IPIX CORP
Form 10-Q
November 09, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2005

IPIX Corporation
(Exact name of registrant as specified in its charter)

Delaware	52-2213841
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12120 Sunset Hills Road
Suite 410
Reston, Virginia 20190
(Address of principal executive offices, zip code)
Registrant s telephone number, including area code: (703) 674-4100

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 þ No o

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

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

The number of shares outstanding of the registrant s Common Stock, $0.001 par value per share, as of November 3, 2005 was 27,421,086.

IPIX CORPORATION
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005
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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

IPIX CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2005 (unaudited)	December 31, 2004 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,746,444	$ 12,784,058
Restricted cash and short-term investments		550,000
Short-term investments	1,474,586	895,254
Accounts receivable	978,952	413,873
Inventory, net of reserves of $292,150 and $346,132	2,386,954	2,334,271
Prepaid and other current assets	663,732	1,511,392
Assets held for sale for discontinued operations		321,384
Total current assets	15,250,668	18,810,232
Computer hardware, software and other, net	1,646,071	715,663
Restricted cash and other long-term assets	85,421	718,343
Total assets	$ 16,982,160	$ 20,244,238
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,852,103	$ 1,042,979
Accrued liabilities	3,668,537	3,376,775
Deferred revenue	3,576	84,100
Liabilities held for sale for discontinued operations		164,112
Capital lease obligations		219,977
Total current liabilities	5,524,216	4,887,943
Long-term restructuring liabilities	276,568	141,675
Total liabilities	5,800,784	5,029,618
Stockholders equity:		
Preferred stock, $0.001 par value, 5,001,100 authorized, 248,967 and 290,347 shares issued and outstanding (aggregate liquidation value: $6,666,510 and $7,325,335)	249	290
Common stock, $0.001 par value, 50,000,000 authorized, 27,347,428 and 21,539,058 shares issued and outstanding	27,347	21,539
Additional paid-in-capital	546,676,788	533,658,473
Accumulated deficit	(535,523,008)	(518,465,682)

Total stockholders equity		11,181,376		15,214,620
Total liabilities and stockholders equity	$	16,982,160	$	20,244,238

(1) The December 31, 2004 balances were derived from the audited consolidated financial statements.

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

IPIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenue:				
Hardware	$ 534,115	$ 1,082,817	$ 1,874,998	$ 1,890,569
Services	773,453	103,695	922,602	166,248
License and other	190,220	278,874	801,220	897,379
Total revenue	1,497,788	1,465,386	3,598,820	2,954,196
Cost of revenue:				
Hardware	537,252	754,896	1,513,490	1,531,251
Services	564,833	50,452	693,380	96,479
License and other	10,499	22,202	27,480	81,929
Total cost of revenue	1,112,584	827,550	2,234,350	1,709,659
Gross profit	385,204	637,836	1,364,470	1,244,537
Operating expense:				
Sales and marketing	1,905,456	1,172,470	5,592,731	3,092,888
General and administrative	3,227,186	1,219,333	7,775,016	2,836,614
Research and development	564,094	542,000	1,890,069	1,498,179
Restructuring charges	(93,242)		1,726,147	
Loss on impairment of asset			253,358	
Total operating expenses	5,603,494	2,933,803	17,237,321	7,427,681
Loss from operations	(5,218,290)	(2,295,967)	(15,872,851)	(6,183,144)
Interest and other (expenses) income, net	31,259	32,288	175,251	52,260
Loss from continuing operations	(5,187,031)	(2,263,679)	(15,697,600)	(6,130,884)
Loss from discontinued operations, net of taxes		(1,156,914)	(1,359,726)	(3,902,447)
Net loss	(5,187,031)	(3,420,593)	(17,057,326)	(10,033,331)
Preferred stock dividends	(100,405)	(132,655)	(330,774)	(756,823)
Net loss available to common stockholders	$ (5,287,436)	$ (3,553,248)	$ (17,388,100)	$ (10,790,154)

Basic and diluted loss per share:								
Continuing operations	$	(0.20)	$	(0.12)	$	(0.67)	$	(0.47)
Discontinued operations				(0.06)		(0.06)		(0.26)
Net loss per share to common stockholders (basic and diluted)	$	(0.20)	$	(0.18)	$	(0.73)	$	(0.73)
Weighted average common shares outstanding (basic and diluted)		27,032,212		19,624,742		23,921,518		14,806,631

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

IPIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30, 2005	2004
Cash flows from operating activities:		
Net loss	$ (17,057,326)	$ (10,033,331)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	476,476	749,000
Bad debt expense		2,675
Stock based compensation expense	818,747	
Changes in assets and liabilities:		
Accounts receivable	(565,079)	(565,956)
Inventory	(52,683)	(912,603)
Prepaid expenses and other current assets	847,660	(4,428)
Other long-term assets	324,306	133,791
Accounts payable	809,126	730,944
Accrued liaibilities	72,923	201,273
Deferred revenue	(80,524)	15,817
Long-term restructuring liabilities	134,893	(158,995)
Net cash used in operating activities	(14,271,481)	(9,841,813)
Cash flows from investing activities:		
Acquisition of computer hardware, software and other	(1,406,886)	(144,830)
Short-term investments	(579,332)	(13,684)
Restricted cash	1,180,000	
Net cash used in investing activities	(806,218)	(158,514)
Cash flow from financing activities:		
Proceeds from:		
Common stock offerings	9,758,750	4,898,431
Exercise of stock options	2,536,241	5,512,831
Conversion of AIR	136,647	5,394,000
Conversion of Series B Preferred		2,989,998
Payments for:		
Capital lease obligation	(219,977)	(518,089)
Preferred stock dividends	(171,576)	(453,867)
Net cash provided by financing activities	12,040,085	17,823,304

Net (decrease)/ increase in cash and cash equivalents	(3,037,614)	7,822,977
Cash and cash equivalents, beginning of the period	12,784,058	10,240,980
Cash and cash equivalents, end of the period	$ 9,746,444	$ 18,063,957
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 37,552	$ 13,852

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

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. THE COMPANY

IPIX Corporation (IPIX or Company), formally Internet Pictures Corporation, provides mission-critical imaging solutions for commerce, communication and security applications. The Company s solutions create, process and manage a rich variety of media including still images, 360-degree by 360-degree immersive images and video. During 2004, the Company focused on realigning its core competencies with its strategic business goals. The InfoMedia business unit, formerly responsible for the development, marketing and sales of immersive photography products, was integrated with the security business unit. The still photography product teams now work closely with the video product teams leveraging mature development processes and expertise, and the sales and marketing of each product line is conducted as a coordinated effort. In markets where customers benefit from combined products (video and stills) in a single offering, this new structure allows IPIX to do so seamlessly. In addition, in February 2005 we sold the AdMission business unit, which developed and sold products to the online advertising market. In accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (FAS) No.144, Accounting for the Impairment or Disposal of Long-Lived Assets"(FAS 144), the assets and liabilities related to the AdMission business unit were classified as held for sale at December 31, 2004, and the operations of this business unit were considered discontinued operations (see Note 3).

The Company s extensive intellectual property covers patents for 360-degree imaging, video and surveillance applications.

The accompanying unaudited condensed consolidated financial statements include the accounts of IPIX Corporation and its wholly-owned subsidiaries, Interactive Pictures Corporation and PW Technology, Inc. The consolidation of these entities will collectively be referred to as the Company or IPIX. All significant intercompany balances and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements of IPIX Corporation, a Delaware corporation, have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these statements do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company s Management, these unaudited condensed consolidated financial statements reflect all adjustments of a normal, recurring nature necessary to present fairly the financial position of the Company and its subsidiaries at September 30, 2005 and December 31, 2004, the results of operations for the three and nine months ended September 30, 2005 and 2004 and cash flows for the nine months ended September 30, 2005 and 2004. Results of operations for the three and nine months ended September 30, 2005 is not necessarily indicative of results of operations expected for the full fiscal year ending December 31, 2005. Please refer to the Company s 2004 Annual Report on Form 10-K, as amended on Form 10-K/A, for the complete consolidated financial statements for the period ended December 31, 2004.

2. GOING CONCERN CONSIDERATIONS

The accompanying unaudited condensed consolidated financial statements have been presented in accordance with U.S. GAAP, which assumes the continuity of the Company as a going concern. During the nine months ended September 30, 2005 and in the prior fiscal years, the Company experienced, and continues to experience, certain issues related to cash flow and profitability. These factors raise substantial doubt about the Company s ability to continue as a going concern. The Company completed a $10 million private placement of common stock, including additional investment rights and warrants to a group of existing and new institutional investors on June 21, 2005. Management will monitor the Company s cash position carefully and evaluate its future operating cash requirements with respect to its strategy, business objectives and performance. The Company completed the sale of the AdMission business unit to AdMission Corporation in the first quarter of 2005 (see Note 3). During the first two quarters of 2005, we incurred certain costs for accountant and lawyer fees, buyout of an equipment lease and abandonment of an operating lease as a result of the sale of the AdMission business unit.

The Company s operating results in 2005 will be dependent upon its ability to provide quality products and services and is subject to the risk of an unfavorable lower demand for its products and services. Management believes that the Company has sufficient cash reserves to meet its funding needs for 2005. However, in order to reduce its cash burn, the Company may implement measures to reduce operating costs, including a reduction in sales and marketing expenses, support and other general and administrative expenses. The Company finished the first nine months of 2005 with $11,221,030 in cash reserves (cash and cash equivalents of $9,746,444 and short-term investments of $1,474,586).

