

NEW MEXICO SOFTWARE, INC  
Form 10-Q  
November 15, 2010

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

FORM 10-Q

(Mark  
One)

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

For the quarterly period ended September 30, 2010

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.  
(Exact name of Registrant as specified in charter)

NEVADA 91-1287406  
(State or other jurisdiction of incorporation (I.R.S. Employer Identification No.)  
or organization)

5021 Indian School Road, Suite 100  
Albuquerque, New Mexico 87110  
(Address of principal executive offices) (Zip Code)

(505) 255-1999  
(Registrant's telephone number, including area code)

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 has submitted electronically and posted on  
its corporate Web site, if any, every Interactive Data File required to be submitted and  
posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the  
preceding 12 months (or for such shorter period that the registrant was required to submit  
and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a  
non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer,"

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“accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares outstanding of each of the issuer’s classes of common stock at November 8, 2010 was 143,049,880.

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

New Mexico Software, Inc.  
Balance Sheet  
(Rounded to the nearest thousand)  
(UNAUDITED)

|  | September 30,<br>2010 | December 31,<br>2009 |
|--|-----------------------|----------------------|
| Assets   |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$ 184,000            | \$ 111,000           |
| Accounts receivable, net   | 755,000               | 736,000              |
| Prepaid expenses and other assets  | 39,000                | 46,000               |
| Total current assets   | 978,000               | 893,000              |
| Furniture, equipment and improvements, net   | 51,000                | 65,000               |
| Security deposits  | 4,000                 | 4,000                |
| Total assets   | \$ 1,033,000          | \$ 962,000           |
| Liabilities and Stockholders' Equity   |                       |                      |
| Current liabilities:   |                       |                      |
| Accounts payable   | \$ 702,000            | \$ 655,000           |
| Accrued expenses   | 47,000                | 50,000               |
| Customer deposits  | 21,000                | 21,000               |
| Deferred revenue   | 8,000                 | 17,000               |
| Capital Lease  | 1,000                 | 10,000               |
| Total current liabilities  | 779,000               | 753,000              |
| Total liabilities  | 779,000               | 753,000              |
| Stockholders' equity:  |                       |                      |
| Preferred stock, \$0.001 par value, 500,000 shares<br>authorized, no shares issued and outstanding as of September 30, 2010              | -                     | -                    |
| Common stock, \$0.001 par value, 200,000,000 shares<br>authorized, 143,049,880 shares issued and outstanding<br>as of September 30, 2010 | 143,000               | 134,000              |
| Paid-in capital  | 14,992,000            | 14,852,000           |
| Subscriptions payable  | 21,000                | 21,000               |
| Deferred compensation  | (75,000)              | -                    |
| Accumulated deficit  | (14,827,000)          | (14,798,000)         |
| Total stockholders' equity   | 254,000               | 209,000              |
| Total liabilities and stockholder's equity   | \$ 1,033,000          | \$ 962,000           |

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

New Mexico Software, Inc.  
Condensed Consolidated Statements of Operations  
(Rounded to the nearest thousand)  
(UNAUDITED)

|   | For the three months ended<br>September 30, |             | For the nine months ended<br>September 30, |              |
|---|---|-------------|--|--------------|
|   | 2010  | 2009        | 2010                                       | 2009         |
| <b>Revenue</b>                                      |   |             |  |              |
| Radiological services                               | \$783,000                                   | \$761,000   | \$2,202,000                                | \$2,197,000  |
| Software usage fees                                 | 94,000                                      | 89,000      | 282,000                                    | 323,000      |
| Software hosting and maintenance                    | 26,000                                      | 53,000      | 99,000                                     | 169,000      |
| Cardiology services                                 | 10,000                                      | -           | 11,000                                     | -            |
| Custom programming                                  | -   | 5,000       | -  | 9,000        |
| Scanning services                                   | -   | -           | -  | 21,000       |
| Software sales and licenses                         | -   | -           | 2,000                                      | -            |
| Hardware sales                                      | -   | -           | -  | -            |
| Gross revenues                                      | 913,000                                     | 908,000     | 2,596,000                                  | 2,719,000    |
| <br>  |   |             |  |              |
| Cost of services                                    | 681,000                                     | 674,000     | 1,964,000                                  | 2,005,000    |
| <br>  |   |             |  |              |
| Gross Profit  | 232,000                                     | 234,000     | 632,000                                    | 714,000      |
| <br>  |   |             |  |              |
| <b>Operating costs and expenses:</b>                |   |             |  |              |
| General and administrative                          | 187,000                                     | 184,000     | 516,000                                    | 610,000      |
| Legal expenses                                      | 9,000                                       | 81,000      | 93,000                                     | 157,000      |
| Depreciation and amortization                       | 4,000                                       | 8,000       | 14,000                                     | 25,000       |
| Research and development                            | 17,000                                      | 15,000      | 43,000                                     | 46,000       |
| Total operating costs and expenses                  | 217,000                                     | 288,000     | 666,000                                    | 838,000      |
| <br>  |   |             |  |              |
| Net operating income (loss)                         | 15,000                                      | (54,000 )   | (34,000 )                                  | (124,000 )   |
| <br>  |   |             |  |              |
| <b>Other income (expense):</b>                      |   |             |  |              |
| Interest income                                     | -   | 4,000       | 15,000                                     | 17,000       |
| Interest (expense)                                  | (4,000 )                                    | (8,000 )    | (11,000 )                                  | (22,000 )    |
| Gain on sale of obsolete inventory                  | -   | -           | 1,000                                      | -            |
| Inventory revaluation                               | -   | (6,000 )    | -  | (10,000 )    |
| Total other income (expense)                        | (4,000 )                                    | (10,000 )   | 5,000                                      | (15,000 )    |
| <br>  |   |             |  |              |
| Net income (loss)                                   | \$11,000                                    | \$(64,000 ) | \$(29,000 )                                | \$(139,000 ) |
| <br>  |   |             |  |              |
| <b>Earnings per share - basic and fully diluted</b> |   |             |  |              |
|   | \$0.00                                      | \$(0.00 )   | \$(0.00 )                                  | \$(0.00 )    |

