We also occasionally realize revenues from hardware sales when the hardware is sold together with the software. To date, license fees and software sales have been directly related. With certain sales of our enterprise-level products, the end user enters into a license agreement for which an initial license fee is paid. The license agreement also provides that in order to continue the license, the licensee must pay an annual software maintenance fee for which the party receives access to product upgrades and bug fixes or product patches. With the marketing of the new prepackaged products, management anticipates that revenues for direct software sales and technical support will increase as those products are sold and the associated technical support programs are purchased. The change in focus to include our newer products reflects

management's belief that a broader range of products and customers will provide greater stability in revenues.

Software maintenance consists primarily of hosting and managing our customers' data on our servers, and to a lesser extent includes technical support programs for our products. This hosting and licensing structure will continue with both our Roswell and XR-EXpress products; therefore, we anticipate a positive impact on license fees, software maintenance, and custom programming revenues from sales of these products.

Scanning services are performed principally for our entertainment clients. To date, management has anticipated that these services will be reserved in the future primarily for existing customers and customers of our core products, although revenue could be generated from unsolicited customers. Accordingly, we are currently assessing the importance of scanning services as part of an overall focus on client services during the coming year.

Cost of services consists primarily of engineering salaries and compensation-related expenses, engineering supplies, connectivity expenses, hardware purchases and equipment rental. General and administrative expenses consist primarily of salaries and benefits of personnel responsible for business development and operating activities, and include corporate overhead expenses. Corporate overhead expenses relate to salaries and benefits of personnel responsible for corporate activities, including acquisitions, administrative, and reporting responsibilities. We record these expenses when incurred.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make certain 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 revenues and expenses during the reporting period. As such, in accordance with the use of accounting principles generally accepted in the United States of America, our actual realized results may differ from management's initial estimates as reported. A summary of our significant accounting policies is detailed in the notes to the financial statements which are an integral component of this filing.

#### *Revenue Recognition*

The Company derives revenues from three main activities: the sale of software licenses to end users, software hosting and maintenance contracts, and software licenses that require us to provide significant production, customization or modification to our core software product. The Company also derives revenue from third party hardware and software sales, and from installation, training and consulting services.

Our software recognition policies are in accordance with the American Institute of Certified Public Accountants' Statement of Position ( SOP ) 97-2, *Software Revenue Recognition* as amended.





The Company sells software licenses directly to its end user customers. These sales do not require further commitment from the Company and are recognized upon persuasive evidence of an arrangement as provided by agreements executed by both parties, delivery of the software, and determination that collection of a fixed or determinable fee is probable, in accordance with paragraph 8 of SOP 97-2.

In connection with the sales of software licenses for our enterprise-level products, we sell hosting and maintenance contracts that vary in terms. For these hosting contracts, the customer has possession of the software, which resides on the customer's hardware, and we host the customer's data. These hosting arrangements fall within the scope of SOP 97-2. However, although a fee may be charged at the beginning of the contract for the software license and any customization of the software, the hosting portion of the arrangement is billed and recognized on a monthly basis for the term of the contract. The Company has established vendor-specific objective evidence (VSOE) of fair value per paragraph 10 of SOP 97-2 for the hosting services. The VSOE for the hosting portion of contracts with multiple elements is the price charged for hosting when it is sold separately.

However, in some of our hosting arrangements both the software application and the customer's data reside on our hardware. The customer accesses and uses the software on an as-needed basis over the internet, and the customer does not have the right to take possession of the software. Therefore, according to paragraph 5 of EITF 00-3, these hosting arrangements do not fall within the scope of SOP 97-2. Accordingly, we recognize revenue from these hosting services on a straight-line basis over the life of the respective contracts.

Maintenance contract revenue also is recognized on a straight-line basis over the life of the respective contracts, as this format best approximates the timing of the services rendered per paragraph 57 of SOP 97-2. If a maintenance contract is sold as part of a contract with multiple elements, the amount allocated to the maintenance portion is based on VSOE of fair value, which is the price charged for software maintenance services sold separately.

We follow the guidance in SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require us to provide significant production, customization or modification to our core software. Revenue is generally recognized for such arrangements under the percentage of completion method. Under percentage of completion accounting, both the product license and custom software development revenue are recognized as work progresses based on specific milestones in accordance with paragraphs 85 through 91 of SOP 97-2. We believe that project milestones based on completion of specific tasks provide the best approximation of progress toward the completion of the contract. If custom programming services are sold as part of a contract with multiple elements, a portion of the contract revenue is allocated to the custom programming services based on VSOE of fair value. VSOE for custom programming services is determined based on the price charged for these services when they are sold separately.

The sale of third party hardware and software generally is billed as a separate deliverable under consulting or custom development contracts.

Installation, training and consulting revenue is recognized as the services are rendered. These services are accounted for separately per paragraph 65 of SOP 97-2. They include services that are not essential to the functionality of the software. They are usually billed separately; however, if they are included in a software agreement with multiple elements, a portion of the contract revenue is allocated to these services based on VSOE of fair value. VSOE is determined based on the price charged for these services when they are sold separately.

Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

The Company follows the guidance provided by SEC Staff Accounting Bulletin ( SAB ) No. 10 *Revenue Recognition in Financial Statements* and SAB No. 104 *Revenue Recognition* which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC.