Available cash reserves may be consumed in the sales and marketing of new products. Depending upon the Company s ability to sell its new products, the timeliness of collection of accounts receivable and other potential working capital needs, as well as the timing and rate of revenue growth and Management s ability to control costs, the Company may require additional equity or debt financing to meet future working capital or capital expenditure needs. There can be no assurance that such additional financing will be available, or if available, that such financing can be obtained on terms satisfactory to the Company. If the Company is not able to raise additional funds, it may be required to significantly curtail its operations which would have an adverse effect on its financial position, results of operations and cash flow. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

3. DISCONTINUED OPERATIONS

On February 11, 2005, the Company and AdMission Corporation, a privately held Delaware corporation (AdMission), closed the transactions under the asset purchase agreement dated January 11, 2005 between the parties (the Asset Purchase Agreement). Pursuant to the terms of the Asset Purchase Agreement, IPIX sold to AdMission certain of its assets (including certain patent rights and other intellectual property) and contracts relating to its IPIX AdMission business unit (the AdMission Business). In consideration for the sale, IPIX received 1,035,000 shares of the Series A Convertible Preferred Stock of AdMission and a warrant to purchase 200,000 shares of the Common Stock of AdMission. Additionally, AdMission assumed certain liabilities associated with the AdMission business unit. In accordance with FAS 144, the assets and liabilities related to the AdMission business were classified as held for sale at December 31, 2004, and the operations of this business unit were considered discontinued operations for each quarter and for each full year presented. The preferred stock and warrant were recorded as an asset investment in AdMission and subsequently written-down to zero. This write-down was based on Management s assessment of the fair market value of the investment related to the carrying value of the asset which was based upon AdMission s first quarter loss until the sale date and the marketability of the private company s stock. The sale of assets and liabilities to AdMission consists of fixed assets of $253 thousand, prepaid items of $62 thousand and deferred revenue of $62 thousand. The operating results of AdMission for 2005 were also reclassified to discontinued operations. During the first quarter of 2005, the Company incurred non-cash compensation expenses of $794 thousand associated with the acceleration of stock options related to the sale of the AdMission business unit. In connection with the Asset Purchase Agreement, IPIX and AdMission entered into a Patent Purchase, License and Repurchase Agreement dated as of February 11, 2005 which provides for the transfer to AdMission of certain patents relating to the AdMission Business, the license of those patents back to IPIX for use by IPIX in the conduct of its security sector business and certain other limited uses, and repurchase right by IPIX in the event of certain triggering events by AdMission. The patent agreement remains in effect until all of the patents transferred by the agreement expire. Patent No. 6,732,162 issued March 4, 2004 Method of Providing Preprocessed Images for a Plurality of Internet Web Sites expires November 15, 2019. An acquired application 09/357,836 was subsequently issued on March 17, 2005 as patent No. 6,895,557 Web-based Media Submission Tool expires July 21, 2019. The agreement does not provide for any payment for the license of the patents. The Company has no expectation of exercising its repurchase right of these patents as there is no present indication that the triggering event will occur. IPIX and AdMission also entered into an IPIX Trademark/Service Mark License Agreement which provides AdMission with an eighteen (18) month royalty-free, nonexclusive license to use certain IPIX marks and certain other trademarks and business brands in connection with the conduct of the AdMission Business.

Other than the obligation to provide AdMission with a license of certain IPIX marks and certain other trademarks and business brands pursuant to the IPIX Trademark/Service Mark License Agreement, the Company has no continuing obligations to AdMission.

Revenues, cost of revenue, operating expenses and loss from discontinued operations for the three and nine months ended September 30, 2005 and 2004 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Revenue	$	$ 275,594	$ 159,643	$ 809,227
Cost of revenue		569,502	220,091	1,808,006
Gross profit		(293,908)	(60,448)	(998,779)
Operating expenses:				
Sales and marketing		452,772	907,915	1,527,508

Research and development		410,234	391,363	1,376,160
Total operating expenses		863,006	1,299,278	2,903,668
Loss from discontinued operations, net of taxes	$	$ (1,156,914)	$ (1,359,726)	$ (3,902,447)

4. CASH, CASH EQUIVALENTS AND RESTRICTED SHORT TERM INVESTMENTS

The Company considers all highly liquid debt instruments with a remaining maturity at date of purchase of three months or less to be cash equivalents.

At September 30, 2005, there was a $1,474,586 short-term investment which matures on June 19, 2006. The Company will renew the investment for successive short-term periods.

5. STOCKHOLDERS EQUITY

During the three months ended March 31, 2005, the Company issued 700,096 shares of common stock upon exercise of employee stock options. The total proceeds from the first quarter exercises of theses options were $1,456,005. During the three months ended June 30, 2005, 148,153 shares of common stock were issued upon exercise of employee stock options. The total proceeds from the second quarter exercises of theses options were $284,614. During the quarter ended June 30, 2005, the Company sold 51,680 shares of common stock to employees under the IPIX Employee Stock Purchase Plan (ESPP). The proceeds to the Company from the ESPP purchases were $132,301. During the three months ended September 30, 2005, 298,511 shares of common stock were issued upon exercise of employee stock options. The total proceeds from the third quarter exercises of theses options were $608,595. As of September 30, 2005, there was $54,726 collected for the employees fourth quarter 2005 Employee Stock Purchase Plan (ESPP) purchases.

During June 2005, the Company received gross proceeds of $10,000,000 through the private placement of 4,149,376 shares of its common stock to a group of investors. In connection with this private placement, the Company issued to the investors four-year warrants to purchase 2,045,642 shares of common stock at $3.11 per share and ninety-day additional investment rights to purchase 248,963 shares of common stock at $2.41 per share. The additional investment rights expire on December 22, 2005. The warrants may not be exercised until six months after issuance of the common stock. During the three months ended September 30, 2005, 56,700 additional investment rights were converted into common stock. The Company received proceeds totaling $136,647 for the conversion of these rights.

During the three months ended March 31, 2004, the Company issued 442,144 shares of common stock upon exercise of stock options. The total proceeds from the first quarter 2004 option exercises were $618,662, of which $256,773 was collected in the second quarter of 2004. During the quarter ended June 30, 2004, the Company issued 1,511,680 shares of common stock upon exercise of stock options. The proceeds to the Company from the option exercises were $4,170,737. During the quarter ended June 30, 2004, there were 91,140 shares of common stock sold to employees under the IPIX Employee Stock Purchase Plan (ESPP). The proceeds to the Company from the ESPP purchases were $112,037. During the quarter ended September 30, 2004, the Company issued 185,127 shares of common stock upon exercise of stock options. The proceeds to the Company from the option exercises were $362,743.

On April 5, 2004, the Company received gross proceeds of approximately $4,900,000 through the private placement of 909,090 shares of its common stock to accredited institutional investors. The shares of common stock were sold at $5.50 per share. In connection with this private placement, the Company issued to the investors additional investment rights to purchase 888,179 shares of common stock at $6.05 per share. The additional investment rights expired September 28, 2004. Of these additional investment rights, 88,818 were exercised in the second quarter of 2004 and the remaining 799,361 were exercised in the third quarter of 2004 resulting in total proceeds of approximately $5,400,000.

At December 31, 2003, there were two Tranche A warrants (Warrant 1 and Warrant 2) outstanding. As of September 30, 2004, Warrant 1, which entitled the holders to purchase 150,000 shares of Series B Preferred Stock at $20 per share, has been exercised in full. We issued 1,375,600 shares of common stock in the third quarter of 2004 and received $3.0 million in cash from the exercise of part of Warrant 1 and the conversion of the underlying Series B Preferred Stock. During the second quarter of 2004, 600 shares of the rest of Warrant 1 were converted into 4,372 shares of common stock. We did not receive any proceeds from the second quarter Warrant 1 exercise. Warrant 2 entitles the holders to purchase 100,000 shares of Series B Preferred Stock at $40 per share and is exercisable at any time before the expiration date of May 14, 2006. During the second quarter of 2004, 400 shares of Warrant 2 were converted into 2,914 shares of common stock. We did not receive any proceeds from the second quarter Warrant 2 exercise. During the third quarter of 2005, 41,380 shares of Series B Preferred Stock plus accumulated and unpaid dividends through date of conversion were converted into 381,007 shares of common stock. We did not receive any proceeds from the third quarter Warrant 2 exercise.

6. NET LOSS PER COMMON SHARE

Basic income (loss) per common share is computed by dividing net income (loss) available to common stockholders for the period by the weighted average number of shares of common stock outstanding. Net income (loss) available to common stockholders is calculated as the net income (loss) less cumulative preferred stock dividends for the period. If dilutive, the participation right of the preferred stock is reflected in the calculation of basic income (loss) per share using the if converted method or the two class method, if more dilutive. Warrants, additional investment rights and stock options could potentially dilute basic income per share in the future but were not included in the computation of diluted loss per share because to do so would have been antidilutive for the three and nine months ended September 30, 2005 and 2004. For all periods presented herein, the Company s diluted loss per share is equal to its basic loss per share because the effects of exercise were anti-dilutive given the losses the Company incurred during such periods.

