

INSIGNIA SYSTEMS INC/MN
Form 10-Q
May 10, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

for the quarterly period ended March 31, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
for the transition period from _____ to _____

Commission File Number: 1-13471

INSIGNIA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Minnesota

41-1656308
(IRS Employer Identification No.)

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(State or other jurisdiction of incorporation or organization)

**8799 Brooklyn Blvd.
Minneapolis, MN 55445**

(Address of principal executive offices)

(763) 392-6200

(Registrant's telephone number, including area code)

Not applicable.

(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 report(s), 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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

Number of shares outstanding of Common Stock, \$.01 par value, as of May 4, 2011, was 15,667,717.

Insignia Systems, Inc.

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Insignia Systems, Inc.
BALANCE SHEETS
(Unaudited)

| | March 31, 2011 | December 31, 2010 |
|--|---------------------------|------------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 90,240,000 | \$ 13,196,000 |
| Short-term investments | | 500,000 |
| Accounts receivable, net | 2,822,000 | 3,227,000 |
| Inventories | 433,000 | 414,000 |
| Deferred tax assets, net | 151,000 | 151,000 |
| Prepaid expenses and other | 658,000 | 360,000 |
| Total Current Assets | 94,304,000 | 17,848,000 |
| Other Assets: | | |
| Property and equipment, net | 928,000 | 975,000 |
| Non-current deferred tax assets, net | 166,000 | 6,581,000 |
| Other | 3,875,000 | 227,000 |
| Total Assets | \$ 99,273,000 | \$ 25,631,000 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | 2,152,000 | 2,335,000 |
| Dividend payable | 31,335,000 | |
| Income tax payable | 25,980,000 | |

| | | |
|---|----------------------|----------------------|
| Accrued liabilities | | |
| Compensation | 1,407,000 | 809,000 |
| Legal | 167,000 | 376,000 |
| Employee stock purchase plan | 49,000 | 170,000 |
| Retailer payments | 37,000 | 1,119,000 |
| Other | 284,000 | 400,000 |
| Deferred revenue | 159,000 | 134,000 |
| Total Current Liabilities | 61,570,000 | 5,343,000 |
| Long-Term Liabilities: | | |
| Accrued income taxes | 400,000 | |
| Accrued compensation | 800,000 | |
| Total Liabilities | 62,770,000 | 5,343,000 |
| Commitments and Contingencies | | |
| Shareholders Equity: | | |
| Common stock, par value \$.01: | | |
| Authorized shares - 40,000,000 | | |
| Issued and outstanding shares - 15,793,000 at March 31, 2011 and 15,847,000 at December 31, 2010 | 158,000 | 159,000 |
| Additional paid-in capital | 27,226,000 | 33,548,000 |
| Retained earnings (accumulated deficit) | 9,119,000 | (13,419,000) |
| Total Shareholders Equity | 36,503,000 | 20,288,000 |
| Total Liabilities and Shareholders Equity | \$ 99,273,000 | \$ 25,631,000 |

See accompanying notes to financial statements.

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Insignia Systems, Inc.
STATEMENTS OF OPERATIONS
(Unaudited)

| Three Months Ended March 31 | 2011 | 2010 |
|--|---------------|--------------|
| Services revenues | \$ 4,374,000 | \$ 5,137,000 |
| Products revenues | 573,000 | 746,000 |
| Total Net Sales | 4,947,000 | 5,883,000 |
| Cost of services | 2,543,000 | 2,436,000 |
| Cost of goods sold | 368,000 | 517,000 |
| Total Cost of Sales | 2,911,000 | 2,953,000 |
| Gross Profit | 2,036,000 | 2,930,000 |
| Operating Expenses: | | |
| Selling | 1,555,000 | 1,636,000 |
| Marketing | 414,000 | 395,000 |
| General and administrative | 2,026,000 | 1,347,000 |
| Gain from litigation settlement, net | (89,762,000) | |
| Total Operating Expenses | (85,767,000) | 3,378,000 |
| Operating Income (Loss) | 87,803,000 | (448,000) |
| Other Income (Expense): | | |
| Interest income | 21,000 | 18,000 |
| Interest expense | | (5,000) |
| Total Other Income | 21,000 | 13,000 |
| Income (Loss) Before Taxes | 87,824,000 | (435,000) |
| Income tax expense | (33,951,000) | |
| Net Income (Loss) | \$ 53,873,000 | \$ (435,000) |
| Net income (loss) per share: | | |
| Basic | \$ 3.37 | \$ (0.03) |
| Diluted | \$ 3.17 | \$ (0.03) |
| Shares used in calculation of net income (loss) per share: | | |
| Basic | 15,990,000 | 15,381,000 |
| Diluted | 16,986,000 | 15,381,000 |

See accompanying notes to financial statements.

