

NEW MEXICO SOFTWARE, INC  
Form 10QSB  
August 13, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-QSB**

(Mark One)

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

For the quarterly period ended June 30, 2007

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

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

*COMMISSION FILE #333-30176*

NEW MEXICO SOFTWARE, INC.

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(Exact name of Registrant as specified in charter)

NEVADA

(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

91-1287406

(IRS EMPLOYER IDENTIFICATION NUMBER)

5021 Indian School Road, Suite 100

Albuquerque, New Mexico 87110

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

(505) 255-1999

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

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR,

IF CHANGED SINCE LAST REPORT)

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

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12b-2 OF THE EXCHANGE ACT).

YES [ ] NO [X]

NUMBER OF SHARES OF THE REGISTRANT'S COMMON STOCK OUTSTANDING AT AUGUST 10, 2007 IS: 100,954,021.

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**Form 10-QSB**

**June 30, 2007**

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**ITEM 1. FINANCIAL STATEMENTS**

**NewMexico Software, Inc.**

**Condensed Consolidated Balance Sheet**

**(Rounded to the nearest thousand)**

**(UNAUDITED)**

**June 30,  
2007**

**Assets**

Current assets:

|                                   |           |
|-----------------------------------|-----------|
| Cash and equivalents              | \$ 45,000 |
| Accounts receivable, net          | 162,000   |
| Inventory                         | 22,000    |
| Prepaid expenses and other assets | 14,000    |
| Total current assets              | 243,000   |

|  |         |
|--|---------|
| Furniture, equipment and improvements, net | 120,000 |
| Security deposits                          | 4,000   |

|              |            |
|--------------|------------|
| Total Assets | \$ 367,000 |
|--------------|------------|

**Liabilities and Stockholders' Equity**

Current liabilities:

|                           |           |
|---------------------------|-----------|
| Accounts payable          | \$ 53,000 |
| Accrued expenses          | 53,000    |
| Deferred revenue          | 50,000    |
| Subscriptions payable     | 46,000    |
| Notes payable             | 26,000    |
| Total current liabilities | 228,000   |

Stockholders' equity:

|  |  |
|--|--|
| Preferred stock, \$0.001 par value, 500,000 shares |  |
|--|--|

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|  |              |
|--|--------------|
| authorized, 0 shares issued and outstanding<br>as of June 30, 2007   | -            |
| Common stock, \$0.001 par value, 200,000,000 shares<br>authorized, 98,725,467 shares issued and<br>outstanding as of June 30, 2007 | 99,000       |
| Paid-in capital  | 13,800,000   |
| Deferred compensation  | (93,000)     |
| Accumulated (deficit)  | (13,667,000) |
| Total stockholders' equity   | 139,000      |
| <br>   |              |
| Total Liabilities and Stockholders' Equity   | \$ 367,000   |

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

**NMXS.com, Inc. and Subsidiaries**

**Condensed Consolidated Statements of Operations**

**(Rounded to the nearest thousand)**

**(UNAUDITED)**

|   | For the three months ended |           | For the six months ended |           |
|---|----------------------------|-----------|--------------------------|-----------|
|   | June 30,                   |           | June 30,                 |           |
|   | 2007                       | 2006      | 2007                     | 2006      |
| Revenue                                 |                            |           |                          |           |
| Software sales and licenses             | \$ 4,000                   | \$ 68,000 | \$ 7,000                 | \$ 97,000 |
| Software hosting and maintenance        | 137,000                    | 103,000   | 256,000                  | 227,000   |
| Custom programming                      | 2,000                      | 32,000    | 5,000                    | 43,000    |
| XR-EXpress report fees                  | 97,000                     | 33,000    | 193,000                  | 62,000    |
| Scanning services                       | 23,000                     | -         | 23,000                   | 1,000     |
| Hardware sales                          | 4,000                      | 10,000    | 23,000                   | 14,000    |
| Other                                   | -                          | -         |                          | 1,000     |
| Gross revenues                          | 267,000                    | 246,000   | 507,000                  | 445,000   |
| Cost of services                        | 104,000                    | 124,000   | 177,000                  | 225,000   |
| Gross Profit                            | 163,000                    | 122,000   | 330,000                  | 220,000   |
| Operating costs and expenses:           |                            |           |                          |           |
| General and administrative              | 187,000                    | 637,000   | 468,000                  | 1,044,000 |
| Depreciation and amortization           | 12,000                     | 7,000     | 22,000                   | 15,000    |
| Research and development                | 35,000                     | 20,000    | 84,000                   | 52,000    |
| Total operating costs and expenses      | 234,000                    | 664,000   | 574,000                  | 1,111,000 |
| Net operating income (loss)             | (71,000)                   | (542,000) | (244,000)                | (891,000) |
| Other income (expense):                 |                            |           |                          |           |
| Interest (expense)                      | (6,000)                    | (7,000)   | (7,000)                  | (17,000)  |
| Gain (loss) on disposal of fixed assets | -                          | -         | 6,000                    | -         |
| Total other income (expense)            | (6,000)                    | (7,000)   | (1,000)                  | (17,000)  |



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|   |             |              |              |              |
|---|-------------|--------------|--------------|--------------|
| Net income (loss)   | \$ (77,000) | \$ (549,000) | \$ (245,000) | \$ (908,000) |
| Earnings per share - basic and fully diluted                                      | \$ (0.00)   | \$ (0.01)    | \$ (0.00)    | \$ (0.02)    |
| Weighted average number of common shares<br>outstanding - basic and fully diluted | 96,273,006  | 59,729,565   | 93,301,657   | 57,108,860   |

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

## New Mexico Software, Inc.

## Condensed Consolidated Statements of Cash Flows

(Rounded to the nearest thousand)