Weighted average number of common  
shares

|                                       |             |             |             |             |
|---------------------------------------|-------------|-------------|-------------|-------------|
| outstanding - basic and fully diluted | 141,413,672 | 130,799,259 | 136,657,468 | 130,502,073 |
|---------------------------------------|-------------|-------------|-------------|-------------|

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

New Mexico Software, Inc.  
Statements of Cash Flows  
(Rounded to the nearest thousand)  
(UNAUDITED)

|  | For the nine months<br>ended<br>September 30, |              |
|--|---|--------------|
|  | 2010  | 2009         |
| Cash flows from operating activities   |   |              |
| Net loss   | \$(29,000 )                                   | \$(139,000 ) |
| Adjustments to reconcile net loss to<br>net cash used by operating activities: |   |              |
| Common stock issued for salaries   | -   | -            |
| Common stock issued for services   | 74,000  | 122,000      |
| Inventory revaluation  | -   | 12,000       |
| Depreciation   | 14,000  | 25,000       |
| Depreciation allocated to cost of services                                     | 6,000   | 6,000        |
| Changes in operating assets and liabilities:                                   |   |              |
| Accounts receivable  | (19,000 )                                     | (283,000 )   |
| Prepaid expenses and other assets  | 7,000   | (34,000 )    |
| Accounts payable   | 47,000  | 349,000      |
| Accrued expenses   | (3,000 )                                      | (43,000 )    |
| Interest on customer deposits  | -   | 1,000        |
| Deferred revenue   | (9,000 )                                      | (20,000 )    |
| Net cash used by operating activities  | 88,000  | (4,000 )     |
| Cash flows from investing activities   |   |              |
| Acquisition of fixed assets  | (6,000 )                                      | (10,000 )    |
| Capital lease  | -   | -            |
| Net cash used by investing activities  | (6,000 )                                      | (10,000 )    |
| Cash flows from financing activities   |   |              |
| Proceeds from notes payable  | -   | 40,000       |
| Repayment of note payable  | -   | (58,000 )    |
| Repayment of principle under capital lease                                     | (9,000 )                                      | (10,000 )    |
| Net proceeds from the issuance of common stock                                 |   | 97,000       |
| Net cash provided by financing activities                                      | (9,000 )                                      | 69,000       |
| Net increase (decrease) in cash equivalents                                    | 73,000  | 55,000       |
| Cash equivalents - beginning   | 111,000                                       | 68,000       |
| Cash equivalents - ending  | \$184,000                                     | \$123,000    |
| Supplemental disclosures:  |   |              |
| Interest paid  | \$16,000                                      | \$14,000     |

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





New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

NOTE A – BASIS OF PRESENTATION

The interim 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 financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2009 and notes thereto included in the Company's Form 10-K. The Company follows the same accounting policies in the preparation of interim reports.

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

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

[1] Revenue recognition:

During the first nine months of 2010, the Company's revenues have been classified into three main categories: radiological services, software usage fees, and software hosting and maintenance. The Company began providing cardiology services during the second quarter of 2010. The Company also occasionally derives revenue from hardware sales associated with sales of our various software products, fees for customization or modification to our core software product, scanning services and other services such as consulting, training and installation. The Company recognizes revenue in accordance with Statement of Position ASC Topic 985 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, software maintenance, upgrade and support arrangements. 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 the Financial Statements  
(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[1] 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 has neither the right nor the ability to operate the software on its own.

Should the sale of 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 FASB ASC Topic 605, 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 FASB ASC Topic 450. 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 September 30, 2010 and September 30, 2009, there were no custom software development arrangements in progress.

The Company also occasionally derives revenue from the sale of third party hardware, which is billed as a separate deliverable under consulting or custom development contracts. Revenue from radiological services, cardiological services, software installation, and any training or consulting services is recognized when the services are rendered. These revenues 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.

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

The application of ASC 605, as amended, requires judgment, including a determination that collectibility is probable and the fee is fixed and determinable.

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.

New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[1] Revenue recognition (continued):

The cost of services, consisting of staff payroll, radiologists' fees, outside services, professional licenses and insurance, communication costs and supplies, is expensed as incurred.

[2] 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 September 30, 2010, the Company had no cash and cash equivalents that exceeded federally insured limits.

[3] 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 \$47,000 and \$42,000 at September 30, 2010 and 2009, 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, amounted to \$0 and \$2,000 for the nine months ended September 30, 2010 and 2009, respectively.

[4] 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.

[5] 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 3,068,500 and 5,166,545 shares of common stock have been excluded from the diluted loss per share calculation for the nine months ended September 30, 2010 and 2009, respectively, because inclusion of such would be antidilutive.

[6] Advertising expenses:

The Company expenses advertising costs which consist primarily of direct mailings, promotional items and print media, as incurred. Advertising expenses amounted to \$5,000 and \$0 for the nine months ended September 30, 2010 and 2009, respectively.

New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[7] 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.

[8] Stock-based compensation:

The Company adopted ASC Topic 505, Share-Based Payment, effective January 1, 2006. ASC 505 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 0 and 0 option awards granted to employees and directors in the quarters ended September 30, 2010 and 2009, respectively. During the nine months ended September 30, 2010 and 2009, the Company did not have expenses related to option grants to employees and directors.

[9] 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 life which is estimated to be two years. There were no capitalized software development costs as of September 30, 2010 and 2009.

[10] Recent pronouncements:

The Company's management has reviewed recent accounting pronouncements issued through the date of the issuance of these financial statements. In management's opinion, except for the pronouncement detailed below, no other pronouncements apply or will have a material effect on the Company's financial statements.

In May 2009, the FASB issued ASC 855 Subsequent Events, which establishes principles and requirements for subsequent events. In accordance with the provisions of ASC 855, the Company currently evaluates subsequent events through the date the financial statements are available to be issued."