The application of SOP 97-2, as amended, requires judgment, including a determination that collectibility is probable and the fee is fixed and determinable. On occasion, we have approved extended payment arrangements for certain customers. In all cases except one, the extended payment arrangements did not exceed 120 days, therefore we considered collectibility to be probable as per paragraph 8 of SOP 97-2. The revenue for the sale of the software licenses to these customers was recognized upon delivery of the software, in accordance with paragraph 28 of SOP 97-2. In one case, a customer was allowed to pay a second installment at the end of twelve months. Since that software license expired at the end of twelve months, the revenue from the second installment payment was recognized at the time that payment became due, in accordance with paragraph 29 of SOP 97-2.

### ***Income Taxes***

Management evaluates the probability of the utilization of the deferred income tax assets. The Company has estimated a \$8,754,000 deferred income tax asset at December 31, 2004, related primarily to net operating loss carryforwards at December 31, 2004. Management determined that because the Company has not yet generated taxable income it was not appropriate to recognize a deferred income tax asset related to the net operating loss carryforward. Therefore, the fully deferred income tax asset is offset by an equal valuation allowance. If the Company begins to generate taxable income, Management may determine that some, if not all of the deferred income tax asset may be recognized. Recognition of the asset could increase after tax income in the future. Management is required to make judgments and estimates related to the timing and utilization of net operating loss carryforwards, utilization of other deferred income tax assets, applicable tax rates and feasible tax planning strategies.

### ***Goodwill***

Goodwill was recognized in the Company's acquisition of Working Knowledge, Inc. In December 2004, based upon the Company's impairment analysis, the remainder of the goodwill was written off.



### ***Stock-Based Compensation***

The Company grants stock awards and stock options to employees and non-employees as consideration for services. Management believes that the best indicator of value for stock awards is the trading value of the shares of stock on the date the Company enters into the agreements. For non-employees, that date is generally the date on which the company is committed to such an agreement. At times the Company may grant stock as payment for accrued but unpaid payroll. In these cases, the Company values the shares at the trading price on the date they are granted and reduces the payroll accrual by the same amount. We have elected to apply the intrinsic value method prescribed in APB No. 25 for stock options granted to employees. For options granted to non-employees, we estimate the value of those awards using the Black-Scholes option pricing model.

### ***Contingencies***

We are subject to the possibility of various law contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an assets or the incurrence of a liability, as well as our ability to reasonably estimate the amount of the loss contingencies.

At September 30, 2005, the Company is involved in litigation related to a dispute over the validity of the issuance of 150,000 of the Company's common stock warrants. The plaintiff has made a claim of damages of \$1,500,000 against the Company. We believe that we have adequate defenses and counter claims and therefore we have not accrued for any potential loss on this case nor are the 150,000 warrants included in the number of our potentially dilutive securities at September 30, 2005.

In October 2003 the Company entered into an interim agreement with the Internal Revenue Service concerning the repayment of federal tax deposits which it failed to pay for the six operating quarters ended September 30, 2003. We agreed to pay and did pay \$5,000 per month toward the past due tax obligation beginning November 1, 2003. On September 1, 2005 we negotiated a final settlement with the IRS. We were notified that our balance due as of August 31, 2005 was \$358,000, and we agreed to pay \$25,000 per month until the total balance due has been paid.

### ***Software Development Costs***

We account for software development costs in accordance with SFAS No. 86 *Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*. Product research and development expenses consist primarily of personnel, outside consulting and related expenses for development, and systems personnel and consultants and are charged to operations as incurred until technological feasibility is established. The Company considers technological feasibility to be established when all planning, designing, coding and testing have been completed to design specifications. After technological feasibility is established, costs are capitalized. Historically, product development has been substantially completed with the establishment of technological feasibility and, accordingly, no costs have been capitalized.



RESULTS OF OPERATIONS

A summary of operating results for the three months ended September 30, 2005 and 2004 is as follows:

|                           | 2005             | % of           | 2004             | % of           |
|---------------------------|------------------|----------------|------------------|----------------|
|                           | <u>Amount</u>    | <u>Revenue</u> | <u>Amount</u>    | <u>Revenue</u> |
| Revenues                  | \$ 640,000       | 100.0%         | \$ 208,000       | 100.0%         |
| Cost of service           | <u>182,000</u>   | 28.4%          | <u>136,000</u>   | 65.4%          |
| Gross profit              | <u>458,000</u>   | 71.6%          | <u>72,000</u>    | 34.6%          |
| General & administrative  | 231,000          | 36.1%          | 260,000          | 125.0%         |
| Research & development    | 53,000           | 8.3%           | 32,000           | 15.4%          |
| Net operating (loss)      | <u>174,000</u>   | 27.2%          | <u>(220,000)</u> | (105.8)%       |
| Other income (expense)    | <u>(125,000)</u> | (19.5)%        | <u>(12,000)</u>  | (5.7)%         |
| Net income (loss)         | 49,000           | 7.7%           | (232,000)        | (111.5)%       |
| Earnings (loss) per share | <u>\$ 0.00</u>   |                | <u>(\$ 0.01)</u> |                |

A summary of operating results for the nine months ended September 30, 2005 and 2004 is as follows:

|                           | 2005             | % of           | 2004             | % of           |
|---------------------------|------------------|----------------|------------------|----------------|
|                           | <u>Amount</u>    | <u>Revenue</u> | <u>Amount</u>    | <u>Revenue</u> |
| Revenues                  | \$ 1,274,000     | 100.0%         | \$ 985,000       | 100.0%         |
| Cost of service           | <u>438,000</u>   | 34.4%          | <u>311,000</u>   | 31.6%          |
| Gross profit              | <u>836,000</u>   | 65.6%          | <u>674,000</u>   | 68.4%          |
| General & administrative  | 778,000          | 61.1%          | 700,000          | 71.1%          |
| Research & development    | 162,000          | 12.7%          | 91,000           | 9.2%           |
| Net operating (loss)      | <u>(104,000)</u> | (8.2)%         | <u>(117,000)</u> | (11.9)%        |
| Other income (expense)    | <u>(137,000)</u> | (10.7)%        | <u>(19,000)</u>  | (1.9)%         |
| Net income (loss)         | (241,000)        | (18.9)%        | (136,000)        | (13.8)%        |
| Earnings (loss) per share | <u>(\$ 0.01)</u> |                | <u>\$ 0.00</u>   |                |