(UNAUDITED)

|  | For the six months ended |              |
|--|--------------------------|--------------|
|  | June 30,                 |              |
|  | 2007                     | 2006         |
| <b>Cash flows from operating activities</b>  |                          |              |
| Net income (loss)  | \$ (245,000)             | \$ (908,000) |
| Adjustments to reconcile net (loss) to<br>net cash provided by (used in) operating activities: |                          |              |
| Common stock issued for salaries   | 264,000                  | 327,000      |
| Common stock issued for services   | 74,000                   | 336,000      |
| Common stock issued for interest   | 1,000                    | -            |
| Stock options issued for salaries  | 6,000                    | 118,000      |
| Stock options issued for services  | 62,000                   | -            |
| Depreciation and amortization  | 22,000                   | 15,000       |
| Depreciation and amortization allocated to cost of goods sold                                  | 3,000                    | 1,000        |
| Changes in operating assets and liabilities:   |                          |              |
| Accounts receivable  | 4,000                    | (7,000)      |
| Inventory  | 2,000                    | 11,000       |
| Prepaid expenses and other assets  | 7,000                    | 48,000       |
| Security deposits  | -                        | 4,000        |
| Accounts payable   | (53,000)                 | 39,000       |
| Legal settlements  | -                        | (150,000)    |
| Accrued expenses   | (69,000)                 | (97,000)     |
| Deferred revenue   | (12,000)                 | (40,000)     |
| Net cash provided by (used in) operating activities  | 66,000                   | (303,000)    |
| <b>Cash flows from investing activities</b>  |                          |              |
| Acquisition of fixed assets  | (42,000)                 | (38,000)     |
| Net cash used in investing activities  | (42,000)                 | (38,000)     |

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

**New Mexico Software, Inc.**

**Condensed Consolidated Statements of Cash Flows**

**(Rounded to the nearest thousand)**

**(UNAUDITED)**

*(CONTINUED)*

|  | <b>For the six months ended</b> |             |
|--|---------------------------------|-------------|
|  | <b>June 30,</b>                 |             |
|  | <b>2007</b>                     | <b>2006</b> |
| <b>Cash flows from financing activities</b>                          |                                 |             |
| Repayment of note payable  | (25,000)                        | (25,000)    |
| Subscriptions payable  | 25,000                          | -           |
| Net proceeds from the issuance of common stock                       | -                               | 298,000     |
| Net cash provided by financing activities                            | -                               | 273,000     |
| <br>   |                                 |             |
| Net increase (decrease) in cash equivalents                          | 24,000                          | (68,000)    |
| Cash equivalents - beginning   | 21,000                          | 157,000     |
| Cash equivalents - ending  | \$ 45,000                       | \$ 89,000   |
| <br>   |                                 |             |
| Supplemental disclosures:  |                                 |             |
| Interest paid  | \$ 4,000                        | \$ 8,000    |
| <br>   |                                 |             |
| Supplemental schedule of noncash operating and investing activities: |                                 |             |
| Inventory converted to fixed asset                                   | \$ -                            | \$ 9,000    |

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



**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 1 - BASIS OF PRESENTATION**

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

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim consolidated financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2006 and notes thereto included in the Company's Form 10-KSB. The Company follows the same accounting policies in the preparation of interim reports.

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

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Revenue recognition:

Our revenues are generally classified into five main categories: the sale of software licenses to end users, software hosting and maintenance contracts, software licenses that require us to provide production, customization or modification to our core software product, XR-EXpress customer usage fees, and hardware sales associated with sales of our various software products. The Company also derives revenue from scanning services and other services such as consulting, training and installation. The Company recognizes revenue in accordance with Statement of Position (SOP) 97-2 *Software Revenue Recognition* as amended.

Revenue from proprietary software sales that does not require further commitment from the Company is recognized upon persuasive evidence of an arrangement as provided by agreements executed by both parties, delivery of the software, and determination that collection of a fixed or determinable fee is probable. These sales are generally direct purchases of a software product and there is no other involvement by the Company.

The Company offers with certain sales of its software products a software maintenance, upgrade and support arrangement. These contracts may be elements in a multiple-element arrangement or may be sold in a stand-alone basis. Revenues from maintenance and support services are recognized ratably on a straight-line basis over the term that the maintenance service is provided. The Company typically charges 17% to 21% of the software purchase price for a 12-month maintenance contract with discounts available for longer-term agreements. The complexity of the software determines the percentage that is charged to any individual customer, and that percentage remains consistent upon renewal unless there is a change in the software or the terms of the agreement.

**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Revenue recognition (continued):

Charges for hosting are likewise spread ratably over the term of the hosting agreement, with the typical hosting agreement having a term of 12 months, with renewal on an annual basis. The Company sells some hosting contracts in conjunction with the sale of software, and some hosting contracts without an associated software sale. When the hosting arrangement is sold in conjunction with a software sale, the Company allocates a portion of the fee to the software license. Hosting services do not require the customer to purchase the software license, and for those hosting contracts that are sold without an associated software sale, the customer does not have the right nor the ability to operate the software on its own.

Should the sale of its software involve an arrangement with multiple elements (for example, the sale of a software license along with the sale of maintenance and support to be delivered over the contract period), the Company allocates revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. The Company defers revenue from the arrangement equivalent to the fair value of the undelivered elements and recognizes the remaining amount at the time of the delivery of the product or when all other revenue recognition criteria have been met. Fair values for the ongoing maintenance and support obligations are based upon separate sales of renewals of maintenance contracts. Fair value of services, such as training or consulting, is based upon separate sales of these services to other customers. The Company follows the guidance in SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require significant production, customization or modification to its core software.

Revenue is generally recognized for such arrangements under the percentage-of-completion method. Under percentage-of-completion accounting, both the product license and custom software development revenue are recognized as work progresses based on specific milestones in accordance with paragraphs 85-91 of SOP 97-2. The Company believes that project milestones based on completion of specific tasks provide the best approximation of progress toward the completion of the contract. At June 30, 2007 and June 30, 2006, there were no custom software development arrangements in progress.

From time to time, the Company has effected sales of its enterprise-level software in return for barter credits for advertising. The software was valued at the same price it would have been valued if it had been sold for cash. The



revenue was recognized when the software was transferred to the customer, along with a corresponding receivable for the barter credits. The advertising expense is recognized as the ads are placed. The value of any remaining barter credits is reviewed at the end of each fiscal year for possible impairment, and any such impairment loss is recorded at that time. During the quarters ended June 30, 2007 and 2006, the Company recognized \$0 and \$0 in revenue from barter transactions. At June 30, 2007, the Company had \$0 in prepaid barter credits.

The Company also derives revenue from the sale of third party hardware, which is billed as a separate deliverable under consulting or custom development contracts. Revenue from installation, training and consulting services is recognized when the services are rendered. They include services that are not essential to the functionality of the software. If these services are included in a software agreement with multiple elements, amounts are allocated to these categories based on the estimated number of hours required to complete the work, which is the same criteria used to bill for the services separately. License revenue is recognized ratably over the term of the license.

**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Revenue recognition (continued):

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

The application of SOP 97-2, as amended, requires judgment, including a determination that collectibility is probable and the fee is fixed and determinable. On occasion, the Company has approved extended payment arrangements for certain customers. These arrangements generally do not exceed 120 days, therefore collectibility is considered probable at the time of delivery. If an installment payment plan exceeds twelve months, revenue for each installment is recognized at the time payment is received.

The Company follows the guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements* and SAB No. 104, *Revenue Recognition*, which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC.

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

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

Cash and cash equivalents:

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. At June 30, 2007, the Company had \$0 in cash and equivalents that exceeded federally insured limits.

Trade Accounts Receivable:

The Company extends unsecured credit to customers under normal trade agreements which generally require payment within 30 - 45 days. Accounts not paid within 15 days after their original due date are considered delinquent. Unless specified by the customer, payments are applied to the oldest unpaid invoice. Accounts receivable are presented at the amount billed.

The Company also estimates an allowance for doubtful accounts, which amounted to \$25,000 and \$15,000 at June 30, 2007 and 2006, respectively. The estimate is based upon management's review of all accounts and an assessment of the Company's historical evidence of collections. Specific accounts are charged directly to the reserve when management obtains evidence of a customer's insolvency. Charge-offs, net of recoveries, for the quarters ended June 30, 2007 and 2006 totaled \$0 and \$0, respectively.

Inventory:

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

**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Furniture, equipment and improvements:

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

Income taxes:

As of June 30, 2007, the Company's federal net operating loss carryforwards were approximately \$11,160,000. The Company had a provision for (benefit from) income taxes of \$0 and \$0 for the three months ended June 30, 2007 and 2006; and \$0 and \$0 for the six months ended June 30, 2007 and 2006, respectively.

The Financial Accounting Standards Board has published FASB Interpretation No. 48 (FIN No. 48), Accounting for Uncertainty in Income Taxes, to address the non-comparability in reporting tax assets and liabilities resulting from a lack of specific guidance in FASB Statement of Financial Accounting Standards No. 109 (SFAS 109), Accounting for Income Taxes, on the uncertainty in income taxes recognized in an enterprise's financial statements. Specifically, FIN No. 48 prescribes (a) a consistent recognition threshold and (b) a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides related guidance on derecognition, classification, interest and penalties, accounting interim periods, disclosure and transition.

To the extent interest and penalties would be assessed by taxing authorities on any underpayment of income taxes, such amounts would be accrued and classified as a component of income tax expenses on the statement of operations.

FIN No. 48 will apply to fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company has completed its evaluation of the effects of FIN No. 48 and has concluded that the adoption of FIN No. 48 did not impact the financial statements for the quarter ended June 30, 2007. The Company's federal tax returns are potentially open to examinations for fiscal years 2003 through 2006.

Per share data:

The basic and diluted per share data has been computed on the basis of the net loss available to common stockholders for the period divided by the historic weighted average number of shares of common stock. All potentially dilutive securities have been excluded from the computations since they would be antidilutive, however, these dilutive securities could potentially dilute earnings per share in the future. Options and warrants exercisable for 5,681,545 and 2,376,545 shares of common stock have been excluded from the diluted loss per share calculation for the years ended June 30, 2007 and 2006 respectively, because inclusion of such would be antidilutive.

Research and development expenses:

Costs of research and development activities are expensed as incurred.

**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

Advertising expenses:

The Company expenses advertising costs which consist primarily of direct mailings, promotional items and print media, as incurred. Advertising expenses amounted to \$9,000 and \$50,000 for the six months ended June 30, 2007 and 2006, respectively.

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Stock-based compensation:

The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), effective January 1, 2006. SFAS 123R requires the recognition of the fair value of stock-based compensation in net income. Stock-based compensation primarily consists of stock options. Stock options are granted to employees at exercise prices equal to the fair market value of our stock at the dates of grant. The Company now recognizes the stock-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. The Company provides newly issued shares to satisfy stock option exercises. There were 12,000,000 and 5,000,000 option awards granted to employees and directors in the years ended December 31, 2006 and 2005. Of the 5,000,000 option awards granted in 2005, 4,500,000 were cancelled in 2006 and 250,000 were cancelled in the first quarter of 2007. During the six months ended June 30, 2007 and 2006, the Company recorded \$61,000 and \$118,000, respectively, in expense related to option grants to employees and directors.

As of June 30, 2007, the Company has reserved 1,000,000 shares of its common stock for issuance upon exercise of stock options and warrants.

Software development:

The Company accounts for computer software development costs in accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed". As such, all costs incurred prior to the product achieving technological feasibility are expensed as research and development costs. Technological feasibility is generally achieved upon satisfactory beta test results. Upon achieving technological feasibility, programming costs are capitalized and amortized over the economic useful live which is estimated to be two years. There were no capitalized software development costs as of June 30, 2007 and 2006.

**New Mexico Software, Inc.**

## Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 3 - GOING CONCERN**

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred cumulative net losses of approximately \$13,667,000 since its inception and requires capital for its contemplated operational and marketing activities to take place. The company's ability to raise additional capital through the future issuances of the common stock is unknown. The obtainment of additional financing, the successful development of the Company's contemplated plan of operations, and its transition, ultimately, to the attainment of profitable operations are necessary for the Company to continue operations. The ability to successfully resolve these factors raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements of the Company do not include any adjustments that may result from the outcome of these aforementioned uncertainties.

**NOTE 4 - FURNITURE, EQUIPMENT, AND IMPROVEMENTS**

Furniture, equipment, and improvements as of June 30, 2007 consisted of the following:

|                                   |            |
|-----------------------------------|------------|
| Computers                         | \$ 375,000 |
| Furniture, fixtures and equipment | 121,000    |
| Automobiles                       | 41,000     |
| Leasehold improvements            | 20,000     |
|                                   | 557,000    |
| Accumulated depreciation          | (437,000)  |
|                                   | \$ 120,000 |

**NOTE 5 - NOTE PAYABLE**

During January 2001, the Company borrowed \$300,000. The loan is collateralized by substantially all of the Company's assets and personally guaranteed by an officer of the Company. The note was renewed with a due date of



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July 24, 2002 at a current interest rate of 7%. On July 24, 2002, the Company paid \$50,000 of principal and \$10,525 of interest. The remaining \$250,000 of principal was extended to October 24, 2002 at a current interest rate of 7%. Management has continued to negotiate extensions by paying a portion of the principal and all accumulated interest owed at the due dates. At December 31, 2006, the Company had a balance due of \$39,000. In April 2007, the Company paid \$25,000 in principal and approximately \$1,000 in interest, and the remaining \$13,000 was extended until October 15, 2007 with a current interest rate of 9.25%. As of June 30, 2007, the Company had a balance due of \$13,000.

In April 2002, the Company borrowed \$12,500. The loan is due on demand and bears no interest. As of June 30, 2007, the Company had a balance due of \$12,500.

**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 6 CAPITAL TRANSACTIONS**

Common stock:

During the six-month period ended June 30, 2007, the Company effected the following stock transactions:

The Company issued a total of 8,316,349 shares of the Company's \$0.001 par value common stock to employees in lieu of salary, which was valued at \$234,000.

The Company issued a total of 2,598,796 shares of the Company's \$0.001 par value common stock to outside contractors in exchange for services rendered of \$74,000.

The Company issued a total of 50,000 shares of the Company's \$0.001 par value common stock to a shareholder in payment of interest, which was valued at \$2,000.

Warrants:

During the six-month period ended June 30, 2007 there were no warrants issued and none exercised.

The following is a summary of warrants outstanding as of June 30, 2007:

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| <u>Number of Warrants</u> | <u>Exercise Price</u> | <u>Expiration Date</u> |
|---------------------------|-----------------------|------------------------|
| 1,161,545                 | \$0.21                | July 24, 2009          |
| 110,000                   | \$0.25                | July 24, 2008          |
| 700,000                   | \$0.15                | June 29, 2011          |
| 2,000,000                 | \$0.03                | October 17, 2011       |

Stock options:

The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), effective January 1, 2006. SFAS 123R requires the recognition of the fair value of stock-based compensation in net income. Stock-based compensation primarily consists of stock options. Stock options are granted to employees at exercise prices equal to the fair market value of our stock at the dates of grant. The Company now recognizes the stock-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. Exercise prices and weighted-average contractual lives of stock options outstanding as of June 30, 2007 are as follows:

| Exercise Prices | <u>Options Outstanding</u> |   |                                   | <u>Options Exercisable</u> |                                 |
|-----------------|----------------------------|---|-----------------------------------|----------------------------|---------------------------------|
|                 | Number Outstanding         | Weighted Average Remaining Contractual Life | Weighted Average Remaining Prices | Number Exercisable         | Weighted Average Exercise Price |
| \$0.01-\$0.049  | 12,500,000                 | 9.35  | \$0.03                            | 500,000                    | \$0.04                          |
| \$0.05-\$0.30   | 3,235,000                  | 4.04  | \$0.06                            | 3,110,000                  | \$0.06                          |
| \$0.31-\$0.50   | 100,000                    | 3.75  | \$0.39                            | 100,000                    | \$0.39                          |

**New Mexico Software, Inc.**

## Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 6 CAPITAL TRANSACTIONS (CONTINUED)**

Summary of Options Granted and Outstanding:

|                                  | For the six months ended June 30, |  |           |  |
|----------------------------------|-----------------------------------|--|-----------|--|
|                                  | 2007                              |  | 2006      |  |
|                                  | Shares                            | Weighted<br>Average<br>Exercise<br>Price | Shares    | Weighted<br>Average<br>Exercise<br>Price |
| Options:                         |                                   |  |           |  |
| Outstanding at beginning of year | 16,085,000                        | \$0.04                                   | 8,879,500 | \$0.12                                   |
| Granted                          | 500,000                           | \$0.04                                   | -         | -  |
| Cancelled                        | (750,000)                         | \$0.07                                   | (294,500) | \$0.22                                   |
| Exercised                        | -                                 | -  | -         | -  |
| Outstanding at end of year       | 15,835,000                        | \$0.04                                   | 8,585,000 | \$0.12                                   |

During the six months ended June 30, 2007, approximately \$61,000 of stock option expense was granted in prior periods using the Black-Scholes option pricing model based upon the following assumptions: term of 10 years, risk free interest rates ranging from 3.5% to 4.5%, a dividend yield of 0% and volatility rates ranging from 155% to 162%.

**NOTE 7 - RELATED PARTY TRANSACTIONS**

Consulting agreement:

The Company entered into a consulting agreement with Brian McGowan to advise the CEO on business strategy and to formulate marketing ideas. The term of the employment agreement was for approximately five years commencing on July 1, 2003 and terminating on December 31, 2008. Mr. McGowan received a total of 5,500,000 shares of the Company's \$0.001 par value common stock valued at \$330,000 pursuant to this contract. The contract was terminated on December 31, 2006.

On October 4, 2005, the Company entered into a third consulting agreement with Brian McGowan to coordinate a number of material events for the purpose of presenting the Company and its products to potential investors and customers. The term of the agreement was for five years commencing on October 4, 2005 and terminating on September 30, 2010. Mr. McGowan received a total of 1,800,000 shares of the Company's \$0.001 par value common stock valued at \$162,000 pursuant to this contract. The contract was terminated on December 31, 2006.

**New Mexico Software, Inc.**

Notes to Condensed Consolidated Financial Statements

(UNAUDITED)

**NOTE 7 - RELATED PARTY TRANSACTIONS (CONTINUED)**

Employment agreement:

The Company entered into an employment and non-competition agreement with a stockholder to act in the capacity of President and Chief Executive Officer (CEO). The term of the employment agreement is for three years commencing on January 1, 2007. The agreement allows for a one-year renewal option unless terminated by either party. Base salary is \$60,000 per annum with available additional cash compensation as defined in the agreement. Compensation under this agreement of \$38,000 is included in general and administrative expenses for the quarter ended June 30, 2007. The non-competition agreement commences upon the termination of the employment agreement for a period of one year. At June 30, 2007, there was a total of \$3,000 in accrued payroll for this executive.

**NOTE 8 COMMITMENTS AND CONTINGENCIES**

Leases:

The Company leases office space in New Mexico. Future minimum lease payments as of June 30, 2007 are as follows:

| <b><u>Year</u></b> | <b><u>Amount</u></b> |
|--------------------|----------------------|
| 2007               | \$ 32,000            |
| 2008               | \$ 60,000            |
| 2009               | \$ 20,000            |

Rent expense for the six months ended June 30, 2007 and 2006 amounted to \$30,000 and \$32,000, respectively.

**NOTE 9 SUBSEQUENT EVENTS**

Since June 30, 2007, the Company has issued 2,228,554 shares of the Company's \$0.001 par value common stock, predominantly consisting of salaries and services.

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

### OVERVIEW

We presently realize revenues from four primary sources: (i) software sales and license fees; (ii) software hosting and maintenance services; (iii) custom programming; and (iv) XR-Express usage fees. We also occasionally realize revenues from scanning services, hardware sales when the hardware is sold together with the software, and occasionally from other services. With each sale of our enterprise-level products, the end user enters into a license agreement for which an initial license fee is paid. The license agreement also provides that in order to continue the license, the licensee must pay an annual software maintenance fee for which the party receives access to product upgrades and bug fixes or product patches. Software maintenance consists primarily of hosting and managing our customers' data on our servers, as well as technical support programs for our products.

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

In general, our key indicator of operating progress is gross revenue, because the majority of our expenses are relatively fixed. For the last two years, personnel-related expenses have ranged from 60% to 70% of our total operating expenses, with fixed costs such as building and equipment rent, utilities, insurance, communications and depreciation accounting for an additional 10%. The only personnel-related costs that are directly variable with sales are those associated with custom programming, because they are directly billable to customers. This means that over 70% of our expenses are relatively fixed. All of the remaining expenses vary, but less than 5% varies directly with sales. Until we have been marketing our products consistently for a certain period of time, gross revenue will remain the best gauge of our progress.

During the year ended 2006, our focus was on increasing our monthly recurring revenues, rather than relying on large one-time software sales. Our monthly recurring revenues have increased from an average of just under \$43,000 per month during the first quarter of 2006 to just under \$80,000 per month during the current quarter, and our customer base for recurring revenues has grown by over 50% during that time period. One of our current goals is to continue this growth during 2007, although there is no guarantee that it will continue at the same rate. During 2007, we are



concentrating on keeping our general and administrative expenses low by allocating our resources where they provide the most value, as well as clearing any remaining old liabilities from our balance sheet. We anticipate that the combination of efforts in growing our recurring revenues and reducing our administrative expenses will help us meet our goal of becoming profitable by the end of 2007.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our software recognition policies are in accordance with the American Institute of Certified Public Accountants Statement of Position ( SOP ) 97-2, *Software Revenue Recognition* as amended. Revenue is recognized when (a) persuasive evidence of an arrangement exists, (b) delivery has occurred, (c) the fee is fixed or determinable, and (d) collectibility is probable. We follow the guidance in SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require us to provide significant production, customization or modification to our core software. Revenue is generally recognized for such arrangements under the percentage of completion method. Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

We follow the guidance provided by SEC Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements* and SAB No. 104 *Revenue Recognition* which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC.

### ***Income Taxes***

Management treats all tax calculations in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, as discussed in Note 2.

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

We grant stock awards and stock options to employees and non-employees as consideration for services. Management believes that the best indicator of value for stock awards is the trading value of the shares of stock on the date the Company enters into the agreements. For non-employees, that date is generally the date on which the company is committed to such an agreement. At times the Company may grant stock as payment for accrued but unpaid payroll. In these cases, the Company values the shares at the trading price on the date they are granted and reduces the payroll accrual by the same amount. We have elected to apply the intrinsic value method prescribed in SFAS 123(R) for stock options granted to employees. For options granted to non-employees, we estimate the value of those awards using the Black-Scholes option pricing model.

### ***Contingencies***

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

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

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

technological feasibility is established, costs are capitalized. Historically, product development has been substantially completed with the establishment of technological feasibility and, accordingly, no costs have been capitalized.

## RESULTS OF OPERATIONS

A summary of operating results for the three months ended June 30, 2007 and 2006 is as follows:

|                             | 2007            |                     | 2006             |                     |
|-----------------------------|-----------------|---------------------|------------------|---------------------|
|                             | <u>Amount</u>   | <u>% of Revenue</u> | <u>Amount</u>    | <u>% of Revenue</u> |
| Revenues                    | \$ 267,000      | 100.0%              | \$ 246,000       | 100.0%              |
| Cost of service             | <u>104,000</u>  | 39.0%               | <u>124,000</u>   | 50.4%               |
| Gross profit                | <u>163,000</u>  | 61.0%               | <u>122,000</u>   | 49.6%               |
| General & administrative    | 187,000         | 70.0%               | 637,000          | 258.9%              |
| Depreciation & amortization | 12,000          | 4.5%                | 7,000            | 2.9%                |
| Research & development      | 35,000          | 13.1%               | 20,000           | 8.1%                |
| Net operating (loss)        | <u>(71,000)</u> | (26.6)%             | <u>(542,000)</u> | (220.3)%            |
| Other income (expense)      | (6,000)         | 2.2%                | <u>(7,000)</u>   | (2.9)%              |
| Net income (loss)           | <u>(77,000)</u> | (28.8)%             | <u>(549,000)</u> | (223.2)%            |
| Earnings (loss) per share   | \$ 0.00         |                     | \$ <u>(0.01)</u> |                     |

A summary of operating results for the six months ended June 30, 2007 and 2006 is as follows:

|                          | 2007           |                     | 2006           |                     |
|--------------------------|----------------|---------------------|----------------|---------------------|
|                          | <u>Amount</u>  | <u>% of Revenue</u> | <u>Amount</u>  | <u>% of Revenue</u> |
| Revenues                 | \$ 507,000     | 100.0%              | \$ 445,000     | 100.0%              |
| Cost of service          | <u>177,000</u> | 34.9%               | <u>225,000</u> | 50.6%               |
| Gross profit             | <u>330,000</u> | 65.1%               | <u>220,000</u> | 49.4%               |
| General & administrative | 468,000        | 92.3%               | 1,044,000      | 234.6%              |

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|                             |                  |         |                  |          |
|-----------------------------|------------------|---------|------------------|----------|
| Depreciation & amortization | 22,000           | 4.3%    | 15,000           | 3.3%     |
| Research & development      | 84,000           | 16.6%   | 52,000           | 11.7%    |
| Net operating (loss)        | <u>(244,000)</u> | (48.1)% | <u>(891,000)</u> | (200.2)% |
| Other income (expense)      | (1,000)          | (0.2)%  | <u>(17,000)</u>  | (3.8)%   |
| Net income (loss)           | <u>(245,000)</u> | (48.3)% | <u>(908,000)</u> | (204.0)% |
| Earnings (loss) per share   | \$ 0.00          |         | \$ <u>(0.02)</u> |          |

Revenues: Total revenues increased 8.5%, or \$21,000, for the quarter ended June 30, 2007, as compared to the same period in the prior year (the comparable prior year period). Total revenues increased 13.9%, or \$62,000 for the six months ended June 30, 2007, as compared to the comparable prior year period. These revenues were primarily generated from the following four revenue streams:

1.

Revenues from software hosting and maintenance increased 33% or \$34,000 for the second quarter of 2007 as compared to the comparable prior year period. Revenues from software hosting and maintenance increased 13%, or \$29,000 for the six months ended June 30, 2007, as compared to the comparable prior year period. This increase is due to a combination of factors. Approximately 20% of the increase for the year to date is a result of a net increase in customers, and the remainder of the increase is from the billing of annual maintenance fees during the second quarter. Software maintenance consists mainly of hosting and managing our customers' data on our systems, and to a lesser extent includes technical support programs associated with our products. Based on the market response to our DFC3 and XR-Express products during 2006, and with the introduction of the TORC backup system and the DDS-Express dental management system in 2007, management anticipates that revenues from software hosting and maintenance will continue to increase in the coming year, although it is not possible to predict the rate of increase until we have been actively marketing the products for some time.

2.

Revenues generated by XR-Express report fees increased 192%, or \$64,000 during the quarter ended June 30, 2007, as compared to the comparable prior year period. Revenues generated by XR-Express report fees increased 212%, or \$131,000 during the six months ended June 30, 2007, as compared to the comparable prior year period. This increase reflects the sales growth of XR-Express over the last year. Approximately 146,000 reports were generated in the first six months of 2007, as compared with approximately 41,000 in the first half of 2006. We are still adding several new XR-Express customers per quarter. As a result, we expect further increases in this revenue category for 2007, but it is not possible to predict the rate of increase until we have been actively marketing the products for some time.

3.

Revenues generated by software sales and licenses decreased 95%, or \$66,000, for the quarter ended June 30, 2007, as compared to the comparable prior year period. Revenues generated by software sales and licenses decreased 96%, or \$94,000 for the six months ended June 30, 2007, as compared to the comparable prior year period. This decrease is a result of several factors. Approximately 65% of the decrease is the result of a major sale of multiple software licenses to two XR-Express customers during the second quarter of 2006 that was not repeated during 2007. However, these sales generated the annual maintenance fees discussed in the paragraph above on software hosting and maintenance revenues. Approximately 17% of the decrease is due to a software upgrade during the first quarter of 2006 that was not repeated during 2007. The remainder of the decrease is due to a new policy allowing XR-Express customers to pay for their software via a higher monthly fee rather than collecting the entire software fee up front. The consequence of this policy is that the fees for the XR-Express software are paid over the entire period of service for the customer, resulting in lower initial revenue for the software sale, but potentially higher overall revenue, as there is

no cap on the higher fees. Software sales will most likely vary from one quarter to the next during 2007 as we continue to add new customers for XR-EXpress, DFC3, DDS-Express and TORC. However, these products tend to provide more revenue from software maintenance than software sales due to our focus on hosted models.

4.

Custom programming revenue decreased 92%, or \$29,000, for the quarter ended June 30, 2007, as compared to the comparable prior year period. Custom programming revenue decreased 89%, or \$38,000 for the six months ended June 30, 2007, as compared to the comparable prior year period. This decrease was primarily attributable to the fact that we have had no major custom programming projects during 2007. Since we have reduced our focus on sales of enterprise-level systems based on our Roswell technology requiring substantial customization, the number of custom programming projects requested by customers has been inconsistent. We continue to offer programming services for customer database integration, and for other projects for our existing customers.

We also generated revenue from hardware sales, scanning services and other services. Revenue from hardware sales decreased 54%, or \$5,000 for the quarter ended June 30, 2007, as compared to the comparable prior year period, and increased 88%, or \$12,000 for the six months ended June 30, 2007, as compared to the comparable prior year period. These sales are associated with sales of our XR-EXpress and DFC3 software. Approximately half of the hardware sales during 2007 have come from new customers. Although we have not emphasized hardware sales in the past, we expect that the diversification of our DFC3 product into various appliance models, along with the continued growth of XR-EXpress, will result in increased hardware revenues during 2007. It will not be possible to predict the impact of these sales on hardware revenues until we have been actively marketing the products for some time. Revenue from scanning services increased 100%, or \$23,000 during the quarter ended June 30, 2007, with approximately the same increase for the six months ended June 30, 2007. This increase is the result of one major scanning project that began in the second half of 2006 and was completed during the second quarter of 2007.

**Cost of Services.** Cost of services decreased 16.1%, or \$20,000, for the quarter ended June 30, 2007, as compared to the comparable prior year period. Cost of services decreased 21.3%, or \$48,000 for the six months ended June 30, 2007. During the first quarter of 2007, we reversed a charge of approximately \$40,000 related to our XR-EXpress product as a result of a contract renegotiation. The remaining cost of services increased 4%, or \$8,000 for the first six months. This increase consists of greater hardware costs associated with the hardware sales mentioned above, greater communications costs as our bandwidth needs increased, and additional salaries for customer support.

For the quarter ended June 30, 2007, cost of services as a percentage of revenues was 39.0%, as compared with 50.4% for the comparable prior year period. For the six months ended June 30, 2007, cost of services as a percentage of revenues was 34.9%, as compared with 50.6% for the comparable prior year period. The decrease this year is a result of the increased revenues for the year to date as compared with the prior year period, coupled with the reversed charge mentioned above. During the current fiscal year, approximately 81% of our cost of sales consists of salaries and compensation-related expenses. We consider these costs to be directly associated with our ability to generate revenues, however, they do not vary with revenues in that much of those costs are fixed. As a result, the gross margin percent will vary as sales vary. We anticipate that as revenues increase in the coming year, the cost of goods and services required to support those revenues will continue to increase, and engineering salaries will also increase as we hire additional staff to support a greater number of products and customers. However, we expect that revenues will increase at a greater rate than cost of services, since most of our costs are relatively fixed.

**General and Administrative.** General and administrative expenses decreased 70.6%, or \$450,000, for the quarter ended June 30, 2007, as compared to the comparable prior year period. General and administrative expenses decreased 55.2%, or \$576,000, for the six months ended June 30, 2007, as compared to the comparable prior year period. Approximately 70% of the decrease is due to a reduction in consulting and legal fees during the current fiscal year, approximately 12% is due to decreased advertising expenses, and the remainder is due to a reduction in administrative staffing as compared to the first half of 2006.



For the quarter ended June 30, 2007, general and administrative expenses as a percentage of revenues were 70.0%, as compared with 258.9% for the comparable prior year period. For the six months ended June 30, 2007, general and administrative expenses as a percentage of revenues were 92.3%, as compared to 234.6% for the comparable prior year period. These decreases are due to the combination of increased revenues and the reductions in administrative expenses mentioned above during the current fiscal year. Management believes the ratio of general and administrative costs to revenues will decrease in the future because revenues will increase at a greater rate than general and administrative costs, but until we have been in the active marketing phase for a longer period, management is unable to yet determine to what extent this percentage may change in the future.

**Depreciation and Amortization.** Depreciation and amortization expenses increased 71.4%, or \$5,000, for the quarter ended June 30, 2007, as compared to the comparable prior year period. Depreciation and amortization expenses increased 46.7%, or \$7,000, for the six months ended June 30, 2007, as compared to the comparable prior year period. Approximately 30% of the increase is due to the purchase of software to be used in the development of several of our products, and the remaining 70% of the increase is due to the purchase of an automobile.

**Research and Development.** Research and development expenses increased 75.0%, or \$15,000, for the quarter ended June 30, 2007, as compared to the comparable prior year period. Research and development expenses increased 61.5%, or \$32,000, for the six months ended June 30, 2007, as compared to the comparable prior year period. This increase is due to the fact that we have directed a slightly larger portion of our personnel into research and development activities in order to complete our TORC and DDS-Express products, as well as to complete the next version of our DFC3 product. However, in the software industry it is common for research and development costs to be ongoing, since development of the next version of the software begins as soon as the current version is completed. Management anticipates that research and development costs in the future will focus both on the upgrading of our existing products and the continued development of new products using our core technology; therefore they will remain relatively steady in the coming year.

**Other Income.** Interest expense decreased 14%, or \$1,000 for the quarter ended June 30, 2007, as compared to the comparable prior year period, and decreased 134%, or \$9,000 for the six months ended June 30, 2007, as compared to the comparable prior year period. The decrease in interest expense was a result of the final payment during the first quarter of 2007 of the past-due tax obligation to the IRS. We also had a gain on disposal of fixed assets of \$6,000 during the first quarter of 2007.

## LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2007, cash and cash equivalents totaled \$45,000, representing a \$24,000 increase from the beginning of the period. This increase results from the following activities:

Operating activities provided a source of \$66,000 of cash for the six months ended June 30, 2007, as compared to using \$303,000 for the comparable prior year period. The increase in the net source of cash was due to several major factors. The first factor is a decline in net loss of \$663,000 from the comparable prior year period. The second factor is the payment of \$150,000 in legal settlements in the first half of 2006 which was not repeated during the current fiscal year. The third factor is a reduction of \$375,000 in stock and options issued for salaries and services during the six months ended June 30, 2007, as compared to the comparable prior year period, which constituted a decrease in sources of cash for the current fiscal year. The final factor is the payment of various accounts payable during 2007, resulting in an increase in net use of cash of \$92,000 for the current fiscal year as compared to the comparable prior year period.

Investing activities used \$42,000 for the six months ended June 30, 2007, as compared to \$38,000 for the comparable prior year period. During the first half of 2007 we purchased a replacement automobile for our CEO, and during the first half of 2006 we purchased new computer equipment.

Financing activities provided no cash for the six months ended June 30, 2007, as compared to \$273,000 for the comparable prior year period. The decrease is solely a result of the fact that no common stock was issued for cash during the current fiscal year.

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

At June 30, 2007 we had a working capital surplus of \$15,000 as opposed to a working capital surplus of \$96,000 at June 30, 2006. This decrease is primarily due to the write-off of the prepaid advertising credits at the end of 2006.

We have incurred operating losses and negative cash flows for the past two fiscal years that have been funded through the issuance of additional equity securities. We have seen our cash flow from operations gradually increase during the last year, and we have had a corresponding reduction in the number of equity securities issued to supplement cash flow. However, we are still issuing securities for the payment of certain salaries and contractors fees. We may also continue to sell equity securities and incur debt as needed to meet our operating needs.

We anticipate that our primary uses of cash in the next six months will be allocated to finish satisfying long-term obligations and for general operating purposes. Based on cash flow projections, our cash requirements for the next six months at the current level of operations will be approximately \$700,000 to \$800,000. We are currently generating cash flow from operating revenues of \$75,000 to \$90,000 per month, and this amount has increased steadily since the beginning of 2006. This level of cash flow will allow us to meet current obligations and maintain our current level of operations as long as we continue to issue equity compensation to employees and consultants. Our goal for 2007 is to generate cash flow from operations as necessary to fund all operating expenses as well as expected growth in the near future and to become profitable by the end of the year. We expect the upward trend in recurring revenues to continue in 2007, although it is not possible to predict the rate of increase until our new products have been established in the market for a reasonable period of time.

#### OFF-BALANCE SHEET ARRANGEMENTS

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources that we expect to be material to investors.

#### RISK FACTORS

#### **If we fail to adequately manage our growth, we may not be successful in growing our business and becoming profitable**

We expect our business to grow over the next 12 months. We expect that our growth will place significant stress on our operation, management, employee base and ability to meet capital requirements sufficient to support our growth. Any failure to address the needs of our growing business successfully could have a negative impact on our chance of success.

**Our business depends on a limited number of key personnel, the loss of whom could negatively affect us**

Richard Govatski and Teresa B. Dickey, our senior executives are important to our success. If they become unable or unwilling to continue in their present positions, our business and financial results could be materially negatively affected.

**If the federal government and state governments enact laws applicable to the internet, it could impose additional financial burdens and other burdens on us**

There are currently few laws and regulations directly applicable to the Internet. It is possible that a number of laws and regulations may be adopted with respect to the Internet covering issues such as user privacy, pricing, content, copyrights, distribution, antitrust and characteristics and quality of products and services. The growth of the market for online commerce may prompt calls for more stringent consumer protection laws that may impose additional burdens on companies conducting business online.

**Reliance on oral agreements with some of our major customers could have a material negative impact on our revenues**

We have oral agreements with a few of our major customers rather than written contracts. As a result, these agreements may be terminated at any time, and therefore they provide little guarantee of future revenues. In addition, if these customers fail to perform their obligations under these agreements, it could have a material negative impact on our future cash flows, and there is little likelihood that we would be able to recover any unpaid receivables from these customers without significant effort and legal costs.

**FORWARD-LOOKING STATEMENTS**

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

- Rapid changes in technology relating to the Internet
- Continued growth and use of the Internet
- Changes in government regulations
- Changes in our business strategies
- Hardware failure of a catastrophic proportion

- 

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

- 

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

- 

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

- 

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

- 

Inability to solve cash flow problems

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

### **ITEM 3. CONTROLS AND PROCEDURES**

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

Our Chief Executive Officer and Chief Financial Officer (collectively the Certifying Officers ) maintain a system of disclosure controls and procedures that are designed to ensure that information which is required to be disclosed by the Company in the reports that it files or submits under the Exchange Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Under the supervision and with the participation of management, at June 30, 2007, the Certifying Officers evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule [13a-15(e)/15d-15(e)] under the Exchange Act). Based upon that evaluation, the Certifying Officers concluded that our disclosure controls and procedures are effective in ensuring that information that is required to be reported is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.





Furthermore, the Certifying Officers concluded that our disclosure controls and procedures in place were designed to ensure that information required to be disclosed by us, including our consolidated subsidiaries, in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported on a timely basis in accordance with applicable Commission rules and regulations; (ii) accumulated and communicated to our management, including our Certifying Officers and other persons that perform similar functions, if any, to allow us to make timely decisions regarding required disclosure in our periodic filings.

(b) Changes in internal controls

In connection with our evaluation of our internal controls during the period ended June 30, 2007, our Certifying Officers have not identified any material deficiencies or weaknesses or other factors that have materially affected or are reasonably likely to materially affect these controls, and therefore, we have not made any changes to these controls.

## **PART II**

### **ITEM 1. LEGAL PROCEEDINGS**

We are not engaged in any legal proceedings, and do not know of any threatened litigation or claims.

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

Not applicable.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

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

31.1 Rule 15d-14 (a) Certification by Principal Executive Officer

31.2 Rule 15d-14 (a) Certification by Principal Financial Officer

32 Section 1350 Certification of Principal Executive Officer and Principal Financial Officer

(b) Reports. No reports on Form 8-K were filed during the quarter ended June 30, 2007.



**SIGNATURES**

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

NEW MEXICO SOFTWARE, INC.

Date: August 13, 2007

By /s/ Richard Govatski

Richard Govatski, President

Date: August 13, 2007

By /s/ Teresa Dickey

Teresa Dickey, Treasurer (Principal

Financial Officer)