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Insignia Systems, Inc.
STATEMENTS OF SHAREHOLDERS EQUITY
(Unaudited)

| | Common Stock | | Additional Paid-In Capital | Retained Earnings (Accumulated) Deficit) | Total |
|--|---------------------|---------------|---|---|---------------|
| | Shares | Amount | | | |
| <u>Three Months Ended March 31, 2011</u> | | | | | |
| Balance at December 31, 2010 | 15,847,000 | \$ 159,000 | \$ 33,548,000 | \$ (13,419,000) | \$ 20,288,000 |
| Issuance of common stock, net | 1,529,000 | 15,000 | 3,054,000 | | 3,069,000 |
| Repurchase of common stock, net | (1,583,000) | (16,000) | (10,656,000) | | (10,672,000) |
| Value of stock-based compensation | | | 145,000 | | 145,000 |
| Windfall tax benefit from share-based compensation | | | 1,135,000 | | 1,135,000 |
| Cash dividends, \$2.00 per share | | | | (31,335,000) | (31,335,000) |
| Net income | | | | 53,873,000 | 53,873,000 |
| Balance at March 31, 2011 | 15,793,000 | \$ 158,000 | \$ 27,226,000 | \$ 9,119,000 | \$ 36,503,000 |
| <u>Three Months Ended March 31, 2010</u> | | | | | |
| Balance at December 31, 2009 | 15,181,000 | \$ 152,000 | \$ 32,578,000 | \$ (21,045,000) | \$ 11,685,000 |
| Issuance of common stock, net | 333,000 | 3,000 | 635,000 | | 638,000 |
| Repurchase of common stock, net | (75,000) | (1,000) | (411,000) | | (412,000) |
| Value of stock-based compensation | | | 113,000 | | 113,000 |

Net loss (435,000) (435,000)

**Balance at March 31,
2010**

15,439,000 \$ 154,000 \$ 32,915,000 \$ (21,480,000) \$ 11,589,000

See accompanying notes to financial statements.

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Insignia Systems, Inc.
STATEMENTS OF CASH FLOWS
(Unaudited)

| Three Months Ended March 31 | 2011 | 2010 |
|--|---------------|--------------|
| Operating Activities: | | |
| Net income (loss) | \$ 53,873,000 | \$ (435,000) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 88,000 | 79,000 |
| Deferred income tax expense | 6,415,000 | □ |
| Windfall tax benefit | 1,135,000 | □ |
| Stock-based compensation | 145,000 | 113,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 405,000 | (229,000) |
| Inventories | (19,000) | (93,000) |
| Prepaid expenses and other | (3,946,000) | 125,000 |
| Accounts payable | (183,000) | (382,000) |
| Accrued liabilities | (130,000) | (1,223,000) |
| Income taxes | 25,245,000 | □ |
| Deferred revenue | 25,000 | (247,000) |
| Net cash provided by (used in) operating activities | 83,053,000 | (2,292,000) |
| Investing Activities: | | |
| Purchases of property and equipment | (41,000) | (198,000) |
| Purchases of investments | □ | (1,300,000) |
| Proceeds from sale of investments | 500,000 | 1,400,000 |
| Net cash provided by (used in) investing activities | 459,000 | (98,000) |
| Financing Activities: | | |
| Proceeds from issuance of common stock, net | 3,069,000 | 638,000 |
| Windfall tax benefit | 1,135,000 | □ |
| Repurchase of common stock, net | (10,672,000) | (412,000) |
| Net cash provided by (used in) financing activities | (6,468,000) | 226,000 |
| Increase (decrease) in cash and cash equivalents | 77,044,000 | (2,164,000) |
| Cash and cash equivalents at beginning of period | 13,196,000 | 8,797,000 |
| Cash and cash equivalents at end of period | \$ 90,240,000 | \$ 6,633,000 |

Supplemental disclosures for cash flow information:

| | | | | |
|--|----|------------|----|--------|
| Cash paid during period for income taxes | \$ | 12,000 | \$ | 40,000 |
| Dividend payable | | 31,335,000 | | □ |

Non-cash financing activities:

| | | | | |
|------------------------------|----|---------|----|---|
| Cashless exercise of options | \$ | 800,000 | \$ | □ |
|------------------------------|----|---------|----|---|

See accompanying notes to financial statements.

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Insignia Systems, Inc.