Revenues: Total revenues increased 207.7%, or \$432,000, for the quarter ended September 30, 2005, as compared to the same period in the prior year (the comparable prior year period). Total revenues for the nine months ended September 30, 2005 increased 29.3%, or \$289,000, as compared to the comparable prior year period. These revenues were primarily generated from the following four revenue streams:

1. Revenues generated by software sales increased 263%, or \$186,000, for the quarter ended September 30, 2005, as compared to the comparable prior year period. This increase is primarily attributable to two large sales of our software in the third quarter of 2005 (\$150,000 and \$100,000). We completed the development phase of Roswell, XR-EXpress and our three desktop products during 2004. As a result, sales of these products have only recently begun to impact our revenues and their sales growth is still inconsistent, especially for the enterprise-level products Roswell and XR-EXpress. We anticipate that sales of Roswell and XR-EXpress will increase gradually over the next two years; however, since they are high-level enterprise systems, their sales are characterized by a small number of contracts with much higher revenues than our other products. As a result, their sales growth will most likely be inconsistent from one quarter to the next. Development was completed on our three desktop products in the third quarter of 2004, and we have been anticipating that sales of the enterprise products would be balanced by sales of our desktop products. However, we have shifted our priorities during the last few months to focus on the development of the next version of our Digital Filing Cabinet (DFC3). We believe that the revamped Digital Filing Cabinet provides greater market opportunities and greater potential return on investment at this time than the desktop products. The DFC3 product became available during the third quarter of 2005, and we anticipate that we will begin to see the impact of its sales on our revenues during the fourth quarter of 2005 and the first quarter of 2006.

Revenues generated by software sales increased 33%, or \$126,000 for the nine months ended September 30, 2005, as compared to the comparable prior year period. This increase is mainly attributable to the barter transactions with Forbes.com. These sales account for \$355,000, or approximately 70% of the software sales for the nine-month period ending September 30, 2005. Although we don't anticipate future sales of this magnitude from this customer, we expect that the advertising credits we received from Forbes.com, when activated, will generate a significant amount of sales of our new products in the coming year, which will offset the reduction in sales directly to Forbes.com. However, since we have no history with these products nor with advertising with Forbes.com, we cannot predict any future sales increase with certainty.

Revenues from software maintenance increased 87% or \$61,000 for the third quarter of 2005 as compared to the comparable prior year period. This increase is due to the addition of several new hosting agreements during 2005. Software maintenance consists mainly of hosting and managing our customers' data on our systems, and to a lesser extent includes technical support programs associated with our products. We will continue hosting for various existing clients and for our Roswell and XR-EXpress products. In addition, we are now offering the Digital Filing Cabinet as a hosted model. Therefore, management anticipates that revenues from software maintenance will increase in the coming year.

Revenues from software maintenance increased 25% or \$64,000 for the first nine months of 2005 as compared to the comparable prior year period. This increase is also due to the addition



of several new hosting agreements during 2005. The monthly average of hosting revenue for the first nine months of 2004 was approximately \$28,000 per month, while the monthly average for the first nine months of 2005 was approximately \$35,000 per month due to the additional hosting contracts.

2. Custom programming revenue increased over 4000%, or \$197,000, for the quarter ended September 30, 2005, as compared to the comparable prior year period. Custom programming revenue increased over 500%, or \$227,000 for the nine-month period ended September 30, 2005, as compared to the comparable prior year period. Both of these increases are entirely due to the barter sales with Forbes.com.

Approximately 10% of the customers that purchase our products will require customization, and we continue to offer this service. In addition, our Roswell and XR-EXpress products are offered chiefly as customizable packages, so we anticipate that custom programming projects associated with new product purchases will continue to provide revenues in this category. We currently are working on two major projects involving custom programming. We also continue to offer programming services for customer database integration. Therefore, we anticipate that this revenue source will increase in the coming year.

3. Revenues generated by license fees decreased 53%, or \$8,000 during the quarter ended September 30, 2005, as compared to the comparable prior year period. License fees revenues decreased 82%, or \$103,000 during the nine months ended September 30, 2005, as compared to the comparable prior year period. The decrease for the nine-month period is the result of a final installment payment of \$70,000 for a license fee received during June 2004. License revenues averaged approximately \$5,000 per month during the first nine months of 2004, but only \$2,500 per month during the first nine months of 2005 because of the termination of one license agreement and the fact that we did not enter into any significant new license agreements during the first nine months of 2005.

Although our products have been developed using open source code, we have added additional code that is considered proprietary technology, particularly in our Roswell, XR-EXpress, and Santa Fe products. This additional technology can be licensed, however we anticipate generating license fees only from the enterprise-level products in the future. As a result, management believes that this category may increase modestly but probably not significantly in the coming years. We anticipate that most revenues will be generated from sales of our software products and monthly software maintenance agreements.

