

INSIGNIA SYSTEMS INC/MN  
Form 10-K  
March 31, 2008  
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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the year ended December 31, 2007

Commission File Number 1-13471

**INSIGNIA SYSTEMS, INC.**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of incorporation or organization)

**41-1656308**

(IRS Employer Identification No.)

**6470 Sycamore Court North**

**Maple Grove, MN 55369**

(Address of principal executive offices)

**(763) 392-6200**

(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class:

Common Stock, \$.01 par value

Name of each exchange on which registered:

The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

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subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

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," "accelerated filer" and "smaller reporting company" 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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of the last business day of the second quarter (June 30, 2007) was approximately \$58,425,000 based upon the last sale price of the registrant's Common Stock on such date.

Number of shares outstanding of Common Stock, \$.01 par value, as of March 24, 2008, was 15,590,097.

### DOCUMENTS INCORPORATED BY REFERENCE:

Insignia Systems, Inc. Proxy Statement to be filed for the Annual Meeting of Shareholders to be held on May 21, 2008 (Part III - Items 10, 11, 12, 13 and 14)

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**Cautionary Statement Regarding Forward-Looking Information**

Statements made in this annual report on Form 10-K, 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 described in Part I, Item 1A.

***PART I.***

Item 1. Business

**General**

Insignia Systems, Inc., (the Company) markets in-store advertising products, programs and services to retailers and consumer packaged goods manufacturers. The Company has been in business since 1990. Since 1998, the Company has been focusing on providing in-store services through the Insignia Point-Of-Purchase Services (POPS) in-store advertising program. Insignia POPS® includes the Insignia POPSign® program.

Insignia's POPSign is a national, account-specific, in-store, shelf-edge advertising program that has been shown to deliver significant sales increases. Funded by consumer packaged goods manufacturers, the program allows manufacturers to deliver vital product information to consumers at the point-of-purchase. The brand information is combined with each retailer's store-specific prices and is displayed on the retailer's unique sign format. The combining of manufacturer and retailer information produces a complete call to action that gets consumers the information they want and need to make purchasing decisions, while building store and brand equity.

For retailers, Insignia's POPSign program is a source of incremental revenue and is the first in-store advertising program that delivers a complete call to action on a product-specific and store-specific basis, with all participating retail stores updated weekly. For consumer goods manufacturers, Insignia's POPSign program provides access to the optimum retail advertising site for their products—the retail shelf-edge. In addition, manufacturers benefit from significant sales increases, short lead times, micro-marketing capabilities, such as store-specific and multiple language options, and a wide variety of program features and enhancements that provide unique advertising advantages.

The Company's Internet address is [www.insigniasystems.com](http://www.insigniasystems.com). The Company has made available on its Web site all of the reports it files with the SEC. The Company's Web site is not incorporated by reference into this Report on Form 10-K. Copies of reports can also be obtained free of charge by requesting them from Insignia Systems, Inc., 6470 Sycamore Court North, Maple Grove, Minnesota 55369-6032; Attention: CFO; telephone 763-392-6200.

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**Industry and Market Background**

According to Point-Of-Purchase Advertising International (POPAI), an industry non-profit trade association, more than 70% of brand purchase decisions are being made in-store. As a result, product manufacturers are constantly seeking in-store vehicles to motivate consumers to buy their branded products. Industry studies estimate that manufacturers spend approximately \$19.33 billion annually on retail, point-of-purchase and in-store services. The Company's market studies indicate that the shelf-edge sign represents the final and best opportunity for manufacturers to convince the consumer to buy. In fact, a 2005 industry study concluded that shelf signs are the most effective type of in-store advertising vehicle after end-aisle displays and in-store leaflets.

Many consumers seek product information beyond price in order to make educated buying decisions. The Company's marketing studies indicate the most effective sign contains information supplied by the product manufacturer in combination with the retailer's price and design look.

**Company Products**

***Insignia's POPSign Program***

Insignia's POPSign program is an in-store, shelf-edge, point-of-purchase advertising program that enables manufacturers to deliver product-specific messages quickly and accurately—in designs and formats that have been pre-approved and supported by participating retailers. Insignia POPSigns deliver vital product selling information from manufacturers, such as product uses and features, nutritional information, advertising tag lines and product images. The brand information is combined with the retailer's store-specific prices and is displayed on the retailer's unique sign format that includes its logo, headline and store colors. Each sign is displayed directly in front of the manufacturer's product in the participating retailer's stores. Insignia's POPSign program offers special features and enhancements, such as Advantage and Custom Advantage headers that allow manufacturers to add visibility and highlight their brand message at-shelf. Insignia offers Color POPSigns with customizable, image-building full-color graphics. Insignia UltraColor® POPSigns offer 75% more area for the full-color creative than Color POPSigns.

Utilizing proprietary technology, the Company collects and organizes the data from both manufacturers and retailers, then formats, prints and delivers the signs to retailers for distribution and display. Store personnel place the signs at the shelf for two-week display cycles. The Company charges manufacturers for the signs placed in stores for each cycle. Retailers are paid a fee to display the signs and for product movement data provided to Insignia.

***The Impulse Retail System and SIGNright Sign System***

Prior to 1996, the Company's primary product offering was the Impulse Retail System, a system developed by an independent product design and development firm (the Developer). In 1996, the Company replaced the Impulse Retail System with the SIGNright Sign System. In 1998, the Company ceased the active domestic sales of the SIGNright Sign System.

Cardstock for the two systems is sold by the Company in a variety of sizes and colors that can be customized to include pre-printed custom artwork, such as a retailer's logo. Approximately 4% of 2007 revenues came from the sale of cardstock. The Company expects this percentage to be lower in the future.

***Stylus Software***

In late 1993, the Company introduced Stylus, a PC-based software application used by retailers to produce signs, labels, and posters. The Stylus software allows retailers to create signs, labels and posters by manually entering the information or by importing information from a database. Approximately 2% of 2007 revenues came from the sale of Stylus products and maintenance. The Company expects this percentage to be lower in the future.

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**Marketing and Sales**

The Company directly markets the Insignia POPSign program to food and drug manufacturers and retailers. By utilizing the Insignia POPSign program, these manufacturers and retailers can easily accomplish what had previously been either impossible or extremely difficult: tailoring national in-store advertising programs to regional and local needs with minimal effort. In addition to the benefits provided to manufacturers and retailers, Insignia's POPSign program provides consumers more information and clearer messages to aid in purchasing decisions. The Company believes its POPSign program is the most complete in-store advertising sign program available, benefiting consumer, retailer, and manufacturer.

On June 12, 2006, the Company entered into an Exclusive Reseller Agreement with Valassis Sales and Marketing Services, Inc. The agreement had an initial term of one year with the objective of increasing the Company's sales of Insignia POPSigns. On December 6, 2006, the Company and Valassis executed Amendment No. 1 to the agreement which finalized certain appendices, made certain other modifications to the agreement and extended the initial term through December 31, 2007. On July 2, 2007 the Company and Valassis executed Amendment No. 2 to the agreement which extended the term of the agreement to December 31, 2017 and expanded the strategic alliance to increase the role of Valassis to include developing and expanding the Company's participating retailer network. In conjunction with Amendment No. 2 Valassis received a five-year warrant to acquire 800,000 shares of Insignia's common stock at a price of \$4.04 and will be paid cash commissions by the Company on the revenue the Company realizes from POPS programs the consumer packaged goods manufacturers conduct in the new retail chains. The Company recorded \$1,521,000 of expense during the year ended December 31, 2007 related to the fair value of the warrant.

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Prior to April 1998, the Company marketed the Impulse Retail System and the SIGNright Sign System through telemarketing by in-house sales personnel and independent sales representatives. In May 1998, the Company discontinued the active marketing of the systems. The Company sells cardstock and supplies related to these systems to U.S. and international customers.

The Company markets its Stylus software in the United States and internationally primarily through resellers that integrate Stylus as an Open Database Connectivity design and publishing component into their retail data and information management software applications.

During 2007, 2006 and 2005, foreign sales accounted for less than 1% of total net sales each year. The Company expects sales to foreign distributors will be less than 1% of total net sales in 2008.

### Competition

#### *Insignia's POPSign Program*

The Insignia POPSign program is competing for the marketing expenditures of branded product manufacturers for at-shelf advertising-related signage. The Insignia POPSign program has two major competitors in its market: News America Marketing In-Store<sup>®</sup>, Inc. (News America) and FLOORgraphics<sup>®</sup>, Inc. (FLOORgraphics).

News America offers a network for in-store advertising, promotion and sales merchandising services. News America has branded its in-store shelf signage products as SmartSource Shelftalk<sup>sm</sup>, SmartSource Shelfvision<sup>sm</sup> and SmartSource Price Pop<sup>®</sup>.

FLOORgraphics offers a network for in-store advertising and promotion programs. FLOORgraphics has branded its advertising shelf signage product SHELPlus!<sup>®</sup>.

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We believe the main strengths of the Insignia POPSign program in relation to its competitors are:

- the linking of manufacturers to retailers at a central coordination point
- providing a complete call to action
- supplying product-specific and store-specific messages at the retail shelf
- delivering vital product information and store-specific prices
- short lead times
- significant sales increases

### Patents and Trademarks

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The Company has developed and is using a number of trademarks, service marks, slogans, logos and other commercial symbols to advertise and sell its products. The Company owns U.S. registered trademarks for Insignia Systems, Inc.® (and Design), Insignia POPS®, POPS Select®, Insignia Color POPS®, Insignia POPSign®, UltraColor®, Stylus®, Stylus Work Center®, SIGNright®, Impulse®, DuraSign®, I-Care®, and Check This Out.®

The Company is in the process of obtaining trademark registrations in the United States for the trademarks Insignia E-POPS and Insignia ShelfPOPS.

The Company filed a Surrender for Cancellation of Registration for the mark VALUSTIX with the U.S Patent and Trademark Office in October of 2006.

The barcode which the Company uses on the sign cards for the Impulse and SIGNright Sign Systems was also developed by the Developer, which has granted the Company an exclusive worldwide license of its rights to the barcode. The license requires the Company to pay a royalty of 1% of the net sales price received by the Company on cardstock or other supply items that bear the barcode used by the Impulse and SIGNright Sign Systems. Although a patent has been issued to the Developer, which covers the use of the barcode, there is no assurance that the Company will be able to prevent other suppliers of cardstock from copying the barcode used by the Company. However, the Company believes that the number, relatively small size and geographic dispersal of Impulse and SIGNright users, their relationship with the Company and the Company's retention of its customer list as a trade secret will discourage other sign card suppliers from offering bar-coded sign cards for use on the Impulse and SIGNright machines.

Key employees are required to enter into nondisclosure and invention assignment agreements, and customers, vendors and other third parties also must agree to nondisclosure restrictions prior to disclosure of our trade secrets or other confidential or proprietary information.

### **Product Development**

Product development for Insignia's POPSign program has been conducted internally and includes the proprietary data management and operations system, as well as the current offering of point-of-purchase and other advertising products. Ongoing internal systems enhancements, as well as the development of point-of-purchase and other advertising or promotional products, will be conducted utilizing both internal and external resources as appropriate.

Product development on the SIGNright Sign System was primarily conducted by the Developer on a contract basis.

The Stylus software product line remains a viable application for the Company's retailer customers. The Company performs development to keep Stylus current and updated to meet industry requirements.

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**Customers**

Two customers accounted for 15% and 11%, 26% and 10%, and 16% and 17% of the Company's total net sales for the years ended December 31, 2007, 2006 and 2005.

**Backlog**

Sales backlog at February 29, 2008 was approximately \$16.9 million, of which \$14.7 million is for delivery during 2008 and \$2.2 million is for delivery during 2009 and 2010. The orders are believed to be firm but there is no assurance that all of the backlog will actually result in revenues. Sales backlog at February 28, 2007 was approximately \$14.7 million.

**Seasonality**

The Company's results of operations have fluctuated from quarter to quarter due to variations in net sales and operating expenses. Before 2003, the Company generated a significant portion of operating income in the fourth quarter of the fiscal year because of seasonal events that affected when customers purchased Insignia POPSign programs. However, the pattern has varied since 2002 and it is unclear whether there will be a consistent seasonality pattern in the future.

Any factor that negatively affects net sales or increases operating expenses could negatively affect annual results of operations, and in particular, quarterly results. As a result of the variability of the business, the Company may incur losses in a given quarter and fluctuations in working capital. In certain quarters the Company may realize strong sales, but due to increased sales promotion activities and investments in growing the business, we may experience reduced operating income. The results of operations fluctuate from quarter to quarter as a result of the following:

- The timing of seasonal events for customers;
- Variations in the specific products which customers choose to advertise;
- Variations in the number of retailers in the Company's network;
- Minimum program level commitments to retailers (called retailer guarantees), and
- Professional fees related to litigation.

**Employees**

As of February 29, 2008, the Company had 108 employees, including all full-time and part-time employees.

