

Anacomp, Inc.



Consolidated Financial Statements

Year Ended September 30, 2012



Independent Auditors' Report	3-4
-------------------------------------	-----

Consolidated Financial Statements

Consolidated Balance Sheet	5
Consolidated Statement of Income	6
Consolidated Statement of Comprehensive Income	7
Consolidated Statement of Stockholders' Deficit	8
Consolidated Statement of Cash Flows	9
Notes to the Consolidated Financial Statements	10-23



Mayer Hoffman McCann P.C.

An Independent CPA Firm

10616 Scripps Summit Court
San Diego, California 92131
858-795-2000 ph
858-795-2001 fx
www.mhm-pc.com

Independent Auditors' Report

To the Board of Directors and Stockholders of
Anacomp, Inc.
San Diego, California

We have audited the accompanying consolidated financial statements of **Anacomp, Inc.** and its subsidiaries ("the Company"), which comprise the consolidated balance sheet as of September 30, 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' deficit, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Anacomp, Inc.** and its subsidiaries as of September 30, 2012, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Mayer Hoffmann McCarron P.C.

San Diego, California
January 31, 2013

ANACOMP, INC.
CONSOLIDATED BALANCE SHEET
SEPTEMBER 30, 2012

(In thousands, except share amounts)

Assets

Current assets:

Cash and cash equivalents	\$	4,327
Accounts receivable, net of allowance for doubtful accounts of \$1		2,253
Restricted short-term certificates of deposit		300
Prepaid expenses and other current assets		285

Total current assets		7,165
----------------------	--	-------

Property and equipment, net		127
Other assets		126
Pension assets		5,828
Total Assets	\$	13,246

Liabilities and Stockholders' Deficit

Current liabilities:

Accounts payable		108
Accrued compensation, benefits and withholdings		306
Other accrued liabilities		1,021
Current portion of long-term promissory note, net of debt discount		1,068

Total current liabilities		2,503
---------------------------	--	-------

Long-term promissory note, net of debt discount		2,677
Pension obligation		8,825
Total Liabilities		14,005

Stockholders' Deficit:

Preferred stock, 1,000,000 shares authorized, none issued		---
Common stock, \$.01 par value; 40,787,711 shares authorized; 3,702,510 shares issued and outstanding at September 30, 2012		37
Additional paid-in capital		93,859
Accumulated other comprehensive loss		(1,620)
Accumulated deficit		(93,035)

Total Stockholders' Deficit		(759)
-----------------------------	--	-------

Total Liabilities and Stockholders' Deficit	\$	13,246
---	----	--------

The accompanying notes are an integral part of this consolidated financial statement.

ANACOMP, INC.
CONSOLIDATED STATEMENT OF INCOME
SEPTEMBER 30, 2012

(In thousands)

Revenues	\$ 16,716
Cost of revenues	10,786
Gross profit	<u>5,930</u>
Operating expenses:	
Selling, general and administrative	2,299
Income from operations	<u>3,631</u>
Other income (expense):	
Interest income	2
Amortization of debt discount	(195)
Interest expense	(4)
Other expense, net	(34)
Income before income taxes	<u>3,400</u>
Income tax provision	(55)
Net income	<u><u>\$ 3,345</u></u>

The accompanying notes are an integral part of this consolidated financial statement.

ANACOMP, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
SEPTEMBER 30, 2012

(In thousands)

Net income	\$	3,345
Other comprehensive loss:		
Additional minimum pension liability		(2,304)
Translation adjustment		(286)
Comprehensive income	<u>\$</u>	<u>755</u>

The accompanying notes are an integral part of this consolidated financial statement.

ANACOMP, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT

(In thousands, except share amounts)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
	Shares	Amount				
SEPTEMBER 30, 2011	3,702,510	\$ 37	\$ 93,859	\$ 970	\$ (96,380)	\$ (1,514)
Net income	-	-	-	-	3,345	3,345
Additional minimum pension liability	-	-	-	(2,304)	-	(2,304)
Translation adjustment	-	-	-	(286)	-	(286)
SEPTEMBER 30, 2012	3,702,510	\$ 37	\$ 93,859	\$ (1,620)	\$ (93,035)	\$ (759)

The accompanying notes are an integral part of this consolidated financial statement.