The following table sets forth the computation of basic and dilutive loss per common share for the periods indicated:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Numerator:				
Loss from continuing operations	$ (5,187,031)	$ (2,263,679)	$ (15,697,600)	$ (6,130,884)
Loss from discontinued operations, net of taxes		(1,156,914)	(1,359,726)	(3,902,447)
Net loss	(5,187,031)	(3,402,593)	(17,057,326)	(10,033,331)
Preferred stock dividends	(100,405)	(132,655)	(330,774)	(756,823)
Net loss available to common stockholders	$ (5,287,436)	$ (3,553,248)	$ (17,388,100)	$ (10,790,154)
Denominator Weighted average common shares outstanding basic and diluted	27,032,212	19,624,742	23,921,518	14,806,631
Basic and diluted loss per share:				
Continued operations	$ (0.20)	$ (0.12)	$ (0.67)	$ (0.47)
Discontinued operations		(0.06)	(0.06)	(0.26)
Net loss per share to common stockholders (basic and diluted)	$ (0.20)	$ (0.18)	$ (0.73)	$ (0.73)

The following table sets forth potential common stock shares that are not included in the diluted net loss per common share calculation because to do so would be antidilutive for the three months ended September 30, 2005 and 2004 as a result of the net loss available to common stockholders:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004
Vested stock options	183,060	1,685,118
Convertible preferred stock	2,292,363	2,834,720
Series B warrants		448,378
Series B Dividend conversion	502,957	
PIPE Additional investment rights	51,230	
Total	3,029,610	4,968,216

Not included in the table above, were the following rights as of September 30, 2005 and 2004 to purchase common stock where the average exercise price was greater than the average common share price during the period and, accordingly, they were excluded from diluted net loss per common share for the three months ended September 30, 2005 and 2004, respectively.

	As of September 30, 2005	2004
Average share price of IPIX Common stock	$ 3.53	$ 8.50
Stock options : Shares excluded (average price $41.93 in 2005 and $114.32 in 2004)	937,609	112,000
Series B warrants (exercise price of $4.34)	917,067	
PIPE warrants (exercise price of $3.11)	2,045,642	
Common warrants (average price of $147.41 in 2005 and $165.33 in 2004)	32,064	136,949

7. RESTRUCTURING

The Company recorded restructuring charges in accordance with FAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities and Staff Accounting Bulleting (SAB) No. 100, Restructuring and Impairment Charges. During the first quarter of 2005, Management adopted a restructuring plan to move the executive office from California to Virginia upon the sale of the AdMission business unit. The plan comprised of terminating a lease for equipment, abandoning certain fixed assets and vacating an additional operating lease. As a result, in the second quarter of 2005, the Company paid a buy out fee of $747,053, which included penalties and a forfeited deposit, to terminate the lease for the computer equipment and wrote off $11,452 of fixed assets. In addition, a charge of $1,060,883 representing the present value of the future cash flows of the abandoned leased office space was recorded as restructuring charges in the second quarter of 2005. The Company paid $148,965 in the third quarter of 2005 for this lease.

At September 30, 2005, the remaining balance in accrued restructuring was $931,325 of which, $276,568 is classified as long-term restructuring liability and represents the present value of the lease payments on the first and fourth floor San Ramon, California office lease. The leases end January 31, 2007. Included in the restructuring liability is the present value of the lease payments for the San Ramon, California office.

The components of the restructuring charge in 2005 are as follows:

Lease obligations	$ 967,642
Equipment lease termination	747,053
Abandonment of fixed assets	11,452
	$ 1,726,147

During the three and nine months ended September 30, 2005, payments of $186,425 and $605,503, respectively, were made against the Company s lease and severance restructuring accrual.

8. STOCK-BASED COMPENSATION FAIR VALUE DISCLOSURES

In December 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (FAS) No. 148, Accounting for Stock Based Compensation-Transition and Disclosure, an amendment to FAS No. 123, Accounting for Stock-Based Compensation. FAS No. 148 amends the disclosure provisions to require prominent disclosure about the effects on reported net loss of an entity s accounting policy decisions with respect to stock-based compensation. Stock options are accounted for using the intrinsic method in accordance with Accounting Principles Board No. 25, Accounting for Stock Issued to Employees, as interpreted, whereby if options are priced at fair market value or above at the date of grant, no compensation expense is recognized. The pro forma information is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net loss available to common stockholders, as reported	$ (5,287,436)	$ (3,553,248)	$ (17,388,100)	$ (10,790,154)
Add:				
Stock-based employee compensation cost included in net loss available to common stockholders, as reported	24,819		818,747	
Deduct:				
Stock-based employee compensation expense under fair value method of SFAS No. 123 for all awards	(485,364)	(504,904)	(1,880,464)	(1,786,000)
Net loss pro forma	$ (5,747,981)	$ (4,058,152)	$ (18,449,817)	$ (12,576,154)
Net loss per share basic and diluted as reported	$ (0.20)	$ (0.18)	$ (0.73)	$ (0.73)
Net loss per share basic and diluted pro forma	$ (0.21)	$ (0.21)	$ (0.77)	$ (0.85)

Grants under the ESPP have a look-back feature and a 15% discount and accordingly under FAS 123 would have had compensation expense calculated as a result. The fair value disclosure associated with the ESPP grants is included in the fair value pro-forma information above.

The fair value of each award is calculated on the date of grant using the Black-Scholes pricing model. The following assumptions were used for each respective period:

9. INVENTORY

The Company s inventory consists primarily of finished camera products and camera components. The inventory is valued at the lower of cost, or market, using the FIFO method. The table below shows the Company s inventory mix as of September 30, 2005 and December 31, 2004:

	As of	
	September 30, 2005 (unaudited)	December 31, 2004
Components	$ 1,437,477	$ 1,628,496
Finished goods	1,241,627	1,051,907
Total Inventory	2,679,104	2,680,403
Inventory Reserve	(292,150)	(346,132)
Total Inventory, net	$ 2,386,954	$ 2,334,271

10. COMMITMENTS AND CONTINGENCIES

Commitments

The table below shows the Company s total contractual obligations as of September 30, 2005:

	Payments Due by Periods				
	Total	**Less than one year**	**1-3 years**	**3-5 years**	**Thereafter**
Operating Leases	$ 2,096,048	$ 617,271	$ 982,577	$ 496,200	$
Restructuring Liability	931,325	654,757	276,568		
	$ 3,027,373	$ 1,272,028	$ 1,259,145	$ 496,200	$

Contingencies

On June 15, 2003, the Company filed an action against Mr. Ford Oxaal and his company, Minds-Eye-View, (together, Oxaal) in the United States District Court for the Eastern District of Tennessee. In the complaint, the Company asserted claims for patent infringement, false designation of origin, false description or representation, unfair or deceptive acts and tortious interference in connection with Oxaal s competing software product marketed under the name Click Away. On August 8, 2003, Oxaal filed its answer asserting counterclaims for non-infringement, invalidity, unenforceability, breach of contract, patent misuse, Lanham Act violations and tortious interference. The Company denied all of Oxaal s allegations. The case was stayed pending settlement negotiations, which have since terminated. On March 15, 2005, a motion was filed by the Company to vacate the stay so that the lawsuit can proceed in due course.

On March 14, 2005, Grandeye, Ltd. filed suit against IPIX in the U.S. District Court for the Eastern District of Virginia, Norfolk Division, seeking a declaratory judgment that (1) its Halocam products do not infringe any valid claim of U.S. Patents No. 5,359,363 (the 363 patent), 6,603,502 B2 (the 502 patent), and Re 36,207 (the 207 patent (2) these three patents are invalid; and (3) these three patents are unenforceable as a result of inequitable conduct committed during prosecution of the patent applications leading to the patents. Grandeye also asserted various state law claims alleging damage to its business relationships as a result of alleged statements and conduct of IPIX. Grandeye also included in its Complaint a claim for antitrust violations but has since dismissed that antitrust claim with prejudice. IPIX has asserted substantial defenses to Grandeye s claims and filed a counter-suit against Grandeye for infringement of the 363 patent, 502 patent, and 207 patent. IPIX has vigorously defended, and continues to defend, its positions. IPIX has filed a motion seeking summary judgment as to Grandeye s state law claims, and Grandeye has filed a motion seeking a summary judgment that its Halocam SP products do not infringe any claims of the 363 patent, 502 patent, or 207 patent. The parties have opposed each other s motions and both motions are scheduled to be heard by the Court during a hearing scheduled to begin on November 7, 2005. In addition to hearing these issues, the Court will hear arguments at the November 7, 2005 hearing on the parties positions regarding the proper construction of terms in the three patents claims. Fact discovery in this case was scheduled to close on October 28, 2005 and trial is scheduled to begin on April 6, 2006.

The Company intends to vigorously defend each of the above referenced lawsuits. Because of the inherent uncertainties related to this type of litigation, the Company is unable to predict the ultimate outcome of these cases, or the likelihood or amount of our potential liability, if any, of these cases. However, if the Company is not successful in defending or settling these matters, these cases could have a material adverse effect on the business, financial condition, results of operations or cash flows of the Company. The Company will incur substantial costs in defending these lawsuits.

The Company is not currently a party to any other legal proceedings, the adverse outcome of which, individually or in the aggregate, is believed could have a material adverse effect on the business, financial condition, results of operations or cash flows of the Company.