**Segment Reporting**



The Company operates in a single reportable segment.

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Item 1A. Risk Factors

Our business faces significant risks, including the risks described below. Additional risks that we do not yet know of or that we currently believe are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks occurs, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

**We Have Had Significant Losses In Prior Periods**

Although we had net income of \$2,343,000 and \$2,396,000 for the years ended December 31, 2007 and 2006 respectively, we experienced a net loss of \$3,308,000 for the year ended December 31, 2005. There can be no assurance that we will be profitable on a quarterly or annual basis. If we are unable to generate net income from operations our business will be adversely affected and our stock price will likely decline.

**We Are Involved In Major Litigation**

In August 2000, News America Marketing In-Store, Inc. (News America), brought suit against the Company in U.S. District Court in New York, New York. The case was settled in November 2002. The terms of the settlement agreement are confidential. The settlement did not impact the Company's operating results.

In October 2003, News America brought suit against the Company in U.S. District Court in New York, New York, alleging that the Company has engaged in deceptive acts and practices, has interfered with existing business relationships with retailers and prospective economic advantage, and has engaged in unfair competition. The suit sought unspecified damages and injunctive relief. In February 2007 the U.S. District Court in New York transferred this action to Minnesota where the claims became part of the lawsuit the Company filed against News America and Albertson's Inc., and the New York action was subsequently dismissed.

On September 23, 2004, the Company brought suit against News America and Albertson's Inc. 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 seeks injunctive relief sufficient to prevent further antitrust injury and an award of treble damages to be determined at trial for the harm caused to the Company. On June 30, 2006 the Court denied the motions of News America and Albertson's to dismiss the suit. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the Minnesota case. In December 2006 News America filed counterclaims similar to the claims in its New York action against Insignia and one of its officers. Motions to dismiss the counterclaims were argued in June 2007, and on September 28, 2007 the Court denied the motions to dismiss the counterclaims. The parties are now engaged in pre-trial discovery. Pursuant to Court order, all discovery and pre-trial matters must

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be completed by December 2008. 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 not to violate Minnesota's statutes prohibiting commercial disparagement.

Management believes that News America's counterclaims are without merit. An evaluation of the likelihood of an unfavorable outcome and an estimate of the potential liability cannot be rendered at this time. If the Company is required to pay a significant amount in settlement or damages, it will have a material adverse effect on its operations and financial condition. In addition, a negative outcome of this litigation could affect long-term competitive aspects of the Company's business.

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The Company filed claims in December 2006 and January 2007 with its director's and officer's liability and general liability insurers related to the defense costs and insurance coverage for claims asserted against the Company and one of its officers in News America's counterclaims. On August 9, 2007, the Company filed a complaint against the insurers in Hennepin County District Court, State of Minnesota requesting a declaratory judgment that the insurers owe the Company and its officer such defense costs and insurance coverage. In December 2007, the Company settled its claim against one of its insurers.

Management currently expects the amount of legal fees that will be incurred in connection with the ongoing lawsuit to be significant throughout 2008 and 2009. During the years ended December 31, 2007, 2006 and 2005, the Company incurred legal fees of \$1,758,000, \$935,000 and \$1,085,000 related to the News America litigation. Legal fees are expensed as incurred.

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.

### **We Are Dependent On Our Contracts With Retailers And Our Ability To Renew Those Contracts When Their Terms Expire**

On an ongoing basis, we negotiate renewals of various retailer contracts. Some of our retailer contracts require us to guarantee minimum payments to our retailers. If we are unable to offer guarantees at the required levels in the new contracts, and the contracts are not renewed because of that or because of other reasons, it will have a material adverse effect on our operations and financial condition.

Our POPS business and results of operations could be adversely affected if the number of retailer partners decreases significantly or if the retailer partners fail to continue to provide good service including performing their duties in placing and maintaining POPSigns at the shelf in their stores and providing product movement data to us.

### **Our Results Of Operations May Be Subject To Significant Fluctuations Which May Result In A Decrease In Our Stock Price**

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Our quarterly and annual operating results have fluctuated in the past and may vary in the future due to a wide variety of factors including:

- the loss of contracts with retailers;
- the continued impact of significant litigation on our business;
- the timing of seasonal events for customers or the loss of customers;
- the timing of new retail stores being added;
- the timing of additional selling, marketing and general and administrative expenses; and
- competitive conditions in our industry.

Due to these factors, our quarterly net sales, expenses and results of operations could vary significantly in the future and this could adversely affect the market price of our common stock.

### **We Have Significant Competitors**

We face significant competition from other providers of at-shelf advertising or promotional signage. Some of these competitors have significantly greater financial resources that can be used to market their products. Should our competitors succeed in obtaining more of the at-shelf advertising business from our current customers, our revenues and related operations would be adversely affected.

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#### **Our Results Are Dependent On The Success Of Our Insignia POPS Program Which Represents A Very Significant Part Of Our Business**

We are largely dependent on our POPS program, which represented approximately 88%, 88% and 84% of total net sales for fiscal 2007, 2006 and 2005, respectively. We expect the POPS program to represent a higher percentage in fiscal 2008 and future periods. Should brand manufacturers no longer perceive value in the POPS program, our business and results of operations would be adversely affected due to our heavy dependence on this program.

#### **Our Results Are Dependent On The Level Of Spending By Branded Product Manufacturers For Advertising And Promotional Expenditures**

We are largely dependent on the net sales from our POPSigns, which are purchased by branded product manufacturers. Changes in economic conditions could result in reductions in advertising and promotional expenditures by branded product manufacturers. Should these reductions occur, our revenues and related results of operations would be adversely affected.

#### **Our Results Are Dependent On Our Manufacturer Partners Continuing To Achieve Sales Increases**

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Our product manufacturer customers use our POPS program to motivate consumers to buy their branded products. Use of our POPS program has historically resulted in sales increases for that particular product. If our POPS program does not continue to result in these product sales increases, our marketing success and sales levels could be adversely affected.

### **Our Stock Price Has Been And May Continue To Be Volatile**

During 2007 our common stock has traded between \$5.11 and \$2.26 per share. The market price of our common stock may continue to be volatile and may be significantly affected by:

- the loss or addition of contracts with major retailers;
- the continued impact of significant litigation on our business;
- actual or anticipated fluctuations in our operating results;
- announcements of new services by us or our competitors;
- developments with respect to conditions and trends in our industry or in the industries we serve;
- general market conditions; and
- other factors, many of which are beyond our control.

### Item 1B. Unresolved Staff Comments

Not applicable.

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### Item 2. Properties

The Company currently leases approximately 47,000 square feet of office and warehouse space in suburban Minneapolis, Minnesota, under a lease effective through July 31, 2008. During 2005, the Company sublet approximately 10,000 square feet of this space and therefore currently operates out of the remaining approximately 37,000 square feet. On March 27, 2008, the Company entered into a lease for approximately 41,000 square feet of office and warehouse space in the same general vicinity in suburban Minneapolis, Minnesota, effective August 1, 2008 through February 29, 2016. The Company believes that the 41,000 square feet of space in the new facility will meet the Company's foreseeable needs.

### Item 3. Legal Proceedings

In August 2000, News America Marketing In-Store, Inc. (News America), brought suit against the Company in U.S. District Court in New York, New York. The case was settled in November 2002. The terms of the settlement agreement are confidential. The settlement did not impact the Company's operating results.

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In October 2003, News America brought suit against the Company in U.S. District Court in New York, New York, alleging that the Company has engaged in deceptive acts and practices, has interfered with existing business relationships with retailers and prospective economic advantage, and has engaged in unfair competition. The suit sought unspecified damages and injunctive relief. In February 2007 the U.S. District Court in New York transferred this action to Minnesota where the claims became part of the lawsuit the Company filed against News America and Albertson's Inc., and the New York action was subsequently dismissed.

On September 23, 2004, the Company brought suit against News America and Albertson's Inc. 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 seeks injunctive relief sufficient to prevent further antitrust injury and an award of treble damages to be determined at trial for the harm caused to the Company. On June 30, 2006 the Court denied the motions of News America and Albertson's to dismiss the suit. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the Minnesota case. In December 2006 News America filed counterclaims similar to the claims in its New York action against Insignia and one of its officers. Motions to dismiss the counterclaims were argued in June 2007, and on September 28, 2007 the Court denied the motions to dismiss the counterclaims. The parties are now engaged in pre-trial discovery. Pursuant to Court order, all discovery and pre-trial matters must be completed by December 12, 2008. 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.

Management believes that News America's counterclaims are without merit. An evaluation of the likelihood of an unfavorable outcome and estimate of the potential liability cannot be rendered at this time. If the Company is required to pay a significant amount in settlement or damages, it will have a material adverse effect on its operations and financial condition. In addition, a negative outcome of this litigation could affect long-term competitive aspects of the Company's business.

The Company filed claims in December 2006 and January 2007 with its director's and officer's liability and general liability insurers related to the defense costs and insurance coverage for claims asserted against the Company and one of its officers in News America's counterclaims. On August 9, 2007, the Company filed a complaint against the insurers in Hennepin County District Court, State of Minnesota requesting a declaratory judgment that the insurers owe the Company and its officer such defense costs and insurance coverage. In December 2007, the Company settled its claim against one of its insurers.

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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 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2007.

**Item 4A. Executive Officers of the Registrant**

The names, ages and positions of the Company's executive officers are as follows:

| <b>Name</b>        | <b>Age</b> | <b>Position</b>  |
|--------------------|------------|--|
| Scott F. Drill     | 55         | President, Chief Executive Officer, Secretary –and Director      |
| Alan M. Jones      | 51         | Senior Vice President of CPG & Retail Sales                      |
| A. Thomas Lucas    | 57         | Senior Vice President of Operations                              |
| Justin W. Shireman | 57         | Vice President of Finance, Chief Financial Officer and Treasurer |
| Scott J. Simcox    | 55         | Senior Vice President of Marketing Services                      |

Scott F. Drill has been President and Chief Executive Officer of the Company since February 24, 1998. From 1996 to December 2002, he was also a partner in Minnesota Management Partners (MMP), a venture capital firm located in Minneapolis, Minnesota. Mr. Drill co-founded Varitronic Systems, Inc. in 1983, and was its President and CEO until it was sold in 1996. Prior to starting Varitronics, Mr. Drill held senior management positions in sales and marketing at Conklin Company and Kroy, Inc.

Alan M. Jones has been Senior Vice President of Consumer Packaged Goods and Retail Sales since May 2007. From August 1998 to May 2007, he held various positions within the Insignia POPS Division including Vice President of Sales for Retail Sales and subsequently Vice President of Sales for CPG Sales. Prior to his positions at Insignia Systems Inc., from 1992 to 1998, Mr. Jones held leadership and sales positions in the in-store advertising field with both Net Value Inc. and Valassis In-store Marketing. From 1981 to 1992, Mr. Jones held various positions at SmithKline Beecham Consumer Brands in the areas of sales training and management including Director of the Mid Atlantic Division.

Thomas Lucas has been Senior Vice President of Operations since April, 2007. Mr. Lucas has been with the Company since 1992. From 1998 to 2007 he was Vice President of Operations, POPS Division, and from 1992 to 1998 he was Manager and Director of Customer Services. Prior to 1992, Mr. Lucas held a variety of management and leadership positions within the United States Air Force and the Joint Chiefs of Staff.

Justin W. Shireman has been Vice President of Finance, Chief Financial Officer and Treasurer since April 2005. From April 2003 to March 2005, he was the Company's Contoller. From 2000 to 2002, he was the Contoller for Learningbyte International, Inc., a developer of e-learning solutions. From 1994 to 2000 Mr. Shireman held several positions, including Contoller and Director of Finance, with LecTec Corporation, a medical device manufacturer.

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Scott J. Simcox has been Senior Vice President of Marketing Services since August 2006. Mr. Simcox has been with the Company since inception in January 1990, initially as Director of Business Development until May 1991 and then as Director of Marketing until July 1998. From July 1998 to July 2006, he was the Company's Vice President of Marketing, POPS Division. From August 1988 through December 1989, Mr. Simcox was with Varitronic Systems in various sales and marketing roles. From 1978 to 1988 Mr. Simcox held several marketing and senior management positions at Conklin Company including Vice President of Marketing.

**PART II.**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

**Market Information**

The Company's common stock trades on the NASDAQ Capital Market® under the symbol ISIG. The following table sets forth the range of high and low bid prices reported on the Nasdaq System. These quotations represent prices between dealers and do not reflect retail mark-ups, mark-downs or commissions.

| <b>2007</b>    | <b>High</b> | <b>Low</b> | <b>2006</b>    | <b>High</b> | <b>Low</b> |
|----------------|-------------|------------|----------------|-------------|------------|
| First Quarter  | \$ 3.64     | \$ 2.69    | First Quarter  | \$ 1.38     | \$ 0.65    |
| Second Quarter | 4.27        | 3.00       | Second Quarter | 2.52        | 0.51       |
| Third Quarter  | 5.08        | 4.00       | Third Quarter  | 3.90        | 2.15       |
| Fourth Quarter | 4.74        | 2.25       | Fourth Quarter | 3.71        | 2.20       |

**Approximate Number of Holders of Common Stock**

As of February 29, 2008, the Company had one class of Common Stock beneficially held by approximately 1,661 owners.