4. Revenue generated by scanning services decreased 55%, or \$23,000 for the quarter ended September 30, 2005, as compared to the comparable prior year period. Scanning revenue for the nine months ended September 30, 2005 decreased by 15%, or \$20,000 as compared to the same period last year. We continued our progress on a long-term scanning project with a major movie studio; however, work on this project decreased during the third quarter due to a temporary decline in the customer's business cycle. The decline in this project is responsible for the decrease in scanning revenue both for the quarter and the year to date as compared to the prior year. This studio has committed to scan over 5,000 titles for this project. At the current rate of progress, we expect the project to continue for approximately two to three years. We had no

additional scanning projects during 2004 or 2005. In general, management is currently assessing the importance of scanning services as part of an overall focus on client services during the coming year. Although we are not emphasizing scanning services at this time, we anticipate that this revenue source will continue to remain steady during the coming year due to the long-term project mentioned above.

We also generated other revenue from hardware sales and the sale of other miscellaneous items and services. Revenue generated by these other items increased 500%, or \$19,000 for the quarter ended September 30, 2005, as compared to the comparable prior year period, but decreased 14%, or \$18,000 for the nine months ended September 30, 2005 as compared to the nine months ended September 30, 2004. The increase during the current quarter is due to sales of hardware associated with sales of our XR-EXpress and DFC3 software products during the quarter.

Cost of Services. Cost of services increased 33.8%, or \$46,000, for the quarter ended September 30, 2005, as compared to the comparable prior year period. Cost of services increased 40.8%, or \$127,000 for the nine months ended September 30, 2005 as compared to the comparable prior year period. Substantially all of the increase both for the quarter and for the year to date is due to the hiring of additional engineering staff during 2005, and the remainder (approximately \$10,000 for the nine-month period) is due to the cost of additional bandwidth for our internet connections.

During the current year, over 80% of our cost of sales consists of engineering salaries and compensation-related expenses. We consider these salaries to be directly associated with our ability to generate revenues, however, they do not vary with revenues in that much of those costs are fixed. As a result, the gross margin percent will vary as sales vary.

For the quarter ended September 30, 2005, cost of services as a percentage of revenues was 28.4%, as compared with 65.4% for the comparable prior year period. For the nine months ended September 30, 2005, cost of services as a percentage of revenues remained nearly constant at 34.4%, as compared with 31.6% for the comparable prior year period. The difference during the current quarter is mainly due to the increase in revenue during the third quarter of 2005. Management anticipates that as revenues increase in the coming year, the cost of goods and services required to support those revenues will continue to increase, and engineering salaries will also increase as we hire additional staff to support a greater number of products and customers. However, we expect that revenues will increase at a greater rate than cost of services, since most of our costs are relatively fixed. We believe the range of percentages during 2004 is more indicative of the percentage of costs associated with future revenues, but until we have been in the active marketing phase for a longer period, management is unable to yet determine to what extent this percentage may change in the future.

General and Administrative. General and administrative expenses decreased 11.2%, or \$29,000, for the quarter ended September 30, 2005, as compared to the comparable prior year period. Approximately 76% (\$22,000) of this decrease is attributable to reduced legal fees during the quarter. The remainder of the increase is due to the combination of several factors, including slightly increased consulting and investing fees, offset by slightly decreased marketing expenses and depreciation. For the nine-month period ended September 30, 2005, general and administrative expenses increased 11.1%, or \$78,000. This increase is almost entirely due to

increased legal and consulting expenses related to the legal matters described in Item 1 of Part II below.

General and administrative expenses as a percentage of revenues for the third quarter of 2005 were 36.1%, as compared with 125.0% for the comparable prior year period, mainly due to decreased revenues during the current period. For the nine months ended September 30, 2005, general and administrative expenses as a percentage of revenues were 61.1%, as compared with 71.1% for the comparable prior year period. This decrease is also mainly due to increased revenues during year-to-date 2005. Management believes the ratio of general and administrative costs to revenues will decrease in the future because revenues will increase at a greater rate than general and administrative costs, but until we have been in the active marketing phase for a longer period, management is unable to yet determine to what extent this percentage may change in the future.

Research and Development. Research and development expenses increased 65.6%, or \$21,000, for the quarter ended September 30, 2005, as compared to the comparable prior year period. Approximately \$17,000 of this increase is attributable to the costs of additional staffing when compared to the second quarter of last year. The remaining increase is a combination of increased internet connectivity and supplies. For the nine-month period ended September 30, 2005, research and development costs increased 78%, or \$71,000. This increase is entirely due to increased staffing costs during 2005.

During 2005, over 90% of our research and development costs are directly associated with staffing. In the software industry it is common for research and development costs to be ongoing, since development of the next version of the software begins as soon as the current version is completed. In addition, we are constantly developing new applications for our existing software which require modification. Management anticipates that research and development costs in the future will focus both on the upgrading of our existing products and the continued development of new products using our core technology; therefore they will remain relatively steady or increase slightly in the coming year.

Other Income. Interest expense increased 942%, or \$113,000 for the quarter ended September 30, 2005, and 621%, or \$118,000 for the nine-month period ended September 30, 2005, as compared to the comparable prior year periods. Both of these increases are due to the accrual of an additional \$118,000 in penalties and interest on the past-due tax obligation during the third quarter of 2005.

There was no loss on disposal of fixed assets in the second quarter of 2005.

In general, our key indicator of operating progress is gross revenue. For the nine-month period ending September 30, 2005, personnel-related expenses have accounted for approximately 60% of our operating expenses, with fixed costs such as building and equipment rent, utilities, insurance, communications and depreciation accounting for an additional 10%. The only personnel-related costs that are directly variable with sales are those associated with custom programming, because they are directly billable. This means that approximately 70% of our expenses are relatively fixed. All of the remaining expenses vary, but less than 5% varies directly

with sales. We will incur more definite variable costs associated with our new consumer products, however, we don't expect to have a significant impact from these sales during 2005. As a result, during 2005 we anticipate that gross revenue will continue to be our primary indicator of when we will achieve profitability and break-even cash flow.