Indemnification Provisions

During the ordinary course of business, in certain limited circumstances, the Company includes indemnification provisions within certain of its contracts. Pursuant to these agreements, the Company will indemnify, hold harmless and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally parties with which the Company has commercial relations, in connection with certain intellectual property infringement claims by any third party with respect to the Company s products and services. The Company discloses indemnification liabilities according to FASB Staff Position FIN45-1, Accounting for Intellectual Property Infringement Indemnifications under FAS Interpretation No. 45. To determine the amount of indemnification liability to accrue, a probability analysis of potential outcomes based on past claims and cost incurred is performed. To date, there have not been any costs incurred in connection with such indemnification clauses; therefore, there is no accrual of such amounts at September 30, 2005. Our insurance policies do not cover the cost of patent infringement claim defense so if a claim was filed against the Company or any party we indemnify, we would incur legal costs to vigorously defend our patents. Under FAS No. 5, Loss Contingencies, a claim would be accrued when a loss is probable and the amount can be reasonably estimated. At September 30, 2005, no such amounts are accrued.

11. EFFECT OF NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued FAS No. 123 (R), Share-Based Payment to replace FAS No. 123, Accounting for Stock-Based Compensation and APB Opinion No. 25, Accounting for Stock Issued to Employees. FAS No. 123 (R) requires, among other things, that all share-based payments to employees, including grants of stock options, be measured based on their grant-date fair value and recognized as expense in the financial statements effective for interim or annual periods beginning after June 15, 2005. Unless observable market prices exist, the grant-date fair value is estimated using an appropriate option-pricing model as determined by Management. Management must also make certain assumptions about employee exercise habits, forfeiture rates and select an appropriate amortization methodology for recognizing compensation expense. The Statement requires a modified prospective method of adoption. Companies may also elect to restate their previously issued financial statements to provide consistency across all periods presented under a modified retrospective method. Management believes the adoption of FAS No. 123(R) will have a material impact on the Company s consolidated results of operations and earnings per share but has not yet determined the method of adoption that will be applied or whether adoption will result in expense amounts materially different from those currently provided under the pro forma disclosures (See Note 8).

In April 2005, the Securities and Exchange Commission announced the adoption of a new rule that amends the effective date of FAS No. 123(R). The effective date of the new standard under these new rules for our consolidated financial statements is January 1, 2006. Adoption of this statement will have a significant impact on the consolidated results of operations and earnings per share as the Company will be required to expense the fair value of stock option grants and stock purchases under the employee stock purchase plan rather than disclose the impact on the Company s consolidated net loss within the footnotes, as is the Company s current practice.

In June 2005, the FASB issued FAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and FASB No. 3, Reporting Accounting Changes in Interim Financial Statements. The Statement applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. FAS 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. It is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Earlier application is permitted for accounting changes and corrections of errors made occurring in fiscal years beginning after June 1, 2005. The Company does not expect the effect of FAS 154 will have material impact on its financial statements.

12. SEGMENTS

In 2004, the Company focused on realigning its core competencies with its strategic business goals. In 2005, the InfoMedia business unit, formerly responsible for the development, marketing and sales of still immersive photography products, was integrated with the security business unit. The still photography product teams now work closely with the video product teams leveraging mature development processes and expertise; and the sales and marketing of both product lines is conducted as a coordinated effort. In markets where customers benefit from combined products (video and stills) in a single offering, this new structure allows IPIX to do so seamlessly. In addition, in February 2005, we sold the AdMission business unit, which developed and sold products to the online advertising market. (See Note 3) The result of this seamless integration is two product lines, immersive video and immersive stills, with the following similar economic characteristics: the nature of the products (immersive solutions), the production process and the type and class of customers. As such, the Company s Management and chief operating decision maker reviews the results of the business as a whole and does not evaluate the performance of any segment of the business, therefore, there are no separate segments to report.

13. CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject us to a concentration of credit risk consist of cash, cash equivalents, short term investments and accounts receivable. Cash, cash equivalents and short term investments are deposited with high quality financial institutions. The Company s accounts receivable are derived from revenue earned from customers located in the U.S. and abroad. Credit evaluations are performed on an ongoing basis of its customers financial condition and in certain instances require partial or full payment prior to shipment; however, the Company does not require collateral from its customers.

The following table summarizes the number of customers that individually comprise greater than 10% of total revenue or total accounts receivable and their aggregate percentage of the Company s total revenue or total accounts receivable:

	As of and for the Three Months Ended September 30,		As of and for the Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenue:				
Number of Customers	2	2	1	2
Percentage of Total Revenue	49%	50%	17%	42%
Accounts Receivable				
Number of Customers	1	2	1	2
Percent of Total Accounts Receivable	64%	47%	64%	47%

14. LIQUIDATION PREFERENCE AND PREFERRED STOCK DIVIDENDS

On September 26, 2001, Image Investor Portfolio, a separate series of Memphis Angels, LLC (Image) and certain strategic investors completed the purchase of 1,115,080 shares of the Series B Preferred Stock for total consideration of $22,301,615. Each share of the Series B Preferred Stock is convertible into approximately 9.2 shares of the Company s common stock and is entitled to vote on matters submitted to holders of common stock on an as-converted basis. As of September 30, 2005, 248,967 shares of Series B Preferred Stock remain outstanding with a liquidation preference, defined below, of $6,666,510, which includes $1,687,170 in accrued dividends in arrears on the Series B Preferred Stock.

Holders of Series B Preferred Stock, in preference to holders of any other series of Preferred Stock and in preference to the holders of Common Stock (collectively, Junior Securities), accrue dividends at the rate of eight percent (8%) of the price paid per annum on each outstanding share of Series B Preferred Stock (Series B Dividends). The Series B Dividends are cumulative, accrue daily and shall be payable, when and if declared by the Board, upon conversion or as an accretion to the liquidation preference, as defined below. Accrued Series B Dividends may be paid in cash or common stock, at the election of the Series B Preferred stockholder. Holders of Series B Preferred Stock participate on an as-if converted basis in any common stock dividends. Upon any liquidation event, before any distribution or payment shall be made to the holders of any Junior Securities, the holders of Series B Preferred Stock shall be entitled to be paid out of the assets of the Company legally available for distribution, or the consideration received in such transaction, an amount per share of Series B Preferred Stock equal to the price paid plus all accrued and unpaid Series B Dividends for each share of Series B Preferred Stock held by them (the liquidation preference). If, upon any such liquidation event, the assets of the Company are insufficient to make payment in full to all holders of Series B Preferred Stock of the liquidation preference, then such assets shall be distributed among the holders of Series B Preferred Stock at the time outstanding, ratably in proportion to the full amounts to which they would otherwise be respectively entitled.

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

The following discussion is intended to assist in the understanding and assessment of significant changes and trends related to the results of operations and the financial condition of the Company and its consolidated subsidiaries. This discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K, as amended on Form 10-K/A. Historical results and percentage relationships set forth in the statement of operations, including trends which might appear, are not necessarily indicative of future operations.

OVERVIEW

Our Business

During the last quarter of 2004, a fundamental restructuring of the Company was undertaken in order to position IPIX as the leader in immersive imaging technologies for visual intelligence applications. The Company develops immersive video and still photography products for major markets in surveillance, visual documentation and forensic analysis. This restructuring included the merging of the InfoMedia and the Security business units and a change in sales structure which broadened the Company s emphasis on direct sales and indirect sales channel development. The new structure also enables the Company to develop product offerings that include both video and still products for customers in the same market. IPIX has aligned its product lines with its core competencies in immersive video and still technology. The restructuring was completed with the sale of the AdMission business unit in February of 2005. In accordance with FAS 144, the assets and liabilities related to the AdMission business unit were classified as held for sale at December 31, 2004, and the operations of this business unit were considered discontinued operations for all periods presented.

Products

The Company currently has two main product lines: Immersive Video and Immersive Stills.

Immersive Video Product Line: develops and delivers products and services that provide customers with enhanced situational awareness. The main product in this line is the CommandView Video. The product line consists of multi-mega-pixel, digital cameras, fisheye lens, patented 360-degree viewing technology and camera management software to provide a unique award-winning see everything video surveillance and security camera system that can see in all directions, simultaneously with no moving parts and no blind spots. Features include low light performance; remote, secure monitoring; digital pan-tilt-zoom; and weather reliability.

Immersive Stills Product Line: provides for the creation of 360-degree panoramic photography and movie content. The main product in this line is the Interactive Studio Still Photography product. This product provides a single integrated solution for panorama photographers that can automate a wide variety of tasks previously requiring separate tools. The technology in this product makes creating multiple 360-degree images as simple as a drag-and-drop of fisheye source images into the application, selecting the output file formats desired and hitting the save button. Features include image editors, image format converter tools and high dynamic range image compositors.

Target Markets

The Company markets its immersive video and immersive stills products to government and commercial markets for a variety of visual intelligence applications. We target government agencies with responsibility for security infrastructure protection related to ports, harbors, waterways, dams, conventional and nuclear power stations, utilities, airports and mass transit rail systems. Our product offers solutions to the military in perimeter force protection, unmanned vehicles and special operations. We also target commercial markets such as retail outlets and casinos. Our products are used for facilities management as well as by vertical market data warehouse solutions providers such as insurance and mapping. In addition, we historically have targeted the real estate and hospitality market, professional photographers, web developers and creators of visual documentation.

Business Models

We market our products through a direct sales force and through channel distributors and resellers. Additionally, we sell our immersive stills software platform and supporting hardware over the internet.

Business Trends and Conditions

In March 2004, the Company launched a new family of 360-degree real-time video camera systems. Shipment of these products to distributors began in late June 2004. These new camera systems generate revenues from sales to both end-users and resellers. In April 2005, the Company launched the CommandView Day/Night Dome camera that combines 360-degree views in low-light, no-light and infrared lighting-assisted environments. The Company continues to develop additional products and features for the security and surveillance market. Also in April 2005 the Company announced an OEM agreement with ObjectVideo to market software for intelligent video surveillance. In April 2005, a partnership with VistaScape was announced to integrate their SiteIQ surveillance software with the Company s CommandView cameras. These products became available for shipment in the third quarter of 2005.