NOTE C – 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 \$14,827,000 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 financial statements of the Company do not include any adjustments that may result from the outcome of these aforementioned uncertainties.

New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

## NOTE D - FURNITURE, EQUIPMENT, AND IMPROVEMENTS

Furniture, equipment, and improvements as of September 30, 2010, consisted of the following:

|                                   | 2010       | 2009       |
|-----------------------------------|------------|------------|
| Computers                         | 426,000    | 421,000    |
| Furniture, fixtures and equipment | 122,000    | 121,000    |
| Automobiles                       | 41,000     | 41,000     |
| Leasehold improvements            | 20,000     | 20,000     |
|                                   | 609,000    | 603,000    |
| Accumulated depreciation          | (558,000 ) | (528,000 ) |
|                                   | \$51,000   | \$75,000   |

Depreciation expense for the nine months ended September 30, 2010 and 2009 was \$14,000 and \$25,000, respectively.

## NOTE E – CAPITAL TRANSACTIONS

Common stock:

During the nine-month period ended September 30, 2010, the Company effected the following stock transactions:

The Company issued a total of 857,142 shares of the Company's \$0.001 par value common stock to outside contractors in exchange for services rendered of \$30,000.

The Company issued a total of 8,000,000 shares of the Company's \$0.001 par value common stock to directors valued at \$120,000 in return for services during 2010 and 2011. At September 30, 2010, \$45,000 of the compensation has been earned. The remaining \$75,000 is included in deferred compensation.

Warrants:

During the nine-month period ended September 30, 2010, there were no warrants issued and none were exercised.

The following is a summary of warrants outstanding as of September 30, 2010:

| Number of<br>Warrants | Exercise<br>Price | Expiration<br>Date |
|-----------------------|-------------------|--------------------|
| 700,000               | \$ 0.15           | June 29,<br>2011   |
| 700,000               | \$ 0.15           |                    |

All warrants outstanding as of September 30, 2010 are exercisable.

Stock options:

Stock options employees and directors – During the nine months ended September 30, 2010 and 2009, the Company made no grants of stock options to employees or directors.

Stock options non-employees and directors – During the nine months ended September 30, 2010 and 2009, the Company made no grants of stock options for services.

New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

## NOTE E – CAPITAL TRANSACTIONS (CONTINUED)

Stock options (Continued):

Exercise prices and weighted-average contractual lives of stock options outstanding as of September 30, 2010, are as follows:

| Exercise Prices | Options Outstanding |                                   | Weighted Average Exercise Prices | Options Exercisable |                                 |
|-----------------|---------------------|-----------------------------------|----------------------------------|---------------------|---------------------------------|
|                 | Number Outstanding  | Weighted Average Contractual Life |                                  | Number Exercisable  | Weighted Average Exercise Price |
| \$ 0.01-\$0.049 | 12,500,000          | 6.11                              | \$ 0.03                          | 12,500,000          | \$ 0.03                         |
| \$ 0.05-\$0.30  | 1,768,500           | 2.10                              | \$ 0.06                          | 1,768,500           | \$ 0.06                         |
| \$ 0.31-\$0.50  | 100,000             | 0.50                              | \$ 0.39                          | 100,000             | \$ 0.39                         |

Summary of Options Granted and Outstanding:

|                                  | For the nine months ended September 30, 2010 |                                 | For the nine months ended September 30, 2009 |                                 |
|----------------------------------|--|---------------------------------|--|---------------------------------|
|                                  | Shares                                       | Weighted Average Exercise Price | Shares                                       | Weighted Average Exercise Price |
| Options:                         |  |                                 |  |                                 |
| Outstanding at beginning of year | 14,489,250                                   | \$0.04                          | 14,805,000                                   | \$0.04                          |
| Granted                          | -  | -                               | -  | -                               |
| Cancelled                        | (120,750 )                                   | \$0.06                          | (250,000 )                                   | \$0.09                          |
| Exercised                        | -  | -                               | -  | -                               |
| Outstanding at end of period     | 14,368,500                                   | \$0.04                          | 14,555,000                                   | \$0.04                          |

## NOTE F - MAJOR CUSTOMERS

During the nine-month period ended September 30, 2010, one customer accounted for 29% or approximately \$755,000 of the Company's revenue.

As of September 30, 2010, balances due from one customer comprised 27% or approximately \$220,000 of total accounts receivable.



New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

## NOTE G - REPORTABLE SEGMENTS

Management has identified the Company's reportable segments based on separate lines of business. New Mexico Software (NMS) derives revenues from the development and marketing proprietary internet technology-based software and Telerad Service (TRS) provides radiological services. Information related to the Company's reportable segments for the nine months ended September 30, 2010 is as follows:

|                            | 2010        |             |             | 2009        |             |             |
|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
|                            | NMS         | TRS         | TOTAL       | NMS         | TRS         | TOTAL       |
| Revenue                    | \$390,000   | \$2,206,000 | \$2,596,000 | \$521,000   | \$2,198,000 | \$2,719,000 |
| Cost of services           | 164,000     | 1,800,000   | 1,964,000   | 204,000     | 1,801,000   | 2,005,000   |
| General and administrative | 277,000     | 322,000     | 609,000     | 362,000     | 405,000     | 767,000     |
| Depreciation               | 10,000      | 4,000       | 14,000      | 21,000      | 4,000       | 25,000      |
| Research and development   | 43,000      | 0           | 43,000      | 46,000      | 0           | 30,000      |
| Operating income (loss)    | \$(104,000) | \$70,000    | \$(34,000)  | \$(112,000) | \$(12,000)  | \$(124,000) |
| Total assets               | \$386,000   | \$647,000   | \$1,033,000 | \$254,000   | \$639,000   | \$893,000   |

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

|                          | 2010         | 2009          |
|--------------------------|--------------|---------------|
| Segment's operating loss | \$( 34,000 ) | \$( 124,000 ) |
| Other income (expense)   | 5,000        | ( 15,000 )    |
| Consolidated net loss    | \$( 29,000 ) | \$( 139,000 ) |

## NOTE H – COMMITMENTS AND CONTINGENCIES

## Leases:

The Company leases office space in New Mexico expiring on April 30, 2014. The Company also leases one automobile which expires in September 2011, as well as computer equipment with lease expiration dates ranging from March 2010 to December 2010. Future minimum lease payments as of September 30, 2010, are as follows:

| Year | Amount |
|------|--------|
| 2010 | 15,000 |
| 2011 | 58,000 |
| 2012 | 57,000 |
| 2013 | 59,000 |
| 2014 | 20,000 |

Rent expense for the nine months ended September 30, 2010 and 2009 amounted to \$50,000 and 45,000, respectively.