#### REPORTABLE SEGMENTS

On January 1, 2005, we reorganized our company's segments to more clearly reflect the company's direction and growth. In addition to having a variety of products and services available (please see our annual report on Form 10K-SB for product descriptions), we have formulated a business strategy for the next two years that will take advantage of opportunities to market these products. Our current business strategy is to form up to twenty joint venture projects over the next two to three years. These joint venture projects would be formed to develop, market and distribute various digital lifecycle management applications built around our core Roswell technology.

In the past, Working Knowledge, Inc. provided data maintenance services related to the NMS digital asset management system. We have absorbed the data maintenance services into New Mexico Software, and redefined Working Knowledge, Inc. to include those product divisions for which we are forming the joint venture projects. Therefore, at this time, Working Knowledge, Inc. includes the healthcare division, which is centered around the product XR-EXpress. Information related to the Company's reportable segments for the nine months ended September 30, 2005 is as follows:

|                            | <b>2005</b>  |           |
|----------------------------|--------------|-----------|
|                            | NMS          | WKI       |
| Revenue                    | \$ 1,244,000 | \$ 30,000 |
| Cost of services           | 397,000      | 41,000    |
| General and administrative | 767,000      | 11,000    |
| Research and development   | 160,000      | 2,000     |
| Impairment of goodwill     | -            | -         |
| Operating income (loss)    | (80,000)     | (24,000)  |
| Total assets               | \$1,209,000  | \$ 38,000 |

In the second quarter of 2004, XR-EXpress and the healthcare division did not exist. Therefore, only 2005 data is reflected in the table, since no comparison is available.

## LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2005, cash and cash equivalents totaled \$106,000, representing a 100% change from the beginning of the period.

Operating activities used \$180,000 of cash for the nine months ended September 30, 2005, as compared to using \$170,000 for the comparable prior year period. This change is attributable to several major differences between the two years. Two significant increases in the use of operating funds during the nine months ended September 30, 2005 as compared with the same period last year were the net loss for the nine months, which used \$241,000 as compared with \$136,000 for the prior period, and the increase in prepaid expenses, which used \$728,000 as compared with \$13,000 for the prior period. These were balanced by two significant increases in sources of funds during the current period: the increase in accounts payable and accrued expenses, which provided \$174,000 as compared with using \$108,000 during the prior period, and the common stock issued for salaries and services, which provided \$502,000 as compared with \$146,000 for the prior period. The changes in prepaid expenses and accounts payable are detailed below.

We continue to accrue the salary of our president, Richard Govatski, which at September 30, 2005, was an aggregate of \$113,000. Total past due payroll taxes due as of September 30, 2005, were approximately \$348,000, including penalties and interest.

The following table shows current balances and payment details of our obligations as of September 30, 2005:

|   | <u>Sept 30<br/>Balance</u> | <u>Negotiated<br/>Payment</u>   | <u>Payment<br/>Frequency</u> |
|---|----------------------------|---------------------------------|------------------------------|
| <u>Notes Payable:</u>                             |                            |                                 |                              |
| Los Alamos National Bank note + interest          | 117,000                    | 25,000                          | semiannually                 |
| Grossman + interest                               | 65,000                     | In negotiations                 |                              |
| Demand note                                       | 13,000                     |                                 |                              |
| <u>Past due Accounts Payable:</u>                 |                            |                                 |                              |
| New Mexico payroll taxes + penalties and interest | 15,000                     | 1,000                           | monthly                      |
| IRS + estimated penalties & interest              | 333,000                    | 25,000                          | monthly                      |
| Attorney fees                                     | 1,000                      | 1,000                           | monthly                      |
| Attorney fees                                     | 6,000                      | No payment plan established yet |                              |
| Other payables (current)                          | 203,000                    |                                 |                              |
| Subscriptions payable                             | 118,000                    |                                 |                              |
| Accrued payroll and deferred revenue              | <u>183,000</u>             |                                 |                              |
| Total Liabilities per Balance Sheet               | 1,054,000                  |                                 |                              |



Accounts receivable decreased from \$433,000 at December 31, 2004 to \$286,000 at September 30, 2005, constituting a source of funds in the amount of \$147,000 during the nine months ended September 30, 2005. The decrease is primarily due to the reclassification of the receivable from three barter transactions totaling \$735,000 (of which \$135,000 was included in accounts receivable as of December 31, 2004) from accounts receivable to prepaid expenses. This source of funds is offset by the use of funds generated by the increase in prepaid expenses.

Prepaid expenses increased from \$26,000 at December 31, 2004 to \$754,000 at September 30, 2005, constituting a use of funds in the amount of \$728,000. This increase is entirely due to the reclassification of the advertising credits from the three barter transactions from accounts receivable to prepaid advertising during the quarter ended September 30, 2005.

During the nine months ended September 30, 2005, we have had two barter transactions totaling \$600,000 for the sale of software to Forbes.com in return for advertising credits. These transactions are in addition to \$135,000 of advertising still owed to us for a prior barter transaction. Although no schedule has been determined (nor is one required by the agreement), we anticipate using a portion of the advertising credits during the fourth quarter of 2005. Since the advertising agreements were barter transactions, the sale of the software will not directly generate cash. This results in a short-term negative impact on cash flow since we won't be collecting cash for that transaction. However, it will allow us to generate advertising in the coming year without expending cash, which will result in a long-term positive impact on cash flow.

In these barter transactions we transferred customized software to the customer in return for print advertising. Paragraph 2 of the Minutes of the 11/18/93 Meeting on EITF Issue 93-11 specifically refers to the transfer of non-monetary assets such as inventory in return for barter credits used to purchase goods and services such as advertising. Paragraph 7 of those Minutes states that it should be presumed that the fair value of the non-monetary asset exchanged is more clearly evident than the fair value of the barter credits received and that the barter credits should be reported at the fair value of the non-monetary asset exchanged. The software and customization was valued at the same price it would have been valued if it had been sold for cash, so no impairment was recorded before the asset was transferred. The revenue was recognized when the software was transferred to the customer in accordance with paragraph 8 of SOP 97-2, and a corresponding receivable for the barter credits was recorded at that time. During the third quarter of 2005, the receivable was reclassified as prepaid advertising. The advertising expense will be recognized as the ads are placed. The value of any remaining barter credits will be reviewed at the end of each fiscal year for possible impairment, and any such impairment loss will be recorded at that time.

Accounts payable and accrued expenses increased from a total of \$570,000 at December 31, 2004 to \$735,000 at September 30, 2005, constituting a source of funds in the amount of \$165,000. (An additional \$9,000 has been included during the current period as payable to Mr. Govatski from the First Mirage stock transaction described below, bringing the total source of funds to \$174,000 for the nine-month period.) Approximately \$118,000 of the increase is attributable to penalties and interest on the unpaid tax obligation that were accrued during the

current period, and approximately \$50,000 relates to a payable for outside services that was accrued in September 2005 and paid in October 2005.

Investing activities used \$20,000 for the nine months ended September 30, 2005, as compared to \$12,000 for the comparable prior year period. We purchased \$20,000 in new computer equipment for testing and demonstrating our Trinity Mothership, XR-EXpress and DFC3 products during the first nine months of 2005.

Financing activities generated \$306,000 in cash for the nine months ended September 30, 2005, as compared to generating \$265,000 for the comparable prior year period. The two key differences in financing activities between the two years are that during the nine months ended September 30, 2004 we borrowed \$105,000 and generated \$185,000 from the sale of stock, while during the nine months ended September 30, 2005 we borrowed nothing and generated \$330,000 from the sale of stock and exercise of warrants.

As of December 31, 2004, we had a note payable of \$75,000 to First Mirage, Inc., plus accumulated interest of approximately \$9,000. The note was secured by 400,000 shares of our common stock owned by the President/CEO of NMXS.com, Inc. On March 31, 2005, we elected to surrender the 400,000 shares owned by the President/CEO as payment in full of the loan and all accumulated interest. The Board of Directors has approved the issuance of 400,000 shares of restricted common stock to the President/CEO to replace the shares surrendered. This noncash transaction is not reflected in the cash flow.

Management anticipates that our primary uses of cash in the next year will be allocated to continue to satisfy delinquent obligations and for general operating purposes. Our business strategy is to increase working capital by internal growth through the development of joint venture projects associated with our new products, continued hosting of our existing customers, sale of licenses for our Roswell products, maintenance of these licenses, and sales of our consumer products, as well as externally through the sale of potentially dilutive securities. We may also continue to incur debt as needed to meet our operating needs. In addition, we may be forced to issue additional equity compensation to employees and outside consultants to meet payroll and pay for needed legal and other services. If we are not able to meet our sales objectives as anticipated, and in addition we are not able to secure debt or additional equity sales, the company probably would have to drastically reduce its size and operations, and could possibly have to cease operations. For the last five years we have been able to raise the funds necessary to continue operations and for our growth objectives through a combination of the approaches mentioned above, and given the positive feedback on our new products, we believe that we will be able to continue using these options until such time as we are able to fund our current operations and growth entirely from sales revenue.

At September 30, 2005, we had an outstanding balance on a line of credit with Los Alamos National Bank (LANB) which was originally due on July 24, 2002. The outstanding principal amount due at that date was \$300,000, plus interest of \$10,545. We negotiated a three month extension on the repayment of the outstanding balance of the line of credit by reducing the principal amount of the debt with the payment of \$50,000 and the payment of the interest due on July 24, 2002. We were able to negotiate an extension of the amount due on the line of credit



until April 24, 2003, by paying \$25,000 of the principal amount due and \$4,555 in interest due at October 24, 2002. On April 24, 2003, we paid \$12,224 of principal and \$12,768 of interest, and we negotiated another six-month extension to October 20, 2003. On October 20, 2003 we negotiated an extension of the amount due until April 23, 2004 by paying \$25,000 in principal and \$7,500 in interest. On March 27, 2004, we received a letter from LANB extending the note until October 15, 2004, with payment of \$25,000 of principal and approximately \$6,000 of interest due on April 15, 2004. On April 5, 2004, we paid the \$25,000 of principal and \$6,000 of interest as agreed. On October 4, 2004, we received a letter from LANB extending the note until April 15, 2005 upon payment of \$25,000 of principal and approximately \$6,000 of interest, which we paid on October 8, 2004. The remaining \$138,000 was extended until April 2005. In May 2005, we paid \$25,000 of principal and approximately \$5,000 of interest, and the remaining balance was extended until October 15, 2005. The outstanding principal balance was \$114,000 at September 30, 2005. The company has the necessary cash to continue to reduce the note under these circumstances. Our inability to retire this debt, negotiate an extension of the payment amount and/or date, or obtain an alternative loan would likely have a material negative impact on our business, and could impair our ability to continue operations if the bank foreclosed on the note. However, the bank has continued to extend the note six months at a time, providing we pay an agreed-upon amount of principal and interest at the time of the extension. We believe that LANB will continue to work with us in this manner.