IPIX still photography products primarily generate revenues in two ways: licenses of software and the sale of camera equipment. In the past, keys were utilized to license the Company s technology to capture and save a single immersive image. With the launch of the IPIX Interactive Studio, IPIX now offers time-based seats or user licenses which permit an unlimited number of immersive images to be captured and saved within a specific time period, usually a year.

In response to the change in sales structure, the Company hired additional sales staff focused on direct and channel sales to market immersive video products. The Company currently has approximately 85 resellers in the U.S. and four distributors internationally.

The immersive still photography products for the virtual tour photography solution and the IPIX Interactive Studio are sold directly to the U.S. real estate market. The Host@IPIX product is being expanded to support a wider range of imaging technologies. As a result, the Company believes that real estate agents/brokers and photographers will benefit from a broader choice of panoramic imaging solutions and enhanced marketing capabilities.

Professional services are also provided to customers that request specific customizations or integrations of the Company s products and services.

CRITICAL ACCOUNTING POLICIES

The following discussion and analysis of financial condition and results of operations is based upon the Company s unaudited condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, uncollectible receivables, inventory reserves, intangible and other long-lived assets and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our unaudited condensed consolidated financial statements: revenue recognition; valuation allowances, specifically the allowance for doubtful accounts and inventory reserves; valuation of goodwill and other long-lived assets; and significant accruals. We believe that full consideration has been given to all relevant circumstances that we may be subject to, and our financial statements accurately reflect Management s best estimate of the results of operations, financial position and cash flows for the periods presented.

Management has discussed the development and selection of the following critical accounting policies, estimates and assumptions with the Audit Committee of our Board of Directors and the Audit Committee has reviewed these disclosures.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the contract price is fixed or determinable, and collectibility is reasonably assured.

We derive revenue from sales of our hardware, sales of licenses and keys for our software and professional services we provide to customers. Professional service revenues include effort performed under government contracts. Formerly professional services consisted of transaction hosting revenue where a reseller uses image management products to enhance their on-line offering. Transaction hosting revenue was primarily performed by the AdMission business unit which was discontinued in 2004 and sold in the first quarter of 2005.

Transaction hosting revenue (which is included in discontinued operations) was recognized ratably as transactions were performed provided there was persuasive evidence of an arrangement, the fee was fixed or determinable and collection of the resulting receivable was reasonably assured.

Hardware and software revenue is recognized upon shipment, if the contract shipping term is FOB shipping point, and upon delivery, if the contract shipping term is FOB destination, provided there are no uncertainties surrounding product acceptance, persuasive evidence of an arrangement exists, there are no significant vendor obligations, the fees are fixed or determinable and collection is reasonably assured. Initial license fees are recognized when a contract exists, the fee is fixed or determinable, software delivery has occurred and collection of the receivable is reasonably assured. If there are continuing obligations, then license fees are recognized ratably over the life of the contract. Revenue from hardware and software sales to distributors is recognized upon shipment (sell-in) if the distributor relationship does not create substantial uncertainty regarding fixed or determinable fees and collectibility. If at the beginning of an arrangement we determine the arrangement fee is not, or is presumed to not be, fixed or determinable, or there is uncertainty over collectibility, revenue is deferred and subsequently recognized as amounts become due or collected.

The Company recognizes revenue in accordance with Statement of Position (SOP) No. 97-2, Software Revenue Recognition and SOP No. 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. If a contract requires significant production, modification or customization of the software, the arrangement is accounted for as a long-term service contract. If it does not, software revenue is realizable when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller s price to the buyer is fixed or determinable and collectibility is reasonably assured.

Other criteria that must be met include the determination of whether the revenue in multiple-element arrangements can be recognized separately for each element as performance occurs and the determination of the fee based on vendor-specific objective evidence (VSOE) of fair value for each element. The Company determines VSOE of fair value of each element by the price charged when the same element is sold separately or based on Management s established prices for elements such as professional rates on comparable service contracts or the price of software with the same functionality available in the industry. If Management is unable to determine the VSOE of a delivered element, the revenue is recognized by the residual method. As performance occurs, the fee for the delivered item is determined by the total fee of the arrangement less the total fair value of the undelivered elements. The total fair value of the undelivered elements is deferred and subsequently recognized as performance occurs. If Management is unable to determine the VSOE of an undelivered element, all revenue from the contract is deferred until the VSOE is established or all performance has occurred. If the only undelivered element without VSOE of fair value is services that can be accounted for separately, the entire fee is recognized over the service period.

Our professional service revenue under government contracts consist primarily of services provided by our employees, consultants and the pass through of costs for equipment or other third party services. Cost of services consists primarily of compensation expenses for program personnel, the fringe benefits associated with this compensation, consulting labor and other direct expenses incurred to complete programs, including cost of equipment. The current government contract is a cost-plus-fixed-fee contract. Revenues for cost-reimbursement contracts are recorded as reimbursable costs are incurred, including a pro-rata share of the contractual fees.

The Company recognizes other professional service revenue from long-term service contracts in accordance with Accounting Research Bulletin (ARB) No. 45, Long-Term Construction Type Contracts, using the relevant guidance in SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, as determined by the terms and conditions of the Company s contracts with its customers. Revenue is typically recognized ratably over the contractual periods or as services are performed. In addition, when professional service contracts involve software that is essential to the functionality of the delivered software product, revenue from the entire arrangement is recognized as services are performed on a percentage of completion method or not until the contract is completed. In fixed price contracts, revenue is recognized based on the percentage of completion method, income is recognized at a consistent profit margin over the period of performance based on estimated profit margins at completion of the contract. This method of accounting requires estimating the total revenues and total contract cost at completion of the contract. Estimated losses on contracts at completion are recognized when identified.

Allowances for Doubtful Accounts

Significant Management judgments and estimates must be made and used in connection with establishing the allowance for doubtful accounts in any accounting period. Management specifically analyzes accounts receivable and historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in the customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Material differences could result in the amount and timing of expense recorded if Management had different judgment or utilized different estimates as the latter related to different reporting periods.

Reserve for Inventory Obsolescence

Significant Management estimates must be made and used in conjunction with establishing the inventory obsolescence reserve in any accounting period. This may occur as a result of technological advances, out of production sub-assemblies, radical changes in market demand or change of suppliers. Management periodically reviews the inventory aging, turnover, sales forecast as well as input from vendors in determining the appropriate amount of the reserve.

Significant Accruals, including Restructuring Charges and Sales Tax

We recorded restructuring charges associated with vacated facilities. The key assumptions associated with these charges include the timing and amount of sub-lease income. In addition, in establishing and providing for sales tax accruals, we make judgments based on the actual tax laws and guidance. While Management believes that its judgments and interpretations regarding tax liabilities are appropriate, significant differences in actual experience may materially affect the Company s future financial results.

Restructuring

The Company recorded restructuring charges in accordance with FAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities and Staff Accounting Bulleting (SAB) No. 100, Restructuring and Impairment Charges. During the first quarter of 2005, Management adopted a restructuring plan to move the executive office from California to Virginia upon the sale of the AdMission business unit. The plan comprised of terminating a lease for equipment, abandoning certain fixed assets and vacating an additional operating lease. As a result, in the second quarter of 2005, the Company paid a buy out fee of $747,053, which included penalties and a forfeited deposit, to terminate the lease for the computer equipment and wrote off $11,452 of fixed assets. In addition, a charge of $1,060,883 representing the present value of the future cash flows of the abandoned leased office space was recorded as restructuring charges in the second quarter of 2005. The Company paid $148,965 in the third quarter of 2005 for this lease.

At September 30, 2005, the remaining balance in accrued restructuring was $931,325 of which, $276,568 is classified as long-term restructuring liability and represents the present value of the lease payments on the first and fourth floor San Ramon, California office lease. The leases end January, 31 2007. Included in the restructuring liability is the present value of the lease payments for the San Ramon, California office.

The components of the restructuring charge in 2005 are as follows:

Lease obligations	$ 967,642
Equipment lease termination	747,053
Abandonment of fixed assets	11,452
	$ 1,726,147

During the three and nine months ended September 30, 2005, payments of $186,425 and $605,503, respectively, were made against the Company s lease and severance restructuring accrual.