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**Dividends**

The Company has never paid cash dividends on its common stock. The Board of Directors presently intends to retain all earnings for use in the Company's business and does not anticipate paying cash dividends in the foreseeable future.

The following graph compares the cumulative total shareholder return on the Company's Common Stock for the five fiscal years beginning December 31, 2002 and ending December 31, 2007, with the cumulative total return on the NASDAQ Stock Market U.S. Index and the Russell 2000 Index over the same period (assuming the investment of \$100 in the Company's Stock, the NASDAQ Stock Market U.S. Index and the Russell 2000 Index on December 31, 2002 and the reinvestment of all dividends).

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Item 6. Selected Financial Data

(In thousands, except per share amounts.)

| <b>For the Years Ended December 31</b>                     | <b>2007</b>          | <b>2006</b> | <b>2005</b> | <b>2004</b>             | <b>2003</b>             |
|--|----------------------|-------------|-------------|-------------------------|-------------------------|
| Net sales  | \$24,431             | \$21,894    | \$19,598    | \$20,992                | \$26,138                |
| Operating income (loss)                                    | 81 <sup>(1)</sup>    | 2,314       | (3,331 )    | (4,875 ) <sup>(3)</sup> | (4,324 ) <sup>(3)</sup> |
| Net income (loss)  | 2,343 <sup>(2)</sup> | 2,396       | (3,308 )    | (4,858 )                | (4,252 )                |
| Net income (loss) per share:                               |                      |             |             |                         |                         |
| Basic  | \$0.15               | \$0.16      | \$(0.22 )   | \$(0.38 )               | \$(0.35 )               |
| Diluted  | \$0.14               | \$0.15      | \$(0.22 )   | \$(0.38 )               | \$(0.35 )               |
| Shares used in calculation of net income (loss) per share: |                      |             |             |                         |                         |
| Basic  | 15,411               | 15,093      | 15,002      | 12,687                  | 12,259                  |
| Diluted  | 16,186               | 15,556      | 15,002      | 12,687                  | 12,259                  |
| Working capital  | \$7,751              | \$5,017     | \$2,592     | \$4,813                 | \$5,797                 |
| Total assets   | 13,340               | 8,583       | 6,673       | 9,921                   | 11,676                  |
| Total shareholders' equity                                 | 9,677                | 4,862       | 2,072       | 5,333                   | 7,822                   |

<sup>(1)</sup> Includes a one-time non-cash charge of \$1,521 for the warrant granted to Valassis more fully described in Note 7 to the financial statements.

<sup>(2)</sup> Includes a tax benefit of \$2,131 related to the reduction of the valuation allowance against deferred tax assets more fully described in Note 8 to the financial statements.

<sup>(3)</sup> Includes a \$960 impairment of goodwill in 2004 and a \$2,133 impairment of goodwill in 2003 related to the acquisition of VALUSTix. During 2006 the Company ceased all business activities related to VALUSTix.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations



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The following discussion should be read in conjunction with the financial statements and the related notes included in this Report. This Report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those in such forward-looking statements as a result of many factors, including those discussed in Cautionary Statements Regarding Forward-Looking Information and elsewhere in this Report.

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#### **Results of Operations**

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.

| <b>Year ended December 31</b>         | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|---------------------------------------|-------------|-------------|-------------|
| Net sales                             | 100.0 %     | 100.0 %     | 100.0 %     |
| Cost of sales                         | 44.6        | 45.9        | 63.9        |
| Gross profit                          | 55.4        | 54.1        | 36.1        |
| Operating expenses:                   |             |             |             |
| Selling                               | 23.2        | 22.1        | 29.1        |
| Marketing                             | 5.8         | 4.8         | 5.8         |
| Warrant expense (selling & marketing) | 6.2         |             |             |
| General and administrative            | 19.9        | 16.6        | 18.2        |
| Total operating expenses              | 55.1        | 43.5        | 53.1        |
| Operating income (loss)               | 0.3         | 10.6        | (17.0 )     |
| Other income                          | 0.6         | 0.3         | 0.1         |
| Income (loss) before taxes            | 0.9         | 10.9        | (16.9 )     |
| Income tax benefit                    | 8.7         |             |             |
| Net income (loss)                     | 9.6 %       | 10.9 %      | (16.9 )%    |

#### **Critical Accounting Policies**

Our discussion of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. During the preparation of these financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, net revenues, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowance for doubtful accounts, income taxes, and stock-based compensation expense. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and the impact of such differences may be material to our consolidated financial statements.

We believe the following critical accounting policies affect our more significant judgements and estimates used in the preparation of our financial statements:

**Revenue Recognition.** The Company recognizes revenue from Insignia POPSigns ratably over the period of service, which is either a two-week or four-week display cycle. We recognize revenue related to equipment, software and sign card sales at the time the products are shipped to customers. Revenue associated with maintenance agreements is recognized ratably over the life of the contract. Revenue that has been billed and not yet recognized is reflected as deferred revenue on our balance sheet.

**Allowance for Doubtful Accounts.** An allowance is established for estimated uncollectible accounts receivable. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, the condition of the general economy and the industry as a whole and other relevant facts and circumstances. Unexpected changes in the aforementioned factors could result in materially different amounts.

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**Income Taxes.** We account for income taxes in accordance with Statement of Financial Accounting Standard No. 109, or FAS 109, *Accounting for Income Taxes*, as clarified by FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). Under this method, deferred income taxes are determined based on the estimated future tax effects of differences between the financial statement and tax bases of assets and liabilities given the provisions of enacted tax laws. Deferred income tax provisions and benefits are based on changes to the assets or liabilities from year to year. In providing for deferred taxes, we consider tax regulations of the jurisdictions in which we operate, estimates of future taxable income, and available tax planning strategies. If tax regulations, operating results or the ability to implement tax-planning strategies vary, adjustments to the carrying value of deferred tax assets and liabilities may be required. Valuation allowances are recorded related to deferred tax assets based on the more likely than not criteria of FAS No. 109.

FIN 48 requires that we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

At December 31, 2007, the Company determined that it was appropriate to recognize approximately \$2.1 million of its deferred tax assets through reversal of its valuation allowance. This leaves approximately \$6.7 million of the Company's net deferred tax assets being offset with a valuation allowance. The Company cannot be certain that it will be more likely than not that these deferred tax assets will be realized in future years.

**Stock-Based Compensation.** Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. We use the Black-Scholes option pricing model to determine the weighted average fair value of options and employee stock purchase plan rights. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as by assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

The expected terms of the options and employee stock purchase plan rights are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to

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the expected life at grant date. Volatility is based on historical and expected future volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to in the future. SFAS 123R requires forfeitures to be estimated at the time of the grant and revised, if necessary, in subsequent periods if actual forfeitures differ from estimates.

If factors change and we employ different assumptions in the application of SFAS 123R to grants in future periods, the compensation expense that we record under SFAS 123R may differ significantly from what we have recorded in the current periods.

### **Fiscal 2007 Compared to Fiscal 2006**

**Net Sales.** Net sales for the year ended December 31, 2007 increased 11.6% to \$24,431,000 compared to \$21,894,000 for the year ended December 31, 2006.

Service revenues from our POPSign programs for the year ended December 31, 2007 increased 12.3% to \$21,589,000 compared to \$19,219,000 for the year ended December 31, 2006. The increase was primarily due to an increase in the number of POPSign programs sold to consumer packaged goods manufacturers.

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Product sales for the year ended December 31, 2007 increased 6.2% to \$2,842,000 compared to \$2,675,000 for the year ended December 31, 2006. The increase was primarily due to increased sales of laser label supplies which were partially offset by decreased sales of thermal sign card supplies.

**Gross Profit.** Gross profit for the year ended December 31, 2007 increased 14.4% to \$13,542,000 compared to \$11,840,000 for the year ended December 31, 2006. Gross profit as a percentage of total net sales increased to 55.4% for 2007 compared to 54.1% for 2006.

Gross profit from our POPSign program revenues for the year ended December 31, 2007 increased 15.8% to \$12,419,000 compared to \$10,725,000 for the year ended December 31, 2006. The increase was primarily due to increased sales and the effect of fixed costs. Gross profit as a percentage of POPSign program revenues increased to 57.5% for 2007 compared to 55.8% for 2006, due to the factors discussed above.

Gross profit from our product sales for the year ended December 31, 2007 increased 0.7% to \$1,123,000 compared to \$1,115,000 for the year ended December 31, 2006. Gross profit as a percentage of product sales decreased to 39.5% for 2007 compared to 41.7% for 2006. The decrease was primarily due to a change in the sales mix toward lower margin products.

### *Operating Expenses*

**Selling.** Selling expenses (exclusive of selling related warrant expense) for the year ended December 31, 2007 increased 17.1% to \$5,664,000 compared to \$4,838,000 for the year ended December 31, 2006, primarily due to increased sales commissions as a result of increased sales, increased labor and benefit costs as a result of increased headcount and salary adjustments, and increased travel related costs. Selling expenses as a percentage of total net sales increased to 23.2% in 2007 compared to 22.1% in 2006, primarily due to the factors described above offset partially by the effect of increased sales in 2007.

**Marketing.** Marketing expenses (exclusive of marketing related warrant expense) for the year ended December 31, 2007 increased 34.3% to \$1,412,000 compared to \$1,051,000 for the year ended December 31, 2006, primarily due to increased labor and benefit costs (as a result of increased headcount and salary adjustments) and increased data acquisition and analysis costs. Marketing expenses as a percentage of total net sales increased to 5.8% in 2007 compared to 4.8% in 2006, primarily due to the factors described above offset partially by the effect of increased sales in 2007.

**Warrant expense (selling and marketing).** On July 2, 2007, the Company and Valassis Sales and Marketing Services, Inc. ( Valassis ), entered into Amendment No. 2 (the Amendment ) to the Exclusive Reseller Agreement between the parties. The Amendment extends the term of the strategic alliance between the parties to December 31, 2017. The Amendment also expands the strategic alliance to increase the role of Valassis in the selling and marketing efforts of developing and expanding the Company s participating retailer network. Valassis received a five-year warrant to acquire 800,000 shares of the Company s common stock at a price of \$4.04 and will be paid a cash commission by the Company on the revenue the Company realizes from POPS programs the consumer packaged goods manufacturers conduct in the new retail chains. For the year ended December 31, 2007, the Company recorded \$1,521,000 of expense related to the fair value of the warrant.

**General and Administrative.** General and administrative expenses for the year ended December 31, 2007 increased 33.7% to \$4,864,000 compared to \$3,637,000 for the year ended December 31, 2006, primarily due to increased legal costs and increased labor and benefit costs (resulting from increased headcount, salary adjustments and increased stock-based compensation costs). General and administrative expenses as a percentage of total net sales increased to 19.9% in 2007 compared to 16.6% in 2006, primarily due to the factors described above offset partially by the effect of increased sales in 2007. Legal fees were \$1,883,000 for the year ended December 31, 2007 compared to \$1,143,000 for the year ended December 31, 2006. The legal fees in each year were incurred primarily in connection with two News America lawsuits described elsewhere herein. Legal fees increased in 2007 primarily due to the increase in activity in the News America litigation as the parties prepare to be trial-ready by December 12, 2008. We currently expect the amount of legal fees that will be incurred in connection with the ongoing lawsuit to be significant throughout 2008 as both parties are now engaged in pre-trial discovery. Also, if the Company is required to pay a significant amount in settlement or damages, it will have a material adverse effect on its operations and financial condition. In addition, a negative outcome of this litigation could affect long-term competitive aspects of the Company s business.

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**Other Income (Expense).** Other income (net) for the year ended December 31, 2007 was \$153,000 compared to other income (net) of \$82,000 for the year ended December 31, 2006. Interest income of \$247,000 for the year ended December 31, 2007 versus interest income of \$123,000 for the year ended December 31, 2006 was the result of higher interest rates and higher cash balances during the 2007 period. Interest expense of \$95,000 for the year ended December 31, 2007 versus \$146,000 for the year ended December 31, 2006 was primarily due to the expiration of the line of credit on April 30, 2007. Other income for the year ended December 31, 2006 also included \$100,000 of income from the sale of certain VALUSTix assets. During 2006, the Company ceased all business activities related to VALUSTix.

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**Income Taxes.** The Company recorded an income tax benefit for the year ended December 31, 2007 of \$2,109,000 as a result of the reversal of \$2,337,000 of the valuation allowance against the deferred tax assets, change in deferred tax assets of \$206,000 and \$22,000 of current income tax expense related to Federal alternative minimum tax liability and other state tax liabilities. The Company recorded no income tax expense for the year ended December 31, 2006 primarily due to the deduction for tax purposes in 2006 of the remaining unamortized goodwill associated with the VALUSTix acquisition. For financial statement purposes the goodwill was determined to be impaired in 2003 and 2004 and was written-off during those periods. During 2006, the Company ceased all business activities related to VALUSTix and abandoned the VALUSTIX trademark.