ANACOMP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
SEPTEMBER 30, 2012

(In thousands)

Cash flows from operating activities:	
Net income	\$ 3,345
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	142
Amortization of debt discount	195
Recoveries of doubtful accounts	(20)
Loss on disposal of property and equipment	43
Change in assets and liabilities:	
Accounts receivables	(564)
Restricted short-term certificates of deposit	245
Prepaid expenses and other assets	137
Accounts payable	(71)
Accrued compensation, benefits and withholdings	(178)
Other accrued liabilities	(980)
Net cash provided by operating activities	2,294
 Cash flows from investing activities:	
Proceeds from sale of former divisions	625
Purchases of property and equipment	(32)
Net cash used in investing activities	593
 Cash flows from financing activities:	
Principal payments on promissory note	(615)
Net cash used in financing activities	(615)
Effect of exchange rate changes on cash and cash equivalents	(28)
Increase in cash and cash equivalents	2,244
Cash and cash equivalents at beginning of year	2,083
Cash and cash equivalents at end of year	\$ 4,327

The accompanying notes are an integral part of this consolidated financial statement.

Notes to the Consolidated Financial Statements**NOTE 1.****ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:**

A summary of the Company's significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

Description of Business

Anacomp®, Inc. (the "Company"), was incorporated in the State of Indiana on April 16, 1968. The Company's primary office and operations are in San Diego, California and Chantilly, Virginia.

The Company provides its customers with document and information capture, conversion, retention, and business process management through the Company's on-demand delivery infrastructure in their document management centers or as a customized on-site solution.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

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 certain reported amounts and disclosures. Significant estimates include the allowance for doubtful accounts receivable and assumptions used in the application of fair value methodologies to calculate the fair value of pension assets and obligations. Accordingly, actual results could differ from those estimates. It is reasonably possible that the significant estimates used will change within the next year.

Cash and Cash Equivalents

Cash equivalents primarily represent highly liquid investments, with original maturities of 90 days or less, in money market funds that are convertible to a known amount of cash and carry an insignificant interest rate risk.

Restricted Short-Term Certificates of Deposit

The Company holds certificates of deposit that will mature within one year as required by the Company's travelers' insurance workers compensation policy. At September 30, 2012, the Company had restricted short-term certificates of deposit of approximately \$0.3 million.

Accounts Receivable

The Company grants unsecured credit to substantially all of its customers. Management does not believe that it is exposed to any extraordinary credit risk as a result of this policy. The Company maintains a reserve for potential credit losses and historically such losses have been within management's estimates. When evaluating the adequacy of the allowance for doubtful accounts, the Company specifically analyzes accounts receivable as well as historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in the Company's customer payment terms.

Notes to the Consolidated Financial Statements**Revenue Recognition**

The Company derives revenues from the development and implementation of document services solutions. The Company recognizes revenues in accordance with authoritative guidance. Accordingly, the Company recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured.

Property and Equipment

Property and equipment, which includes leasehold improvements, are recorded at cost and depreciated or amortized using the straight-line method over estimated useful lives. Leasehold improvements are amortized over the shorter of their estimated useful life or the remaining term of the related lease. Processing equipment and other property and equipment have useful lives ranging from two to twelve years. Repair and maintenance costs are expensed as incurred.

Defined Benefit Pension Plans

The Company recognizes the funded status (the difference between the fair value of plan assets and the projected benefit obligations) of its defined benefit plan in the Consolidated Balance Sheet, with a corresponding adjustment to accumulated other comprehensive income, net of tax, to measure the fair value of plan obligations.

Income Taxes

Deferred income taxes are recognized for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the combination of the tax payable for the year and the change during the year in deferred tax assets and liabilities.

Foreign Currency Translation

The financial position and results of operations of the Company's inactive German subsidiary are measured using the foreign subsidiary's local currency as the functional currency. Revenues and expenses of such subsidiaries have been translated into U.S. dollars at average exchange rates prevailing during the period. Assets and liabilities have been translated at the rates of exchange on the balance sheet date. The resulting translation gain and loss adjustments are recorded directly as a separate component of stockholders' equity. The cumulative translation adjustment, which is recorded in accumulated other comprehensive income, decreased approximately \$286,000 for the year ended September 30, 2012.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued authoritative guidance for the presentation of comprehensive income. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity, requires the consecutive presentation of the statement of net income and other comprehensive income, and requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income. This new standard does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor does it affect how earnings per share is calculated or presented. This guidance must be applied retrospectively and is effective for fiscal years and interim periods within those years beginning after December 15, 2011, with early adoption permitted. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Notes to the Consolidated Financial Statements**Recent Accounting Pronouncements, Cont'd**