RESULTS OF OPERATIONS
THREE MONTHS ENDED SEPTEMBER 30, 2005 AND SEPTEMBER 30, 2004

	Three Months Ended September 30, 2005	2004*	Increase/ (Decrease)	Percent Increase/ (Decrease)
Revenue:				
Hardware	$ 534,115	$ 1,082,817	$ (548,702)	(51)%
Services	773,453	103,695	669,758	646%
License and other	190,220	278,874	(88,654)	(32)%
Total revenue	1,497,788	1,465,386	32,402	2%
Cost of revenue:				
Hardware	537,252	754,896	(217,644)	(29)%
Services	564,833	50,452	514,381	1020%
License and other	10,499	22,202	(11,703)	(53)%
Total cost of revenue	1,112,584	827,550	285,034	34%
Gross profit	385,204	637,836	(252,632)	(40)%
Operating expense:				
Sales and marketing	1,905,456	1,172,470	732,986	63%
General and administrative	3,227,186	1,219,333	2,007,853	165%
Research and development	564,094	542,000	22,094	4%
Restructuring charges	(93,242)		(93,242)	(100)%
Total operating expenses	5,603,494	2,933,803	2,669,691	91%
Loss from operations	(5,218,290)	(2,295,967)	2,922,323	127%
Interest and other (expenses) income, net	31,259	32,288	(1,029)	(3)%
Loss from continuing operations	(5,187,031)	(2,263,679)	2,923,352	129%
Loss from discontinued operations, net of taxes		1,156,914	(1,156,914)	(100)%
Net loss	(5,187,031)	(3,420,593)	1,766,438	52%
Preferred stock dividends	(100,405)	(132,655)	(32,250)	(24)%
Net loss available to common stockholders	$ (5,287,436)	$ (3,553,248)	$ 1,734,188	49%

* As adjusted for discontinued operations

NINE MONTHS ENDED SEPTEMBER 30, 2005 AND SEPTEMBER 30, 2004

	Nine Months Ended September 30, 2005	2004*	Increase/ (Decrease)	Percent Increase/ (Decrease)
Revenue:				
Hardware	$ 1,874,998	$ 1,890,569	$ (15,571)	(1)%
Services	922,602	166,248	756,354	455%
License and other	801,220	897,379	(96,159)	(11)%
Total revenue	3,598,820	2,954,196	644,624	22%
Cost of revenue:				
Hardware	1,513,490	1,531,251	(17,761)	(1)%
Services	693,380	96,479	596,901	619%
License and other	27,480	81,929	(54,449)	(66)%
Total cost of revenue	2,234,350	1,709,659	524,691	31%
Gross profit	1,364,470	1,244,537	119,933	10%
Operating expense:				
Sales and marketing	5,592,731	3,092,888	2,499,843	81%
General and administrative	7,775,016	2,836,614	4,938,402	174%
Research and development	1,890,069	1,498,179	391,890	26%
Restructuring charges	1,726,147		1,726,147	100%
Loss on impairment of asset	253,358		253,358	100%
Total operating expenses	17,237,321	7,427,681	9,809,640	132%
Loss from operations	(15,872,851)	(6,183,144)	9,689,707	157%
Interest and other (expenses) income, net	175,251	52,260	122,991	235%
Loss from continuing operations	(15,697,600)	(6,130,884)	9,566,716	156%
Loss from discontinued operations, net of taxes	(1,359,726)	(3,902,447)	(2,542,721)	(65)%
Net loss	(17,057,326)	(10,033,331)	7,023,995	70%
Preferred stock dividends	(330,774)	(756,823)	(426,049)	(56)%
Net loss available to common stockholders	$ (17,388,100)	$ (10,790,154)	$ 6,597,946	61%

* As adjusted for discontinued operations

REVENUE. The Company derives its revenue from product sales of its 360-degree technology sold as licenses of software and hardware sales of camera equipment and from professional services. Total revenue for the three months ended September 30, 2005 was $1,497,788, an increase of $32,402, or 2% as compared to the three months ended

September 30, 2004. Revenue for the nine months ended September 2005 of $3,598,820 increased by $644,624 or 22% over the prior year.

For the three months ended September 2005, hardware sales of the immersive video products decreased to $396,428, a 45% decrease from the prior year. This decrease in 2005 reflects lower shipments to the Company s UK distributor (NMI), whose exclusive distribution agreement was terminated during the third quarter of 2005. NMI continues to operate under a non-exclusive distribution agreement in the UK. The immersive video products sales increased to $1,412,831 for the nine months ended September 30, 2005, an increase of 25% over the same period the prior year.

For the three and nine month periods ended September 2005 hardware sales of the immersive stills products decreased to $137,687, or 62% and $462,167 or 39%, respectively, as compared to the same periods in 2004. The Company has deemphasized sales of commercially available cameras which have low margin opportunities. Hardware for the immersive stills product line consists of brand name cameras which can be obtained from the brand s major distributors at competitive prices.

Professional services revenue for the third quarter and nine months of 2005 increased to $729,127 and $837,333, respectively, over the same period the prior year, for which there were no comparable amounts. This increase is due to the efforts expended on the first phase of the $2.4 million research contract from the Defense Advanced Research Projects Agency (DARPA) to research and build the world s highest resolution video camera, as well as other professional services arising from a commercial client. Professional services related to the immersive stills product line decreased to $44,326 or 57%, in the current period as compared to the prior year and $85,269 or a decrease of 49% for the nine month period.

License and other revenue, primarily related to the immersive stills product line, decreased to $190,220, or 32% for the three months ended September 30, 2005 as compared to the same period the prior year. For the nine month period in 2005 license and other revenue decreased to $801,220, or 11%, over the same nine months of the prior year.

COST OF REVENUE. The Company s cost of revenue consists of cost of components and cost of assembly for video and immersive cameras, internally developed software, licensed software, fulfillment and shipping costs, customer and technical support, internet hosting fees, professional service expenses and direct labor. Total cost of revenue for the three months ended September 30, 2005 was $1,112,584, an increase of $285,034 as compared to the three months ended September 30, 2004. The cost of revenue for the nine months ended September 2005 of $2,234,350, increased by $524,691 over the prior year.

Hardware cost of revenue decreased 29% as compared to a 51% decrease in hardware revenue resulting in a hardware gross margin for the three months ended September 30, 2005 of (1)% as compared to 30% for the same period in 2004. The decrease in hardware gross margin is due to an increase in lower margin transactions of immersive video products. The margin on the video products was adversely affected by a number of low margin transactions and inventory adjustments in the period which are not anticipated to reoccur in future periods. Hardware cost of revenue for the nine months ended September 2005 decreased 1% as compared to a 1% decrease in hardware revenue resulting in a hardware gross margin for the nine month period of 19%. Hardware cost of revenue for the nine months ended September 2004 was also 19%.

The increase in services cost of revenue over the same periods the prior year was due to the significant increase in the cost of professional services, primarily for performance under the cost-plus-fixed-fee DARPA contract that has low gross margin relative to revenue. The cost for professional services for the DARPA contract is due primarily to direct labor and other direct purchased costs. The DARPA contract gross margin is 8%.

Cost of license and other revenue in the third quarter 2005 decreased 53% from the same period 2004 which is greater than the 32% decrease in license and other revenue. For the nine month period of 2005, cost of license and other revenue decreased 66% from the same period 2004 versus an 11% decrease in license and other revenue over the nine months of the prior year. This was the result, in both periods, of improving revenue derived from our on-line store that has minimal variable cost associated with this type of sale.

SALES AND MARKETING. Sales and marketing expenses of $1,905,456 increased by $732,986, or 63%, during the quarter ended September 30, 2005 as compared to the quarter ended September 30, 2004, primarily due to additional marketing personnel and expenditures focused on building strong product awareness for the immersive video product line. The increase consisted of employee salary, benefits and recruitment and facility expenses related to the increase in our sales force of $337,272 and an increase in marketing, travel and trade show activities of $395,718. For the nine months ended September 2005, sales and marketing expenses of $5,592,731 increased by $2,499,843 over the prior year. The increase consisted of employee salary, benefits and recruitment and facility expenses related to the increase in our sales force and marketing personnel of $1,362,261 and an increase in marketing travel and trade show activities of $1,137,584.

GENERAL AND ADMINISTRATIVE. General and administrative expenses consist primarily of salaries and related benefits for administrative and executive staff, fees for outside professional services, legal fees, insurance and other costs associated with being a public company.

General and administrative expenses of $3,227,186 increased by $2,007,853 during the quarter ended September 30, 2005 as compared with the quarter ended September 30, 2004 as a result of: an increase in expenses of $131,883 incurred in association with compliance with public company regulations, including Sarbanes-Oxley compliance; an increase in professional fees to lawyers of $1,548,360 primarily due to patent litigation and financing activities; and an

increase of $167,471 in director and officer s insurance premiums due to increased coverage. In addition, facilities expenses increased $213,744 due to an increase in rent of the new facilities in Tennessee and Virginia and also an increase in depreciation from acquisitions of furniture and computer equipment. For the nine months ended September 2005, general and administrative expenses of $7,775,016 increased by $4,938,402 over the prior year as a result of: increase in headcount of executive, administrative and information technology professionals resulting in an increase in salaries, benefits, bonuses and related costs of $242,395; an increase in recruiting costs of $127,327; an increase in expenses of $810,725 incurred in association with compliance with public company regulations, including Sarbanes-Oxley compliance; an increase in professional fees to lawyers of $2,189,052 primarily due to patent litigation and financing activities; and an increase of $502,413 in director and officer s insurance premiums due to increased coverage. In addition, facilities expenses increased $669,172 due to an increase in rent of the new facilities in Tennessee and Virginia and also an increase in depreciation from acquisitions of furniture and computer equipment.
RESEARCH AND DEVELOPMENT. Research and development expenses consist primarily of personnel costs and consulting labor related to building and enhancing our digital media infrastructure and immersive imaging technology. Research and development expense for the three and nine month periods ended September 30, 2005 was $564,094 and $1,890,069, respectively. These expenses increased by $22,094 and $391,890 during the respective periods as compared to the same periods ended September 30, 2004. The increases in expenses are due to increases in head count of research and engineering personnel focused on the integration of the IPIX IP camera into a variety of digital video recording (DVR) devices utilized in the surveillance market that IPIX addresses and development of a three megapixil version of the camera.