**Net Income.** Net income for the year ended December 31, 2007 was \$2,343,000 compared to \$2,396,000 for the year ended December 31, 2006.

### Fiscal 2006 Compared to Fiscal 2005

**Net Sales.** Net sales for the year ended December 31, 2006 increased 11.7% to \$21,894,000 compared to \$19,598,000 for the year ended December 31, 2005.

Service revenues from our POPSign programs for the year ended December 31, 2006 increased 16.9% to \$19,219,000 compared to \$16,445,000 for the year ended December 31, 2005. The increase was primarily due to a change in the sales mix towards higher-priced custom POPSign programs sold to customers during the year combined with an increase in the number of programs sold.

Product sales for the year ended December 31, 2006 decreased 15.2% to \$2,675,000 compared to \$3,153,000 for the year ended December 31, 2005. The decrease was due to general decreasing demand for our products from our customers.

**Gross Profit.** Gross profit for the year ended December 31, 2006 increased 67.3% to \$11,840,000 compared to \$7,079,000 for the year ended December 31, 2005. Gross profit as a percentage of total net sales increased to 54.1% for 2006 compared to 36.1% for 2005.

Gross profit from our POPSign program revenues for the year ended December 31, 2006 increased 90.5% to \$10,725,000 compared to \$5,630,000 for the year ended December 31, 2005. The increase was primarily due to the effect of reduced retailer expense and other cost reductions. Gross profit as a percentage of POPSign program revenues increased to 55.8% for 2006 compared to 34.2% for 2005, due to the factors discussed above.

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Gross profit from our product sales for the year ended December 31, 2006 decreased 23.1% to \$1,115,000 compared to \$1,449,000 for the year ended December 31, 2005. Gross profit as a percentage of product sales decreased to 41.7% for 2006 compared to 46.0% for 2005. The decreases were primarily due to decreases in sales of higher margin products and the effect of fixed costs on decreased sales.

*Operating Expenses*

**Selling.** Selling expenses for the year ended December 31, 2006 decreased 15.1% to \$4,838,000 compared to \$5,697,000 for the year ended December 31, 2005, primarily due to sales force reductions in December of 2005 and decreased third-party compliance costs which were partially offset by increased sales commissions due to increased sales. Selling expenses as a percentage of total net sales decreased to 22.1% in 2006 compared to 29.1% in 2005, primarily due to the factors described above, combined with the effect of increased sales.

**Marketing.** Marketing expenses for the year ended December 31, 2006 decreased 7.4% to \$1,051,000 compared to \$1,135,000 for the year ended December 31, 2005, primarily due to reductions in staff, decreased out-sourced data analysis and reduced advertising expense. Marketing expenses as a percentage of total net sales decreased to 4.8% in 2006 compared to 5.8% in 2005, primarily due to the factors described above, combined with the effect of higher net sales.

**General and Administrative.** General and administrative expenses for the year ended December 31, 2006 increased 1.6% to \$3,637,000 compared to \$3,578,000 for the year ended December 31, 2005, primarily due to increased employed and temporary staffing costs in 2006, increased public relations expense in 2006, and stock-based compensation costs recognized in 2006 due to the adoption of SFAS 123R, which were partially offset by decreased legal costs in 2006. General and administrative expenses as a percentage of total net sales decreased to 16.6% in 2006 compared to 18.2% in 2005, primarily due to the factors described above, combined with the effect of increased sales. Legal fees were \$1,143,000 for the year ended December 31, 2006 compared to \$1,352,000 for the year ended December 31, 2005. The legal fees in each year were incurred primarily in connection with the News America lawsuit described elsewhere herein.

**Other Income (Expense).** Other income (net) for the year ended December 31, 2006 was \$82,000 compared to other income (net) of \$23,000 for the year ended December 31, 2005. Other income (net) in 2006 included \$100,000 from the sales of certain assets per the terms of the settlement agreement with Paul Richards and his company (see Note 3 to the financial statements). Higher interest income of \$123,000 for the year ended December 31, 2006 versus interest income of \$71,000 for the year ended December 31, 2005 was the result of higher interest rates and higher cash balances during the 2006 period. Interest expense of \$146,000 in 2006 versus \$53,000 in 2005 was primarily due to interest expense in 2006 related to an agreement reached with a retailer effective December 31, 2005, for the deferred payment of certain obligations.

**Income Taxes.** The Company recorded no income tax expense for the year ended December 31, 2006, primarily due to the deduction for tax purposes in 2006 of the remaining unamortized goodwill associated with the VALUSTix acquisition. For financial statement purposes the goodwill was determined to be impaired in 2003 and 2004 and was written-off during those periods. During 2006, the Company ceased all business activities related to VALUSTix and abandoned the VALUSTIX trademark. For the year ended December 31, 2005, the Company reported losses for financial statement and tax purposes.

**Net Income (Loss).** Net income for the year ended December 31, 2006 was \$2,396,000 compared to a net loss of \$(3,308,000) for the year ended December 31, 2005.

## 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 December 31, 2007, working capital was \$7,751,000 compared to \$5,017,000 at December 31, 2006. During the same period total cash and cash equivalents increased \$3,608,000 to \$7,393,000.

Net cash provided by operating activities during 2007 was \$3,724,000. The increase in cash and cash equivalents resulted from net income of \$2,343,000, non-cash expense (net) of \$132,000 (for depreciation, amortization, deferred income tax benefit, stock-based compensation and warrant expense) and \$1,249,000 of cash provided by changes in operating assets and liabilities. Accounts receivable decreased \$770,000 during 2007 primarily due to lower net sales in the last two months of 2007 as compared to net sales in the last two months of 2006. Accrued liabilities increased \$476,000 during 2007 primarily as a result of increased commissions and legal expense payable at December 31, 2007. The Company expects accounts receivable, accounts payable and accrued liabilities to fluctuate during future periods depending on the level of quarterly POPSign revenues and legal activity related to the News America litigation.

Net cash of \$164,000 was used in investing activities in 2007 due to the purchase of property and equipment, primarily information technology hardware and software expenditures. The Company expects that the level of 2008 capital expenditures will be in the range of \$550,000 to \$750,000 as the Company makes additional information technology expenditures, purchases several replacement digital printers for POPSign production and anticipates some capital expenditures related to its move to a new facility in the summer of 2008.

Net cash of \$48,000 was provided by financing activities for the year ended December 31, 2007, as a result of \$475,000 of proceeds from the issuance of common stock (from warrant, employee stock option and employee stock purchase plan exercises, net of expenses) which were partially offset by the \$186,000 paydown on the line of credit and the payment of \$241,000 of principal on long-term liabilities. Through April 30, 2007 the Company maintained a line of credit balance sufficient to generate interest charges to cover the required monthly minimum fee. The Company did not renew the line of credit agreement which expired on April 30, 2007.

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 during 2008. 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.

## New Accounting Pronouncements

### Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, Fair Value Measurements (SFAS 157). SFAS 157 provides guidance for using fair value to measure assets and liabilities and requires additional disclosure about the use of fair value measures, the information used to measure fair value and the effect fair value measurements have on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and will be effective for the Company on January 1, 2008. In February 2008, the FASB issued Statement of Position, No. 157-2 (FSP 157-2), Partial Deferral of the Effective Date of Statement 157, which delays the effective date of SFAS 157, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The Company currently believes that the adoption of SFAS 157 will have no material impact on its financial position or results of operations.

Table of ContentsThe Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No 115

In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No 115 (SFAS 159). SFAS 159 provides an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS is effective for fiscal years beginning after November 15, 2007 and will be effective for the Company on January 1, 2008. The Company currently believes that the adoption of SFAS 159 will have no material impact on its financial position or results of operations.

Business Combinations

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141 (R)). SFAS No. 141 (R) requires an acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141 (R) is effective for fiscal years after December 15, 2008. We expect to adopt SFAS No. 141 (R) on January 1, 2009, and we do not expect it to have a material effect on its financial position or results of operations.

Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statement-amendments of ARB No. 51 (SFAS No. 160). SFAS No. 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. The SFAS No. 160 also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008, which corresponds to the Company's year beginning January 1, 2009. The Company currently believes that the adoption of SFAS No. 160 will have no material impact on its financial position or results of operations.

**Contractual Obligations**

The following table summarizes the Company's contractual obligations and commercial commitments as of December 31, 2007:

**Payments due by Period**

|   | <b>Total</b> | <b>Less than<br/>1 Year</b> | <b>2-3<br/>Years</b> | <b>4-5<br/>Years</b> | <b>After<br/>5 years</b> |
|---|--------------|-----------------------------|----------------------|----------------------|--------------------------|
| Contractual Obligations:                    |              |                             |                      |                      |                          |
| Operating leases, excluding operating costs | \$ 3,745,000 | \$ 543,000                  | \$ 849,000           | \$ 882,000           | \$ 1,471,000             |
| Payments to retailers*                      | 9,551,000    | 3,995,000                   | 5,519,000            | 37,000               |                          |
| Long-term liabilities                       | 688,000      | 266,000                     | 422,000              |                      |                          |
| Purchase commitments                        | 544,000      | 495,000                     | 49,000               |                      |                          |



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Total contractual obligations                      \$ 14,528,000    \$ 5,299,000    \$ 6,839,000    \$ 919,000    \$ 1,471,000

\*On an ongoing basis, the Company negotiates renewals of various retailer agreements, some of which provide for fixed or store-based payments rather than sign placement-based payments. Upon the completion of renewals, the annual commitment amounts could be in excess of the amounts above.

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#### **Off-Balance Sheet Transactions**

None.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

#### **Item 8. Financial Statements and Supplementary Data**

### **INDEX TO FINANCIAL STATEMENTS**

The following are included on the pages indicated:

|   |    |
|---|----|
| Report of Independent Registered Public Accounting Firm                                 | 24 |
| Balance Sheets as of December 31, 2007 and 2006   | 25 |
| Statements of Operations for the years ended December 31, 2007, 2006 and 2005           | 26 |
| Statements of Shareholders' Equity for the years ended December 31, 2007, 2006 and 2005 | 27 |
| Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005           | 28 |
| Notes to Financial Statements   | 29 |

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders

Insignia Systems, Inc.

We have audited the accompanying balance sheets of Insignia Systems, Inc. (the Company) as of December 31, 2007 and 2006, and the related statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. Our audit of the basic financial statements included the financial statement schedule under Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Insignia Systems, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the financial statements, the Company adopted Financial Accounting Standards Board Statement No. 123(R), Share-Based Payments (SFAS 123R) effective January 1, 2006.

/s/ Grant Thornton LLP

Minneapolis, Minnesota

March 28, 2008

Table of Contents**Insignia Systems, Inc.****BALANCE SHEETS**

| <b>As of December 31</b>  | <b>2007</b>          | <b>2006</b>         |
|---|----------------------|---------------------|
| <b>ASSETS</b>   |                      |                     |
| <b>Current Assets:</b>  |                      |                     |
| Cash and cash equivalents   | \$ 7,393,000         | \$ 3,785,000        |
| Accounts receivable net of \$10,000 allowance in 2007 and 2006          | 2,155,000            | 2,925,000           |
| Inventories   | 397,000              | 452,000             |
| Deferred tax assets, net  | 164,000              |                     |
| Prepaid expenses and other  | 883,000              | 888,000             |
| <b>Total Current Assets</b>   | <b>10,992,000</b>    | <b>8,050,000</b>    |
| <b>Other Assets:</b>  |                      |                     |
| Property and equipment, net   | 375,000              | 477,000             |
| Non-current deferred tax assets, net                                    | 1,967,000            |                     |
| Other   | 6,000                | 56,000              |
| <b>Total Assets</b>   | <b>\$ 13,340,000</b> | <b>\$ 8,583,000</b> |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                              |                      |                     |
| <b>Current Liabilities:</b>   |                      |                     |
| Line of credit  | \$                   | \$ 186,000          |
| Current maturities of long-term liabilities                             | 266,000              | 241,000             |
| Accounts payable  | 1,369,000            | 1,345,000           |
| Accrued liabilities   |                      |                     |
| Compensation  | 622,000              | 468,000             |
| Employee stock purchase plan  | 98,000               | 98,000              |
| Legal   | 208,000              | 105,000             |
| Other   | 373,000              | 154,000             |
| Deferred revenue  | 305,000              | 436,000             |
| <b>Total Current Liabilities</b>  | <b>3,241,000</b>     | <b>3,033,000</b>    |
| <b>Long-Term Liabilities, less current maturities</b>                   | <b>422,000</b>       | <b>688,000</b>      |
| <b>Commitments and Contingencies</b>                                    |                      |                     |
| <b>Shareholders Equity:</b>   |                      |                     |
| Common stock, par value \$.01:  |                      |                     |
| Authorized shares 40,000,000 in 2007 and 2006                           |                      |                     |
| Issued and outstanding shares 15,550,000 in 2007 and 15,152,000 in 2006 | 156,000              | 152,000             |
| Additional paid-in capital  | 32,025,000           | 29,557,000          |

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|   |                      |                     |
|---|----------------------|---------------------|
| Accumulated deficit                               | (22,504,000)         | (24,847,000)        |
| Total Shareholders' Equity                        | 9,677,000            | 4,862,000           |
| <b>Total Liabilities and Shareholders' Equity</b> | <b>\$ 13,340,000</b> | <b>\$ 8,583,000</b> |

See accompanying notes to financial statements.