Notes To Financial Statements

(Unaudited)

1. Summary of Significant Accounting Policies.

Description of Business. Insignia Systems, Inc. (the Company) markets in-store advertising products, programs and services to consumer packaged goods manufacturers (customers) and retailers. The Company has been in business since 1990. The Company's products and services includes the Insignia POPSign® program, thermal sign card supplies for the Company's SIGNright and Impulse systems, Stylus software and laser printable cardstock and label supplies. Since 1998, the Company has been focusing on providing in-store services through the Insignia Point-of-Purchase Services (Insignia POPSign®) in-store advertising program.

Basis of Presentation. Financial statements for the interim periods included herein are unaudited; however, they contain all adjustments, including normal recurring accruals, which in the opinion of management, are necessary to present fairly the financial position of the Company at March 31, 2011, and its results of operations and cash flows for the three months ended March 31, 2011 and 2010. Results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year.

The financial statements do not include certain footnote disclosures and financial information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and, therefore, should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

The Summary of Significant Accounting Policies in the Company's 2010 Annual Report on Form 10-K describes the Company's accounting policies.

Inventories. Inventories are primarily comprised of parts and supplies for Impulse and SIGNright machines, sign cards, rollstock and POPSign supplies. Inventory is valued at the lower of cost or market using the first-in, first-out (FIFO) method, and consists of the following:

| | March 31, | | December 31, | |
|-----------------|------------------|---------|---------------------|---------|
| | 2011 | | 2010 | |
| Raw materials | \$ | 93,000 | \$ | 132,000 |
| Work-in-process | | 31,000 | | 25,000 |
| Finished goods | | 309,000 | | 257,000 |
| | \$ | 433,000 | \$ | 414,000 |

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Property and Equipment. Property and equipment consists of the following:

| | March 31, 2011 | December 31, 2010 |
|---|---------------------------|------------------------------|
| Property and Equipment: | | |
| Production tooling, machinery and equipment | \$ 2,346,000 | \$ 2,344,000 |
| Office furniture and fixtures | 258,000 | 258,000 |
| Computer equipment and software | 975,000 | 936,000 |
| Web site | 38,000 | 38,000 |
| Leasehold improvements | 351,000 | 351,000 |
| | 3,968,000 | 3,927,000 |
| Accumulated depreciation and amortization | (3,040,000) | (2,952,000) |
| Net Property and Equipment | \$ 928,000 | \$ 975,000 |

Stock-Based Compensation. The Company measures and recognizes compensation expense for all stock-based payments at fair value using the Black-Scholes option pricing model to determine the weighted average fair value of options and employee stock purchase plan rights. The Company recognizes stock-based compensation expense on a straight-line method over the requisite service period of the award.

There were no stock option awards granted during the three months ended March 31, 2011. The Company used the Black-Scholes option pricing model to estimate the fair value of stock-based rights granted during the three months ended March 31, 2011, under the employee stock purchase plan using the following weighted average assumptions: expected life of 1 year, expected volatility of 30%, dividend yield of 0% and risk-free interest rate of 0.30%. Total stock-based compensation expense recorded for the three months ended March 31, 2011 and 2010, was \$145,000 and \$113,000, respectively.

Dividend Payable. On February 22, 2011, the Board of Directors approved a special \$2.00 per common share dividend totaling \$31,335,000. The dividend was accrued at March 31, 2011, and paid on May 2, 2011.

Net Income (Loss) Per Share. Basic net income (loss) per share is computed by dividing net income by the weighted average shares outstanding and excludes any dilutive effects of options, warrants and convertible securities. Diluted net income (loss) per share gives effect to all diluted potential common shares outstanding during the period. Options and warrants to purchase approximately 315,000 and 438,000 shares of common stock with weighted average exercise

prices of \$8.80 and \$8.01 were outstanding at March 31, 2011 and 2010 and were not included in the computation of common stock equivalents for the three months ended March 31, 2011 and 2010 because their exercise prices were higher than the average fair market value of the common shares during the reporting period. During the three months ended March 31, 2010, the effect of options and warrants outstanding was anti-dilutive due to the net loss incurred during the period. Had net income been achieved, approximately 1,324,000 of common stock equivalents would have been included in the computation of diluted net income per share.

Weighted average common shares outstanding for the three months ended March 31, 2011 and 2010 were as follows:

| Three Months Ended March 31 | 2011 | 2010 |
|---|-------------|-------------|
| Denominator for basic net income (loss) per share - weighted average shares | 15,990,000 | 15,381,000 |
| Effect of dilutive securities: | | |
| Stock options and warrants | 996,000 | □ |
| Denominator for diluted net income (loss) per share - weighted average shares | 16,986,000 | 15,381,000 |

