INTEGRITY MUTUAL FUNDS INC
Form 10QSB
August 12, 2005
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

OR

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

For the transition period from ____________ to ____________

Commission file number 0-25958

INTEGRITY MUTUAL FUNDS, INC.
(Exact name of small business issuer as specified in its charter)

North Dakota	45-0404061
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1 Main Street North, Minot, North Dakota, 58703
(Address of principal executive offices)

(701) 852-5292
(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes X No

As of July 29, 2005, there were 13,478,543 shares of common stock of the issuer outstanding.

Transitional Small Business Disclosure Format (check one):

Yes No X

FORM 10-QSB

INTEGRITY MUTUAL FUNDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTEGRITY MUTUAL FUNDS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

		(Unaudited) June 30, 2005		December 31, 2004
CURRENT ASSETS				
Cash and cash equivalents	$	1,120,762	$	867,528
Securities available-for-sale		5,530		5,489
Accounts receivable		1,378,741		1,185,284
Prepaids		56,509		93,510
Total current assets	$	2,561,542	$	2,151,811
PROPERTY AND EQUIPMENT	$	1,908,786	$	1,884,129
Less accumulated depreciation		(711,276)		(670,101)
Net property and equipment	$	1,197,510	$	1,214,028
OTHER ASSETS				

	Deferred sales commissions	$	298,288	$	416,908
	Goodwill		9,699,377		9,429,485
	Deferred tax asset		19,424		-
	Other assets (net of accumulated amortization of $128,905 for 2005 and $122,230 for 2004)		358,414		344,919
	Total other assets	$	10,375,503	$	10,191,312
TOTAL ASSETS		$	14,134,555	$	13,557,151

CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)

LIABILITIES AND STOCKHOLDERS' EQUITY

		(Unaudited) June 30, 2005		December 31, 2004
CURRENT LIABILITIES				
Service fees payable	$	73,036	$	98,025
Accounts payable		177,663		37,348
Other current liabilities		1,674,498		1,517,136
Current portion of long-term debt		509,440		848,206
Total current liabilities	$	2,434,637	$	2,500,715
LONG-TERM LIABILITIES				
Notes payable	$	1,223,397	$	1,343,649
Subordinated debentures		-		595,000
Subordinated commercial notes		561,000		561,000
Subordinated corporate notes		844,000		-
Convertible debentures		250,000		250,000
Deferred tax liability		-		24,300
Other long-term liabilities		222,023		-
Less current portion of long-term debt		(509,440)		(848,206)
Total long-term liabilities	$	2,590,980	$	1,925,743
TOTAL LIABILITIES	$	5,025,617	$	4,426,458
STOCKHOLDERS' EQUITY				
Series A preferred stock - 5,000,000 shares authorized, $.0001 par value; 3,050,000 and 3,050,000 shares issued and outstanding, respectively	$	305	$	305
Additional paid in capital - series A preferred stock		1,524,695		1,524,695
Common stock - 1,000,000,000 shares authorized, $.0001 par value;		1,349		

13,478,543 and 13,228,543 shares issued and outstanding, respectively				1,323
Additional paid in capital - common stock		8,545,883		8,546,560
Receivable - unearned ESOP shares		(72,112)		(75,455)
Preferred dividends declared		(45,750)		(94,550)
Accumulated deficit		(845,729)		(772,441)
Accumulated other comprehensive gain		297		256
Total stockholders' equity	$	9,108,938	$	9,130,693
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	14,134,555	$	13,557,151

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTEGRITY MUTUAL FUNDS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

			(Unaudited) Three Months Ended June 30,	
		2005		2004
OPERATING REVENUES				
Fee income	$	1,173,647	$	1,123,305
Commissions		3,457,546		3,127,934
Total revenue	$	4,631,193	$	4,251,239
OPERATING EXPENSES				
Compensation and benefits	$	795,276	$	673,363
Commission expense		3,106,232		2,802,443
General and administrative expenses		624,625		602,597
Sales commissions amortized		76,630		93,923
Depreciation and amortization		30,999		25,869
Total operating expenses	$	4,633,762	$	4,198,195
OPERATING INCOME (LOSS)	$	(2,569)	$	53,044
OTHER INCOME (EXPENSES)				
Interest and other income	$	17,797	$	16,848
Interest expense		(69,210)		(78,500)
Net other expenses	$	(51,413)	$	(61,652)
LOSS BEFORE INCOME TAX BENEFIT (EXPENSE)	$	(53,982)	$	(8,608)
INCOME TAX BENEFIT (EXPENSE)		17,964		(2,165)
NET LOSS	$	(36,018)	$	(10,773)
NET LOSS PER SHARE:				
Basic	$	(.00)	$	(.00)
Diluted	$	(.00)	$	(.00)
AVERAGE COMMON SHARES OUTSTANDING:				
Basic		13,414,964		13,074,186
Diluted		13,414,964		13,074,186

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTEGRITY MUTUAL FUNDS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited) Six Months Ended June 30,	
	2005	2004
OPERATING REVENUES		
Fee income	$ 2,252,214	$ 2,295,007
Commissions	6,927,000	6,262,900
Total revenue	$ 9,179,214	$ 8,557,907
OPERATING EXPENSES		
Compensation and benefits	$ 1,465,503	$ 1,182,504
Commission expense	6,248,083	5,651,155
General and administrative expenses	1,121,717	1,078,170
Sales commissions amortized	152,232	161,134
Depreciation and amortization	54,098	51,222
Total operating expenses	$ 9,041,633	$ 8,124,185
OPERATING INCOME	$ 137,581	$ 433,722
OTHER INCOME (EXPENSES)		
Interest and other income	$ 30,209	$ 29,738
Interest expense	(131,294)	(157,864)
Net other expenses	$ (101,085)	$ (128,126)
INCOME BEFORE INCOME TAX EXPENSE	$ 36,496	$ 305,596
INCOME TAX EXPENSE	(15,234)	(134,753)
NET INCOME	$ 21,262	$ 170,843
NET INCOME PER SHARE:		
Basic	$ .00	$ .01
Diluted	$ .00	$ .01
AVERAGE COMMON SHARES OUTSTANDING:		
Basic	13,329,887	13,033,677
Diluted	13,329,887	13,033,677