RESTRUCTURING CHARGES. In the first quarter of 2005, the Company entered into a plan to move the executive office from California to Virginia upon the sale of the AdMission business unit which comprised the following actions: termination of a lease for equipment, abandon certain fixed assets and abandon an additional operating lease. As a result, in the second quarter of 2005, the Company paid a buy out fee of $747,053, which included penalties and a forfeited deposit, to terminate the lease for the computer equipment and wrote off $11,452 of fixed assets. In addition, a charge of $1,060,883 representing the net present value of the abandoned leased office space was recorded as restructuring charges in the second quarter of 2005. Restructuring charges were reduced by $93,242, but increased $1,726,141, respectively, for the three and nine months ended September 30, 2005.

LOSS ON IMPAIRMENT OF ASSETS. Loss on impairment of assets for the nine months ended September 30, 2005 was $253,358. This amount was due to a write down to zero net book value of the investment which was acquired as a result of the sale of the AdMission business unit in the first quarter of 2005 (see Note 3).

INTEREST AND OTHER INCOME, NET. Interest and other income for the three and nine months ended September 30, 2005 was $31,259 and $175,251 as compared to $32,288 and $52,260 for the same periods in 2004. This increase is primarily due to the sale of one of the Company s discontinued web domain names during the first quarter of 2005 for which there is no such amount in 2004. In addition, increased interest rates and higher balances for the period in cash and short-term investments also caused an increase.

LOSS FROM DISCONTINUED OPERATIONS. Loss from discontinued operations was $0 and $1,359,726, respectively, for the three and nine months ended September 30, 2005, compared to $1,156,914 and $3,902,447, respectively, for the same periods in 2004. This was due to the discontinued operations of the Company s AdMission business unit which was classified as discontinued operations in the fourth quarter of 2004 and sold in the first quarter of 2005. The prior period results were reclassified to properly classify the business unit as discontinued operations.

NET LOSS. As a result of the factors described above, the net loss for the three and nine months ended September 30, 2005 was $5,187,031 and $17,057,326, respectively. This was an increase of $1,766,438 and $7,023,995, respectively as compared to the same periods in 2004.

LIQUIDITY AND CAPITAL RESOURCES

Since inception, the Company has financed its operations through registered public offerings, the private placements of capital stock, a convertible debenture, a convertible promissory note and warrant and option exercises. At September 30, 2005, the Company had $11,221,030 of cash reserves, which consisted of cash, cash equivalents and a short-term investment of $1,474,586.

Common Stock

During the three months ended March 31, 2005, the Company issued 700,096 shares of common stock upon exercise of employee stock options. The total proceeds from the first quarter exercises of theses options were $1,456,005. During the three months ended June 30, 2005, 148,153 shares of common stock were issued upon exercise of employee stock options. The total proceeds from the second quarter exercises of theses options were $284,614. During the quarter ended June 30, 2005, the Company sold 51,680 shares of common stock to employees under the IPIX Employee Stock Purchase Plan (ESPP). The proceeds to the Company from the ESPP purchases were $132,301. During the three months ended September 30, 2005, 298,511 shares of common stock were issued upon exercise of employee stock options. The total proceeds from the third quarter exercises of theses options were $608,595. As of September 30, 2005, there was $54,727 collected for the employees fourth quarter 2005 Employee Stock Purchase Plan (ESPP) purchases.

During June 2005, the Company received gross proceeds of $10,000,000 through the private placement of 4,149,376 shares of its common stock to a group of investors. In connection with this private placement, the Company issued to the investors four-year warrants to purchase 1,825,725 shares of common stock at $3.11 per share and ninety-day additional investment rights to purchase 248,963 shares of common stock at $2.41 per share. The additional investment rights expire on December 22, 2005. The warrants may not be exercised until six months after issuance of the common shares. During the three months ended September 30, 2005, 56,700 additional investment rights were converted into common stock. The Company received proceeds totaling $136,647 for the conversion of these rights.

During the three months ended March 31, 2004, the Company issued 442,144 shares of common stock upon exercise of stock options. The total proceeds from the first quarter 2004 option exercises were $618,662, of which $256,773 was collected in the second quarter of 2004. During the quarter ended June 30, 2004, the Company issued 1,511,680 shares of common stock upon exercise of stock options. The proceeds to the Company from the option exercises were $4,170,737. During the quarter ended June 30, 2004, there were 91,140 shares of common stock sold to employees under the IPIX Employee Stock Purchase Plan (ESPP). The proceeds to the Company from the ESPP purchases were $112,037. During the quarter ended September 30, 2004, the Company issued 187,127 shares of common stock upon exercise of stock options. The proceeds to the Company from the option exercises were $362,743.

On April 5, 2004, the Company received gross proceeds of approximately $4,900,000 through the private placement of 909,090 shares of its common stock to accredited institutional investors. The shares of common stock were sold at $5.50 per share. In connection with this private placement, the Company issued to the investors additional investment rights to purchase 888,179 shares of common stock at $6.05 per share. The additional investment rights expired September 28, 2004. Of these additional investment rights, 88,818 were exercised in the second quarter of 2004 and the remaining 799,361 were exercised in the third quarter of 2004 resulting in total proceeds of approximately $5,400,000.

At December 31, 2003, there were two Tranche A warrants (Warrant 1 and Warrant 2) outstanding. As of September 30, 2004, Warrant 1, which entitled the holders to purchase 150,000 shares of Series B Preferred Stock at $20 per share, has been exercised in full. We issued 1,375,600 shares of common stock in the third quarter of 2004 and received $3.0 million in cash from the exercise of part of Warrant 1 and the conversion of the underlying Series B Preferred Stock. During the second quarter of 2004, 600 shares of the rest of Warrant 1 were converted into 4,372 shares of common stock. We did not receive any proceeds from the second quarter Warrant 1 exercise. Warrant 2 entitles the holders to purchase 100,000 shares of Series B Preferred Stock at $40 per share and is exercisable at any time before the expiration date of May 14, 2006. During the second quarter of 2004, 400 shares of Warrant 2 were converted into 2,914 shares of common stock. We did not receive any proceeds from the second quarter Warrant 2 exercise. During the third quarter of 2005, 41,380 shares of Warrant 2 were converted into 381,007 shares of common stock. We did not receive any proceeds from the third quarter Warrant 2 exercise.

Other Liquidity and Capital Resources

Summary Consolidated Cash Flow Data

	Nine Months Ended September 30, 2005	2004
Net cash used in operating activities	$ (14,271,481)	$ (9,841,813)
Net cash used in investing activities	(806,218)	(158,514)
Net cash provided by financing activities	12,040,085	17,823,304
Net increase / (decrease) in cash and cash equivalents	(3,037,614)	7,822,977
Cash and cash equivalents, beginning of period	12,784,058	10,240,980
Cash and cash equivalents, end of period	$ 9,746,444	$ 18,063,957

Cash flows from operating activities for the nine months ending September 30, 2005, reflect a net loss of $17,057,326 as compared to a net loss of $10,033,331 for the same period ending September 30, 2004. The increase in net loss is primarily due to an increase in sales and marketing expenses of $2.5 million for an expanded focus on building direct and channel sales, an increase in general and administrative expenses of $4.9 million due to relocation of company headquarters, litigation expense, and increased public company expenses to comply with legislation requiring documentation of internal controls, and fees associated with the sale of the AdMission business unit. Also impacting the change in operating activities is a decrease in inventory purchases and utilization as compared to the prior year of $859,920, a reduction of prepaid expenses and other current assets of $847,660 due to the reclassification of collateral held for a letter of credit to short term investment and the release of assets held for sale relating to the discontinued operations and sale of the AdMission business unit. The Company incurred non-cash compensation expenses of $818,747 associated with the acceleration of stock options primarily related to the sale of the AdMission business unit which also impacted the change in operating activities.

Net cash used in investing activities for the nine months ending September 30, 2005 increased by $647,704 compared with the same period ending September 30, 2004. The increase was primarily related to the acquisition of computer software and hardware to support the increase in staffing and to complete the build-out of a new computer and communication center in Oak Ridge, Tennessee and Reston, Virginia. Restricted cash was released and partially invested in short-term investments, increasing cash by $586,984.

Net cash provided by financing activities for the nine months ending September 30, 2005 was primarily related to $9,758,750 of net proceeds from the private placement of common stock in June 2005 compared to $4,898,431 of net proceeds from a private placement of common stock in April 2004. Offsetting the increase cash from private placement financings, the Company had a $2,976,590 decrease in net proceeds from the exercise of stock options from the nine months ended September 30, 2005 compared with the same period in 2004. As compared to the nine month period 2004, the Company did not have similar exercise in the current year of warrants and Additional Investment Rights resulting in lower cash proceeds of $8,247,351.

During the nine months ended September 30, 2005 and in the prior fiscal years, the Company experienced, and continues to experience, certain issues related to cash flow and profitability. These factors raise substantial doubt about the Company s ability to continue as a going concern. The Company completed a $10 million private placement of common stock, including additional investment rights and warrants to a group of existing and new institutional investors on June 21, 2005. Management will monitor the Company s cash position carefully and evaluate its future operating cash requirements with respect to its strategy, business objectives and performance. In order to reduce its cash burn, the Company may implement measures to reduce operating costs, including a reduction in sales and marketing expenses, support and other general and administrative expenses. The Company finished the third quarter of 2005 with $11,221,030 in cash reserves (cash and cash equivalents of $9,746,444 and short-term investments of $1,474,586).