New Mexico Software, Inc.  
Notes to the Financial Statements  
(Unaudited)

NOTE I – LEGAL PROCEEDINGS

On February 18, 2009, Premier Medical Enterprise Solutions, Inc. (“Premier”) filed a complaint in the Federal District Court in Albuquerque against us and our chief executive officer. Premier has been a customer of our XR-EXpress application. The complaint alleges among other things breaches of (i) fiduciary duty, (ii) covenant of good faith and fair dealing and (iii) contract, along with claims of conversion and tortious interference and seeks an accounting. The suit seeks compensatory, punitive and exemplary damages in excess of \$75,000, together with injunctive relief against unfair competition and attorney’s fees. The case is Premier Medical Enterprise Solutions, Inc. v. New Mexico Software, Inc. and Richard Govatski, Case No. Civ – 09 – 165.

At the time suit was filed, we were making demand for payment of past due invoices and had given notice of termination of the agreement with Premier for nonpayment. On March 9, 2009, we filed our Answer and Counterclaims for breach of contract, demanding payment in full for past due amounts owed and ongoing charges, attorney’s fees and costs and for Declaratory Judgment asserting that we properly terminated the Agreement with Premier for breach of contract, nonpayment and as a result of other misconduct by Premier. The Company has also asserted a counterclaim for money owed and malicious abuse of process. We believe the suit by Premier is without merit and are vigorously contesting the claims of Premier. We also intend to vigorously pursue our affirmative claims against Premier. The Court granted partial summary judgment to the Company on certain claims.

Trial was set to commence November 15, 2010, to resolve all remaining issues except for the Company’s malicious abuse of process claim, which was held in abeyance pending resolution of the underlying claims. Trial was cancelled because Premier filed for bankruptcy in the Middle District of Florida on November 11, 2010. The Company is now exploring its options regarding this new development.

NOTE J – COMMITMENTS AND CONTINGENCIES

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 \$40,000 is included in general and administrative expenses for the nine months ended September 30, 2010. The non-competition agreement commences upon the termination of the employment agreement for a period of one year. At September 30, 2010, there was a total of \$0 in accrued payroll for this executive.

NOTE K – SUBSEQUENT EVENTS

In November 2010, the Board of Directors approved the issuance of 1,500,000 shares of the Company’s \$0.001 par value common stock as employee bonuses in the amount of \$53,000, and 285,700 shares of the Company’s \$0.001 par value common stock to one radiologist in payment of future services.





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

### OVERVIEW

New Mexico Software provides Software-as-a-Service (SaaS) solutions for a wide variety of industries. We offer our services via our web-based technology that allows our customers in any type of commercial business and not-for-profit organization to optimize their operations without spending significant time and money on upfront costs for hardware, software, tech support and training.

Our medical division continues to provide significant growth opportunities for us. Because of the potential opportunities in telemedicine (including teleradiology, telecardiology, video and nuclear medicine) as health care reform is pursued in the country, we will continue to focus the majority of our marketing efforts toward growing our business in these areas during the remainder of 2010 and into 2011. We believe that we can continue to take advantage of the growth in the telemedicine market during the next few years to further expand our customer base and our revenues.

Through September 30, 2010, we have realized revenues from three primary sources:

1. radiological services
2. software usage fees
3. software hosting and maintenance services

In addition, we are continuing to expand both our software services and our medical services into a variety of areas:

- We began providing telecardiology services during the first quarter of 2010.
- We began providing nuclear scans during the third quarter of 2010.
- We completed programming for our Remote Dicom to Dicom Server (RDDS) during the third quarter of 2010, which provides communication between dissimilar PACS systems (Picture Archiving Communications Systems) within organizations. We anticipate that revenues from this service will begin during the fourth quarter of 2010.
- We expect to be adding Telemed Video (providing video services for remote diagnosis), as well as services for orthopedics and ophthalmology during the next six months.

We also occasionally realize revenues from the sale of customized software, hardware sales associated with the sales of our software products, custom programming services, scanning services and from other services.

Telerad Service began operations in May 2008 as a radiological services business and a wholly-owned subsidiary of New Mexico Software, Inc. We continue to add new customers each quarter for this service.

The gross profit percentage of our medical division increased to 20% during the third quarter of 2010, providing a year-to-date gross profit of 19%. The overall gross profit for the company increased to 25% during the third quarter of 2010 from 24% during the second quarter of 2010, providing a year-to-date gross profit for the company of 24%. Our normal operating expenses (including depreciation, R&D and interest expense, but not including cost of services or legal fees related to the legal proceedings described in Part II, Item 1 below) continue to range from \$200,000 to \$250,000 per quarter.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires our management to make certain estimates and assumptions that affect the reported amounts of assets

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

## Revenue Recognition

With each sale of our enterprise-level hosted software 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. Software usage comprises any charges for actual usage of our software.

Currently, software usage consists primarily of XR-EX report fees and IMedCon case fees.

Our software recognition policies are in accordance with the ASC Topic 985, 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 ASC Topic 605, 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. Revenue from radiological services, software installation, training and consulting services is recognized when the services are rendered.