Table of Contents**2. Commitments and Contingencies.**

Legal. On September 23, 2004, the Company brought suit against News America and Albertson's Inc. (Albertson's) in Federal District Court in Minneapolis, Minnesota, for violations of federal and state antitrust and false advertising laws, alleging that News America has acquired and maintained monopoly power through various wrongful acts designed to harm the Company in the in-store advertising and promotion products and services market. The suit sought injunctive relief sufficient to prevent further antitrust injury and an award of treble damages for the harm caused to the Company. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the case. In December 2006, News America filed counterclaims in the case that included claims of alleged interference with contracts and alleged libel and slander against Insignia and one of its officers. On February 4, 2008, the Court approved a consent decree entered into by News America and the State of Minnesota under which News America agreed to not violate Minnesota's statutes prohibiting commercial disparagement. On July 29, 2008, the Company and Albertson's entered into a settlement agreement and mutual release, in which they each agreed to release all claims against the other, and the Company agreed to dismiss its lawsuit against Albertson's.

On February 7, 2011, trial in the Company's lawsuit against News America commenced in U.S. District Court for the District of Minnesota. On February 9, 2011, the Company and News America entered into a Settlement Agreement to settle the lawsuit. Pursuant to the Settlement Agreement, News America paid the Company \$125,000,000, and the Company paid News America \$4,000,000 in exchange for a 10-year arrangement to sell signs with price into News America's network of retailers as News America's exclusive agent. As of the date of this filing, the definitive agreement for the 10-year arrangement was still being negotiated, and had not yet been signed. If the parties cannot reach agreement, the Magistrate Judge of the U.S. District Court, District of Minnesota, will resolve any remaining issues. The Settlement Agreement included the dismissal with prejudice of the Company's lawsuit against News America.

During the quarter ended March 31, 2011, the Company incurred legal fees of \$32,076,000 in connection with the News America lawsuit. A contingent fee payment of \$31,250,000 was made to the Company's lead trial counsel out of the settlement proceeds. Additional legal fees of \$826,000 were incurred in connection with the lawsuit as the Company prepared for trial, worked through settlement discussions, and post settlement activities.

Management does not expect significant legal fees and expenses in future periods after post-settlement activities are concluded. Legal fees and expenses are expensed as incurred and are included in general and administrative expenses in the statements of operations, except for the contingent fee which was included as a reduction of the gain from the litigation settlement.

The Company is subject to various other legal proceedings in the normal course of business. Management believes the outcome of these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

- 3. Income Taxes.** For the three months ended March 31, 2011, the provision for income taxes was \$33,951,000, or 38.7% of income before income taxes. The loss for the three months ended March 31, 2010, resulted in no provision for income taxes or tax benefit for that period. The provision for income taxes during the three months ended March 31, 2011, is comprised of federal and state taxes. The primary difference between the Company's March 31, 2011, effective tax rate and the statutory federal rate is state income taxes. The lack of profitability in the first quarter of 2010 and the use of a full valuation allowance against the Company's deferred tax assets resulted in no provision for taxes or tax benefit for the period.

As of March 31, 2011, the Company had unrecognized tax benefits totaling \$400,000 excluding interest which relate to state nexus issues. The amount of the unrecognized tax benefits, if recognized, that would affect the effective income tax rates of future periods is \$400,000. Due to the current statute of limitations regarding the unrecognized tax benefits, the unrecognized tax benefits and associated interest is not expected to decrease in 2011.

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4. **Concentrations.** During the three months ended March 31, 2011, Nestle Co. and Valassis Sales and Marketing Services, Inc. accounted for 29% and 18%, respectively, of the Company's total net sales. At March 31, 2011, these two customers represented 26% and 12%, respectively, of the Company's total accounts receivable. During the three months ended March 31, 2010, General Mills, Inc., Valassis Sales and Marketing Services, Inc., and Nestle Co. accounted for 23%, 13% and 13%, respectively, of the Company's total net sales. At March 31, 2010 these three customers represented 14%, 14% and 15%, respectively, of the Company's total accounts receivable. Valassis Sales and Marketing Services, Inc. is a reseller of the Company's POPSign program to consumer packaged goods manufacturers.
Although there are a number of customers that the Company sells to, the loss of a major customer could cause a delay in and possible loss of sales, which would adversely affect operating results. Additionally, the loss of a major retailer from the Company's retail network could adversely affect operating results.
5. **New Accounting Pronouncements.** In December 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures Topic 820 Improving Disclosures about Fair Value Measurements*. This ASU requires some new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Codification Subtopic 820-10. The FASB's objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Some of the new disclosures were effective for reporting periods beginning after December 15, 2009, with the remaining new disclosures effective for reporting periods beginning after December 15, 2010. The Company adopted the amended guidance and it did not have a significant impact on the Company's financial statements. In July 2010, the FASB issued ASU No. 2010-20, *Receivables Topic 310 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, to enhance the disclosures required for financing receivables (for example, loans, trade accounts receivable, notes receivable, and receivables relating to a lessor's leveraged, direct financing, and sales-type leases) and allowances for credit losses. The amended disclosures are designed to provide more information to financial statement users regarding the credit quality of a creditor's financing receivables and the adequacy of its allowance for credit losses. The amended guidance is effective for period-end balances beginning with the first interim or annual reporting period ending on or after December 15, 2010. The amended guidance is effective for activity during a reporting period beginning on or after December 15, 2010. The Company adopted the amended guidance and it did not have a significant impact on the Company's financial statements.