In December 2011, the FASB issued authoritative guidance related to disclosures about offsetting assets and liabilities. The amendments in this guidance require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. Coinciding with the release of this guidance, the International Accounting Standards Board ("IASB") has issued Disclosures – Offsetting Financial Assets and Financial Liabilities. This amendment requires disclosures about the offsetting of financial assets and financial liabilities common to those in the guidance. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Company does not expect the adoption of this pronouncement to have a material impact on its consolidated financial statements.

NOTE 2.**FAIR VALUE MEASUREMENTS:**

The Company accounts for fair value measurements in accordance with authoritative guidance which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements.

Authoritative guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level - 1: Uses unadjusted quoted prices that are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the assets or liabilities occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level - 2: Uses inputs other than Level 1 that are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in markets that are not active. Level 2 also includes assets and liabilities that are valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in the models, such as interest rate volatility factors, are corroborated by readily observable data.

Level - 3: Uses inputs that are unobservable and are supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participants' assumptions.

The following table sets forth the Company's financial assets and liabilities measured at fair value by level within the fair value hierarchy. As required by authoritative guidance, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Notes to the Consolidated Financial Statements

FAIR VALUE MEASUREMENTS, CONT'D:

(In thousands)	Fair Value at September 30, 2012		
	Level 1	Level 2	Level 3
Item measured at fair value on a recurring basis:			
Pension assets excluded from net pension obligation in accordance with authoritative guidance (see Note 6)	\$ -	\$ -	\$ 5,828
Pension assets included in net pension obligation (see Note 6)	-	-	4,354
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,182</u>

The following table presents the changes in the fair value of the Company's financial assets categorized as Level 3 for the year ended September 30, 2012:

(In thousands)	Pension assets excluded from net pension obligation in accordance with authoritative guidance (see Note 6)	Pension assets included in net pension obligation (see Note 6)	Total
Balance as of September 30, 2011	\$ 6,150	\$ 4,497	\$ 10,647
Realized and unrealized losses, pension settlements - net	(322)	(143)	(465)
Balance as of September 30, 2012	<u>\$ 5,828</u>	<u>\$ 4,354</u>	<u>\$ 10,182</u>

The Company's pension assets are classified within Level 3 of the fair value hierarchy as they represent the cash surrender value of insurance contracts that are held to carry out the provisions of the plan and to finance the benefits offered under the plan. All plan assets are held in a trust and managed in a policyholder pool in Germany by outside investment managers. The investment objectives of the portfolio of plan assets are designed to generate returns that will enable the plans to meet their future obligations.

The Company monitors the activity within each level and any changes with the underlying valuation techniques or inputs utilized to recognize if any transfers between levels are necessary. That determination is made, in part, by working with outside valuation experts for Level 3 instruments and monitoring market related data and other valuation inputs for Level 1 and Level 2 instruments.

Notes to the Consolidated Financial Statements

NOTE 3.**FIXED ASSETS:**

Fixed assets consisted of the following as of September 30, 2012:

<u>(In thousands)</u>	<u>2012</u>
Office Equipment (3 years)	\$ 39
Operating Equipment (3 - 10 years)	609
	<u>648</u>
Less accumulated depreciation	<u>521</u>
Total	<u>\$ 127</u>

Total depreciation expense for the year ended September 30, 2012 was approximately \$105,000 of which approximately \$100,000 was recorded in cost of sales and approximately \$5,000 was recorded in selling, general, and administrative expenses in the consolidated statement of income.