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**Insignia Systems, Inc.**

**STATEMENTS OF OPERATIONS**

| <b>Year Ended December 31</b>                              | <b>2007</b>         | <b>2006</b>         | <b>2005</b>           |
|--|---------------------|---------------------|-----------------------|
| Services revenues  | \$ 21,589,000       | \$ 19,219,000       | \$ 16,445,000         |
| Products sold  | 2,842,000           | 2,675,000           | 3,153,000             |
| Total Net Sales  | 24,431,000          | 21,894,000          | 19,598,000            |
| Cost of services   | 9,170,000           | 8,494,000           | 10,815,000            |
| Cost of goods sold   | 1,719,000           | 1,560,000           | 1,704,000             |
| Total Cost of Sales  | 10,889,000          | 10,054,000          | 12,519,000            |
| Gross Profit   | 13,542,000          | 11,840,000          | 7,079,000             |
| <b>Operating Expenses:</b>                                 |                     |                     |                       |
| Selling  | 5,664,000           | 4,838,000           | 5,697,000             |
| Marketing  | 1,412,000           | 1,051,000           | 1,135,000             |
| Warrant expense  | 1,521,000           |                     |                       |
| General and administrative                                 | 4,864,000           | 3,637,000           | 3,578,000             |
| Total Operating Expenses                                   | 13,461,000          | 9,526,000           | 10,410,000            |
| Operating Income (Loss)                                    | 81,000              | 2,314,000           | (3,331,000)           |
| <b>Other Income (Expense):</b>                             |                     |                     |                       |
| Interest income  | 247,000             | 123,000             | 71,000                |
| Interest expense   | (95,000)            | (146,000)           | (53,000)              |
| Other income   | 1,000               | 105,000             | 5,000                 |
| Total Other Income   | 153,000             | 82,000              | 23,000                |
| Income (Loss) Before Taxes                                 | 234,000             | 2,396,000           | (3,308,000)           |
| Income tax benefit   | 2,109,000           |                     |                       |
| <b>Net Income (Loss)</b>                                   | <b>\$ 2,343,000</b> | <b>\$ 2,396,000</b> | <b>\$ (3,308,000)</b> |
| Net income (loss) per share:                               |                     |                     |                       |
| Basic  | \$ 0.15             | \$ 0.16             | \$ (0.22)             |
| Diluted  | \$ 0.14             | \$ 0.15             | \$ (0.22)             |
| Shares used in calculation of net income (loss) per share: |                     |                     |                       |
| Basic  | 15,411,000          | 15,093,000          | 15,002,000            |
| Diluted  | 16,186,000          | 15,556,000          | 15,002,000            |

See accompanying notes to financial statements.

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**Insignia Systems, Inc.**

**STATEMENTS OF SHAREHOLDERS EQUITY**

|                                       | Common Stock |            | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Total        |
|---------------------------------------|--------------|------------|----------------------------------|------------------------|--------------|
|                                       | Shares       | Amount     |                                  |                        |              |
| <b>Balance at December 31, 2004</b>   | 14,974,000   | \$ 150,000 | \$ 29,118,000                    | \$ (23,935,000)        | \$ 5,333,000 |
| Issuance of common stock, net         | 28,000       |            | 47,000                           |                        | 47,000       |
| Net loss                              |              |            |                                  | (3,308,000 )           | (3,308,000 ) |
| <b>Balance at December 31, 2005</b>   | 15,002,000   | 150,000    | 29,165,000                       | (27,243,000)           | 2,072,000    |
| Issuance of common stock, net         | 150,000      | 2,000      | 133,000                          |                        | 135,000      |
| Value of stock-based compensation     |              |            | 259,000                          |                        | 259,000      |
| Net income                            |              |            |                                  | 2,396,000              | 2,396,000    |
| <b>Balance at December 31, 2006</b>   | 15,152,000   | 152,000    | 29,557,000                       | (24,847,000)           | 4,862,000    |
| Issuance of common stock, net         | 398,000      | 4,000      | 471,000                          |                        | 475,000      |
| Value of stock-based compensation     |              |            | 476,000                          |                        | 476,000      |
| Value of warrants issued for services |              |            | 1,521,000                        |                        | 1,521,000    |
| Net income                            |              |            |                                  | 2,343,000              | 2,343,000    |
| <b>Balance at December 31, 2007</b>   | 15,550,000   | \$ 156,000 | \$ 32,025,000                    | \$ (22,504,000)        | \$ 9,677,000 |

See accompanying notes to financial statements.

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**Insignia Systems, Inc.**

**STATEMENTS OF CASH FLOWS**

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| Year Ended December 31   | 2007         | 2006        | 2005           |
|--|--------------|-------------|----------------|
| <b>Operating Activities:</b>   |              |             |                |
| Net income (loss)  | \$2,343,000  | \$2,396,000 | \$(3,308,000 ) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |              |             |                |
| Depreciation and amortization  | 266,000      | 207,000     | 239,000        |
| Deferred income tax benefit  | (2,131,000 ) |             |                |
| Provision for bad debt expense   |              | (31,000 )   | 14,000         |
| Stock-based compensation   | 476,000      | 259,000     |                |
| Warrant expense  | 1,521,000    |             |                |
| Changes in operating assets and liabilities:   |              |             |                |
| Accounts receivable  | 770,000      | (600,000 )  | (74,000 )      |
| Inventories  | 55,000       | (4,000 )    | 47,000         |
| Prepaid expenses and other   | 55,000       | (133,000 )  | (295,000 )     |
| Accounts payable   | 24,000       | (425,000 )  | (159,000 )     |
| Accrued liabilities  | 476,000      | (132,000 )  | (52,000 )      |
| Deferred revenue   | (131,000 )   | (176,000 )  | 320,000        |
| Net cash provided by (used in) operating activities  | 3,724,000    | 1,361,000   | (3,268,000 )   |
| <b>Investing Activities:</b>   |              |             |                |
| Purchases of property and equipment  | (164,000 )   | (275,000 )  | (128,000 )     |
| Net cash used in investing activities  | (164,000 )   | (275,000 )  | (128,000 )     |
| <b>Financing Activities:</b>   |              |             |                |
| Net change in line of credit   | (186,000 )   | 54,000      | (96,000 )      |
| Payment of long-term liabilities   | (241,000 )   | (201,000 )  |                |
| Proceeds from issuance of common stock, net  | 475,000      | 135,000     | 47,000         |
| Net cash provided by (used in) financing activities  | 48,000       | (12,000 )   | (49,000 )      |
| Increase (decrease) in cash and cash equivalents   | 3,608,000    | 1,074,000   | (3,445,000 )   |
| Cash and cash equivalents at beginning of year   | 3,785,000    | 2,711,000   | 6,156,000      |
| Cash and cash equivalents at end of year   | \$7,393,000  | \$3,785,000 | \$2,711,000    |
| <b>Non-cash transaction:</b>   |              |             |                |
| Accrued liabilities (retailer guarantees) converted to long-term liabilities (see Note 5)          | \$           | \$          | \$1,130,000    |
| <b>Supplemental disclosures for cash flow information:</b>   |              |             |                |
| Cash paid during the year for interest   | \$53,000     | \$103,000   | \$52,000       |
| Cash paid during the year for income taxes   | \$60,000     | \$          | \$             |

See accompanying notes to financial statements.

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Insignia Systems, Inc.

**NOTES TO FINANCIAL STATEMENTS**

1. **Summary of Significant Accounting Policies.**

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**Description of Business.** Insignia Systems, Inc. (the Company) markets in-store advertising products, programs and services to retailers and consumer packaged goods manufacturers. The Company's products include the Insignia Point-of-Purchase Services (POPS) in-store advertising program, thermal sign card supplies for the Company's SIGNright and Impulse systems, Stylus software and laser printable cardstock and label supplies.

**Revenue Recognition.** The Company recognizes revenue from Insignia POPSigns ratably over the period of service. The Company recognizes revenue related to equipment, software and sign card sales at the time the products are shipped to customers. Revenue associated with maintenance agreements is recognized ratably over the life of the contract. Revenue that has been billed and not yet earned is reflected as deferred revenue on the Balance Sheet.

**Cash Equivalents.** The Company considers all highly liquid investments with an original maturity date of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value. At December 31, 2007, \$1,345,000 was invested in an overnight repurchase account, \$6,000,000 was invested in certificates of deposit and \$5,000 was invested in a short-term money market account. At December 31, 2006, \$980,000 was invested in an overnight repurchase account, \$2,800,000 was invested in certificates of deposit and \$5,000 was invested in a short-term money market account.

**Fair Value of Financial Instruments.** The financial statements include the following financial instruments: cash and cash equivalents, accounts receivable, line of credit, accounts payable and long-term liabilities. The fair value of the long-term liabilities is estimated based on the use of discounted cash flow analysis using interest rates for other debt offered to the Company. The Company estimates the carrying value of the long-term liabilities approximates fair value. All other financial instruments approximate fair value because of the short-term nature of these instruments.

**Accounts Receivable.** The majority of the Company's accounts receivable is due from companies in the consumer packaged goods industry. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are due within 30-60 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts receivable outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Changes in the Company's allowance for doubtful accounts are as follows:

| <b>December 31</b>            | <b>2007</b> | <b>2006</b> |
|-------------------------------|-------------|-------------|
| Beginning balance             | \$ 10,000   | \$ 50,000   |
| Bad debt provision (recovery) |             | (31,000)    |
| Accounts written-off          |             | (9,000)     |
| Ending balance                | \$ 10,000   | \$ 10,000   |

## Insignia Systems, Inc.

## NOTES TO FINANCIAL STATEMENTS

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

| December 31     | 2007      | 2006      |
|-----------------|-----------|-----------|
| Raw materials   | \$82,000  | \$162,000 |
| Work-in-process | 36,000    | 8,000     |
| Finished goods  | 279,000   | 282,000   |
|                 | \$397,000 | \$452,000 |

**Property and Equipment.** Property and equipment is recorded at cost. Significant additions or improvements extending asset lives are capitalized, while repairs and maintenance are charged to expense when incurred. Depreciation is provided in amounts sufficient to relate the cost of assets to operations over their estimated useful lives. The straight-line method of depreciation is used for financial reporting purposes and accelerated methods are used for tax purposes. Estimated useful lives of the assets are as follows:

|                                 |           |
|---------------------------------|-----------|
| Production tooling              | 1-3 years |
| Machinery and equipment         | 5 years   |
| Office furniture and fixtures   | 3 years   |
| Computer equipment and software | 3 years   |

Leasehold improvements are amortized over the shorter of the remaining term of the lease or estimated life of the asset.

**Impairment of Long-Lived Assets.** The Company records impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. Impaired assets are then recorded at their estimated fair market value. There were no impairments during the years ended December 31, 2007, 2006 and 2005.

**Income Taxes.** Income taxes are accounted for under the liability method. Deferred income taxes are provided for temporary differences between the financial reporting and tax basis of assets and liabilities. Deferred taxes are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment. It is the Company's policy to provide for uncertain tax positions and the related interest and penalties based upon management's assessment of whether a tax benefit is more likely than not to be sustained upon examination by tax authorities.

**Stock-Based Compensation.** Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. We use the Black-Scholes option pricing model to determine the weighted average fair value of options and employee stock purchase plan rights. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as by assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.



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**Insignia Systems, Inc.****NOTES TO FINANCIAL STATEMENTS**

The expected terms of the options and employee stock purchase plan rights are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on historical and expected future volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to in the future. SFAS 123R requires forfeitures to be estimated at the time of the grant and revised, if necessary, in subsequent periods if actual forfeitures differ from estimates.

If factors change and we employ different assumptions in the application of SFAS 123R to grants in future periods, the related compensation expense that we record under SFAS 123R may differ significantly from what we have recorded in the current periods.

**Advertising Costs.** Advertising costs are charged to operations as incurred. Advertising expenses were approximately \$9,000, \$8,000 and \$69,000 during the years ended December 31, 2007, 2006 and 2005.