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

Overview

Insignia Systems, Inc. (the Company) markets in-store advertising products, programs and services to consumer packaged goods manufacturers (customers) and retailers. The Company's products and services includes the Insignia

POPSign® program, thermal sign card supplies for the Company's SIGNright and Impulse systems, Stylus software and laser printable cardstock and label supplies.

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The following table sets forth, for the periods indicated, certain items in the Company's Statements of Operations as a percentage of total net sales.

| Three Months Ended March 31 | 2011 | 2010 |
|--------------------------------------|-------------|-------------|
| Net sales | 100.0% | 100.0% |
| Cost of Sales | 58.8 | 50.2 |
| Gross Profit | 41.2 | 49.8 |
| Operating expenses: | | |
| Selling | 31.4 | 27.8 |
| Marketing | 8.4 | 6.7 |
| General and administrative | 41.0 | 22.9 |
| Gain from litigation settlement, net | (1,814.5) | □ |
| Total operating expenses | (1,733.7) | 57.4 |
| Operating income (loss) | 1,774.9 | (7.6) |
| Other income | 0.4 | 0.2 |
| Income (loss) before taxes | 1,775.3 | (7.4) |
| Income tax expense | (686.3) | □ |
| Net income (loss) | 1,089.0% | (7.4)% |

Decreased net sales in the first three months of 2011 compared to the first three months of 2010, combined with the effect of fixed costs in the costs of sales, resulted in a decrease in gross profit in the 2011 period. The decrease in gross profit and increased operating expenses in the 2011 period were dramatically offset by the litigation settlement, resulting in significant net income in 2011 as compared to a net loss in the 2010 period. See the non-GAAP financial measures information which follows later in this section for a comparison of the 2011 and 2010 periods non-GAAP net losses.

Three Months ended March 31, 2011, Compared to Three Months Ended March 31, 2010

Net Sales. Net sales for the three months ended March 31, 2011 decreased 15.9% to \$4,947,000 compared to \$5,883,000 for the three months ended March 31, 2010.

Service revenues from our POPSign programs for the three months ended March 31, 2011 decreased 14.9% to \$4,374,000 compared to \$5,137,000 for the three months ended March 31, 2010. The decrease was primarily due to a decrease in the average sign price as well as a decrease in the number of POPSign signs displayed for customers at stores in the Company's retail network. The decrease in the number of signs displayed in the 2011 period was primarily related to the expiration of the Kroger retailer contract at the end of 2010.

Product sales for the three months ended March 31, 2011 decreased 23.2% to \$573,000 compared to \$746,000 for the three months ended March 31, 2010. This was primarily due to lower sales volume of laser printer supplies.

Gross Profit. Gross profit for the three months ended March 31, 2011 decreased 30.5% to \$2,036,000 compared to \$2,930,000 for the three months ended March 31, 2010. Gross profit as a percentage of total net sales decreased to 41.2% for 2011 compared to 49.8% for 2010.

Gross profit from our POPSign program revenues for the three months ended March 31, 2011 decreased 32.2% to \$1,831,000 compared to \$2,701,000 for the three months ended March 31, 2010. The decrease was primarily due to decreased sales in 2011 combined with the effect of fixed costs. Gross profit as a percentage of POPSign program revenues decreased to 41.9% for 2011 compared to 52.6% for 2010, primarily due to the effect of fixed costs against decreased revenues.

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Gross profit from our product sales for the three months ended March 31, 2011 decreased 10.5% to \$205,000 compared to \$229,000 for the three months ended March 31, 2010. The decrease was primarily due to decreased sales. Gross profit as a percentage of product sales increased to 35.8% for 2011 compared to 30.7% for 2010. The decreased laser printer supplies in 2011 were lower margin products which resulted in the higher gross profit percentage in 2011.

Operating Expenses

Selling. Selling expenses for the three months ended March 31, 2011 decreased 5.0% to \$1,555,000 compared to \$1,636,000 for the three months ended March 31, 2010, primarily due to decreased sales commissions in 2011 due to decreased sales. Selling expenses as a percentage of total net sales increased to 31.4% in 2011 compared to 27.8% in 2010, primarily due to the effect of decreased sales.