We do not currently have material commitments for capital expenditures and do not anticipate entering into any such commitments during the next twelve months. Our current commitments consist primarily of lease obligations for office space.

Management anticipates that the capital requirements for operations for the next twelve months will be approximately \$1,800,000 - \$2,000,000, based on cash flow projections. The company currently has contracts which provide for recurring revenues of approximately \$700,000 over the next twelve months. Although one annual contract for software maintenance for 2005 was prepaid at the end of 2004, the remaining software maintenance contracts provide a monthly cash flow of approximately \$50,000. Based on the prior two years' licensing and custom programming revenue, we can expect these services to generate an additional \$200,000 - \$300,000 over the next twelve months. We have several projects in process (combined maintenance and custom programming) that will generate additional cash flow of approximately \$30,000 per month plus initial custom programming fees of approximately \$300,000. We anticipate that new clients and our new products will provide the remaining necessary cash flow for the next year.

We have received a non-binding letter of intent from a fiduciary trust, In God We Trust, to invest up to \$500,000 in the company through December 31, 2005. These funds, if made available, would provide additional working capital necessary for operations over the next twelve months and to retire long-term debt and past-due payroll taxes. The letter of intent does not require the investor to fund. If we are not able to raise funds through sales of products and services, sales of stock or debt, and the funds from this investor are also not obtainable, the company may have to drastically reduce its size and operations, and could possibly have to cease operations. To date, we have not received any financing from this investor, because we have been able to raise any needed financing through other means. However, we have had a long-term relationship with this

investor and believe that the investor has the willingness and wherewithal to provide funds should our cash requirements exceed our abilities to generate cash elsewhere. Through a combination of increased marketing efforts and continued reduction of expenses, management anticipates positive working cash flow during 2005.

#### FORWARD-LOOKING STATEMENTS

This report contains statements that plan for or anticipate the future. Forward-looking statements include statements about the future of operations involving the marketing and maintenance of products which manage large volumes of media or digital material, statements about our future business plans and strategies, and most other statements that are not historical in nature. In this report forward-looking statements are generally identified by the words anticipate, plan, believe, expect, estimate, and the like. Although management believes that any forward-looking statements it makes in this report are reasonable, because forward-looking statements involve future risks and uncertainties, there are factors that could cause actual results to differ materially from those expressed or implied. For example, a few of the uncertainties that could affect the accuracy of forward-looking statements include the following:

- Rapid changes in technology relating to the Internet

- Continued growth and use of the Internet

- Changes in government regulations

- Changes in our business strategies

- Hardware failure of a catastrophic proportion

- Terrorist interference with the operation of the Internet or effects of terrorist activities on the economy

- Difficulty recruiting and retaining staff of sufficient technical caliber to provide adequate and on-going customer support and product maintenance and development

- Failure to successfully market our products through the Internet and our representatives

- Inability to locate sources to retire our line of credit or to obtain alternative lending sources

- Inability to solve cash flow problems

In light of the significant uncertainties inherent in the forward-looking statements made in this report, particularly in view of our early stage of operation, the inclusion of this information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

#### ITEM 3. CONTROLS AND PROCEDURES

##### (a) Evaluation of disclosure controls and procedures

Our Chief Executive Officer and Chief Financial Officer (collectively the Certifying Officers ) maintain a system of disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Under the supervision



and with the participation of management, the Certifying Officers evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the fiscal quarter. Based upon that evaluation, the Certifying Officers concluded that our disclosure controls and procedures are effective in ensuring that information that is required to be reported is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

(b) Changes in internal controls

In connection with our evaluation of our internal controls during the period ended September 30, 2005, our Certifying Officers have not identified any material deficiencies or weaknesses or other factors that have materially affected or are reasonably likely to materially affect these controls, and therefore, we have not made any changes to these controls.

PART II

ITEM 1. LEGAL PROCEEDINGS

Grossman Lawsuit: Kurt Paul Grossman and Ann Grossman filed a complaint for Breach of Contract on a Promissory Note against us on November 25, 2003, in the Superior Court of California, Orange County Division, case # 03CC14074. There was a question of whether the complaint was properly served and whether the California courts have jurisdiction over us. The Grossmans filed an Application for Writ of Attachment which was denied on January 30, 2004. The Grossmans asked for \$55,000 (\$50,000 on the promissory note plus \$5,000 interest); \$304.40 in costs; and \$24,000 in attorney's fees. The Grossmans, through a separate entity, Doctors Telehealth Network, purchased software from us, and it has not been paid for. We filed a motion to quash the service of summons for lack of personal jurisdiction and to vacate a default judgment against us. The court tentatively ruled in favor of the Grossmans. However, after our oral argument on April 23, 2004, the court withdrew its tentative ruling and ruled in favor of us. Specifically, the court ruled that we do not have sufficient contact with California to warrant the exercise of personal jurisdiction. Mr. Grossman appealed this ruling on the issue of the quashing of service on jurisdictional grounds. After the case was fully briefed to the Appellate Court, the Appellate Court affirmed the decision of the trial court, in favor of us, finding that there was no jurisdiction in California for this matter. The Appellate Court also stated that the Company shall recover its costs on appeal. Because of the Appellate Court's ruling, the Grossman action is no longer pending against us.