**Net Income (Loss) Per Share.** Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average shares outstanding and excludes any dilutive effects of options, warrants and convertible securities. Diluted net income per share gives effect to all diluted potential common shares outstanding during the year. Options and warrants to purchase approximately 1,396,000, 1,086,000 and 1,737,000 shares of common stock with weighted average exercise prices of \$5.81, \$6.29 and \$4.92 were outstanding at December 31, 2007, 2006 and 2005 and were not included in the computation of common stock equivalents because their exercise prices were higher than the average fair market value of the common shares during the reporting periods.

For the year ended December 31, 2005, the effect of options and warrants was anti-dilutive due to the net losses incurred during the periods. Had net income been achieved, approximately 17,000 of common stock equivalents would have been included in the computation of diluted net income per share for the years ended December 31, 2005.

Weighted average common share outstanding for the years ended December 31, 2007, 2006 and 2005 were as follows:

| <b>Year ended December 31</b>                     |                         | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|---|-------------------------|-------------|-------------|-------------|
| Denominator for basic net income (loss) per share | weighted average shares | 15,411,000  | 15,093,000  | 15,002,000  |
| Effect of dilutive securities:                    |                         |             |             |             |
| Stock options                                     |                         | 775,000     | 460,000     |             |
|   |                         | 16,186,000  | 15,556,000  | 15,002,000  |

Denominator for diluted net income (loss) per share adjusted weighted average shares

**Use of Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

**Reclassifications.** Certain 2005 amounts have been reclassified to conform to the presentation in the 2006 and 2007 financial statements.

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

***New Accounting Pronouncements.***

***Fair Value Measurements:*** In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, Fair Value Measurements (SFAS 157). SFAS 157 provides guidance for using fair value to measure assets and liabilities and requires additional disclosure about the use of fair value measures, the information used to measure fair value and the effect fair value measurements have on earnings. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and will be effective for the Company on January 1, 2008. In February 2008, the FASB issued Statement of Position, No. 157-2 (FSP 157-2), Partial Deferral of the Effective Date of Statement 157, which delays the effective date of SFAS 157, for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The Company currently believes that the adoption of SFAS 157 will have no material impact on its financial position or results of operations.

***The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No 115:*** In February 2007, the FASB issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No 115 (SFAS 159). SFAS 159 provides an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS is effective for fiscal years beginning after November 15, 2007 and will be effective for the Company on January 1, 2008. The Company currently believes that the adoption of SFAS 159 will have no material impact on its financial position or results of operations.

***Business Combinations:*** In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141 (R)). SFAS No. 141 (R) requires an acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141 (R) is effective for fiscal years after December 15, 2008. We expect to adopt SFAS No. 141 (R) on January 1, 2009, and we do not expect it to have a material effect on its financial position or results of operations.

*Noncontrolling Interests in Consolidated Financial Statements:* In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statement-amendments of ARB No. 51 (SFAS No. 160). SFAS No. 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. The SFAS No. 160 also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008, which corresponds to the Company's year beginning January 1, 2009. The Company currently believes that the adoption of SFAS No. 160 will have no material impact on its financial position or results of operations.

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

2. **Property and Equipment.** Property and equipment consists of the following at December 31:

|   | <b>2007</b>  | <b>2006</b>  |
|---|--------------|--------------|
| <b>Property and Equipment:</b>              |              |              |
| Production tooling, machinery and equipment | \$ 1,725,000 | \$ 1,792,000 |
| Office furniture and fixtures               | 191,000      | 191,000      |
| Computer equipment and software             | 698,000      | 661,000      |
| Leasehold improvements                      | 368,000      | 341,000      |
|   | 2,982,000    | 2,985,000    |
| Accumulated depreciation and amortization   | (2,607,000 ) | (2,508,000 ) |
| Net Property and Equipment                  | \$ 375,000   | \$ 477,000   |

3. **Line of Credit.** On September 16, 2004, the Company entered into a Financing Agreement, Security Agreement and Revolving Note (collectively, the Credit Agreement ) with Marquette Business Credit, Inc. which was in effect through April 30, 2007. Borrowings of \$186,000 were outstanding with an effective rate of 10.75% as of December 31, 2006. The Company did not renew the Credit Agreement and all borrowings were repaid as of April 30, 2007.

4. **Long-Term Liabilities.** Effective December 31, 2005 the Company reached an agreement with a retailer for the deferred payment of certain obligations on an interest-free basis. These obligations are recorded as long-term liabilities with an imputed annual interest rate of 10.0%.

| <b>December 31</b>   | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|
| Uncollateralized three year liability, payable in monthly installments | \$ 290,000  | \$ 531,000  |
| Uncollateralized liability, due December 31, 2009                      | 179,000     | 179,000     |
| Uncollateralized liability, due December 31, 2010                      | 219,000     | 219,000     |
| Total  | 688,000     | 929,000     |
| Less current maturities  | (266,000 )  | (241,000 )  |
|  | \$ 422,000  | \$ 688,000  |

5. **Commitments and Contingencies.**

**Operating Leases.** The Company conducts its operations in a leased facility. The operating lease is effective until July 31, 2008. During 2005 the Company entered into an agreement to sub-lease a portion of its facility which is in effect through July 31, 2008. On March 27, 2008, the

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Company entered into an operating lease for a replacement facility which is in effect from August 2008 through February 2016. The Company also leases equipment under operating lease agreements effective through September 2009. Rent expense under all of these leases, net of sub-lease rental income, was approximately \$527,000, \$527,000 and \$1,070,000 for the years ended December 31, 2007, 2006 and 2005.

Minimum future lease obligations under these leases, net of sub-lease rental income and excluding operating costs, are approximately as follows for the years ending December 31:

|            |            |
|------------|------------|
| 2008       | \$ 543,000 |
| 2009       | 422,000    |
| 2010       | 427,000    |
| 2011       | 436,000    |
| 2012       | 446,000    |
| Thereafter | 1,471,000  |

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#### **Insignia Systems, Inc.**

#### **NOTES TO FINANCIAL STATEMENTS**

**Legal.** In August 2000, News America Marketing In-Store, Inc. (News America), brought suit against the Company in U.S. District Court in New York, New York. The case was settled in November 2002. The terms of the settlement agreement are confidential. The settlement did not impact the Company's operating results.

In October 2003, News America brought suit against the Company in U.S. District Court in New York, New York, alleging that the Company has engaged in deceptive acts and practices, has interfered with existing business relationships with retailers and prospective economic advantage, and has engaged in unfair competition. The suit sought unspecified damages and injunctive relief. In February 2007 the U.S. District Court in New York transferred this action to Minnesota where the claims became part of the lawsuit the Company filed against News America and Albertson's Inc., and the New York action was subsequently dismissed.

On September 23, 2004, the Company brought suit against News America and Albertson's Inc. 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 seeks injunctive relief sufficient to prevent further antitrust injury and an award of treble damages to be determined at trial for the harm caused to the Company. On June 30, 2006 the Court denied the motions of News America and Albertson's to dismiss the suit. On September 20, 2006, the State of Minnesota through its Attorney General intervened as a co-plaintiff in the business disparagement portion of the Minnesota case. In December 2006 News America filed counterclaims similar to the claims in its New York action against Insignia and one of its officers. Motions to dismiss the counterclaims were argued in June 2007, and on September 28, 2007 the Court denied the motions to dismiss the counterclaims. The parties are now engaged in pre-trial discovery. Pursuant to Court order, all discovery and pre-trial matters must be completed by December 12, 2008. 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.

Management believes that News America's counterclaims are without merit. An evaluation of the likelihood of an unfavorable outcome and an estimate of the potential liability cannot be rendered at this time. If the Company is required to pay a significant amount in settlement or damages, it will have a material adverse effect on its operations and financial condition. In addition, a negative outcome of this litigation could affect long-term competitive aspects of the Company's business.

The Company filed claims in December 2006 and January 2007 with its director's and officer's liability and general liability insurers related to the defense costs and insurance coverage for claims asserted against the Company and one of its officers in News America's counterclaims. On August 9, 2007, the Company filed a complaint against the insurers in Hennepin County District Court, State of Minnesota requesting a declaratory judgment that the insurers owe the Company and its officer such defense costs and insurance coverage. In December 2007, the company settled its claim against one of its insurers.

Management currently expects the amount of legal fees that will be incurred in connection with the ongoing lawsuit to be significant throughout 2008 and 2009. During the twelve months ended December 31, 2007, the Company incurred legal fees of \$1,758,000 related to the News America litigation. Legal fees are expensed as incurred.

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

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.

**Retailer Agreements.** The Company has contracts in the normal course of business with various retailers, some of which during the year ended December 31, 2005, provided for minimum annual program levels. If those minimum levels were not met, the Company was obligated to pay the contractual difference to the retailers. During the year ended December 31, 2005 the Company incurred approximately \$2,131,000 of costs related to these minimums. Other retailer agreements provide for fixed or store-based payments rather than sign placement-based payments. During the years ended December 31, 2007 and 2006, the Company incurred \$3,730,000 and \$3,502,000 of costs related to fixed and store-based payments. The amounts were recorded in Cost of Services in the Statements of Operations.

Aggregate commitment amounts under agreements with retailers are approximately as follows for the years ending December 31:

|      |              |
|------|--------------|
| 2008 | \$ 3,995,000 |
| 2009 | 2,852,000    |
| 2010 | 2,667,000    |
| 2011 | 37,000       |

On an ongoing basis the Company negotiates renewals of various retailer agreements. Upon the completion of future contract renewals, the annual commitment amounts for 2008 and thereafter could be in excess of the amounts above.

**6. Shareholders Equity.**

**Private Placements and Warrants.** On December 18, 2002, the Company closed a private placement of \$7,500,000 of common stock to a small group of accredited investors at a price of \$9.19 per share, pursuant to a Securities Purchase Agreement. The price represented a 15% discount from the average closing bid price of the Company's common stock over the five days prior to the closing. As part of this offering, the Company also issued warrants to the investors entitling them to purchase an additional 244,827 shares of the Company's common stock at an initial exercise price of \$12.44 per share for a five-year period. Additionally, a warrant to purchase 40,805 shares with the same terms was issued to the Placement Agent. The warrant agreements were amended, effective December 29, 2003, to adjust the exercise price of the warrants to \$2.75 per share in exchange for certain terms of the warrant agreement being deleted in their entirety. During the year ended December 31, 2007, 110,122 of the warrants were exercised and the remaining 175,510 warrants expired on December 18, 2007.

On July 2, 2007, the Company issued a warrant to purchase 800,000 shares of the Company's common stock to Valassis Sales and Marketing Services, Inc. ( Valassis ) at a price of \$4.04 for a term of five years. The warrant was issued for services to develop and expand the Company's participating retailer network in conjunction with Amendment No. 2 to the Exclusive Reseller Agreement which defines the terms of the strategic sales alliance between the Company and Valassis. The Company recorded \$1,521,000 of expense related to the fair value of the warrant. The Black-Scholes option-pricing model was used to estimate the fair value of the warrant using an expected life of 5 years, volatility of 40%, a dividend yield of 0% and a risk-free interest rate of 4.9%. At December 31, 2007, all 800,000 of the warrants were outstanding and exercisable.

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

**Stock-Based Compensation.** The Company's stock-based compensation plans are administered by the Compensation Committee of the Board of Directors, which selects persons to receive awards and determines the number of shares subject to each award and the terms, conditions, performance measures and other provisions of the award.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123R, *Share-Based Payment* (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123R is being applied on the modified prospective basis. Prior to the adoption of SFAS 123R, the Company accounted for its stock-based compensation plans under the intrinsic value method of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and accordingly, recognized no compensation expense related to the stock-based plans where the exercise price of options granted equaled the market value of the underlying common stock on the date of grant.

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Under the modified prospective approach, SFAS 123R applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized beginning in the first quarter of fiscal 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested on January 1, 2006, and compensation cost for all share-based payments granted subsequent to January 1, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Prior periods were not restated to reflect the impact of adopting the new standard.