Marketing. Marketing expenses for the three months ended March 31, 2011 increased 4.8% to \$414,000 compared to \$395,000 for the three months ended March 31, 2010. Marketing expenses as a percentage of total net sales increased to 8.4% in 2011 compared to 6.7% in 2010, due to the effect of decreased sales.

General and administrative. General and administrative expenses for the three months ended March 31, 2011 increased 50.4% to \$2,026,000 compared to \$1,347,000 for the three months ended March 31, 2010. General and administrative expenses as a percentage of total net sales increased to 41.0% in 2011 compared to 22.9% in 2010, due to increased legal expense in 2011. Legal fees were \$989,000 for the three months ended March 31, 2011, compared to \$523,000 for the three months ended March 31, 2010. The legal fees in each quarter were incurred primarily in connection with the News America lawsuit described in Note 2 to the financial statements. Management does not expect significant legal fees and expenses in future periods in connection with post-settlement activities.

Gain from litigation settlement. On February 9, 2011, the Company entered into a Settlement Agreement in its lawsuit against News America. As part of the Settlement Agreement, News America paid the Company \$125,000,000. Netted against this payment was a contingent fee payment of \$31,250,000 to the Company's lead trial counsel as well as performance bonus payments of \$3,988,000 to certain employees in connection with the settlement, resulting in a net pre-tax gain of \$89,762,000.

Other Income. Other income for the three months ended March 31, 2011 was \$21,000 compared to \$13,000 for the three months ended March 31, 2010. The difference was due to increased interest income in the 2011 period due to higher cash, cash equivalents and short-term investment balances, partially offset by lower interest rates, and a decrease in interest expense in 2011.

Income Taxes. For the three months ended March 31, 2011, the provision for income taxes was \$33,951,000, or 38.7% of income before income taxes. The loss for the three months ended March 31, 2010, resulted in no provision for income taxes or tax benefit for that period. The provision for income taxes during the three months ended March 31, 2011, is comprised of federal and state taxes. The primary difference between the Company's March 31, 2011, effective tax rate and the statutory federal rate is state income taxes. The lack of profitability in the first quarter of 2010 and the use of a full valuation allowance against the Company's deferred tax assets resulted in no provision for taxes or tax benefit for the period.

Net Income (Loss). Our net income for the three months ended March 31, 2011 was \$53,873,000 compared to a net loss of \$(435,000) for the three months ended March 31, 2010.

Non-GAAP Financial Measures

To supplement the Company's financial statements presented in accordance with GAAP, the Company has provided certain non-GAAP financial measures of financial performance in prior public announcements. These non-GAAP measures include:

net income (loss) before gain from litigation settlement (net of tax), and

net income before News America related legal fee expense.

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The Company's reference to these non-GAAP measures should be considered in addition to results prepared under current accounting standards, but are not a substitute for, or superior to, GAAP results.

These non-GAAP measures are provided to enhance investors' overall understanding of the Company's current financial performance and ability to generate cash flows. In many cases non-GAAP financial measures are used by analysts and investors to evaluate the Company's performance. Reconciliation to the nearest GAAP measure can be found in the financial table included below.

| Three Months Ended March 31 | 2011 | 2010 |
|--|----------------|--------------|
| Net income (loss) | \$ 53,873,000 | \$ (435,000) |
| Adjustment: | | |
| Gain from litigation settlement (net of tax) (<i>see below</i>) | (55,062,000) | |
| Non-GAAP net loss before gain from litigation settlement (net of tax) | (1,189,000) | (435,000) |
| Adjustment: | | |
| News America related legal expense | 826,000 | 404,000 |
| Non-GAAP net loss before gain from litigation settlement (net of tax) and News America related legal expense | \$ (363,000) | \$ (31,000) |
| Gain from litigation settlement (net of tax) | | |
| Settlement proceeds | \$ 125,000,000 | |
| Less contingent attorney's fees | (31,250,000) | |
| Less bonuses paid to employees | (3,988,000) | |
| | 89,762,000 | |
| Less settlement related income taxes | (34,700,000) | |
| Gain from litigation settlement (net of tax) | \$ 55,062,000 | |

Liquidity and Capital Resources

The Company has financed its operations with proceeds from public and private stock sales and sales of its services and products. At March 31, 2011, working capital was \$32,734,000 compared to \$12,505,000 at December 31, 2010. During the three months ended March 31, 2011, cash, cash equivalents and short-term investments increased \$76,544,000 from \$13,696,000 at December 31, 2010 to \$90,240,000 at March 31, 2011.