## Software Development Costs

We account for software development costs in accordance with ASC Topic 985, Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed. Product research and development expenses consist primarily of personnel, outside consulting and related expenses for development, and systems personnel and consultants and are charged to operations as incurred until technological feasibility is established. The Company considers technological feasibility to be established when all planning, designing, coding and testing have been completed to design specifications. After technological feasibility is established, costs are capitalized. Historically, product development has been substantially completed with the establishment of technological feasibility and, accordingly, no costs have been capitalized.

See Note B to the Company's Consolidated Financial Statements for a full discussion of the Company's critical accounting policies and estimates.

## RESULTS OF OPERATIONS

### Revenues:

For the Quarter Ended September 30,

| 2010      | 2009      | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|-----------|-----------|------------------------|----------------------|---|
| \$913,000 | \$908,000 | \$ 5,000               | 0.6                  | % |

For the Nine Months Ended September 30,

| 2010        | 2009        | Increase<br>(Decrease) | Percent<br>Inc (Dec) |
|-------------|-------------|------------------------|----------------------|
| \$2,596,000 | \$2,719,000 | \$ (123,000 )          | (4.5 )%              |

These changes are a result of the following factors:

1. Radiological services:

For the Quarter Ended September 30,

| 2010      | 2009      | Increase<br>(Decrease) | Percent<br>Inc (Dec) |
|-----------|-----------|------------------------|----------------------|
| \$783,000 | \$761,000 | \$ 22,000              | 2.9 %                |

For the Nine Months Ended September 30,

| 2010        | 2009        | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|-------------|-------------|------------------------|----------------------|---|
| \$2,202,000 | \$2,197,000 | \$ 5,000               | 0.2                  | % |

The increase in radiological services revenue during both the third quarter and the year-to-date 2010 is due to a net increase in customers during 2010. During the first nine months of 2009, we provided reads for 32 customers, generating approximately 450 reports per customer per month. During the first nine months of 2010, we provided reads for 40 customers, generating approximately 370 reports per customer per month. Therefore, the total number of cases has increased during 2010 as compared to 2009, but they are spread among an increased number of customers.

## 2. Software usage fees:

For the Quarter Ended September 30,

| 2010     | 2009     | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|----------|----------|------------------------|----------------------|---|
| \$94,000 | \$89,000 | \$ 5,000               | 5.6                  | % |

For the Nine Months Ended September 30,

| 2010      | 2009      | Increase<br>(Decrease) | Percent<br>Inc (Dec) |    |
|-----------|-----------|------------------------|----------------------|----|
| \$282,000 | \$323,000 | \$ (41,000 )           | (12.7                | )% |

Software usage fees consist of charges for the use of our XR-Express software. The increase for the third quarter of 2010 as compared to the third quarter of 2009 is primarily the result of a net increase in XR-Express users during the third quarter of 2010. The decrease for the first nine months of 2010 as compared to the first nine months of 2009 is primarily due to the termination of services to the customer involved in the lawsuit described in Part II, Item 1 below. We continue to add new XR-EXpress customers, but the rate of growth slowed significantly during 2009 and the first half of 2010. We expect these revenues to remain stable or even decline slightly during the remainder of 2010, as we continue to focus on the addition of our new telemedicine services.

## 3. Software hosting and maintenance:

For the Quarter Ended September 30,

| 2010     | 2009     | Increase<br>(Decrease) | Percent<br>Inc (Dec) |    |
|----------|----------|------------------------|----------------------|----|
| \$26,000 | \$53,000 | \$ (27,000 )           | (50.9                | )% |

For the Nine Months Ended September 30,

| 2010     | 2009      | Increase<br>(Decrease) | Percent<br>Inc (Dec) |    |
|----------|-----------|------------------------|----------------------|----|
| \$99,000 | \$169,000 | \$ (70,000 )           | (41.4                | )% |

This decrease is the result of our continued focus on our medical division and our decreased focus on our older enterprise-level software applications that were developed prior to DFC3 and XR-EXpress. This shift in focus has resulted in a net decrease in customers for whom we provide hosting services during 2010. Software maintenance consists mainly of hosting and managing our customers' data on our systems, and to a lesser extent includes technical support programs associated with our products. We expect revenues in this category to continue to decrease during 2010, as we continue to focus our efforts on growing our medical division.

## 4. Software sales and licenses:

For the Quarter Ended September 30,

| 2010 | 2009 | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|------|------|------------------------|----------------------|---|
| \$0  | \$0  | \$ 0                   | 0.0                  | % |

For the Nine Months Ended September 30,

| 2010    | 2009 | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|---------|------|------------------------|----------------------|---|
| \$2,000 | \$0  | \$ 2,000               | 100.0                | % |

The increase in software sales and license revenue is the result of a recurring license fee for one customer during the first quarter of 2010. At this time, we do not anticipate any software sales during the remainder of 2010.

## 5. Cardiology services:

For the Quarter Ended September 30,

| 2010     | 2009 | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|----------|------|------------------------|----------------------|---|
| \$10,000 | \$0  | \$ 10,000              | 100.0                | % |

For the Nine Months Ended September 30,

| 2010     | 2009 | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|----------|------|------------------------|----------------------|---|
| \$11,000 | \$0  | \$ 11,000              | 100.0                | % |

Our telecardiology service began preliminary operations during the first quarter of 2010. We have added new cardiology customers each quarter since beginning operations.

## 5. Custom programming and scanning revenues:

For the Quarter Ended September 30,

|                    | 2010 | 2009     | Increase<br>(Decrease) | Percent Inc<br>(Dec) |   |
|--------------------|------|----------|------------------------|----------------------|---|
| Custom programming | \$ 0 | \$ 5,000 | \$ (5,000 )            | (100.0 )             | % |
| Scanning services  | \$ 0 | \$ 0     | \$ 0                   | 0                    | % |

- The decrease in custom programming revenue during the first nine months of 2010 is due to the continuing decrease in the number of custom programming projects. Since we have reduced our focus on sales of enterprise-level systems requiring substantial customization, no custom programming projects have been requested by customers. We will have one custom programming project for a new customer during the fourth quarter of 2010; however, we do not anticipate other significant revenues in this category in the coming months.
-



We had one major scanning project in early 2009, and no scanning projects during the first nine months of 2010. Although we still offer scanning, we are not emphasizing this service, so we do not anticipate any major projects in the future.