Internal Revenue Service Payments: In October 2003 we entered into an interim agreement with the Internal Revenue Service concerning the repayment of federal tax deposits which we failed to pay for the six operating quarters ended September 30, 2003. We agreed to pay and did pay \$5,000 per month toward the past due tax obligation beginning November 1, 2003. On September 1, 2005 we negotiated a final settlement with the IRS. We agreed to pay \$25,000 per month until the total balance of \$358,000 has been paid.

Manhattan Scientifics Lawsuit: On March 9, 2004, our legal counsel received a letter from an attorney representing Manhattan Scientifics. The letter threatened litigation against us for alleged



breach of contract and against Richard Govatski for alleged tortious interference with contract. This is based on the fact that we were alleged to have declined to honor Manhattan Scientifics' request for a cashless exercise of 150,000 of our Common Stock Purchase Warrants (the Warrants ) allegedly issued to Manhattan Scientifics. It is our position that the Warrants, among other things, were issued in a transaction that was not an arms-length transaction and therefore, the Warrants should be cancelled, and that in any event, the alleged cashless exercise was not properly done and itself is a nullity. In May 2004, Manhattan Scientifics filed a suit in Federal Court in New York against us and Mr. Govatski for damages in this matter. The case was dismissed by the Federal Court due to a lack of diversity jurisdiction. On June 25, 2004, we were served with a complaint filed in the Supreme Court of the State New York, County of New York, Index No. 601793/04, asserting the same claims. Manhattan Scientifics seeks damages against us for an alleged breach of contract for failure to allow the cashless exercise, in an amount of \$1.5 million, and alleges a tortious interference claim against Mr. Govatski.

We served our Answer to the Complaint on August 16, 2004. Mr. Govatski is seeking dismissal of the claim against him for lack of personal jurisdiction and for failure to state a claim. Mr. Govatski's motion to dismiss has been fully submitted to the court, but has not yet been decided. Along with our Answer, we are asserting Counterclaims against Manhattan Scientifics for monies owed by Manhattan Scientifics and for a declaratory judgment, and against a former Company Director, Marvin Maslow for fraud and breach of fiduciary duty due to his persuading the Company to enter into the Warrant transaction with Manhattan Scientifics, which we contend was done for the benefit of Maslow and Manhattan Scientifics, and not for the benefit of the Company. We believe that due to the fact that Mr. Maslow and a second former Company director (Scott Bach), were also Directors of Manhattan Scientifics at the time of the transactions in dispute, and constituted two of the Company's three Directors at the time, Mr. Maslow and Mr. Bach should have excused themselves from participating in negotiating and voting on the issue of whether to approve the Warrants. Messrs. Maslow and Bach resigned as our Directors in December 2002. It is our position that such financial conflicts include Mr. Maslow's causing the Company to pay for third-party consulting services provided to Manhattan Scientifics, while stating that such services would be provided to, and were needed by, the Company as part of the transaction. It is our position that Mr. Maslow also misrepresented the fairness of the transaction in dispute at the time to us, which we contend was being done for the benefit of Mr. Maslow and Manhattan Scientifics, to the detriment of the Company. In our counterclaims, we are seeking, among other relief, a determination that the Warrants should be declared null and void from inception, plus damages against Mr. Maslow. It is further our position that even if the Warrants were properly issued (we contend they were not), the Warrants were never properly exercised by Manhattan Scientifics. Manhattan Scientifics and Mr. Maslow have moved to dismiss certain of our Counterclaims alleged against them. That motion too has been fully submitted to the court, but not yet decided.

Other than listed above, neither our parent company nor any of its subsidiaries, or any of their properties, is a party to any pending legal proceeding. We are not aware of any contemplated proceeding by a governmental authority. Also, we do not believe that any director, officer, or affiliate, any owner of record or beneficially of more than five percent of the outstanding common stock, or security holder, is a party to any proceeding in which he or she is a party adverse to us or has a material interest adverse to us.

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

During the quarter ended September 30, 2005, no securities were sold by us without registering the securities under the Securities Act.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

During the quarter ended September 30, 2005, we were delinquent in the payment of interest and principal on a \$50,000 promissory note payable to Kurt and Ann Grossman. The note was due and payable on April 23, 2003, and bears interest of \$5,000. As of the filing date of this report, the total amount due on the note is \$65,000, assuming an imputed annual interest rate of 10%.

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

On September 30, 2005, NMXS.Com, Inc. held its annual meeting of stockholders. At the meeting, the stockholders approved:

1. The election of Richard F. Govatski, Teresa B. Dickey, John E. Handley and Frank A. Reidy as directors for the coming year.
2. A change of the state of incorporation to Nevada from Delaware by statutory merger into a newly created, wholly-owned subsidiary.
3. A change in the name to New Mexico Software, Inc. from NMXS.Com, Inc.
4. An increase in the authorized common stock of the corporation to 200 million shares from 50 million shares.
5. The engagement of Epstein Weber and Conover, PLC as NMXS.com, Inc.'s independent auditors for the 2005 fiscal year.

Management intends to implement items 2 and 3 effective January 1, 2006.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits. The following exhibits are attached to this report:

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- 31.1 Rule 15d-14 (a) Certification by Principal Executive Officer
- 31.2 Rule 15d-14 (a) Certification by Principal Financial Officer
- 32 Section 1350 Certification of Principal Executive Officer and Principal Financial Officer

(b) Reports. There were no Form 8-K s filed with the SEC during the third quarter of 2005.

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

NMXS.com, INC.

Date: March 24, 2006

By /s/ Richard Govatski

Richard Govatski, President

Date: March 24, 2006

By /s/ Teresa Dickey

Teresa Dickey, Treasurer (Principal Financial Officer)