On February 9, 2011, the Company entered into a settlement agreement in its lawsuit against News America. As part of the settlement agreement, News America paid the Company \$125,000,000 less \$4,000,000 related to a 10-year business arrangement. Litigation counsel for the Company received a contingent fee payment of \$31,250,000 which resulted in net cash to the Company of \$89,750,000 after the contingent fee.

On February 22, 2011, the Board of Directors approved a series of actions. First, the Board of Directors authorized a special \$2.00 per common share dividend which resulted in a payment to shareholders of \$31,335,000 on May 2, 2011. Second, the Board approved a Performance Bonus Plan, providing for the payment of \$3,988,000 to certain employees of the Company. Third, the Board authorized the repurchase of up to \$15,000,000 of the Company's common stock on or before January 31, 2012. The plan does not obligate the Company to repurchase any particular number of shares, and may be suspended at any time at the Company's discretion.

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Net cash provided by operating activities during the three months ended March 31, 2011, was \$83,053,000. Net income of \$53,873,000, plus non-cash adjustments of \$7,783,000 and changes in operating assets and liabilities of \$21,397,000 resulted in the \$83,053,000 of cash provided by operating activities. The net non-cash adjustments of \$7,783,000 consisted of deferred income tax expense, stock-based compensation expense, and depreciation expense. The most significant component of the \$21,397,000 change in operating assets and liabilities was income taxes. Income taxes increased by \$25,245,000, which excludes the windfall tax benefit of \$1,135,000, primarily due to taxable income related to the litigation settlement. This was partially offset by a change in other assets which primarily related to the payment of \$4,000,000 in exchange for a 10-year business arrangement. Accrued retailer payments decreased \$1,082,000 primarily related to the payment to one of our retailers, and accrued compensation increased \$1,398,000 primarily due to the terms of the performance bonus plan related to the News America settlement. The Company expects accounts receivable, accounts payable, accrued liabilities and deferred revenue to fluctuate during future periods depending on the level of POPSign revenues and related business activity as well as billing arrangements with customers and payment terms with retailers.

Net cash of \$459,000 was provided by investing activities during the three months ended March 31, 2011. Proceeds from the sale of investments were partially offset by the purchase of property and equipment. Proceeds of \$500,000 during the first quarter consisted entirely of redemptions of twenty-six week certificates of deposit. Capital expenditures of \$41,000 during the quarter consisted primarily of information technology equipment and software. The Company expects to make capital expenditures of up to \$2,000,000 for the remainder of 2011.

Net cash of \$6,468,000, which includes the windfall tax benefit of \$1,135,000, was used in financing activities during the three months ended March 31, 2011. The repurchase of common stock of \$10,672,000, pursuant to a plan adopted on February 22, 2011, was partially offset by \$3,069,000 of proceeds from the issuance of common stock from the exercise of employee stock options and the employee stock purchase plan. The stock repurchase plan allows for the repurchase of up to \$15,000,000 of the Company's common stock on or before January 31, 2012.

The Company believes that based upon current business conditions, its existing cash balance and future cash from operations will be sufficient for its cash requirements for the remainder of 2011. However, there can be no assurances that this will occur or that the Company will be able to secure additional financing from public or private stock sales or from other financing agreements if needed.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Our significant accounting policies are described in Note 1 to the annual financial statements as of and for the year ended December 31, 2010, included in our Form 10-K filed with the Securities and Exchange Commission on March 16, 2011. We believe our most critical accounting policies and estimates include the following:

- revenue recognition;
- allowance for doubtful accounts;
- accounting for deferred income taxes; and
- stock-based compensation.

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Cautionary Statement Regarding Forward Looking Information

Statements made in this quarterly report on Form 10-Q, in the Company's other SEC filings, in press releases and in oral statements to shareholders and securities analysts, which are not statements of historical or current facts, are forward looking statements. Such forward looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results or performance of the Company to be materially different from the results or performance expressed or implied by such forward looking statements. The words believes, expects, anticipates, seeks and similar expressions identify forward looking statements. Readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date the statement was made. These statements are subject to the risks and uncertainties that could cause actual results to differ materially and adversely from the forward looking statements. These risks and uncertainties include, but are not limited to, the risks presented in our Annual Report on Form 10-K for the year ended December 31, 2010, and updated in Part II, Item 1A of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company's management carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. Disclosure controls and procedures ensure that information required to

be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and are designed to ensure that information required to be disclosed by us in these reports is accumulated and communicated to the Company's management, including its Chief Executive Office and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosures.

(b) Changes in Internal Controls Over Financial Reporting

There was no change in our internal controls over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On September 23, 2004, the Company brought suit against News America and Albertson's Inc. (Albertson's) in Federal District Court in Minneapolis, Minnesota, for violations of federal and state antitrust and false advertising laws, alleging that News America has acquired and maintained monopoly power through various wrongful acts designed to harm the Company in the in-store advertising and promotion products and services market. The suit sought injunctive relief sufficient to prevent further antitrust injury and an award of treble damages for the harm caused to the Company. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the case. In December 2006, News America filed counterclaims in the case that included claims of alleged interference with contracts and alleged libel and slander against Insignia and one of its officers. On February 4, 2008, the Court approved a consent decree entered into by News America and the State of Minnesota under which News America agreed to not violate Minnesota's statutes prohibiting commercial disparagement. On July 29, 2008, the Company and Albertson's entered into a settlement agreement and mutual release, in which they each agreed to release all claims against the other, and the Company agreed to dismiss its lawsuit against Albertson's.

On February 7, 2011, trial in the Company's lawsuit against News America commenced in U.S. District Court for the District of Minnesota. On February 9, 2011, the Company and News America entered into a Settlement Agreement to settle the lawsuit. Pursuant to the Settlement Agreement, News America paid the Company \$125,000,000, and the Company paid News America \$4,000,000 in exchange for a 10-year arrangement to sell signs with price into News America's network of retailers as News America's exclusive agent. As of the date of this filing, the definitive agreement for the 10-year arrangement was still being negotiated, and had not yet been signed. If the parties cannot reach agreement, the Magistrate Judge of the U.S. District Court, District of Minnesota, will resolve any remaining issues. The Settlement Agreement included the dismissal with prejudice of the Company's lawsuit against News America.

During the quarter ended March 31, 2011, the Company incurred legal fees of \$32,076,000 in connection with the News America lawsuit. A contingent fee payment of \$31,250,000 was made to the Company's lead trial counsel out of the settlement proceeds. Additional legal fees of \$826,000 were incurred in connection with the lawsuit as the Company prepared for trial, worked through settlement discussions, and post settlement activities. Management does not expect significant legal fees and expenses in future periods after post-settlement activities are concluded. Legal fees and expenses are expensed as incurred and are included in general and administrative expenses in the statements

of operations, except for the contingent fee which was included as a reduction of the gain from the litigation settlement.

The Company is subject to various other legal proceedings in the normal course of business. Management believes the outcome of these proceedings will not have a material adverse effect on the Company's financial position or results of operations.

Item 1A. Risk Factors

Not applicable.

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On February 23, 2010, the Board of Directors authorized the repurchase of up to \$2,000,000 of the Company's common stock on or before January 31, 2011. The plan has now expired.

Our share repurchase program activity for the three months ended March 31, 2011, under the expired plan was:

| | Total Number Of Shares Repurchased | Average Price Paid Per Share | Total Number Of Shares Purchased As Part Of Publicly Announced Plans Or Programs | Approximate Dollar Value of Shares That May Yet Be Purchased Under The Plans Or Programs |
|--------------------|---|---|---|---|
| January 1-31, 2011 | | \$ | | \$ |

On February 22, 2011, the Board of Directors authorized the repurchase of up to \$15,000,000 of the Company's common stock on or before January 31, 2012, under a new plan. The plan does not obligate the Company to repurchase any particular number of shares, and may be suspended at any time at the Company's discretion.

Our share repurchase program activity for the three months ended March 31, 2011, under the new plan was:

| Total Number Of Shares Repurchased | Average Price Paid Per Share | Total Number Of Shares Purchased As | Approximate Dollar Value of Shares That May Yet Be Purchased |
|---|---|--|---|
|---|---|--|---|

| | | | | Part Of Publicly Announced Plans Or Programs | | Under The Plans Or Programs |
|----------------------|-----------|----|--------|---|----|--|
| February 22-28, 2011 | | \$ | | | \$ | 15,000,000 |
| March 1-31, 2011 | 1,583,700 | \$ | 6.6883 | 1,583,700 | \$ | 4,407,700 |

Item 3. Defaults upon Senior Securities

None.

Item 4. Removed and Reserved**Item 5. Other Information**

None.

Item 6. Exhibits

The following exhibits are included herewith:

- 10.1 Settlement Agreement and Release with News America Marketing In-Store, LLC, dated February 9, 2011, including exhibits (confidential treatment requested)
- 31.1 Certification of Principal Executive Officer
- 31.2 Certification of Principal Financial Officer
- 32 Section 1350 Certification

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SIGNATURES

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

Dated: May 10, 2011

Insignia Systems, Inc.
(Registrant)

/s/ Scott F. Drill
Scott F. Drill
President and Chief Executive Officer
(principal executive officer)

/s/ Justin W. Shireman
Justin W. Shireman
Vice President, Finance and
Chief Financial Officer
(principal financial officer)

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