Cost of services:

For the Quarter Ended September 30,

| 2010      | 2009      | Increase<br>(Decrease) | Percent<br>Inc (Dec) |   |
|-----------|-----------|------------------------|----------------------|---|
| \$681,000 | \$674,000 | \$ 7,000               | 1.0                  | % |

For the Nine Months Ended September 30,

| 2010        | 2009        | Increase<br>(Decrease) | Percent<br>Inc (Dec) |    |
|-------------|-------------|------------------------|----------------------|----|
| \$1,964,000 | \$2,005,000 | \$ (41,000 )           | (2.0                 | )% |

Approximately 90% of the cost of services is related to Telerad Service. These costs consist of doctor fees, management fees, professional credentialing and professional liability insurance, as well as customer service staffing costs. Approximately 75% of the cost of services is directly related to revenues. As a result, this cost category will tend to mirror the increases and decreases in revenues, which is the primary reason for the decrease in cost of services for the first nine months of 2010 as compared to the first nine months of 2009. We expect the cost of services to increase in the fourth quarter and in 2011 as revenues increase.

General and administrative expenses:

For the Quarter Ended September 30,

|                    | 2010       | 2009       | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|--------------------|------------|------------|------------------------|----------------------|
| Legal expenses     | \$ 9,000   | \$ 81,000  | \$ (72,000 )           | (88.9 )%             |
| Other G&A expenses | \$ 187,000 | \$ 184,000 | \$ 3,000               | 1.6 %                |

For the Quarter Ended September 30,

|                    | 2010       | 2009       | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|--------------------|------------|------------|------------------------|----------------------|
| Legal expenses     | \$ 9,000   | \$ 81,000  | \$ (72,000 )           | (88.9 )%             |
| Other G&A expenses | \$ 187,000 | \$ 184,000 | \$ 3,000               | 1.6 %                |

For the Nine Months Ended September 30,

|                    | 2010       | 2009       | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|--------------------|------------|------------|------------------------|----------------------|
| Legal expenses     | \$ 93,000  | \$ 157,000 | \$ (64,000 )           | (40.8 )%             |
| Other G&A expenses | \$ 516,000 | \$ 610,000 | \$ (94,000 )           | (15.4 )%             |

Approximately \$81,000 of the decrease in other G&A expenses for the first nine months of 2010 as compared to the first nine months of 2009 is due to sales and marketing staffing reductions since mid-2009, and the remainder is primarily due to reductions in accounting fees during 2010. We expect this category to remain relatively stable during the coming months. The variances in legal expenses are due to the timing of actions during 2009 and 2010 in the legal proceedings described in Part II, Item 1 below.

Research and development costs:

For the Quarter Ended September 30,

| 2010     | 2009     | Increase<br>(Decrease) | Percent<br>Inc (Dec) |
|----------|----------|------------------------|----------------------|
| \$17,000 | \$15,000 | \$ 2,000               | 33.3 %               |

For the Nine Months Ended September 30,

| 2010 | 2009 | Increase<br>(Decrease) | Percent<br>Inc (Dec) |
|------|------|------------------------|----------------------|
|------|------|------------------------|----------------------|

\$43,000    \$46,000    \$ (3,000 )    (6.5 )%

The increase in research and development costs during the third quarter of 2010 as compared to the third quarter of 2009 is due to the purchase of engineering supplies. The decrease for the first nine months of 2010 as compared to the first nine months of 2009 is due to our increased focus on existing customers and services during 2010.

During the first nine months of 2010, over 90% of our research and development costs were directly associated with staffing. In the software industry it is common for research and development costs to be ongoing, since development of the next version of the software begins as soon as the current version is completed. In addition, we are constantly developing new applications for our existing software that require modification. Management anticipates that research and development costs in the future will focus both on the upgrading of our existing products and the continued development of new products using our core technology; therefore they will remain relatively steady during the coming year.

## Depreciation:

For the Quarter Ended September 30,

|                      | 2010     | 2009     | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|----------------------|----------|----------|------------------------|----------------------|
| Depreciation expense | \$ 4,000 | \$ 8,000 | \$ (4,000 )            | (50.0 )%             |

For the Nine Months Ended September 30,

|                      | 2010      | 2009      | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|----------------------|-----------|-----------|------------------------|----------------------|
| Depreciation expense | \$ 14,000 | \$ 25,000 | \$ (11,000 )           | (44.0 )%             |

The decrease in depreciation expense is due to assets being fully depreciated during the first nine months of 2010.

## Other income (expense):

For the Quarter Ended September 30,

|                           | 2010     | 2009     | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|---------------------------|----------|----------|------------------------|----------------------|
| Interest income           | \$ 0     | \$ 4,000 | \$ (4,000 )            | (100.0 )%            |
| Gain on sale of inventory | \$ 0     | \$ 0     | \$ 0                   | 0 %                  |
| Interest expense          | \$ 4,000 | \$ 8,000 | \$ (4,000 )            | (50.0 )%             |
| Inventory revaluation     | \$ 0     | \$ 6,000 | \$ (6,000 )            | (100.0 )%            |

For the Nine Months Ended September 30,

|                           | 2010      | 2009      | Increase<br>(Decrease) | Percent Inc<br>(Dec) |
|---------------------------|-----------|-----------|------------------------|----------------------|
| Interest income           | \$ 15,000 | \$ 17,000 | \$ (2,000 )            | (11.8 )%             |
| Gain on sale of inventory | \$ 1,000  | \$ 0      | \$ 1,000               | 100.0 %              |
| Interest expense          | \$ 11,000 | \$ 22,000 | \$ (11,000 )           | (50.0 )%             |
| Inventory revaluation     | \$ 0      | \$ 10,000 | \$ (10,000 )           | (100.0 )%            |

- The decrease in interest income during the third quarter and the first nine months of 2010 is primarily related to the decrease in interest charges on the past-due balance of the customer account associated with the legal proceedings described in Part II, Item 1 below due to the termination of that account in mid-2010.
- The inventory revaluation expense is due to the write-down of obsolete inventory during 2009. During the second quarter of 2010, we sold some of that inventory, resulting in the gain on sale of inventory income.
- The decrease in interest expense is due to fewer past-due obligations during the first nine months of 2010 as compared to the first nine months of 2009 as our cash flow has improved.