As a result of the adoption of SFAS 123R, our financial results were lower than under our previous accounting method for stock-based compensation by the following amounts:

| <b>Year ended December 31</b>              | <b>2007</b> | <b>2006</b> |
|--|-------------|-------------|
| Income from operations before income taxes | \$476,000   | \$259,000   |
| Income from operations                     | \$476,000   | \$259,000   |
| Net income                                 | \$476,000   | \$259,000   |
| Earnings per share:                        |             |             |
| Basic                                      | \$0.03      | \$0.02      |
| Diluted                                    | \$0.03      | \$0.02      |

The following table summarizes the stock-based compensation expense which was recognized in the Statements of Operations for the years ended December 31, 2007 and 2006:

| <b>Year ended December 31</b> | <b>2007</b> | <b>2006</b> |
|-------------------------------|-------------|-------------|
| Cost of sales                 | \$91,000    | \$61,000    |
| Selling                       | 80,000      | 55,000      |
| Marketing                     | 58,000      | 32,000      |
| General and administrative    | 247,000     | 111,000     |
|                               | \$476,000   | \$259,000   |

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**Insignia Systems, Inc.**

### **NOTES TO FINANCIAL STATEMENTS**

The following table illustrates the effect on net loss and net loss per share had the Company accounted for stock-based compensation in accordance with SFAS 123R for the year ended December 31, 2005:

| <b>Year Ended December 31</b> | <b>2005</b>    |
|-------------------------------|----------------|
| Net loss, as reported         | \$(3,308,000 ) |

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|  |                |  |
|--|----------------|--|
| Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards | (480,000 )     |  |
| Pro forma net loss   | \$(3,788,000 ) |  |
|  |                |  |
| Basic and diluted net loss per share:  |                |  |
| As reported  | \$(0.22 )      |  |
| Pro forma  | \$(0.25 )      |  |

The Company uses the Black-Scholes option-pricing model to estimate fair value of stock-based awards with the following weighted average assumptions:

|                         | 2007   | 2006   | 2005   |  |
|-------------------------|--------|--------|--------|--|
| <i>Stock Options:</i>   |        |        |        |  |
| Expected life (years)   | 3.92   | 2.64   | 3.00   |  |
| Expected volatility     | 40 %   | 63 %   | 73 %   |  |
| Dividend yield          | 0 %    | 0 %    | 0 %    |  |
| Risk-free interest rate | 4.77 % | 4.91 % | 3.77 % |  |

The expected terms of the options and employee stock purchase plan rights are based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the expected life at grant date. Volatility is based on historical and expected future volatility of the Company's stock. The Company has not historically issued any dividends and does not expect to in the future.

The Company uses the straight-line attribution method to recognize expense for unvested options. The amount of share-based compensation recognized during a period is based on the value of the awards that are ultimately expected to vest. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company will re-evaluate the forfeiture rate annually and adjust it as necessary.

As of December 31, 2007, there was \$411,000 of total unrecognized compensation costs related to the outstanding stock options which is expected to be recognized over a weighted average period of 1.10 years.

**Stock Options.** Prior to 2003 the Company had a stock option plan (the 1990 Plan) for its employees and directors under which substantially all of the shares reserved for issuance had been issued. During May 2003, the Company's shareholders approved the 2003 Incentive Stock Option Plan (the 2003 Plan) and an aggregate of 350,000 shares of common stock were reserved for issuance. The shareholders approved an additional 650,000 shares for issuance in May of 2004, an additional 625,000 shares for issuance in May of 2005, and an additional 250,000 for issuance in May of 2007. The 2003 Plan replaced the 1990 Plan. Options granted under the 1990 Plan will remain in effect until they are exercised or expire according to their terms. All current option grants are made under the 2003 Plan.

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**Insignia Systems, Inc.**



**NOTES TO FINANCIAL STATEMENTS**

Under the terms of the stock option plans, the Company grants incentive or non-qualified stock options to employees and directors generally at an exercise price at or above 100% of fair market value at the close of business on the date of grant. The stock options expire five or ten years after the date of grant and generally vest over three years.

The following table summarizes activity under the Option Plans:

|                              | <b>Plan Shares<br/>Available<br/>for Grant</b> | <b>Plan<br/>Options<br/>Outstanding</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price Per<br/>Share</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|------------------------------|--|---|--|--|
| Balance at December 31, 2004 | 358,100  | 1,471,996                               | \$ 5.33  |  |
| Reserved                     | 625,000  |   |  |  |
| Granted                      | (578,300 )                                     | 578,300                                 | 0.91   |  |
| Cancelled 2003 Plan          | 158,566  | (158,566 )                              | 1.74   |  |
| Cancelled 1990 Plan          |  | (32,401 )                               | 7.63   |  |
| Balance at December 31, 2005 | 563,366  | 1,859,329                               | 4.22   |  |
| Reserved                     |  |   |  |  |
| Granted                      | (615,100 )                                     | 615,100                                 | 1.24   |  |
| Exercised                    |  | (113,331 )                              | 1.52   | \$ 179,000                               |
| Cancelled 2003 Plan          | 252,934  | (252,934 )                              | 2.44   |  |
| Cancelled 1990 Plan          |  | (61,066 )                               | 7.66   |  |
| Balance at December 31, 2006 | 201,200  | 2,047,098                               | 3.59   |  |
| Reserved                     | 250,000  |   |  |  |
| Granted                      | (513,100 )                                     | 513,100                                 | 3.74   |  |
| Exercised                    |  | (142,616 )                              | 1.23   | \$ 478,000                               |
| Cancelled 2003 Plan          | 96,968   | (96,968 )                               | 1.60   |  |
| Cancelled 1990 Plan          |  | (66,400 )                               | 8.17   |  |
| Balance at December 31, 2007 | 35,068   | 2,254,214                               | \$ 3.73  |  |

The numbers of options exercisable under the Option Plans were:

|                   |           |
|-------------------|-----------|
| December 31, 2005 | 1,207,131 |
| December 31, 2006 | 1,242,487 |
| December 31, 2007 | 1,372,417 |

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The following table summarizes information about the stock options outstanding at December 31, 2007:

| Ranges of Exercise Prices | Options Outstanding |   |   | Options Exercisable |   |
|---------------------------|---------------------|---|---|---------------------|---|
|                           | Number Outstanding  | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price Per Share | Number Exercisable  | Weighted Average Exercise Price Per Share |
| \$0.58 \$ 0.95            | 75,401              | 7.93 years                                  | \$ 0.76                                   | 41,997              | \$ 0.71                                   |
| 0.96 1.01                 | 240,600             | 7.38 years                                  | 0.96                                      | 165,263             | 0.96                                      |
| 1.02 1.20                 | 405,200             | 8.37 years                                  | 1.19                                      | 140,208             | 1.19                                      |
| 1.21 1.31                 | 270,000             | 6.71 years                                  | 1.31                                      | 240,000             | 1.31                                      |
| 1.32 1.95                 | 47,284              | 6.14 years                                  | 1.95                                      | 47,284              | 1.95                                      |
| 1.96 2.86                 | 10,800              | 8.56 years                                  | 2.86                                      | 3,602               | 2.86                                      |
| 2.87 4.28                 | 599,597             | 8.29 years                                  | 3.79                                      | 129,731             | 3.95                                      |
| 4.29 5.80                 | 90,199              | 5.28 years                                  | 5.74                                      | 89,199              | 5.75                                      |
| 5.81 8.60                 | 313,133             | 2.80 years                                  | 7.77                                      | 313,133             | 7.77                                      |
| 8.61 11.36                | 202,000             | 3.74 years                                  | 9.58                                      | 202,000             | 9.58                                      |
| \$0.58 \$11.36            | 2,254,214           | 6.67 years                                  | \$ 3.73                                   | 1,372,417           | \$ 4.49                                   |

Options outstanding under the Option Plans expire at various dates during the period October 2009 through December 2017. Options outstanding at December 31, 2007 had a weighted average remaining life of 6.67 years and an aggregate intrinsic value of \$1,702,000. Options exercisable at December 31, 2007 had a weighted average remaining life of 5.29 years and an aggregate intrinsic value of \$1,022,000. The weighted average grant-date fair value of options granted during the years ended December 31, 2007, 2006 and 2005, were \$1.38, \$0.52 and \$0.45.

**Employee Stock Purchase Plan.** The Company has an Employee Stock Purchase Plan (the Plan) that enables employees to contribute up to 10% of their compensation toward the purchase of the Company's common stock at 85% of market value. During the years ended December 31, 2007, 2006 and 2005, employees purchased 164,040, 57,460, and 28,231 shares under the Plan. At December 31, 2007, 195,577 shares are reserved for future employee purchases of common stock under the Plan. For the year ended December 31, 2007, the Company recognized \$56,000 of stock-based compensation expense related to the Plan.

7. **Income Taxes.** The provision (benefit) for income taxes consists of the following:

| Year Ended December 31                      | 2007           | 2006 | 2005 |
|---|----------------|------|------|
| Current taxes - Federal                     | \$7,000        | \$   | \$   |
| Current taxes - State                       | 15,000         |      |      |
| Deferred taxes - Federal                    | 189,000        |      |      |
| Deferred taxes - State                      | 17,000         |      |      |
| Benefit from release of valuation allowance | (2,337,000 )   |      |      |
| Provision (benefit) for income taxes        | \$(2,109,000 ) | \$   | \$   |

Table of Contents**Insignia Systems, Inc.****NOTES TO FINANCIAL STATEMENTS**

Significant components of the deferred taxes are as follows:

| <b>As of December 31</b>                                 | <b>2007</b>  | <b>2006</b>  |
|--|--------------|--------------|
| <b>Current Deferred Tax Assets:</b>                      |              |              |
| Net operating loss carryforwards                         | \$ 550,000   | \$           |
| Accrued expenses   | 96,000       | 76,000       |
| Inventory reserve  | 27,000       | 35,000       |
| Other  | 4,000        | 4,000        |
| Current deferred tax assets before valuation allowance   | 677,000      | 115,000      |
| Less valuation allowance                                 | (513,000 )   | (115,000 )   |
| Current deferred tax assets                              | \$ 164,000   | \$           |
| <b>Long -Term Deferred Tax Assets:</b>                   |              |              |
| Net operating loss carryforwards                         | \$ 7,182,000 | \$ 8,508,000 |
| Warrant expense  | 563,000      |              |
| Accrued expenses   | 215,000      | 300,000      |
| Depreciation   | 96,000       | 56,000       |
| Stock options  | 52,000       | 16,000       |
| Alternative minimum tax credits                          | 31,000       | 6,000        |
| Other  |              | 21,000       |
| Long-term deferred tax assets before valuation allowance | 8,139,000    | 8,907,000    |
| Less valuation allowance                                 | (6,172,000 ) | (8,907,000 ) |
| Long-term deferred tax assets                            | \$ 1,967,000 | \$           |

At December 31, 2007, the Company had net operating loss carryforwards of approximately \$21,600,000, which are available to offset future taxable income. The Company has determined that these carryforwards are not currently subject to the limitations of Internal Revenue Code Section 382 which provides limitations on the availability of net operating losses to offset current taxable income if an ownership change has occurred. These carryforwards will begin expiring in 2010.

During 2007 the Company generated \$25,000 of alternative minimum tax credits. At December 31, 2007, the Company had indefinite-lived alternative minimum tax credit carryforwards of \$31,000.

The Company has established a valuation allowance due to uncertainties regarding the realization of deferred tax assets. During the year ended December 31, 2007, the Company recorded a \$2,337,000 net release to the valuation allowance due to changes in the Company's expectations regarding its ability to realize certain deferred tax assets, which resulted from a determination that it was more likely than not that these deferred tax assets would be realized. The Company evaluates all significant available positive and negative evidence, including the existence of losses in recent years and its forecast of future taxable income, in assessing the need for a valuation allowance. The underlying assumptions the Company uses in forecasting future taxable income require significant judgement and take into account the Company's recent performance.

The Company will continue to assess the valuation allowance and to the extent it is determined that said allowance is no longer required, the tax benefit of the remaining deferred tax assets will be recognized in the future. Included as part of the Company's net operating loss carryforwards are approximately \$3,300,000 in tax deductions that resulted from the exercise of stock options. When these loss carryforwards are realized the

corresponding changes in the valuation allowance will be recorded as additional paid-in capital.

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**Insignia Systems, Inc.**

**NOTES TO FINANCIAL STATEMENTS**

The actual tax expense attributable to income from continuing operations differs from the expected tax expense (benefit) computed by applying the U.S. federal corporate income tax rate of 34% to the net income (loss) as follows:

| <b>Year Ended December 31</b>     | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|-----------------------------------|-------------|-------------|-------------|
| Federal statutory rate            | 34.0 %      | 34.0 %      | (34.0 )%    |
| Change in valuation allowance     | (961.0 )    | (48.2 )     | 22.2        |
| Stock options                     | 56.8        | 0.5         |             |
| State taxes                       | (41.9 )     | (0.4 )      | (0.3 )      |
| Meals & entertainment             | 9.4         | 0.8         | 0.6         |
| Expiration of carryforwards       | -           | 13.3        | 11.5        |
| Effective federal income tax rate | (902.7 )%   | 0.0 %       | 0.0 %       |

On January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No 109 (FIN 48). As a result of implementation of FIN 48, the Company has determined that no liability is required to be recognized. The Company files income tax returns in the United States and numerous state and local tax jurisdictions. Tax years that are open for examination and assessment by the Internal Revenue Service are 2004 through 2007. With limited exceptions, tax years prior to 2003 are no longer open in major state and local tax jurisdictions.

8. **Employee Benefit Plans.** The Company has a Retirement Profit Sharing and Savings Plan under Section 401(k) of the Internal Revenue Code. The plan allows employees to defer up to 50% of their wages, subject to Federal limitations, on a pre-tax basis through contributions to the plan. During the year ended December 31, 2007 the Company made a matching contribution of \$66,000 and during the years ended December 31, 2006 and 2005 the Company made no matching contributions.