NOTE 4.**DEBT AND LIQUIDITY:**

On May 25, 2007, the Company acquired certain assets of Caselogistix, Inc. ("CLX") a litigation support, document review and software application Company. Total consideration included \$7.0 million to be paid over the fiscal years commencing October 1, 2007 and ending September 30, 2010. On April 21, 2009 the Company and CLX restructured the agreement and entered into a noninterest bearing unsecured promissory note for the \$7.0 million that was to be paid over the fiscal years listed above to \$7.15 million to be paid over the fiscal years commencing October 1, 2008 and ending September 30, 2012. On July 28, 2011 the Company and CLX amended and restated the noninterest bearing unsecured promissory note to extend the payments of the principal balance of \$4.8 million to December 2015. In consideration of the amendment to the noninterest bearing unsecured promissory note, the Company granted CLX a warrant to purchase 205,441 shares of Class A Common Stock of the Company. The warrant has an exercise price of \$0.01 per share and may be exercised at any time from July 28, 2011 until July 28, 2021 (see Note 9). In accordance with authoritative guidance, the Company recorded a debt discount on the noninterest bearing unsecured promissory note based upon an imputed interest of 4.75% resulting in a debt discount of approximately \$520,000 which the Company will amortize over the term of the agreement using the interest method. Amortization for the debt discount amounted to approximately \$195,000 for the year ended September 30, 2012 which has been recorded in other income (expense) in the consolidated statement of income.

Notes to the Consolidated Financial Statements

DEBT AND LIQUIDITY, CONT'D:

The noninterest bearing unsecured promissory note payable at September 30, 2012 consisted of the following:

(In thousands)	<u>Principal</u>	<u>Unamortized Discount</u>	<u>Total</u>
Noninterest bearing unsecured promissory note (discount is based on imputed interest rate of 4.75%):			
Current portion	\$ 1,225	\$ 157	\$ 1,068
Long-term portion	2,845	168	2,677
	<u>\$ 4,070</u>	<u>\$ 325</u>	<u>\$ 3,745</u>

The future principal payments of the noninterest bearing unsecured promissory note are as follows:

<u>Fiscal Year</u>	<u>Amount (In thousands)</u>
2013	\$ 1,225
2014	1,175
2015	1,327
2016	343
	<u>\$ 4,070</u>

In November 2010, the Company entered into an amended and restated Business Financing Agreement with Bridge Bank, N.A. (the "credit facility") for a revolving line of credit collateralized by the Company's accounts receivable. Under the credit facility, the Company can borrow up to \$1.7 million subject to a borrowing base of eligible receivables. The borrowings under the revolving line of credit bear interest at the greater of 3.25% or prime rate plus 1.50%. The credit facility continues in perpetuity unless cancelled by either party. The agreement contains certain financial and non-financial covenants. At September 30, 2012, management was not aware of any violations of these covenants.

NOTE 5.

OTHER ACCRUED LIABILITIES:

Other accrued liabilities consist of the following as of September 30, 2012:

(In thousands)	<u>2012</u>
Accrued legal settlement	\$ 610
Accrued workers compensation	225
Other accrued liabilities	186
	<u>\$ 1,021</u>

Notes to the Consolidated Financial Statements**NOTE 6.****RETIREMENT PLANS:****Defined Contribution Plans**

The Company sponsors a retirement savings plan that qualifies under Section 401(k) of the Internal Revenue Code. Participating employees may contribute up to 15% of their pretax salary, but not more than statutory limits. The Company may contribute, at its discretion, up to fifty cents for each dollar a participant contributes, with a maximum contribution of \$2,500 per employee per plan year. For fiscal year 2012 the Company did not contribute to the retirement savings plan.

Defined Benefit Pension Plans

During 2012 the Company maintained retirement plans in place for its inactive German subsidiary that qualify as defined benefit pension plans. The plans provide benefits based primarily on length of service and final average earnings. Funding policy for the plans is to contribute amounts sufficient to meet minimum funding requirements as set forth in employee benefit and tax laws.

In accordance with accounting principles generally accepted in the United States of America, the consolidated balance sheet reflects an unfunded pension obligation of approximately \$8.8 million as of September 30, 2012. Accounting principles generally accepted in the United States of America require that the Company exclude certain German insurance contracts from the plan assets, which were valued at approximately \$5.83 million. These assets are included on the Company's consolidated balance sheet as "Pension assets." These assets exist only to provide a component of the total pension benefits payable to German employees, consistent with local law. The unfunded pension obligation would be approximately \$3 million at September 30, 2012, when reviewing the plans and including these additional assets.

The investment objectives of the portfolio of plan assets are designed to generate returns that will enable the plans to meet their future obligations. The precise amount for which these obligations will be settled depends on future events, including the life expectancy of the Plans' members. The obligations are estimated using actuarial assumptions, based on the current economic environment. The strategy balances the requirement to generate return using higher-returning assets such as equity securities, with the need to control risk in the plans with less volatile assets, such as fixed income securities.

The discount rate assumptions used for pension plan accounting reflect the prevailing rates available on high-quality, fixed-income debt instruments. The discount rate used for the year ended September 30, 2012 was 3.5% as compared to 5.0% for the year ended September 30, 2011. The decrease in the discount rate was a result of lower interest rates available on fixed-income debt instruments in Germany during 2012 as compared to 2011 which contributed to the increase in the Company's benefit obligation of approximately \$2.2 million during the year ended September 30, 2012.

The Company uses a September 30 measurement date for all of its pension plans.

Notes to the Consolidated Financial Statements

Defined Benefit Pension Plans, cont'd

The following table sets forth the benefit obligation, fair value of plan assets (excluding the \$5.83 million Pension assets noted above), and the funded status of the Company's plan; amounts recognized in the Company's consolidated financial statements; and the assumptions used in determining the actuarial present value of the benefit obligations as of September 30, 2012:

(dollars in thousands)	Year Ended September 30, 2012
Change in projected benefit obligation:	
Benefit obligation at the beginning of the year	\$ 11,082
Interest cost.....	523
Actuarial loss.....	2,634
Foreign currency exchange rate changes.....	(462)
Benefits and expenses paid	(598)
Benefit obligation at the end of the year.....	13,179
Change in fair value of plan assets:	
Fair value of plan assets at the beginning of the year.....	4,497
Expected return on plan assets.....	149
Actuarial gain	120
Foreign currency exchange rate changes.....	(178)
Benefits and expenses paid	(234)
Fair value of plan assets at the end of the year	4,354
Funded status	(8,825)
Unrecognized actuarial loss	2,514
Additional minimum liability	(2,514)
Net amount recognized	\$ (8,825)
Plan assets	
Plan assets were comprised of the following asset categories at September 30, 2012:	
Equity securities	-
Debt securities	-
Other	100%
Total.....	100%

Notes to the Consolidated Financial Statements

Defined Benefit Pension Plans, cont'd

(dollars in thousands)	Year Ended September 30, 2012
Components of net periodic benefit cost were as follows:	
Interest cost on projected benefit obligations	\$ 523
Expected return on plan assets	(149)
Net periodic benefit costs	<u>\$ 374</u>
The weighted-average assumptions used to determine net periodic benefit cost for the year ended September 30, 2012 were:	
Discount rate	3.5%
Expected return on plan assets	3.5%
Pension increases	2.0%

The following discloses information about the Company's defined benefit pension plan that had an accumulated benefit obligation in excess of plan assets as of September 30, 2012:

Projected benefit obligation	\$ 13,179
Accumulated benefit obligation	\$ 13,179
Fair value of plan assets	\$ 4,354

The following benefit payments are expected to be paid as follows:

2013	\$ 633
2014	\$ 655
2015	\$ 666
2016	\$ 675
2017	\$ 718
2018 - 2022	\$ 3,745

The Company made contributions to the plan of approximately \$37,000 during the year ended September 30, 2012 which were used to fund benefits paid to participants in excess of the return on plan assets.

NOTE 7.

COMMON STOCK:

Class A and Class B Common Stock

The Company is authorized to issue up to 40,000,000 shares of Class A Common Stock and 787,111 shares of Class B Common Stock. Each share of Class A and Class B Common Stock is identical, including voting rights, dividends, when and if declared, and liquidation rights, subject to any preference of preferred stock as may be issued in the future.

Preferred Stock

The Company's Board of Directors has the ability, at its discretion, to create one or more series of Preferred Stock and to determine each such series' preferences, limitations, and relative voting and other rights. The Company is

Notes to the Consolidated Financial Statements

Preferred Stock, cont'd

authorized to issue up to 1,000,000 shares of Preferred Stock. As of September 30, 2012, the Company has not issued any Preferred Stock.

NOTE 8.

STOCK PLANS:

The Company has reserved 1,203,400 shares of Class A Common Stock for issuance to employees of Anacomp, Inc. or its subsidiaries as incentive compensation. The Company currently maintains two such compensation plans, consisting of the 2001 Stock Option Plan and the 2004 Outside Directors Compensation Plan (the "2004 Plan").

On February 26, 2004, the Company's shareholders approved the 2004 Plan, which provides for the future issuance of stock options, restricted stock and deferred stock units. A maximum of 100,000 of the authorized but unissued or reacquired shares of the Company's Class A Common Stock may be issued under this plan.

Transactions under the Company's stock option plans are summarized as follows:

	Shares	Weighted-Avg. Exercise Price
Outstanding on September 30, 2011.....	178,598	\$ 13.64
Granted	-	-
Exercised	-	-
Canceled	(65,000)	26.00
Outstanding on September 30, 2012.....	<u>113,598</u>	<u>\$ 6.57</u>

The following table summarizes all options outstanding and exercisable by price range as of September 30, 2012:

Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Options Exercisable	Weighted-Average Exercise Price
\$ 0.01 - \$4.58	70,598	6.56	\$ 6.56	68,699	\$ 4.46
\$ 4.59 - \$7.50	3,000	4.60	7.50	3,000	7.50
\$ 7.51 - \$11.25	40,000	5.05	10.00	40,000	10.00
	<u>113,598</u>	<u>5.98</u>	<u>\$ 6.57</u>	<u>111,699</u>	<u>\$ 6.60</u>

As of September 30, 2012, the Company elected to not record any compensation expense from stock options as the amount was not considered significant.

NOTE 9.

WARRANTS:

In consideration of the July 28, 2011 amendment to the noninterest bearing unsecured promissory note with CLX (see Note 4) the Company issued a warrant to purchase 205,441 shares of Class A Common Stock of the Company. The warrant has an exercise price of \$0.01 per share and may be exercised at any time from July 28, 2011 until July 28, 2021. The Company valued the warrant using the Black-Scholes option pricing model using the following assumptions: term of 10 years, a risk free interest rate of 3%, a dividend yield of 0%, and volatility of 33%, which amounted to approximately \$21,000 which was not considered significant.

Notes to the Consolidated Financial Statements

NOTE 10.
INCOME TAXES:

The components of income (loss) before income taxes were:

(dollars in thousands)	Year Ended September 30, 2012
United States	\$ 3,436
Foreign.....	(36)
	<u>\$ 3,400</u>

The components of the consolidated income tax provision are summarized below:

(dollars in thousands)	Year Ended September 30, 2012
Current	
Federal	\$ 54
Foreign.....	-
State	<u>1</u>
Sub-total	\$ 55
 Deferred	
Federal	-
Foreign.....	-
State	<u>-</u>
	<u>\$ 55</u>

The following is a reconciliation of income taxes from continuing operations calculated at the United States federal statutory rate to the provision for income taxes:

(dollars in thousands)	Year Ended September 30, 2012
Income taxes at statutory rates.....	\$ 1,158
State income tax, net of federal benefit	118
Permanent items	3
Foreign tax differential.....	(4)
Expiring credits & other.....	(353)
Change in valuation allowance	(867)
	<u>\$ 55</u>

Notes to the Consolidated Financial Statements

INCOME TAXES, CONT'D:

The components of deferred tax assets and liabilities are as follows:

(dollars in thousands)	September 30, 2012
DEFERRED TAX ASSETS:	
Tax effects of future temporary differences related to:	
Accrued expenses and reserves	\$ 2,178
Depreciation and amortization	914
Other.....	3,378
Total Deferred Tax Assets	6,470
Tax effects of carryforward benefits:	
Federal net operating loss carryforwards	40,750
Foreign net operating loss carryforwards	12,923
Tax effects of carryforwards.....	53,673
Tax effects of future taxable differences and carryforward benefits	60,143
Less valuation allowance.....	(60,143)
Net deferred tax asset	\$ -

According to authoritative guidance, deferred tax assets may be recognized for temporary differences that will result in deductible amounts in future periods. A valuation allowance is recorded if based upon the weight of available evidence it is more likely than not that some portion or all of the deferred tax assets will not be realized. Realization of the net deferred tax asset is dependent upon generating sufficient taxable income during the periods in which the temporary differences will reverse. As of September 30, 2012, the Company has established a valuation allowance for all jurisdictions that it is more likely than not that the deferred tax assets will not be realized.

As of September 30, 2012, the Company had net operating loss carryforwards for federal and state tax purposes of approximately \$101.4 million and \$132.6 million, which begin to expire in 2023 and 2013, respectively, unless previously utilized. In addition, the Company also had foreign net operating losses that do not expire.

Pursuant to Internal Revenue Code Section 382 and 383, use of the Company's net operating loss carryforwards may be limited if a cumulative change in ownership of more than 50% has occurred within a three-year period.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accrual for interest and penalties on the Company's balance sheet and has not recognized interest and/or penalties in the statements of operations for the year ended September 30, 2012.

The Company accounts for income taxes in accordance with authoritative guidance which addresses accounting for the uncertainty in income taxes. The evaluation of a tax position in accordance with this topic is a two-step process. The first step involves recognition. The Company determines whether it is more-likely-than-not that a tax position will be sustained upon tax examination, including resolution of any related appeals or litigation, based on only the technical merits of the position. The technical merits of a tax position derive from both statutory and judicial authority (legislation and statutes, legislative intent, regulations, rulings, and case law) and their applicability to the facts and circumstances of the tax position. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. The second step is measurement.

Notes to the Consolidated Financial Statements**INCOME TAXES, CONT'D:**

A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate resolution with a taxing authority.

The Company is subject to taxation in the US, Canada, and various states jurisdictions. For the year ended September 30, 2012, management has evaluated the various tax positions reflected in the Company's income tax returns for both federal and state jurisdictions. Management believes that there are no tax positions for which a liability for unrecognized tax benefits should be recorded as of September 30, 2012. The Company's federal filings prior to September 30, 2008 and the Company's California filings prior to September 30, 2007 are no longer subject to examination.

**NOTE 11.
CONCENTRATIONS:****Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade accounts receivable. The Company grants unsecured credit to its customers. Management believes its credit policies do not result in significant adverse risk and historically has not experienced any credit-related loss.

The Company maintains cash balances at a financial institution located in San Jose, California. Accounts at this institution are secured by the Federal Deposit Insurance Corporation. At times, bank balances held in this financial institution may exceed federally insured limits. The Company has not experienced any losses in such accounts. Management believes that the Company is not exposed to any significant credit risk on cash and cash equivalents.

Customer

The Company's primary revenue source, amounting to 99% of revenues for the year ended September 30, 2012, was a subcontract with a major government contractor. At September 30, 2012, the amount receivable from this customer was approximately \$2.3 million. The subcontract with the customer is renewable annually through December 31, 2014. While there are no guarantees that the subcontract will be renewed, Management believes that this situation is unlikely.

If the subcontract is not renewed or government funding for the contract is halted, the loss of potential revenues will have a significant impact on the Company's operations.

**NOTE 12.
COMMITMENTS AND CONTINGENCIES:****Lease Commitments**

Anacomp has commitments under long-term operating leases, principally for building space and data service center equipment expiring at various dates through February 2017. The Company's rent and lease expense was \$1.5 million for the fiscal year ended September 30, 2012.

The Company had sublease agreements associated with the sublease of the Company's Carmel Mountain Ranch office location which ended May 31, 2012. The Company received sublease income of \$0.4 million for the fiscal year ended September 30, 2012.

Notes to the Consolidated Financial Statements

Lease Commitments, cont'd

The following summarizes the future minimum lease payments under all non-cancelable operating lease obligations that extend beyond one year:

(dollars in thousands)	Lease Payments	
Year Ending September 30,		
2013	\$	570
2014		413
2015		394
2016		406
2017		171
	\$	1,954

Legal Matters

In the normal course of business, the Company is occasionally named as a defendant in various lawsuits. Based on consultation with outside legal counsel, there are no outstanding claims or assessments on the Company, other than the matters noted below, which the Company believes could result in material loss as of the date of this report.

In May 2012, Cal-EPA's Department of Toxic Substances Control issued a Corrective Action Enforcement Order ("order") to companies that had formerly resided in a warehouse location in San Jose. The order requests that the named parties conduct an environmental investigation and cleanup of potential contamination at the property. Xidex Corporation, a predecessor company of Anacomp, was named as one of the parties in the order. The Company along with others named in the order, are currently conducting an environmental study of the location to determine the extent of potential contamination, if any. As of September 30, 2012 the Company is unable to determine any potential loss in accordance with authoritative guidance and therefore has not recorded a loss contingency.

In May 2012, the Company settled an ongoing employment related lawsuit for \$1,250,000. As of September 30, 2012 the Company owed \$610,000, as a result of the settlement, which is included in other accrued liabilities on the consolidated balance sheet and was paid in November 2012.

NOTE 13.

SUBSEQUENT EVENTS:

The Company has evaluated subsequent events through January 31, 2013, which is the date the consolidated financial statements were available to be issued.