## REPORTABLE SEGMENTS

We have identified the our reportable segments based on separate lines of business. New Mexico Software (NMS) derives revenues from the development and marketing proprietary internet technology-based software and Telerad

Service (TRS) provides radiological and other medical diagnostic services. Information related to our reportable segments for the nine months ended September 30, 2010 is as follows:

|                            | 2010        |             |             | 2009        |             |             |
|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
|                            | NMS         | TRS         | TOTAL       | NMS         | TRS         | TOTAL       |
| Revenue                    | \$390,000   | \$2,206,000 | \$2,596,000 | \$521,000   | \$2,198,000 | \$2,719,000 |
| Cost of services           | 164,000     | 1,800,000   | 1,964,000   | 204,000     | 1,801,000   | 2,005,000   |
| General and administrative | 277,000     | 322,000     | 609,000     | 362,000     | 405,000     | 767,000     |
| Depreciation               | 10,000      | 4,000       | 14,000      | 21,000      | 4,000       | 25,000      |
| Research and development   | 43,000      | 0           | 43,000      | 46,000      | 0           | 30,000      |
| Operating income (loss)    | \$(104,000) | \$70,000    | \$(34,000)  | \$(112,000) | \$(12,000)  | \$(124,000) |
| Total assets               | \$386,000   | \$647,000   | \$1,033,000 | \$254,000   | \$639,000   | \$893,000   |

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

|                          | 2010       | 2009        |
|--------------------------|------------|-------------|
| Segment's operating loss | \$(34,000) | \$(124,000) |
| Other income (expense)   | 5,000      | (15,000)    |
| Consolidated net loss    | \$(29,000) | \$(139,000) |

## LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2010, cash and cash equivalents totaled \$184,000, representing a \$73,000 increase from December 31, 2009. The increase in available cash was due to the following factors during the period:

Operating activities:

For the Nine Months Ended September 30,

| 2010              | 2009         | Inc (Dec) in available cash |
|-------------------|--------------|-----------------------------|
| provided \$88,000 | used \$4,000 | \$92,000                    |

The increase in available cash from operations during the first nine months of 2010 as compared to the first nine months of 2009 is mainly due to a combination of the following factors:

- a \$48,000 decrease in available cash due to a reduction in stock issued for salaries and services during the first nine months of 2010 as compared to the first nine months of 2009. The reduction in stock issuances is mainly due to improved cash flow during 2010.
- a \$264,000 increase in available cash due to an increase in accounts receivable of \$19,000 during the first nine months of 2010 as compared to an increase of \$283,000 during the first nine months of 2009. The increase during the first nine months of 2009 was primarily due to the addition of several large new radiology customers, and the decrease during the first half of 2010 is primarily due to the loss of two major radiology customers. One of these was a middleman customer that is no longer providing mobile radiology services; during the third quarter we contracted directly with most of their mobile radiology end users.
- a \$262,000 decrease in available cash due to the net increase in accounts payable and accrued expenses of \$44,000 during the first nine months of 2010 as compared to an increase of \$306,000 during the first nine months of

2009. The increase during the first nine months of 2009 is primarily due to increased radiologist fees as a result of new teleradiology customers. Radiologist fees comprise approximately 60% of our accounts payable. Since radiologist fees vary directly with revenue, this relationship will cause our accounts payable balance to vary with accounts receivable to a certain extent.

- offset by a \$110,000 increase in available cash due to the reduction in net loss for the first nine months of 2010 as compared to the first nine months of 2009.

## Investing activities:

For the Nine Months Ended September 30,

| 2010         | 2009          | Inc (Dec) in available cash |
|--------------|---------------|-----------------------------|
| used \$6,000 | used \$10,000 | \$4,000                     |

We purchased \$6,000 of computer equipment during the first nine months of 2010 as compared to leasing and purchasing \$10,000 of computer equipment during the first nine months of 2009.

## Financing activities:

For the Nine Months Ended September 30,

| 2010         | 2009              | Inc (Dec) in available cash |
|--------------|-------------------|-----------------------------|
| used \$9,000 | provided \$69,000 | \$(78,000)                  |

This decrease is primarily due to the decrease in proceeds from issuance of shares during the first nine months of 2010 as compared to the first nine months of 2009.

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, computer equipment and a vehicle.

At September 30, 2010, we had a working capital surplus of \$199,000 as opposed to a working capital surplus of \$140,000 at the beginning of the period, an increase of \$59,000. This increase is primarily due to a \$19,000 increase in accounts receivable, offset by a \$50,000 increase in accounts payable during the first nine months of 2010, coupled with a \$73,000 increase in cash on hand at the end of the period. 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. Our monthly recurring revenues remain at approximately \$300,000 per month during the first nine months of 2010. Although our cash flow has improved during 2010, we may continue to experience some cash flow shortages. Although we anticipate meeting our operating cash flow needs entirely from the increased revenues, we may continue to sell equity securities and incur debt as needed to meet our operating needs during the remainder of 2010 and during 2011.

We anticipate that our primary uses of cash in the next year will continue to be for general operating purposes and to expand our cardiology and nuclear diagnostic services and to add video services. We anticipate that our operating cash requirements for the next twelve months will continue to be in the range of \$3,500,000 to \$5,000,000. This level of cash flow will allow us to maintain our current level of operations and introduce our new services, and we expect the revenues from operations to provide the necessary operating funds. Our goal for 2010 remains to consistently generate operating profits in each quarter. We expect the upward trend in recurring revenues to continue in 2010 and 2011 as we continue to add new radiological customers as well as customers for our new services.