Contractual Obligations

The table below shows the Company s total contractual obligations as of September 30, 2005:

	Payments Due by Periods				
	Total	**Less than one year**	**1-3 years**	**3-5 years**	**Thereafter**
Operating Leases	$ 2,096,048	$ 617,271	$ 982,577	$ 496,200	$
Restructuring Liability	931,325	654,757	276,568		
	$ 3,027,373	$ 1,272,028	$ 1,259,145	$ 496,200	$

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of September 30, 2005, the Company had $11,221,030 of cash, cash equivalents, and short term investments. Interest income is sensitive to changes in the general level of United States interest rates, particularly since the majority of its investments are in short term instruments. Due to the nature of the short term investments, the Company has concluded that there is not a material market risk exposure.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. The Company s Management, with the participation of the Company s chief executive officer and chief financial officer, have evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, the chief executive officer and chief financial officer have concluded that the Company s disclosure controls and procedures were not effective due to material weaknesses in the Company s internal control over financial reporting which were set forth in Management s Annual Report on Internal Control Over Financial Reporting included in the Company s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004. Material weaknesses were identified in the following areas:

1. Period-end close process

2. Purchases and accounts payable

3. Inventory

4. Revenue and receivables

5. Information technology

Changes in Internal Control over Financial Reporting and Management s Remediation Initiatives. The discussion below describes the planned and actual changes to the Company s internal control over financial reporting during the fourth quarter of 2004 and subsequent to December 31, 2004 that materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting. As described in Management s Annual Report on Internal Control over Financial Reporting, the Company identified material weaknesses in the Company s internal control over financial reporting and, as described below, the Company has made, and plans to make, changes to its internal control over financial reporting.

In response to the matters discussed in Management s Annual Report on Internal Control Over Financial Reporting, the Company plans to continue to review and make necessary changes to the overall design of its control environment, including the roles and responsibilities of each functional group within the organization and reporting structure, as well as policies and procedures to improve the overall internal control over financial reporting. To document, test internal controls and provide project management, the Company has retained the services of an experienced consulting firm. The Company continues to document and test its internal controls over financial reporting and remediate control deficiencies it identifies as a result of this process. The Company has implemented, and plans to implement during 2005, the specific measures described below to remediate the material weaknesses described in Management s Annual Report on Internal Control Over Financial Reporting. The Company plans to continue to review and make changes to its internal control environment as it deems appropriate or necessary to remediate the material weaknesses described herein.

Period-End Close Process. To address these material weaknesses, the Company appointed a new chief financial officer, a controller and an assistant controller in April, 2005. The new accounting team has extensive background in auditing and reporting for public companies and has had additional training to heighten awareness of generally accepted accounting principles. The Company has adopted more rigorous policies and procedures regarding the review and approval process for complex calculations and unusual transactions.

The Company implemented a periodic report checklist, which requires the signature of the controller or Chief Financial Officer. The Company assigned to the assistant controller responsibility for referencing the financial statements to supporting documentation and verifying the mathematical accuracy of the financial statements prior to the filing of any periodic report. The Company plans to adopt documentation and testing of controls to require the appropriate review and approval of journal entries. Additionally, the chief financial officer and controller are required to review all related party transactions and to note such review on the periodic report checklist.

As part of the reorganization of the Company s business, the Company has eliminated, in 2005, the positions of business unit s general managers.

The Company utilizes the operational expertise of chief executive officer, chief financial officer and controller to review significant fluctuations in expenses in order to ensure that the Company s expenses are appropriately recorded and classified in the financial statements.

Purchases and Accounts Payable The Company has implemented internal controls related to wire transfers and has documented and tested these controls during the third fiscal quarter of 2005. The Company has implemented and plans to conduct testing of controls requiring that authorized check signers adequately review supporting documentation during the check signing process and that evidence of such process be maintained for future review. Controls to require monthly review of accruals for accounts payable have been implemented and will be tested. Additionally, the Company implemented controls requiring that an approved vendor list be maintained and reviewed periodically by the chief financial officer or controller. The Company plans to document and test written policies and procedures related to purchases and accounts payable.

Inventory Through December 2004, the Company remediated identified inventory-related control deficiencies by implementing documentation to evidence controls relating to the approval of inventory purchases, the proper receipt and accounting of inventory receipts, the reconciliation of accounting records and inventory counts and the proper costing and valuation of inventory. The Company plans to test these controls in order to obtain sufficient evidence about their operating effectiveness. The Company will continue to evaluate these controls and may in the future implement additional measures based on the results of such testing.

Receivables and Revenue The Company remediated identified receivables and revenue related control deficiencies by implementing documentation of controls relating to the matters described in Management s Annual Report on Internal Control Over Financial Reporting Receivables and Revenue. The Company plans to test these controls in order to obtain sufficient evidence about their operating effectiveness. The Company will continue to evaluate these controls and may in the future implement additional measures based on the results of such testing.

Information Technology To remediate the identified information technology related control deficiencies, the Company implemented a security and backup recovery plan which will address each of the control deficiencies described in Management s Annual Report on Internal Control Over Financial Reporting Information Technology. The Company will continue to evaluate these controls and may in the future implement additional measures based on results of such testing.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains statements about future events and expectations which are characterized as forward-looking statements. Forward-looking statements are based on Management s beliefs, assumptions and expectations of the Company s future economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties that may cause the Company s actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements.

The words believe , may , will , should , anticipate , estimate , expect , intends , objective or similar word of these words are intended to identify forward-looking statements. We qualify any forward-looking statements entirely by these cautionary factors.

Although the Company believes that the expectations and assumptions reflected in these statements are reasonable in view of the information currently available, there can be no assurance that these expectations will prove to be correct. These forward-looking statements involve a number of risks and uncertainties, including those set forth below and in our 2004 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2005 under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations under the caption Risk Factors. Actual results may differ materially from the results discussed in the forward-looking statements. In addition to the specific factors discussed in our 2004 Form 10-K, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements:

- changes in the demand for our products and services,

- our third-party supplier s ability to deliver high quality components to us in a timely fashion,

- our ability to control or effect reductions in costs,

- uncertainty regarding our ability to continue as a going concern,
- our ability to raise capital and fund our operations,
- our ability to attract and retain highly qualified personnel,
- our ability to design, manufacture and deliver high quality products in a timely fashion,
- the burdens and costs of defending against potential infringement claims,

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On June 15, 2003, the Company filed an action against Mr. Ford Oxaal and his company, Minds-Eye-View, (together, Oxaal) in the United States District Court for the Eastern District of Tennessee. In the complaint, the Company asserted claims for patent infringement, false designation of origin, false description or representation, unfair or deceptive acts and tortious interference in connection with Oxaal s competing software product marketed under the name Click Away. On August 8, 2003, Oxaal filed its answer asserting counterclaims for non-infringement, invalidity, unenforceability, breach of contract, patent misuse, Lanham Act violations and tortious interference. The Company denied all of Oxaal s allegations. The case was stayed pending settlement negotiations, which have since terminated.
On March 15, 2005, a motion was filed by the Company to vacate the stay so that the lawsuit can proceed in due course.

On March 14, 2005, Grandeye, Ltd. filed suit against IPIX in the U.S. District Court for the Eastern District of Virginia, Norfolk Division, seeking a declaratory judgment that (1) its Halocam products do not infringe any valid claim of U.S. Patents No. 5,359,363 (the 363 patent), 6,603,502 B2 (the 502 patent), and Re 36,207 (the 207 patent (2) these three patents are invalid; and (3) these three patents are unenforceable as a result of inequitable conduct committed during prosecution of the patent applications leading to the patents. Grandeye also asserted various state law claims alleging damage to its business relationships as a result of alleged statements and conduct of IPIX. Grandeye also included in its Complaint a claim for antitrust violations but has since dismissed that antitrust claim with prejudice. IPIX has asserted substantial defenses to Grandeye s claims and filed a counter-suit against Grandeye for infringement of the 363 patent, 502 patent, and 207 patent. IPIX has vigorously defended, and continues to defend, its positions. IPIX has filed a motion seeking summary judgment as to Grandeye s state law claims, and Grandeye has filed a motion seeking a summary judgment that its Halocam SP products do not infringe any claims of the 363 patent, 502 patent, or 207 patent. The parties have opposed each other s motions and both motions are scheduled to be heard by the Court during a hearing scheduled to begin on November 7, 2005. In addition to hearing these issues, the Court will hear arguments at the November 7, 2005 hearing on the parties positions regarding the proper construction of terms in the three patents claims. Fact discovery in this case was scheduled to close on October 28, 2005 and trial is scheduled to begin on April 6, 2006.

The Company intends to vigorously defend each of the above referenced lawsuits. Because of the inherent uncertainties related to this type of litigation, the Company is unable to predict the ultimate outcome of these cases, or the likelihood or amount of our potential liability, if any, of these cases. However, if the Company is not successful in defending or settling these matters, these cases could have a material adverse effect on the business, financial condition, results of operations or cash flows of the Company. The Company will incur substantial costs in defending these lawsuits.

The Company is not currently a party to any other legal proceedings, the adverse outcome of which, individually or in the aggregate, is believed could have a material adverse effect on the business, financial condition, results of operations or cash flows of the Company.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer

IPIX CORPORATION
SIGNATURES

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

DATE: November 8, 2005	*IPIX CORPORATION* *(Registrant)* */s/ Charles A. Crew* *Charles A. Crew* *Authorized Officer* *Chief Financial Officer and* *Chief Accounting Officer*

IPIX CORPORATION
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EXHIBIT NO.	EXHIBIT DESCRIPTION
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer