CREATIVE COMPUTER APPLICATIONS INC
Form 10QSB
November 14, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-QSB

(Mark One)

ý QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005.

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from to

Commission file number 0-12551

CREATIVE COMPUTER APPLICATIONS, INC.

(Exact name of small business issuer as specified in its charter)

California	**95-3353465**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

26115-A Mureau Road, Calabasas, California 91302

(Address of principal executive offices)

(818) 880-6700

(Issuer s telephone number, including area code):

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý **No o**

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o **No ý**

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date: 3,491,400 common shares as of October 31, 2005.

Transitional Small Business Disclosure Format (check one):

Yes o **No ý**

CREATIVE COMPUTER APPLICATIONS, INC.

FORM 10-QSB

I N D E X

CREATIVE COMPUTER APPLICATIONS, INC.

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

		September 30, 2005 (Unaudited)		December 31, 2004 (Unaudited)
ASSETS				
CURRENT ASSETS:				
Cash	$	861,027	$	1,655,063
Receivables, net		852,477		1,736,768
Inventory		138,110		86,298
Prepaid expenses and other assets		333,047		256,289
Deferred tax asset				539,420
TOTAL CURRENT ASSETS		2,184,661		4,273,838
PROPERTY AND EQUIPMENT, net		479,065		345,004
INVENTORY OF COMPONENT PARTS		194,135		186,599
CAPITALIZED SOFTWARE COSTS, net of accumulated amortization of $1,137,971 and $878,021		1,783,044		1,531,573
DEFERRED MERGER COSTS		340,077		
DEFERRED TAX ASSET				254,457
	$	4,980,982	$	6,591,471
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES:				
Notes payable to bank (Note 4)		200,000		300,000
Accounts payable		431,425		377,768
Accrued liabilities:				
Vacation pay		227,503		243,060
Accrued payroll		39,733		128,227
Other		125,841		173,808
Deferred service contract income		1,085,341		1,235,032
Deferred revenue on system sales		290,928		226,111
TOTAL CURRENT LIABILITIES		2,400,771		2,684,006
SHAREHOLDERS EQUITY:				
Common shares, no par value; 20,000,000 shares authorized; 3,409,900 and 3,321,900 shares issued and outstanding		6,367,092		6,195,692
Accumulated deficit		(3,786,881)		(2,288,227)
TOTAL SHAREHOLDERS EQUITY		2,580,211		3,907,465
	$	4,980,982	$	6,591,471

See Notes to Condensed Consolidated Financial Statements.

CREATIVE COMPUTER APPLICATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended September 30, 2005		2004	
	(Unaudited)			
NET SYSTEM SALES AND SERVICE REVENUE:				
System sales	$	545,886	$	1,177,629
Service revenue		1,181,786		1,107,579
		1,727,672		2,285,208
COSTS OF PRODUCTS AND SERVICES SOLD:				
System sales		393,686		448,285
Service revenue		414,985		380,797
		808,671		829,082
Gross profit		919,001		1,456,126
OPERATING EXPENSES				
Selling, general and administrative		883,704		769,854
Research and development		314,456		258,825
Total operating expenses		1,198,160		1,028,679
Operating income (loss)		(279,159)		427,447
INTEREST AND OTHER INCOME		3,873		2,555
INTEREST EXPENSE		(3,989)		(173)
Income (Loss) before provision for income taxes		(279,275)		429,829
PROVISION FOR INCOME TAXES		793,877		117,763
NET INCOME (LOSS)	$	(1,073,152)	$	312,066
EARNINGS (LOSS) PER SHARE (Note 3):				
Basic	$	(.31)	$	.09
Diluted		(.31)		.09
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:				
Basic		3,465,900		3,318,900
Diluted		3,465,900		3,369,832

See Notes to Condensed Consolidated Financial Statements.

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CREATIVE COMPUTER APPLICATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Nine Months Ended September 30, 2005	2004
	(Unaudited)	
NET SYSTEM SALES AND SERVICE REVENUE:		
System sales	$ 1,429,593	$ 2,795,480
Service revenue	3,679,374	3,243,422
	5,108,967	6,038,902
COSTS OF PRODUCTS AND SERVICES SOLD:		
System sales	1,218,254	1,424,824
Service revenue	1,239,678	1,187,360
	2,457,932	2,612,184
Gross profit	2,651,035	3,426,718
OPERATING EXPENSES		
Selling, general and administrative	2,483,681	2,088,928
Research and development	873,396	773,705
Total operating expenses	3,357,077	2,862,633
Operating income (loss)	(706,042)	564,085
INTEREST AND OTHER INCOME	13,015	4,413
INTEREST EXPENSE	(11,750)	(1,858)
Income (Loss) before provision for income taxes	(704,777)	566,640
PROVISION FOR INCOME TAXES	793,877	117,763
NET INCOME (LOSS)	$ (1,498,654)	$ 448,877
EARNINGS (LOSS) PER SHARE (Note 3):		
Basic	$ (.44)	$ .14
Diluted	(.44)	.13
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:		
Basic	3,401,011	3,318,900
Diluted	3,401,011	3,405,437

See Notes to Condensed Consolidated Financial Statements.

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CREATIVE COMPUTER APPLICATIONS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash

	Nine Months Ended September 30, 2005 (Unaudited)	Nine Months Ended September 30, 2004 (Unaudited)
OPERATING ACTIVITIES		
Net Income (loss)	$ (1,498,654)	$ 448,877
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	122,864	82,241
Provision for doubtful accounts	30,880	60,000
Amortization of capitalized software costs	259,950	324,952
Deferred tax provision	793,877	105,858
Increase (decrease) from changes in:		
Receivables	853,411	(272,786)
Inventories	(59,348)	79,949
Prepaid expenses and other assets	(76,758)	1,950
Accounts payable	53,657	(20,220)
Accrued liabilities	(152,018)	19,910
Deferred service contract income	(149,691)	35,265
Deferred revenue on system sales	64,817	174,814
Net cash provided by operating activities	242,987	1,040,810
INVESTING ACTIVITIES		
Additions to property and equipment	(256,925)	(122,365)
Additions to deferred merger costs	(340,077)	
Additions to capitalized software costs	(511,421)	(427,803)
Net cash used in investing activities	(1,108,423)	(550,168)
FINANCING ACTIVITIES		
Payments on notes payable	(100,000)	
Exercise of stock options	171,400	
Net cash provided by financing activities	71,400	
NET INCREASE (DECREASE) IN CASH	(794,036)	490,642
CASH, beginning of period	1,655,063	889,521
CASH, end of period	$ 861,027	$ 1,380,163

See notes to Condensed Consolidated Financial Statements.

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CREATIVE COMPUTER APPLICATIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1-Presentation of Financial Statements

In the opinion of management of Creative Computer Applications, Inc. (the Company or CCA), the accompanying unaudited condensed consolidated financial statements reflect all adjustments (which include only normal recurring accruals) necessary to present fairly the Company s financial position as of September 30, 2005, the results of its operations for the three and nine month periods ended September 30, 2005 and 2004, and cash flows for the nine months ended September 30, 2005 and 2004. These results have been determined on the basis of accounting principles generally accepted in the United States of America and practices applied consistently with those used in preparation of the Company s Annual Report on Form 10-KSB for the fiscal year ended August 31, 2004 and the Transitional Report on Form 10-QSBT for the period ended December 31, 2004.

The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of the results expected for any other period or for the entire year.

Note 2- Inventories

Inventories consist primarily of computer hardware held for resale and are stated at the lower of cost or market (net realizable value). Cost is determined using the first-in, first-out method. Supplies are charged to expense as incurred.

The Company also maintains an inventory pool of component parts to service systems previously sold, which is classified as non-current in the accompanying balance sheets. Such inventory is carried at the lower of cost or market and is charged to cost of sales based on usage. Allowances are made for quantities on hand in excess of estimated future usage. At September 30, 2005 and 2004 the inventory allowance was $195,073 and $141,273.

Note 3-Earnings per Share

The Company accounts for its earnings per share in accordance with SFAS No.128, which requires presentation of basic and diluted earnings per share. Basic earnings per share is computed by dividing income or loss available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts, such as stock options, to issue common stock were exercised or converted into common stock.

Earnings per share has been computed as follows:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
NET INCOME (LOSS)	$ (1,073,152)	$ (1,498,654)	$ 312,066	$ 448,877
Basic weighted average number of common shares outstanding	3,465,900	3,401,011	3,318,900	3,318,900
Dilutive effect of stock options			50,932	86,537
Diluted weighted average number of common shares outstanding	3,465,900	3,401,011	3,369,832	3,405,437
Basic earnings (loss) per share	$ (.31)	$ (.44)	$ .09	$ .14
Diluted earnings (loss) per share	$ (.31)	$ (.44)	$ .09	$ .13

For the three and nine months ended September 30, 2005 and 2004, options to purchase 210,000 and 150,000 shares of common stock at per share prices ranging from $.72 to $1.76 were not included in the computation of diluted earnings (loss) per share because inclusion would have been anti-dilutive.

Note 4-Debt Obligations

The Company s line of credit with its bank provides for $1,000,000 on a revolving basis through February 1, 2006. On September 30, 2005, the total amount due to the bank was $200,000.

Note 5-Stock-Based Compensation

As allowed by Statement of Financial Accounting Standards No. 123 (SFAS 123), the Company has adopted the intrinsic value method of accounting for employee stock options under the principles of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and discloses the pro forma effect on net income (loss) and income (loss) per share as if the fair value based method had been applied. For equity instruments, including stock options, issued to non-employees, the fair value of the equity instruments or the fair value of the consideration received, whichever is more readily determinable, is used to determine the value of services or goods received and the corresponding charge to operations.

The following table illustrates the effect on net income (loss) and income (loss) per share as if the Company had applied the fair value recognition provision of SFAS No. 123 to stock-based employee compensation:

		Three Months Ended September 30, 2005		**Nine Months Ended September 30, 2005**		**Three Months Ended September 30, 2004**		**Nine Months Ended September 30, 2004**
Net income (loss), as reported	$	(1,073,152)	$	(1,498,654)	$	312,066	$	448,877
Add: Stock-based compensation expense included in reported net income, net of related tax effects								
Less: total stock based employee compensation expense determined under fair value based method for all awards		(11,011)		(33,032)		(19,513)		(58,539)
Net loss, pro forma	$	(1,084,163)	$	(1,531,686)	$	292,553	$	390,338
Basic net earnings (loss) per share, as reported	$	(.31)	$	(.44)	$	.09	$	.14
Basic net earnings (loss) per share, pro forma	$	(.31)	$	(.45)	$	.09	$	.12
Diluted net earnings (loss) per share, as reported	$	(.31)	$	(.44)	$	09	$	13

Diluted net earnings (loss) per share, pro forma	$ (.31)	$ (.45)	$ .09	$ .12

The Company issues all of its options at fair market value at the time of grant; therefore, no expense has been recorded under the intrinsic value method for the three and nine months ended September 30, 2005 and 2004. As required by SFAS 123, the Company provides the following disclosure of estimated values for these awards: The fair value of each option was estimated on the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions for 2004: risk free interest rates ranging from 3.4% to 6.1%, expected lives of 5 years; volatility ranging from 67% to 126% and no assumed dividends. The weighted-average grant-date fair value of options granted during 2004 was estimated to be $.93. There were no options granted in the nine months ended September 30, 2005.

Note 6-Commitments and Contingencies

In accordance with the bylaws of the Company, officers and directors are indemnified for certain events or occurrences arising as a result of the officer or director s serving in such capacity. The term of the indemnification period is for the lifetime of the officer or director. The maximum potential amount of future payments the Company could be required to make under the indemnification provisions of its bylaws is unlimited. However, the Company has a director and officer liability insurance policy that reduces its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated exposure for the indemnification provisions of its bylaws is minimal and, therefore, the Company has not recorded any related liabilities.

The Company enters into indemnification provisions under agreements with various parties in the normal course of business, typically with customers and landlords. Under these provisions, the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by the Company with regard to intellectual property rights. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions cannot be estimated. The Company maintains general liability, errors and omissions, and professional liability insurance in order to mitigate such risks. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, the Company believes the estimated exposure under these agreements is minimal. Accordingly, the Company has not recorded any related liabilities.

Note 7-New Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), (Share-Based Payment (SFAS 123R), which replaces SFAS No. 123, Accounting for Stock-Based Compensation, (SFAS 123) and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair value. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. We are required to adopt SFAS 123R in the first quarter of fiscal 2006. Under SFAS 123R, we must determine the appropriate fair value model to be used for valuing share-payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include prospective and retroactive adoption methods. The prospective method requires that compensation expense be recorded for all unvested stock options at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive method would restate prior periods to record compensation expense for all unvested stock options beginning with the first period restated. We are evaluating the requirements of SFAS 123R and expect that the adoption of SFAS 123R will have a material impact on our consolidated results of operations and earnings per share. We have not yet determined the method of adoption or the effect of adopting SFAS 123R, and we have not yet determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

In March 2005, the SEC staff issued a Staff Accounting Bulletin (SAB 107) which expressed views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provide the staff s views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of

SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management s Discussion and Analysis subsequent to adoption of SFAS No. 123R.

In December 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, which requires that abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) be recognized as current-period charges. In addition, the statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and the Company does not believe the adoption will have a material effect on the Company s results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The statement defines a nonmonetary exchange with commercial substance as one in which the future cash flows of an entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and it does not believe the adoption will have a material effect on the Company s results of operation or financial condition.

In May 2005, the Financial Accounting Standards Board issued Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, or SFAS No.154. SFAS No. 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS No. 154 generally requires retrospective application to prior periods financial statements of voluntary changes in accounting principles. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of SFAS No. 154 will have a material effect on our consolidated results of operations or financial position.

Note 8-Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109 Accounting for Income Taxes, which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the differences between the financial statements and the tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense represents the tax payable for the period and the change during the period in deferred tax assets and liabilities

For the third quarter and nine-month period ended September 30, 2005, the Company recorded an additional valuation allowance of $793,877. The Company invested heavily in integration activities in anticipation of the impending merger. As a result, additional loss was generated in the quarter and nine-month period necessitating an additional valuation allowance against the deferred tax asset. The Company evaluates the realization of the net deferred tax asset, taking into consideration prior earnings history, projected operating results, and the reversal of temporary tax differences. Although the net deferred tax asset may have been eliminated as a result of the purchase transaction upon the completion of the merger with StorCOMM, the Company evaluated the net deferred tax asset at September 30, 2005, taking into consideration operating results, and determined that an additional valuation allowance of $793,877 should be maintained.

Note 9-Merger

On August 16, 2005, the Company entered into a definitive merger agreement with StorCOMM, Inc. of Jacksonville, Florida, a private company providing Picture Archive Communication Systems (PACS) and Clinical Image Management Systems for the medical imaging market (the StorCOMM Merger). CCA will be the

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surviving entity and StorCOMM shareholders will own one-half of the merged entity. The transaction is subject to shareholder approval and other conditions to closing contained in the merger agreement. It is expected that the post merger company will offer integrated applications and services to a broad sector of the healthcare provider market. The merger is expected to be completed on or about November 21, 2005. For the nine-month period ended September 30, 2005, the Company deferred approximately $340,000 in merger costs primarily related to legal and third party due diligence expenses.

On August 18, 2005, the Company entered into a private placement transaction with a small group of investors for the issuance of $3,000,000 in common stock and warrants contingent upon the completion of the StorCOMM merger.

Item 2. Management s Discussion and Analysis or Plan of Operation

The SEC encourages companies to disclose forward-looking information so that investors can better understand a company s future prospects and make informed investment decisions. This Quarterly Report on Form 10-Q contains such forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Words such as anticipate, believe, estimate, expect, intend, may, plan, project, seek, will and words and terms of similar subs connection with any discussion of future events, operating or financial performance, financing sources, product development, capital requirements, market growth and the like, identify forward-looking statements. Forward-looking statements are merely predictions and therefore inherently subject to uncertainties and other factors which could cause the actual results to differ materially from the forward-looking statement. These forward-looking statements include:

projections of revenues and other financial items;

statements of strategies and objectives for future operations;

expectations regarding the completion of the merger with StorCOMM;

statements regarding integration plans following the merger with StorCOMM;

statements concerning proposed applications or services;

statements regarding future economic conditions, performance or business prospects;

statements regarding competitors or competitive actions; and

statements of assumptions underlying any of the foregoing.

All forward-looking statements are present expectations of future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. The risks related to CCA s business discussed under Risk Factors of this Quarterly Report on Form 10-QSB, among others, could cause actual results to differ materially from those described in the forward-looking statements. Such risks include, among others: whether the merger with StorCOMM will be completed; if the merger is completed, whether the combined company will realize the potential benefits of the merger; the competitive environment; unexpected technical and marketing difficulties inherent in major product development efforts such as those described about CyberLAB 7.0; the potential need for changes in our long-term strategy in response to future developments; future advances in clinical information technology and procedures, as well as potential changes in government regulations and healthcare policies, both of which could adversely affect the economics of the products offered by CCA; and rapid technological change in the microelectronics and software industries.

The Company makes no representation as to whether any projected or estimated information or results contained in any forward-looking statements will be obtained or achieved. Shareholders are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-QSB. The Company is under no obligation, and it expressly disclaims any obligation, to update or alter any forward-looking statements after the date of this Quarterly Report on Form 10-QSB, whether as a result of new information, future events or otherwise.

Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

CCA generates revenues primarily from the sale of its Clinical Information Systems (CIS), which includes the licensure of proprietary application software, the licensure of third party software, and the sale of servers upon which the application software operates. In connection with its sales of CIS products, the Company provides implementation services for the installation, integration, and training of end users personnel. The Company generates sales of ancillary software and hardware, including its data acquisition products, to its CIS clients and to third parties. The Company also generates recurring revenues from the provision of comprehensive post-implementation services to its CIS clients, pursuant to extended service agreements.

Because of the nature of its business, CCA makes significant investments in research and development for new products and enhancements to existing products. Historically, CCA has funded its research and development programs through cash flow primarily generated from operations. Management anticipates that future expenditures in research and development will either continue at current levels or may increase for the foreseeable future, and will be funded primarily out of the Company s cash flow.

CCA s results of operations for the third fiscal quarter and nine-month period ended September 30, 2005 were marked by a decrease in sales and operating income over the comparable period of 2004. The Company s decrease in revenues for the third fiscal quarter and nine-month period was due to a number of factors, the primary being the loss of members of our sales force. During the second and third quarters of 2005, the Company experienced an unexpected significant turnover in its sales force, including the loss of its Vice President of Sales, which affected its ability to close near term sales opportunities. The Company has since hired a new Vice President of Sales and three new regional sales managers and is actively recruiting additional sales personnel. In addition, the Company has invested additional funds into marketing activities to rebuild its sales pipeline. Despite the shortfall in our new system sales, there were positive areas in our business. For instance, service revenues increased for the quarter and nine-month period by $74,207 or 6.7% and $435,952 or 13.4%, respectively. Generally, sales cycles for CIS products are lengthy and on average exceed one year from inception to closure. Because of the complexity of the sales process, a number of factors that are beyond the control of the Company can delay the closing of transactions.

Since the beginning of fiscal year 2005, management has been involved in activities related to the proposed merger with StorCOMM. The Company originally anticipated that the merger would be completed in the summer of 2005. However, due to a number of factors the merger completion date was extended and the Company now expects it to close on or about November 21, 2005, subject to shareholder approval. In order to mitigate the delays in completing the merger and put the combined company in the best position to immediately execute its integration plan and launch new products following the merger, management determined it was in the best interests of the company to proceed with the development of its integration plan with StorCOMM prior to the completion of the merger. This required significant investment in infrastructure and product development. This investment has been financed through the utilization of working capital and short-term borrowings, which management anticipates repaying once the merger and related private placement are consummated. The costs associated with this investment have been expensed as incurred, which increased the operating expenses of CCA during the current quarter and nine-month period ended September 30, 2005, and is more fully discussed below in Results of Operations. While some of these expenses are non-recurring, others including the addition of key personnel in product management, regulatory affairs, and product development, were important additions to management in order to assure the success of the company s integration strategy.

The operating losses incurred by the Company during the nine-month period ended September 30, 2005 were primarily a result of expenses incurred in connection with the proposed merger with StorCOMM and the related integration plan. Due to the accumulated net losses incurred by the Company, we have established an additional valuation allowance against our net deferred tax asset. Management anticipated the net deferred tax asset would have been eliminated in any case as a result of the accounting for the purchase transaction upon the completion of the merger as described in the Company s registration statement on Form S-4 filed on October 3, 2005.

Results of Operations

The following table sets forth certain line items in our condensed consolidated statement of operations as a percentage of total revenues for the periods indicated:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2004
Revenues:				
System sales	31.6%	28.0%	51.5%	46.3%
Service revenues	68.4	72.0	48.5	53.7
Total revenues	100.0	100.0	100.0	100.0
Cost of products and services sold:				
System sales	22.8	23.8	19.6	23.6
Service revenues	24.0	24.3	16.7	19.7
Total cost of products and services	46.8	48.1	36.3	43.3
Gross profit	53.2	51.9	63.7	56.7
Operating expenses:				
Selling, general and administrative	51.2	48.6	33.7	34.6
Research and development	18.2	17.1	11.3	12.8
Total operating expenses	69.4	65.7	45.0	47.4
Operating income (loss)	(16.2)	(13.8)	18.7	9.3
Income (loss) before provision for income taxes	(16.2)	(13.8)	18.8	9.4
Provision for income taxes	45.9	15.5	5.1	2.0
Net income (loss)	(62.1)	(29.3)	13.7	7.4

Revenues

Sales for the third fiscal quarter ended September 30, 2005 decreased to $1,727,672, as compared to $2,285,208 for the comparable quarter ended September 30, 2004, an overall decrease of approximately $557,536 or 24.4%. For the nine-month period ended September 30, 2005, sales decreased $929,935 or 15.4% compared to the same period of 2004. When analyzed by product category for the quarter, sales of CIS products decreased by $668,948, or 61.7% and a decrease in other revenues of $7,560 or 76.3%, partially offset by an increase in sales of data acquisition products of $44,765, or 53.6%, and an increase in service revenues of $74,207, or 6.7% when compared to the same quarter of fiscal 2004. When analyzed by product category for the nine-month period ended September 30, 2005, sales of CIS products decreased by $1,474,865, or 58.4% and a decrease in other revenues of $9,060 or 55.6%, partially offset by an increase in sales of data acquisition products of $118,038, or 46.5%, and an increase in service revenues of $435,952, or 13.4% when compared to the same period of fiscal 2004. The decrease in sales of CIS products was primarily attributable to the turnover in the sales force as described above under Overview . The Company has been in the process of rebuilding its direct sales force and has recently hired three new regional sales managers. The increase in service revenues is attributable to a greater number of client accounts under contract and an increase in the average fees charged for such contracts. Service revenues are expected to continue to increase as and when the Company s installed base of CIS installations increases.

The increase in the sales of data acquisition products is primarily attributable to a greater number of units shipped to LIS customers. However, management believes that in the future, there will be reduced sales of data acquisition products as there has been a technological shift to software-based clinical instrument interfaces. Furthermore, fewer OEM customers remain active in the marketplace or no longer use CCA s data acquisition products. Management does not believe the data acquisition product business is a material part of CCA s business today and it will not be in the future, as the Company s emphasis is being placed on its CIS products and related services.

Although the Company continues to invest in sales and marketing activities, management is cautious about the near-term outlook for its sales of CIS products as it focuses on rebuilding its sales force and transaction pipeline. The Company s future operating results will continue to be subject to quarterly variations based upon a wide variety of factors, including the volume mix and timing of orders received during any quarter, and the temporary delays in the closing of new CIS sales. In addition, the Company s revenues associated with CIS sales may be delayed due to client related issues such as client staff availability for training, information technology infrastructure readiness, and the performance of third party contractors, all of which are issues outside of the control of CCA.

Costs of products and services sold

Cost of sales for the third quarter and nine-month period ended September 30, 2005 decreased by $20,411 or 2.5% and $154,252 or 5.9%, respectively, as compared to the same periods of fiscal 2004. For the quarter and nine-month period, the decrease in cost of sales was primarily attributable to a decrease in material costs of $62,717 or 54.6% and $168,163 or 44.6%, respectively. For the nine-month period there was also a decrease in other costs of $20,226 or 2.2%. Such decreases were partially offset by an increase in labor costs, for the quarter and nine-month period, of $13,768 or 3.2% and $34,137 or 2.6%, respectively and for the quarter there was an increase in other costs of $28,537 or 10.2%. The decrease in material costs was attributable to the decrease in sales of CIS products discussed above. The increase in labor costs was attributable to additions of personnel to the Company s support department. For the nine-month period, the decrease in other costs of sales was attributable to decreased expenses related to telephone costs as a result of better rates negotiated under a new contract for telephone and data services. For the current quarter and nine-month period, cost of sales as a percentage of sales was 47% and 48%, respectively, as compared to 36% and 43%, respectively, for the comparable periods of 2004. The overall percentage increase in cost of sales, as a percentage of sales, in the quarter and nine-month period was attributable to a reduced number of sales of CIS products sold. The Company could potentially experience quarterly variations in gross margin as a result of the factors discussed above.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by $113,850 or 14.8% and $394,753 or 18.9%, respectively, for the current fiscal quarter and nine-month period ended September 30, 2005 as compared to the same periods of fiscal 2004. The increase in selling, general and administrative expenses were primarily attributable to additional expenses as follows: legal and accounting fees of approximately $31,000 in the current quarter and $72,000 for the nine-month period were the result of the Company changing its fiscal year-end. There were increased expenses related to the implementation of a new customer relationship management system of approximately $25,000 for the current quarter and nine month period. Additional expenses attributable to marketing consulting and telemarketing expenses were approximately $18,000 in the current quarter and $50,000 for the nine-month period. There were expenses associated with the addition of a new product consultant, a controller, a radiology product manager, and a director of regulatory affairs and recruitment fees paid in conjunction with some of the new hires of approximately $35,000 in the current quarter and $100,000 for the nine-month period. In addition, the Company had an increase in its insurance costs of approximately $20,000 for the nine-month period. The balance of increased expenses during the current quarter and nine month period were attributable to the StorCOMM merger. Management anticipates that it will incur increases in legal and accounting expenses, trade show expenses, and other general and administrative expenses in the last quarter of fiscal 2005 that are related to marketing efforts and the annual shareholders meeting. It is also likely that the Company will incur significant additional expenses in the last quarter of fiscal 2005 related to the StorCOMM Merger that will be expensed when incurred.

Research and development expenses

Research and development expenses increased by $55,631, or 21.5% and $99,691 or 12.9%, respectively, for the third fiscal quarter and nine-month period ended September 30, 2005 as compared to the same periods of fiscal 2004. The increase is attributable to increases in salaries, other personnel related expenses, and the addition of new personnel in product engineering. For the comparable third quarters of 2005 and 2004, the Company capitalized software costs of $171,000 and $147,179, respectively, which are generally amortized over the estimated useful life, not to exceed five years. Such costs were attributable to enhancements and new modules for the Company s CIS products, and new applications under development, as well as the completion of new software that integrates the Company s radiology product CyberRAD with the StorCOMM PACS system.

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Income taxes

For the third quarter and nine-month period ended September 30, 2005, the Company recorded an additional valuation allowance of $793,877. The Company invested heavily in integration activities in anticipation of the proposed merger with StorCOMM. As a result, additional loss was generated in the quarter and nine-month period necessitating an additional valuation allowance against the deferred tax asset. The Company evaluates the realization of the net deferred tax asset, taking into consideration prior earnings history, projected operating results, and the reversal of temporary tax differences. Although the net deferred tax asset may have been eliminated as a result of the purchase transaction upon the completion of the merger with StorCOMM, the Company evaluated the net deferred tax asset at September 30, 2005, taking into consideration operating results, and determined that an additional valuation allowance of $793,877 should be maintained. In 2004, the Company was operating under a different fiscal year-end and at the time, the Company recorded a tax provision of $117,763.

Net income (loss)

As a result of the factors discussed above, the Company incurred a net loss of $1,073,152 or basic and diluted loss per share of $.31 in the third fiscal quarter of 2005 as compared to net income of $312,066 or basic and diluted earning per share of $.09 for the third fiscal quarter of 2004. For the nine-month period ended September 30, 2005, the Company incurred a net loss of $1,498,654 or basic and diluted loss per share of $.44 as compared to net income of $448,877 or basic and diluted earning per share of $.14 and $.13, respectively, for the same period of 2004.

Liquidity and Capital Resources

The Company s primary need for capital has been to invest in software development, in computers and related equipment for its internal use, and its integration plan for the impending merger with StorCOMM. The Company invested $511,421 and $427,803 in software development during the nine-month periods ended September 30, 2005 and 2004, respectively. These expenditures related to the new browser version of the Company s LIS product, CyberLAB 7.0, and new software that integrates the Company s radiology product CyberRAD with the StorCOMM PACS system.

The Company anticipates expending additional sums during the remainder of fiscal 2005 on product enhancements to all its products, the further enhancements of the new browser version of the Company s CyberLAB 7.0 product, and the integration of the Company s radiology product CyberRAD with the StorCOMM PACS system. During the nine-month period ended September 30, 2005, the Company invested an aggregate of $256,925 in additions to fixed assets, primarily consisting of computers and software related to the new customer relationship management system, which replaced its former aged help desk application, as compared to an investment of $122,365 in the comparable period of 2004. Furthermore, the Company deferred approximately $340,000 in merger costs primarily related to legal and third party due diligence expenses which will be adjusted to the aggregate merger transaction costs at closing

As of September 30, 2005, the Company had negative working capital of $216,110, compared to working capital of $1,589,832 as of December 31, 2004. The negative working capital is primarily due to the valuation allowance taken against the net deferred tax asset and the reduction in cash and receivables since December 31, 2004. The Company s current ratio was 0.91 at September 30, 2005 compared to 1.6 at December 31, 2004. At September 30, 2005, the Company s credit facilities with its bank consisted of a revolving line of credit of $1,000,000, of which there was $200,000 outstanding. The bank credit agreement expires on February 1, 2006. In addition, the Company has entered into a private placement transaction with a small group of investors for the issuance of $3,000,000 in common stock and warrants contingent upon the completion of the StorCOMM merger.

Cash flows from operating activities were $242,987 for the nine-month period ended September 30, 2005 compared to cash flows of $1,040,810 for the comparable period of fiscal 2004. The decrease in cash flow from operating activities was primarily attributable to the net change in accrued receivables, inventories, payables, deferred tax asset, and deferred revenues offset by the reduction in income from operations in the nine-month period ended September 30, 2005 compared to the same period of fiscal 2004.

Net cash used in investing activities totaled $1,108,423 for the nine-month period ended September 30, 2005, compared to $550,168 used in investing activities during the comparable period of 2004. The increase in cash used in investing activities was due to increased investment in property and equipment related to the new customer relationship management system, additional investment in capitalized software, and additions to capitalized acquisition costs.

Cash flows from financing activities amounted to $71,400 during the nine-month period ended September 30, 2005. There were no financing activities during the comparable period of fiscal 2004. The change from fiscal 2004 to fiscal 2005 resulted primarily from payments on its revolving line of credit with the bank offset by cash flows from exercises of stock options.

The Company s primary source of working capital has been generated from earnings, and from borrowings on its line of credit. The Company produced cash flows amounting to $242,987 to fund its operations in the nine-month period ended September 30, 2005. Management believes that its projected cash flow from operations, together with its bank credit facilities, should be sufficient to fund its working capital requirements for the next twelve months. Furthermore, we will have additional funds available to us from the private placement transaction. However, an unanticipated decline in sales or continued delays in closing new transactions, delays in implementations where payments are tied to delivery and/or performance of services, or cancellations of contracts could have a negative effect on cash flow from operations and could in turn create short-term liquidity problems. If such events were to occur, the Company may have to seek alternative financing. Additionally, we may seek additional funds to finance our future growth and operations. There can be no assurance that such funds will be available when required or available on terms acceptable to us.

<u>Seasonality, Inflation and Industry Trends</u>

The Company s sales are generally higher in the winter and spring due to budgetary cycles of its clients. Inflation has not had a material effect on the Company s business since the Company has been able to adjust the prices of its products and services in response to inflationary pressures. Management believes that most phases of the healthcare segment of the computer industry will continue to be highly competitive, and that potential healthcare reforms including those promulgated by Health Insurance Portability and Accountability Act (HIPAA) may have a long-term positive impact on its business. With respect to the compliance issues brought about by HIPAA, the Company has invested heavily in new application modules to assist its clients in meeting their regulatory goals. Management believes that the new modules will be key selling points and will provide a competitive advantage. In addition, management believes that the healthcare information technology industry will be marked with more significant technological advances, which will improve the quality of service and reduce costs. The Company is poised to meet these challenges by continuing to employ new technologies when they become available, diversifying its product offerings, improving and expanding its services, and by constantly enhancing its software applications.

Critical Accounting Policies and Estimates

Management s discussion and analysis of CCA s financial condition and results of operations are based upon the condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, management evaluates estimates, including those related to the valuation of inventory and the allowance for uncollectible accounts receivable. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments 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. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Inventory

The Company s inventory is comprised of a current inventory account that consists of items that are held for resale and a long-term inventory account that consists of items that are held for repairs and replacement of hardware components that are serviced by the Company under long-term Extended Service Agreements with its clients. Current inventory is valued at the lower of cost to purchase or the current estimated market value of the inventory items. Inventory is evaluated on a continual basis and adjustments to recorded costs are made based on management s estimate of future sales value, or in the case of the long-term component inventory, on management s estimation of the usage of specific inventory items and net realizable value. Management reviews inventory quantities on hand and makes determination of the excess or obsolete items in the inventory, which, are specifically reserved. In addition, adjustments are made for the difference between the cost of the inventory and the estimated market value and charged to operations in the period in which the facts that give rise to the adjustments become known. At September 30, 2005, the inventory reserve was approximately $195,000.

Accounts Receivable

Accounts receivable balances are evaluated on a continual basis and allowances are provided for potentially uncollectible accounts based on management s estimate of the collectability of customer accounts. If the financial condition of a customer were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance may be required. Allowance adjustments are charged to operations in the period in which the facts that give rise to the adjustments become known. The accounts receivable balance at September 30, 2005 was $852,477, net of an allowance for doubtful accounts of approximately $57,700.

Revenue Recognition

Revenues are derived primarily from the sale of CIS products and the provision of services. The components of the system sales revenues are the licensing of computer software, installation, and the sale of computer hardware and sublicensed software. The components of service revenues are software support and hardware maintenance, training, and implementation services. The Company recognizes revenue in accordance with the provisions of Statement of Position (SOP) No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-4, SOP 98-9 and clarified by Staff Accounting Bulletin (SAB) 104 Revenue Recognition in Financial Statements. SOP No 97-2, as amended, generally requires revenue earned on software arrangements involving multiple-elements to be allocated to each element based on the relative fair values of those elements. The Company allocates revenue to each element in a multiple-element arrangement based on the element s respective fair value, with the fair value determined by the price charged when that element is sold and specifically defined in a quotation or contract. The Company determines the fair value of the maintenance portion of the arrangement based on the renewal price of the maintenance charged to clients, professional services portion of the arrangement, other than installation services, based on hourly rates which the Company charges for these services when sold apart from a software license, and the hardware and sublicense of software based on the prices for these elements when they are sold separately from the software. At September 30, 2005, deferred revenue on system sales was $290,928.

Post Implementation software and hardware maintenance services are marketed under monthly and annual arrangements and are recognized as revenue ratably over the contracted maintenance term as services are provided. Deferred revenue related to CIS sales is comprised of deferrals for license fees, hardware, and other services for which the implementation has not yet been completed and revenues have not been recognized. During the second fiscal quarter, the Company implemented a new customer relationship management system. The new system replaced the Company s aged help desk system and was integrated with the Company s accounting system. The integration of these systems necessitated a change in the Company s billing procedures, which resulted in a partial reduction of accounts receivable and a concurrent decrease in deferred revenues. At September 30, 2005, deferred service contract income was $1,085,341.

Software Development Costs

Costs incurred internally in creating computer software products are expensed until technological feasibility has been established upon completion of a program design. Thereafter, applicable software development costs are capitalized and subsequently reported at the lower of amortized cost or net realizable value. Capitalized costs are amortized based on current and expected future revenue for each product with minimum annual amortization equal to the straight-line amortization over the estimated economic life of the product, not to exceed five years.

For the nine-month periods ended September 30, 2005 and 2004, the Company capitalized $511,421 and $427,803, respectively. At September 30, 2005, the balance of capitalized software costs was $1,783,044, net of accumulated amortization of $1,137,971.

Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109   Accounting for Income Taxes,   which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the differences between the financial statements and the tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense represents the tax payable for the period and the change during the period in deferred tax assets and liabilities.

Risk Factors

In evaluating the Company, various risk factors and other information should be carefully considered. The risks and uncertainties described below are not the only ones that impact the Company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also have an adverse impact on us. Among other things, this discussion contains forward-looking statements that are based on certain assumptions about future risks and uncertainties. We believe that our assumptions are reasonable. Nonetheless, it is likely that at least some of these assumptions will not come true.

We face intense competition from both established entities and new entries in the market that may adversely affect our revenues and profitability.

Our markets are competitive. There are many companies with active research and development programs both in and outside of the healthcare information technology industry. Many of these companies have considerable experience in areas of competing interest to us. Additionally, we cannot determine if other firms are conducting potentially competitive research, which could result in the development and introduction of products that are either comparable or superior to the products we sell. Further, new product introductions, product enhancements and the use of other technologies by our competitors could lead to a loss of market acceptance and cause a decline in sales or gross margins.

If we are unable to anticipate or react to competition or if existing or new competitors gain market share, our sales may decline or be impaired and we may experience a decline in the prices we can charge for our products, which could adversely affect our operating results. Our competitive position depends on several factors, including:

our ability to adapt effectively to the continued development, acquisition or licensing of technology or product rights by our competitors;

our ability to enhance our products or develop new products;

our ability to adapt to changing technological demands; and

our strategic decisions regarding the best allocation of our limited resources.

Several of our current and potential competitors have greater financial, technical, sales, marketing and other resources than we do and consequentially may have an ability to influence customers to purchase their products that compete with ours. Our future and existing competitors could introduce products with superior features, scalability and functionality at lower prices than our products, and could also bundle existing or new products with other more established products in order to compete with us. Our competitors could also gain market share by acquiring or forming strategic alliances with our other competitors. If we do not adapt our business in the face of this competition, our business and operating results may be harmed.

Any failure to successfully introduce future products into the market could adversely affect our business.

The commercial success of future products depends upon their acceptance by the medical community. Our future product plans include capital-intensive clinical information systems. We believe that these products can significantly reduce labor costs, improve patient care and offer other distinctive benefits to the medical community. However, there is often market resistance to products that require significant capital expenditures or which eliminate jobs through automation. We can make no assurance that the market will accept our future products and systems, or that sales of our future products and systems will grow at the rates expected by our management.

If we fail to meet changing demands of technology, we may not continue to be able to compete successfully with competitors.

The market for our products is characterized by rapid technological advances, changes in customer requirements and frequent new product introductions and enhancements. Our future success depends upon our ability to introduce new products that keep pace with technological developments, enhance current product lines and respond to evolving client requirements. CCA has incurred, and we will need to continue to incur, significant research and development expenditures in future periods as we strive to remain competitive. Our failure to meet these demands could result in a loss of our market share and competitiveness and could harm our revenues and results of operations.

Our success depends on our ability to attract, retain and motivate management and other skilled employees.

Our future success and growth depend on the continued services of our key management and employees, including Steven M. Besbeck, Bruce M. Miller, and James R. Helms. The loss of the services of any of these individuals or any other key employee could materially affect our business. Our future success also depends on our ability to identify, attract and retain additional qualified personnel. Competition for employees in our industry is intense and we may not be successful in attracting or retaining them. There are a limited number of people with knowledge of, and experience in, our industry. We do not have employment agreements with most of our key employees. However, we generally enter into agreements with our employees regarding patents, confidentiality and related matters. We do not maintain life insurance polices on our employees. Our loss of key personnel, especially without advance notice, or our inability to hire or retain qualified personnel, could have a material adverse effect on sales and our ability to maintain our technological edge. We cannot guarantee that we will continue to retain our key management and skilled personnel, or that we will be able to attract, assimilate and retain other highly qualified personnel in the future.

If we do not protect our proprietary information and prevent third parties from making unauthorized use of our products and technology, our financial results could be harmed.

We rely on a combination of confidentiality agreements and procedures and copyright, patent, trademark and trade secret laws to protect our proprietary information. However, all of these measures afford only limited protection and may be challenged, invalidated, or circumvented by third parties. Third parties may copy aspects of our products or otherwise obtain and use our proprietary information without authorization. Third parties may also develop similar or superior technology independently, including by designing around our patents. Furthermore, the laws of some foreign countries do not offer the same level of protection of our proprietary rights as the laws of the United States, and we may be subject to unauthorized use of our products in those countries. Any legal action that we may bring to protect proprietary information could be expensive and may distract management from day-to-day operations. Unauthorized copying or use of our products or proprietary information could result in reduced sales of our products.

Third parties claiming that we infringe their proprietary rights could cause us to incur significant legal expenses and prevent us from selling our products.

We could receive claims that we have infringed the intellectual property rights of others. Any such claim, with or without merit, could:

- be time consuming to defend;

result in costly litigation;

divert management s time and attention from our business;

require us to stop selling, to delay shipping or to redesign our products; or

require us to pay monetary amounts as damages to our customers.

In addition, we license and use software from third parties in our business. These third party software licenses may not continue to be available to us on acceptable terms. Also, these third parties may from time to time receive claims that they have infringed the intellectual property rights of others, including patent and copyright infringement claims, which may affect our ability to continue licensing their software. Our inability to use any of this third party software could result in disruptions in our business, which could materially and adversely affect our operating results.

We operate in a consolidating industry which creates barriers to market penetration.

The healthcare information technology industry in recent years has been characterized by consolidation by both healthcare providers who are our clients and by those companies that we compete against. Large hospital chains and groups of affiliated hospitals prefer to negotiate comprehensive contracts for all of their system needs with larger vendors who offer broader product lines and services. The convenience offered by these large vendors are administrative and financial incentives that we cannot offer our clients.

Our products may be subject to government regulation in the future that could impair our operations.

CCA s products could be subject to stringent government regulation in the United States and other countries in the future. Furthermore, assuming we complete the merger with StorCOMM, we expect that the integration of our product and service offering with those of StorCOMM will require us to comply with regulatory requirements and that we will devote significant time and resources to this effort. These regulatory processes can be lengthy, expensive and uncertain. Additionally, securing necessary clearances or approvals may require the submission of extensive data and other supporting information. Failure to comply with applicable requirements could result in fines, recall, total or partial suspension of distribution, withdrawal of existing product, or our inability to integrate our service and product offerings with those of StorCOMM. If any of these things occur, it could have a material adverse impact on our business.

Changes in government regulation of the healthcare industry could adversely affect our business.

Federal and state legislative proposals are periodically introduced or proposed that would affect major changes in the healthcare system, nationally, at the state level or both. Future legislation, regulation or payment policies of Medicare, Medicaid, private health insurance plans, health maintenance organizations or other third-party payors could adversely affect the demand for our current or future products and our ability to sell our products on a profitable basis. Moreover, healthcare legislation is an area of extensive and dynamic change, and we cannot predict future legislative changes in the healthcare field or their impact on our industry or our business.

We are subject to the Health Insurance Portability and Accountability Act (HIPAA) and the cost of complying with HIPAA may negatively impact our net income.

Our business is substantially impacted by the requirements of HIPAA and our products must maintain the confidentiality of a patient s medical records and information. These requirements also apply to most of our clients. We believe our products meet the standards of HIPAA and may require our clients to upgrade their systems, but our clients preoccupation with HIPAA may adversely impact sales of our products, and the costs of compliance with HIPAA could have an impact on our product margins and sales, the general and administrative expenses incurred by us and could negatively impact our net income.

Defective products or product failure may subject us to liability and could substantially increase our costs.

CCA s products are used to gather information for professionals to make medical decisions, diagnosis, and treatment. Accordingly, the manufacture and sale of our products entails an inherent risk of product liability arising from an inaccurate, or allegedly inaccurate, test or procedure result. CCA may discover errors and failures in certain of its product offerings, which could result in delays or lost revenue during the period required to correct these errors. Errors and failures in products released by us could result in negative publicity, product returns, loss of or delay in market acceptance of our products, loss of competitive position or claims by customers or others. Alleviating any of these problems could require significant expenditures of our capital and resources and could cause interruptions, delays or cessation of our sales, which could cause us to lose existing or potential customers and would adversely affect our operating results. We may be subject to product liability claims as a result of any failure or errors in our products. If a customer is successful in proving its damages, it could prove expensive and time-consuming to defend against these claims, and we could be liable for the damages suffered by our customers and other related expenses, which could adversely affect our operating results. We currently maintain product liability insurance coverage for up to $2.0 million per incident and up to an aggregate of $4.0 million per year. Although management believes this liability coverage is sufficient protection against future claims, there can be no assurance of the sufficiency of these policies. We have not received any indication that our insurance carrier will not renew our product liability insurance at or near current premiums; however, we cannot guarantee that this will continue to be the case.

System or network failures could reduce our sales, increase costs or result in a loss of customers.

We rely on our management information systems to operate our business and to track our operating results. Our management information systems will require modification and refinement as we grow and our business needs change. If we experience a significant system failure or if we are unable to modify our management information systems to respond to changes in our business needs, then our ability to properly run our business could be adversely affected and could lead to a reduction in our sales, increased costs and a loss of customers.

Our evaluation of internal controls and remediation of potential problems will be costly and time consuming and could expose weakness in our financial reporting.

While we believe that we currently have adequate internal control procedures in place, we are still exposed to potential risks from recent legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002. We are evaluating our internal controls system in order to allow management to report on, and our independent registered public accounting firm to attest to, our internal controls over financial reporting, beginning with our Annual Report on Form 10-KSB for fiscal year 2006 as required in Section 404 of the Sarbanes-Oxley Act of 2002.

Future sales of our common stock could adversely affect our stock price.

Future sales of substantial amounts of shares of our common stock in the public market, or the perception that these sales could occur, may cause the market price of our common stock to decline. In addition, we may be required to issue additional shares upon exercise of previously granted options or warrants, such as the warrants to purchase up to 300,000 shares of CCA common stock that CCA is issuing in a private placement and the CCA options and warrants to be issued in exchange for StorCOMM s options and warrants in the merger. Increased sales of our common stock in the market after exercise of stock options or warrants could exert significant downward pressure on our stock price. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price we deem appropriate.

Our stock price may be volatile in the future, and you could lose the value of your investment.

The market prices of the common stock for CCA has experienced significant fluctuations and our stock price may continue to fluctuate significantly, and you could lose the value of your investment. The market price of our common stock may be affected by a number of factors, including:

announcements of quarterly operating results and revenue and earnings forecasts by us, our competitors or our customers;

failure to achieve financial forecasts, either because expected sales do not occur or because they occur at lower prices or on terms that are less favorable to us;

rumors, announcements or press articles regarding changes in our management, organization, operations or prior financial statements;

changes in revenue and earnings estimates by securities analysts;

announcements of planned acquisitions by us or by our competitors;

announcements of new or planned products by us, our competitors or our customers;

gain or loss of a significant customer;

inquiries by the SEC, AMEX, law enforcement or other regulatory bodies; and

acts of terrorism, the threat of war and economic slowdowns in general.

The stock market has experienced extreme price volatility, which has adversely affected and may continue to adversely affect the market price of our common stock for reasons unrelated to our business or operating results.

Fluctuations in our quarterly financial results have affected the stock prices of CCA in the past and could affect our stock price in the future.

The quarterly financial results of CCA have fluctuated in the past and the quarterly financial results of the Company are likely to vary significantly in the future. A number of factors associated with the operation of our business may cause our quarterly financial results to fluctuate, including our ability to:

- effectively align sales resources to meet customer needs and address market opportunities;
- effectively respond to competitive pressures;
- effectively manage our operating expense levels; and
- effectively manage and incentivize our selling organization.

A number of factors associated with our industry and the markets for our products, many of which are outside our control, may cause our quarterly financial results to fluctuate, including:

- reduced demand for any of our products;
- timing and amount of orders by customers and seasonality in the buying patterns of customers;
- cancellation, deferral or limitation of orders by customers;
- fluctuations in foreign currency exchange rates; and
- weakness or uncertainty in general economic or industry conditions.

Quarterly changes in our financial results could cause the trading price of our common stock to fluctuate significantly. If our quarterly financial results or our predictions of future financial results fail to meet the expectations of securities analysts and investors, our stock price could be negatively affected. Any volatility in our quarterly financial results may make it more difficult for us to raise capital in the future or pursue acquisitions that involve issuances of our stock or securities convertible into or exercisable for our stock. You should not rely on the results of prior periods as predictors of our future performance.

Factors outside of our control may adversely affect our operations and operating results.

Our operations and operating results may be adversely affected by many different factors which are outside of our control, including:

deterioration in economic conditions in any of the healthcare information technology industry, which could reduce customer demand and ability to pay for our products and services;

political and military instability, which could slow spending within our target markets, delay sales cycles and otherwise adversely affect our ability to generate revenues and operate effectively;

budgetary constraints of customers, which are influenced by corporate earnings and spending objectives;

earthquakes, floods, hurricanes or other natural disasters affecting our headquarters located in Calabasas, California, an area known for seismic activity, or our other locations worldwide;

acts of war or terrorism; and

inadvertent errors.

Any of these factors could result in a loss of revenues and/or higher expenses, which could adversely affect our financial results.

Our international operations involve special risks that could increase our expenses, adversely affect our operating results and require increased time and attention of our management.

We expect to generate less than 5% of our revenues from customers located outside of the United States in the fiscal year ending December 31, 2005. Assuming the merger with StorCOMM is completed, our international operations will expand since StorCOMM has significant operations outside of the United States. We expect to expand our international operations and such expansion is contingent upon the successful growth of our international revenues. Our international operations are subject to risks in addition to those faced by our domestic operations, including:

potential loss of proprietary information due to piracy, misappropriation or laws that may be less protective of our intellectual property rights;

imposition of foreign laws and other governmental controls, including trade and employment restrictions;

enactment of additional regulations or restrictions on imports and exports;

fluctuations in currency exchange rates and economic instability such as higher interest rates and inflation, which could make our products more expensive in those countries;

limitations on future growth or inability to maintain current levels of revenues from international sales if we do not invest sufficiently in our international operations;

longer payment cycles for sales in foreign countries and difficulties in collecting accounts receivable;

difficulties in staffing, managing and operating our international operations;

difficulties in coordinating the activities of our geographically dispersed and culturally diverse operations; and

political unrest, war or terrorism, particularly in areas in which we have facilities.

A portion of StorCOMM s transactions outside of the United States are denominated in foreign currencies. Our functional currency is the U.S. dollar. Accordingly, our future operating results will continue to be subject to fluctuations in foreign currency rates. Hedging foreign currency transaction exposures is complex and subject to uncertainty. We may be negatively affected by fluctuations in foreign currency rates in the future, especially if international sales continue to grow as a percentage of our total sales.

Changes to financial accounting standards and new exchange rules could make it more expensive to issue stock options to employees, which would increase compensation costs and may cause us to change our business practices.

We prepare our financial statements to conform with generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the Public Company Accounting Oversight Board, the Securities and Exchange Commission and various other regulatory bodies. A change in those policies could have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced.

For example, we have used stock options and other long-term equity incentives as a fundamental component of our employee compensation packages. We believe that stock options and other long-term equity incentives directly motivate our employees to maximize long-term shareholder value and, through the use of vesting, encourage employees to remain with our company. Several regulatory agencies and entities are considering regulatory changes that could make it more difficult or expensive for us to grant stock options to employees. For example, the Financial Accounting Standards Board has issued SFAS 123R that will require us to record a charge to earnings for employee stock option grants. In addition, regulations implemented by the American Stock Exchange generally require shareholder approval for all stock option plans, which could make it more difficult or expensive for us to grant stock options to employees. We may, as a result of these changes, incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business, operating results and financial condition.

We may be unable to complete the StorCOMM Merger.

On October 3, 2004, CCA filed a registration statement on Form S-4 in connection with the proposed merger of StorCOMM with Xymed.com, Inc., a wholly owned subsidiary of CCA. The registration statement was declared effective by the SEC on October 28, 2005. Assuming the merger is approved by the shareholders of CCA and StorCOMM, CCA expects the merger to close on or about November 21, 2005. The merger is risky and may be subject to a lengthy process to close and it could divert management s time and focus from operating our business. We may seek additional debt or equity financing in connection with the merger. Additional financing may not be available to us on acceptable terms or at all. We may not be able to close the transaction on the timetable we anticipate, if at all. If we are unable to complete the merger, we may incur significant non-recoverable expenses that may have a material adverse effect on our financial position. As of September 30, 2005, we have incurred expenses related to the integration of StorCOMM and CCA and additional expenses related to the merger. We will not be able to recover these expenses if the merger is not completed.

Failure to complete the merger could adversely affect CCA s and StorCOMM s future business and operation as well as the market price of CCA common stock.

The merger is subject to the satisfaction of closing conditions, including the approval by both CCA and StorCOMM shareholders, and neither CCA nor StorCOMM can assure you that the merger will be successfully completed. In the event that the merger is not completed, CCA and StorCOMM may be subject to many risks, including the costs related to the merger, such as legal, accounting and advisory fees, which must be paid even if the merger is not completed, or the payment of a termination fee under specified circumstances. If the merger is not completed, the market price of CCA common stock could decline.

If the merger is completed but CCA and StorCOMM fail to effectively integrate their operations, the combined company may not realize the potential benefits of the merger.

Assuming the merger is completed, the integration of CCA and StorCOMM will be a time consuming and expensive process and may disrupt the combined company s operations if it is not completed in a timely and efficient manner. If this integration effort is not successful, the combined company s results of operations could be harmed, employee morale could decline, key employees could leave, customers could cancel existing orders or choose not to place new ones and the combined company could have difficulty complying with regulatory requirements. In addition, the combined company may not achieve anticipated synergies or other benefits of the merger. Following the merger, CCA and StorCOMM must operate as a combined organization utilizing common information and communication systems, operating procedures, financial controls and human resources practices. The combined company may encounter the following difficulties, costs and delays involved in integrating their operations:

failure to successfully manage relationships with customers and other important relationships;

failure of customers to accept new services or to continue using the products and services of the combined company;

difficulties in successfully integrating the management teams and employees of CCA and StorCOMM;

challenges encountered in managing larger, more geographically dispersed operations;

the loss of key employees;

diversion of the attention of management from other ongoing business concerns;

potential incompatibilities of technologies and systems;

potential difficulties integrating and harmonizing financial reporting systems; and

potential incompatibility of business cultures.

If the combined company s operations after the merger do not meet the expectations of existing customers of CCA or StorCOMM, then these customers may cease doing business with the combined company altogether, which would harm the results of operations and financial condition of the combined company.

If the anticipated benefits of the merger are not realized or do not meet the expectations of financial or industry analysts, the market price of CCA common stock may decline after the merger. The market price of CCA common stock may decline as a result of the merger if:

the integration of CCA and StorCOMM is unsuccessful;

the combined company does not achieve the expected benefits of the merger as quickly as anticipated or the costs of or operational difficulties arising from the merger are greater than anticipated;

the combined company s financial results after the merger are not consistent with the expectations of financial or industry analysts;

the anticipated operating and product synergies of the merger are not realized; or

the combined company experiences the loss of significant customers or employees as a result of the merger.

Completion of the merger may result in dilution of future earnings per share to the shareholders of CCA.

The completion of the merger may not result in improved earnings per share of CCA or a financial condition superior to that which would have been achieved by either CCA or StorCOMM on a stand-alone basis. The merger could fail to

produce the benefits that the companies anticipate, or could have other adverse effects that the companies currently do not foresee. In addition, some of the assumptions that either company has made, such as the achievement of operating synergies, may not be realized. In this event, the merger could result in a reduction of earnings per share of CCA as compared to the earnings per share that would have been achieved by CCA or StorCOMM if the merger had not occurred.

The costs associated with the merger are difficult to estimate, may be higher than expected and may harm the financial results of the combined company.

CCA estimates that it will incur aggregate direct transaction costs of approximately $700,000 associated with the merger, and additional costs associated with consolidation and integration of operations, which cannot be estimated accurately at this time. Assuming the merger is completed, if the total costs of the merger exceed estimates or the benefits of the merger do not exceed the total costs of the merger, the financial results of the combined company could be adversely affected.

The businesses of CCA could suffer due to the closing of the merger.

The closing of the merger may have a negative impact on CCA s or StorCOMM s ability to sell their respective products and services, attract and retain key management, technical, sales or other personnel, maintain and attract new customers and maintain strategic relationships with third parties. For example, CCA and StorCOMM may experience deferral, cancellations or a decline in the size or rate of orders for their respective products or services or a deterioration in their respective customer or business partner relationships. Any such events could harm the operating results and financial condition of the combined company following the merger.

New Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123 (revised 2004), (Share-Based Payment (SFAS 123R), which replaces SFAS No. 123, Accounting for Stock-Based Compensation, (SFAS 123) and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair value. The pro forma disclosures previously permitted under SFAS 123 will no longer be an alternative to financial statement recognition. We are required to adopt SFAS 123R in the first quarter of fiscal 2006. Under SFAS 123R, we must determine the appropriate fair value model to be used for valuing share-payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include prospective and retroactive adoption methods. The prospective method requires that compensation expense be recorded for all unvested stock options at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive method would restate prior periods to record compensation expense for all unvested stock options beginning with the first period restated. We are evaluating the requirements of SFAS 123R and expect that the adoption of SFAS 123R will have a material impact on our consolidated results of operations and earnings per share. We have not yet determined the method of adoption or the effect of adopting SFAS 123R, and we have not yet determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

In March 2005, the SEC staff issued a Staff Accounting Bulletin (SAB 107) which express views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and provide the staff s views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R and disclosures in Management s Discussion and Analysis subsequent to adoption of SFAS No. 123R.

In December 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, which requires that abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) be recognized as current-period charges. In addition, the statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and the Company does not believe the adoption will have a material effect on the Company s results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The statement defines a nonmonetary exchange with commercial substance as one in which the future cash flows of an entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for fiscal years beginning after June 15, 2005. The Company will adopt this statement as required, and it does not believe the adoption will have a material effect on the Company s results of operation or financial condition.

In May 2005, the Financial Accounting Standards Board issued Statement No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, or SFAS No.154. SFAS No. 154 changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS No. 154 generally requires retrospective application to prior periods financial statements of voluntary changes in accounting principles. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements. We do not believe adoption of SFAS No. 154 will have a material effect on our consolidated results of operations or financial position.

Item 3. Controls and Procedures

Quarterly Controls Evaluation and Related Chief Executive Officer and Chief Financial Officer Certifications

Our Chief Executive Officer, Steven M. Besbeck, and Chief Financial Officer, Anahita Villafane, with the participation of our management, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer believe that, as of the end of the period covered by this report, the Company s disclosure controls and procedures are effective in timely making known to them material information relating to the Company (including its consolidated subsidiaries) required to be included in this report.

Attached as exhibits to this quarterly report are certifications of the Chief Executive Officer and the Chief Financial Officer, which are required in accordance with Rule 13a-14 of the Exchange Act. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Definition of Disclosure Controls and Procedures

Disclosure controls and procedures are methods designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act, such as this quarterly report, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Limitations on the Effectiveness of Disclosure Controls and Procedures

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving a company s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes.

Changes in Internal Control over Financial Reporting

There was no change in the Company s internal control over financial reporting, known to the Chief Executive Officer or the Chief Financial Officer, which occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 6. **Exhibits**

Exhibit 3.1 Restated Articles of Incorporation, as Amended (previously filed as an exhibit to the Company s Registration Statement on Form S-18 dated September 22, 1983, SEC File No. 2-85265).

Exhibit 3.2 By-Laws, as amended (previously filed as an exhibit to the Company s Registration Statement on Form S-18 dated September 22, 1983, SEC File No. 2-85265).

Exhibit 11 Statement re: computation of per share earnings.

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

Exhibit 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.

Exhibit 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934.

Exhibit 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934.

SIGNATURES

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

CREATIVE COMPUTER APPLICATIONS, INC.
(Registrant)

Date:	November 14, 2005	/S/ Steven M. Besbeck Steven. M. Besbeck, President and Chief Executive Officer
Date:	November 14, 2005	/S/ Anahita Villafane Anahita Villafane, Chief Financial Officer

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