## OFF-BALANCE SHEET ARRANGEMENTS

We currently have no off-balance sheet arrangements.



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 i makes in this report are reasonable, because forward-looking statements involve future risks and uncertainties, there are factors that could cause actual results to differ materially from those expressed or implied. For example, a few of the uncertainties that could affect the accuracy of forward-looking statements include the following:

- Rapid changes in technology relating to the Internet
- Continued growth and use of the Internet
- Changes in government regulations
- Changes in our business strategies
- Hardware failure of a catastrophic proportion
- Terrorist interference with the operation of the Internet or effects of terrorist activities on the economy
- Difficulty recruiting and retaining staff of sufficient technical caliber to provide adequate and on-going customer support and product maintenance and development
  - Failure to successfully market our products through the Internet and our representatives
  - Inability to locate sources to retire our line of credit or to obtain alternative lending sources
    - Inability to solve cash flow problems

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

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

### Item 4T. CONTROLS AND PROCEDURES

307 – Disclosure controls and procedures: As of September 30, 2010, we carried out an evaluation of the effectiveness of our disclosure controls and procedures, with the participation of our principal executive and principal financial officers. Disclosure controls and procedures are defined in Exchange Act Rule 15d-15(e) as “controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the 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 [and] include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.” Based on our evaluation, our President/Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2010, such disclosure controls and procedures were not effective. The primary reasons for management’s conclusions are that we did not have a plan in place for implementing controls and procedures and insufficient personnel to implement checks and balances. We believe that we will not have sufficient funds available to develop a plan in the foreseeable future. We do not anticipate that our business will need sufficient personnel in the foreseeable future that are needed to implement checks and balances.

308T(b) – Changes in internal control over financial reporting: Based upon an evaluation by our management of our internal control over financial reporting, with the participation of our principal executive and principal financial officers, there were no changes made in our internal control over financial reporting during the quarter ended September 30, 2010 that have materially affected or are reasonably likely to materially affect this control.

Limitations on the Effectiveness of Internal Control: Our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because

of the inherent limitations on all internal control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake.

Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, and/or by management override of the control. The design of any system of internal control is also based in part upon certain assumptions about risks and the likelihood of future events, and there is no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in circumstances and the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective internal control system, financial reporting misstatements due to error or fraud may occur and not be detected on a timely basis.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

On February 18, 2009, Premier Medical Enterprise Solutions, Inc. (“Premier”) filed a complaint in the Federal District Court in Albuquerque against us and our chief executive officer. Premier has been a customer of our XR-EXpress application. The complaint alleges among other things breaches of (i) fiduciary duty, (ii) covenant of good faith and fair dealing and (iii) contract, along with claims of conversion and tortious interference and seeks an accounting. The suit seeks compensatory, punitive and exemplary damages in excess of \$75,000, together with injunctive relief against unfair competition and attorney’s fees. The case is Premier Medical Enterprise Solutions, Inc. v. New Mexico Software, Inc. and Richard Govatski, Case No. Civ – 09 – 165.

At the time suit was filed, we were making demand for payment of past due invoices and had given notice of termination of the agreement with Premier for nonpayment. On March 9, 2009, we filed our Answer and Counterclaims for breach of contract, demanding payment in full for past due amounts owed and ongoing charges, attorney’s fees and costs and for Declaratory Judgment asserting that we properly terminated the Agreement with Premier for breach of contract, nonpayment and as a result of other misconduct by Premier. The Company has also asserted a counterclaim for money owed and malicious abuse of process. We believe the suit by Premier is without merit and are vigorously contesting the claims of Premier. We also intend to vigorously pursue our affirmative claims against Premier. The Court granted partial summary judgment to the Company on certain claims.

Trial was set to commence November 15, 2010, to resolve all remaining issues except for the Company’s malicious abuse of process claim, which was held in abeyance pending resolution of the underlying claims. Trial was cancelled because Premier filed for bankruptcy in the Middle District of Florida on November 11, 2010. The Company is now exploring its options regarding this new development.

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

The following table sets forth information about our unregistered sales of common stock during the nine months ended September 30, 2010:

| Class of Purchaser | Aggregate Number of Shares |
|--------------------|----------------------------|
| Vendors (1)        | 285,714                    |
| Doctors (2)        | 571,428                    |
| Directors (3)      | 8,000,000                  |

(1) The shares listed above were issued in return for services valued at \$10,000.

(2) The shares listed above were issued in return for cash totaling \$20,000.

(3) The shares listed above were issued in return for services totaling \$120,000.

We did not pay and to our knowledge no one acting on our behalf paid any commissions or other compensation with respect to the sales identified in the foregoing table. We made the sale directly to each purchaser for the consideration stated in the table. We used any cash proceeds and any cash which would have been used to pay bonuses and contractor fees, but for the issue of the shares, for working capital in payment of current obligations. Each purchaser acknowledged the investment nature of the transaction and a legend was placed on each certificate, prohibiting public resale of the shares, except in compliance with Rule 144. We believe each purchaser has either (a) such relationship with us or (b) such knowledge and experience in business and financial transactions that he or she is able to understand and evaluate the risks and merits of investment in our common stock. We relied upon the exemption from the registration requirement of the Securities Act of 1933, as amended (the "Act") provided in Section 4(2) of the Act and the rules and regulations thereunder, on grounds that these sales did not involve a public offering within the meaning of the Act.

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

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

SIGNATURES

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

NEW MEXICO SOFTWARE, INC.

Date: November 12, 2010

By /s/ Richard F. Govatski  
Richard F. Govatski, President

Date: November 12, 2010

By /s/ Teresa B. Dickey  
Teresa B. Dickey, Treasurer (Principal Financial  
Officer)