9. **Concentrations.**

**Major Customers.** During the year ended December 31, 2007, two customers accounted for 15% and 11% of the Company's total net sales. At December 31, 2007, these two customers represented 23% and 4% of the Company's total accounts receivable. During the year ended December 31, 2006 two customers accounted for 26% and 10% of the Company's total net sales. At December 31, 2006, these two customers represented 20% and 14% of the Company's total accounts receivable and two other customers represented 15% and 12% of the Company's total accounts receivable.

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.

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*Export Sales.* Export sales accounted for approximately 1% of total net sales during the years ended December 31, 2007, 2006 and 2005.

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**Insignia Systems, Inc.**

### **NOTES TO FINANCIAL STATEMENTS**

#### 10. **Quarterly Financial Data.** (Unaudited)

Quarterly data for the years ended December 31, 2007 and 2006 was as follows:

| <b>Year Ended December 31, 2007</b> | <b>1st Quarter</b> | <b>2nd Quarter</b> | <b>3rd Quarter</b> | <b>4th Quarter</b> |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
| Net sales                           | \$6,065,000        | \$6,969,000        | \$6,461,000        | \$4,936,000        |
| Gross profit                        | 3,358,000          | 4,160,000          | 3,608,000          | 2,416,000          |
| Net income (loss)                   | 427,000            | 1,198,000          | (907,000 )         | 1,625,000          |
| Net income (loss) per share:        |                    |                    |                    |                    |
| Basic                               | \$0.03             | \$0.08             | \$(0.06 )          | \$0.10             |
| Diluted                             | \$0.03             | \$0.07             | \$(0.06 )          | \$0.10             |

| <b>Year Ended December 31, 2006</b> | <b>1st Quarter</b> | <b>2nd Quarter</b> | <b>3rd Quarter</b> | <b>4th Quarter</b> |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
| Net sales                           | \$5,422,000        | \$5,853,000        | \$5,112,000        | \$5,507,000        |
| Gross profit                        | 2,974,000          | 3,232,000          | 2,600,000          | 3,034,000          |
| Net income                          | 639,000            | 949,000            | 228,000            | 580,000            |
| Net income per share:               |                    |                    |                    |                    |
| Basic                               | \$0.04             | \$0.06             | \$0.02             | \$0.04             |
| Diluted                             | \$0.04             | \$0.06             | \$0.01             | \$0.04             |

#### Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosures

Not applicable.

#### Item 9A. Controls and Procedures

##### **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 (principal financial officer), of the effectiveness of the design and operation of the Company's

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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 December 31, 2007, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and the Company's Chief Financial Officer (principal financial officer) concluded that the Company's disclosure controls and procedures as of December 31, 2007 were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and are designed to ensure that information required to be disclosed by us in these reports is accumulated and communicated to our management, as appropriate to allow timely decisions regarding disclosures.

We will consider further actions and continue to evaluate the effectiveness of our disclosure controls and internal controls and procedures on an ongoing basis, taking corrective action as appropriate. Management does not expect that disclosure controls and procedures or internal controls can prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable and 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. While management believes that its disclosure controls and procedures provide reasonable assurance that fraud can be detected and prevented, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

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#### **Management's Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2007. In conducting its evaluation, our management used the criteria set forth by the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management believes our internal control over financial reporting was effective as of December 31, 2007.

The certification of the Company's Principal Executive Officer and Principal Financial Officer attached as Exhibits 31.1 and 31.2 to this Annual Report on Form 10-K include, in paragraph 4 of such certifications, information concerning the Company's disclosure controls and procedures and internal controls over financial reporting. Such certifications should be read in conjunction with the information contained in the Item 9A for a more complete understanding of the matters covered by such certifications.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

#### **Changes in Internal Control Over Financial Reporting**

No changes in the Company's internal control over financial reporting have occurred during the fourth quarter of 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

***PART III.***

Item 10. Directors, Executive Officers and Corporate Governance

Information concerning Executive Officers of the Company is included in this Annual Report in Item 4A under the caption Executive Officers of the Registrant. The information required by Item 10 concerning the directors of the Company and corporate governance is incorporated herein by reference to the Company's proxy statement for its 2008 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

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Item 11. Executive Compensation

The information required by Item 11 is incorporated herein by reference to the Company's proxy statement for its 2008 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by Item 12 is incorporated herein by reference to the Company's proxy statement for its 2008 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

Item 13. Certain Relationships and Related Transactions and Director Independence

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The information required by Item 13 is incorporated herein by reference to the Company's proxy statement for its 2008 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

### Item 14. Principal Accounting Fees and Services

The information required by Item 14 is incorporated herein by reference to the Company's proxy statement for its 2008 Annual Meeting of Shareholders which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the close of the fiscal year for which this report is filed.

### Item 15. Exhibits and Financial Statement Schedules

The following financial statements of Insignia Systems, Inc. are included in Item 8:

Report of Independent Registered Public Accounting Firm

Balance Sheets as of December 31, 2007 and 2006

Statements of Operations for the years ended December 31, 2007, 2006 and 2005

Statements of Shareholders' Equity for the years ended December 31, 2007, 2006 and 2005

Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005

Notes to Financial Statements

The following schedule of Insignia Systems, Inc. is included in Item 15:

Schedule II. Valuation and Qualifying Accounts

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(a) Exhibits



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### Exhibit

| Number | Description   | Incorporation By Reference To   |
|--------|---|---|
| 3.1    | Articles of Incorporation of Registrant, as amended to date   | Exhibit 3.1 of the Registrant's Registration Statement on Form S-18, Reg. No. 33-40765C           |
| 3.2    | Bylaws, as amended to date  | Exhibit 3.1 of the Registrant's Form 8-K filed February 23, 2007                                  |
| 4.1    | Specimen Common Stock Certificate of Registrant   | Exhibit 4.1 of the Registrant's Registration Statement on Form S-18, Reg. No. 33-40765C           |
| 10.1   | The Company's 1990 Stock Plan, as amended   | Exhibit 10.3 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001  |
| 10.2   | Lease Agreement between Insignia Systems, Inc. and the Landlord, dated October 31, 2002   | Exhibit 10.6 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2002  |
| 10.3   | Sublease Agreement between Insignia Systems, Inc. and the Sublessee dated March 31, 2005  | Exhibit 10.2 of the Registrant's Form 10-Q for the quarterly period ended March 31, 2005          |
| 10.4   | License Agreement between Thomas and Lawrence McGourty and Insignia Systems, Inc. dated January 23, 1990, as amended            | Exhibit 10.1 of the Registrant's Registration Statement on Form S-18, Reg. No. 33-40765C          |
| 10.5   | Barcode License and Support Agreement between Thomas and Lawrence McGourty and Insignia Systems, Inc. dated January 23, 1990    | Exhibit 10.2 of the Registrant's Registration Statement on Form S-18, Reg. No. 33-40765C          |
| 10.6   | Employee Stock Purchase Plan, as amended  | Exhibit 4.1 of the Registrant's Registration Statement on Form S-8, Reg. No. 333-136591           |
| 10.7   | The Company's 2003 Incentive Stock Option Plan, as amended  | Exhibit 4.1 of the Registrant's Registration Statement on Form S-8, Reg. No. 333-145506           |
| 10.8   | Amended Change in Control Severance Agreement with Scott F. Drill dated December 20, 2005                                       | Exhibit 10.10 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005 |
| 10.9   | Amended Change in Control Severance Agreement with Justin W. Shireman dated December 20, 2005                                   | Exhibit 10.11 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005 |
| 10.10  | Consulting Agreement, effective February 1, 2006, between Gary L. Vars and the Company  | Exhibit 4.1 of the Registrant's Form 8-K filed February 1, 2006                                   |
| 10.11  | Nonqualified Stock Option Agreement, effective February 1, 2006, between Gary L. Vars and the Company                           | Exhibit 4.2 of the Registrant's Form 8-K filed February 1, 2006                                   |
| 10.12  | Exclusive Reseller Agreement between Valassis Sales & Marketing Services, Inc. and the Company entered into as of June 12, 2006 | Exhibit 10.1 of the Registrant's Form 10-Q for the quarterly period ended June 30, 2006           |
| 10.13  | 2007 CEO Bonus Plan   | Exhibit 10.1 of the Registrant's Form 8-K filed January 4, 2007                                   |
| 10.14  | Amended Change in Control Severance Agreement with Scott J. Simcox dated February 20, 2007                                      | Exhibit 10.1 of the Registrant's Form 8-K filed February 23, 2007                                 |

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|-------|---|---|
| 10.15 | 2007 Annual Executive Incentive Plan dated February 20, 2007  | Exhibit 10.25 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2006 |
| 10.16 | Amended Change in Control Severance Agreement with Alan Jones dated May 23, 2007  | Exhibit 10.1 of the Registrant's Form 8-K filed May 30, 2007                                      |
| 10.17 | Amended Change in Control Severance Agreement with A. Thomas Lucas dated May 23, 2007   | Exhibit 10.2 of the Registrant's Form 8-K filed May 30, 2007                                      |
| 10.18 | Amendment #2 dated July 2, 2007 to Exclusive Reseller Agreement dated June 12, 2006 between Valassis Sales & Marketing Services, Inc. and the Company   | Exhibit 10.1 of the Registrant's Form 10-Q for the quarterly period ended June 30, 2007           |
| 10.19 | Form of Warrant dated July 2, 2007 to purchase shares of common stock issued to Valassis Sales & Marketing Services, Inc. by the Company per Amendment #2 to the Exclusive Reseller Agreement | Exhibit 10.2 of the Registrant's Form 10-Q for the quarterly period ended June 30, 2007           |
| 10.20 | Lease Termination Agreement between the Company and the Landlord, dated October 12, 2007  | Filed herewith  |
| 10.21 | Sublease Termination Agreement between the Company and the Sublessee dated October 12, 2007   | Filed herewith  |
| 10.22 | Lease Agreement between the Company and the Landlord (Opus Northwest, L.L.C.) dated March 27, 2008 (exhibits omitted)   | Filed herewith  |
| 10.23 | 2008 CEO Bonus Plan   | Filed herewith  |
| 10.24 | 2008 Executive Incentive Bonus Plan   | Filed herewith  |
| 14    | Code of Ethics  | Exhibit 14 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003    |
| 23.1  | Consent of Independent Registered Public Accounting Firm  | Filed herewith  |
| 31.1  | Certification of Principal Executive Officer  | Filed herewith  |
| 31.2  | Certification of Principal Financial Officer  | Filed herewith  |
| 32    | Section 1350 Certification  | Filed herewith  |

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**SCHEDULE II. Valuation and Qualifying Accounts**

| Description  | Balance at<br>Beginning<br>of Period | Charged to<br>Costs and<br>Expenses | Deductions<br>Describe | Balance at<br>End of<br>Period |
|--|--------------------------------------|-------------------------------------|------------------------|--------------------------------|
| Year ended December 31, 2007                               |                                      |                                     |                        |                                |
| Allowance for doubtful accounts                            | \$ 10,000                            | \$                                  | \$                     | \$ 10,000                      |
| Provision for inventory lower of cost or market adjustment | 95,000                               | (14,000 )                           | (8,000 )               | (2) 73,000                     |
| Year ended December 31, 2006                               |                                      |                                     |                        |                                |
| Allowance for doubtful accounts                            | \$ 50,000                            | \$ (31,000 )                        | \$ 9,000               | (1) \$ 10,000                  |
| Provision for inventory lower of cost or market adjustment | 107,000                              | 11,000                              | (23,000 )              | (2) 95,000                     |
| Year ended December 31, 2005                               |                                      |                                     |                        |                                |
| Allowance for doubtful accounts                            | \$ 50,000                            | \$ 14,000                           | \$ 14,000              | (1) \$ 50,000                  |
| Provision for inventory lower of cost or market adjustment | 113,000                              | (6,000 )                            | (2)                    | 107,000                        |

- (1) Uncollectible accounts written off, net of recoveries.  
(2) Inventory scrapped and disposed of.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Scott F. Drill  
Scott F. Drill  
President and CEO

Dated: March 28, 2008

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant in the capacities and on the dates indicated.

| Signature                                    | Title   | Date           |
|--|---|----------------|
| /s/ Scott F. Drill<br>Scott F. Drill         | President, Chief Executive Officer (principal executive officer) Secretary and Director                       | March 28, 2008 |
| /s/ Justin W. Shireman<br>Justin W. Shireman | Vice President of Finance, Chief Financial Officer (principal financial and accounting officer) and Treasurer | March 28, 2008 |
| /s/ Peter V. Derycz<br>Peter V. Derycz       | Director  | March 28, 2008 |
| /s/ Donald J. Kramer<br>Donald J. Kramer     | Director  | March 28, 2008 |
| /s/ Reid V. MacDonald<br>Reid V. MacDonald   | Director  | March 28, 2008 |
| /s/ W. Robert Ramsdell<br>W. Robert Ramsdell | Director  | March 28, 2008 |
| /s/ Gordon F. Stofer<br>Gordon F. Stofer     | Director  | March 28, 2008 |