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTEGRITY MUTUAL FUNDS, INC., AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

		(Unaudited) Six Months Ended June 30, 2005		2004
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	$	21,262	$	170,843
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		47,850		50,451
Sales commissions amortized/charged off		152,232		161,210
Loss on sale of available-for-sale securities		-		938
(Increase) decrease in:				
Accounts receivable		(193,457)		(158,823)
Prepaids		37,001		2,747
Deferred sales commissions capitalized, net of CDSC collected		(33,612)		(838)
Other assets		(20,167)		(382)
Increase (decrease) in:				
Service fees payable		(24,989)		(4,272)
Accounts payable		140,315		(47,577)
Deferred tax		(43,724)		(47,850)
Other liabilities		(93,724)		74,569
Net cash provided (used) by operating activities	$	(11,013)	$	201,016
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of property and equipment	$	(24,657)	$	(22,482)
Purchase of available-for-sale securities		(4)		(3)
Proceeds from sale of available-for-sale securities		-		24,019
Purchase of goodwill		(96,806)		(31,932)
Net cash used by investing activities	$	(121,467)	$	(30,398)
CASH FLOWS FROM FINANCING ACTIVITIES				
Redemption of common stock	$	-	$	(18,219)
Sale of common stock warrants		-		3,000
Sale of subordinated corporate notes		844,000		-
Reduction of short-term borrowing		(100,000)		-
Reduction of notes payable		(120,252)		(119,970)
Repayments from ESOP		3,343		3,347
Preferred dividends paid		(45,750)		(25,925)
Short-term borrowing		650,025		300,000
Loss on allocation of ESOP shares		(651)		(349)

Redemption of corporate notes		-		(962,000)
Redemption of subordinated debentures		(595,000)		-
Reduction of other current liabilities		(250,000)		(250,000)
Net cash provided (used) by financing activities	$	385,715	$	(1,070,116)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$	253,235	$	(899,498)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	$	867,527		2,581,360
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	1,120,762	$	1,681,862
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:				
Change in unrealized gain (loss) on available-for-sale securities	$	41	$	767
Increase (decrease) in goodwill		173,086		(80,869)
Increase (decrease) in other current liabilities		(48,937)		(54,417)
Increase (decrease) in other long-term liabilities		222,023		(26,452)
Preferred stock dividends declared		22,875		22,875

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTEGRITY MUTUAL FUNDS, INC., AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2005 and 2004

NOTE 1 - BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of Integrity Mutual Funds, Inc., a North Dakota corporation, and its subsidiaries (collectively, the "Company"), included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the footnotes thereto contained in the Annual Report on Form 10-KSB for the year ended December 31, 2004, of Integrity Mutual Funds, Inc., as filed with the SEC. The condensed consolidated balance sheet at December 31, 2004, contained herein, was derived from audited financial statements, but does not include all disclosures included in the Form 10-KSB and applicable under accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America, but not required for interim reporting purposes, have been condensed or omitted.

In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (which are of a normal, recurring nature) necessary for a fair presentation of the financial statements. The results of operations for the six months ended June 30, 2005, are not necessarily indicative of operating results for the entire year.

NOTE 2 - INCOME TAXES

The Company sponsors several mutual funds. Deferred sales commissions relating to some of its sponsored mutual funds are amortized over 5 years for income tax purposes and amortized over 8 years for financial reporting purposes. The effects of these differences will create timing differences between when the commissions are deducted for income tax purposes and expensed as amortization for financial reporting purposes. Deferred tax assets or deferred tax liabilities may result from these timing differences.

NOTE 3 - RECLASSIFICATION

Certain amounts in the 2004 condensed consolidated financial statements have been reclassified to conform with the 2005 presentation. These reclassifications had no effect on the Company's net income.

NOTE 4 - BUSINESS ACQUISITIONS

On April 22, 2005, the Company acquired the management rights to the IPS Millennium Fund and the IPS New Frontier Fund from IPS Advisory, Inc. ("IPS Advisory"), and merged them into a new Integrity Fund called the Integrity Growth & Income Fund. The two funds had combined assets of approximately $57 million at the time of acquisition. The purchase agreement called for total consideration of approximately 656,000 common shares of the Company. The Company provided IPS Advisory with 250,000 common shares upon closing. The remaining consideration of approximately 406,000 common shares, which is subject to adjustment based on retention of assets in the fund, is to be issued as follows: 203,000 common shares at the one year anniversary of the closing date, and 203,000 common shares at the two year anniversary of the closing date. The shares will be subject to a put option which will allow the holders of the shares to put them back to the Company at a price equal to the market price of the Company's shares as of the closing date, which was $.36 per share. The put option will be exercisable with respect to one-third of the shares per year starting on the third anniversary of the closing date. The Company will also provide IPS Advisory with a stock option incentive bonus based on growth in assets in the Fund based on the following schedule: 150,000 options on the Company's common shares when assets of the fund reach $100,000,000 and 150,000 options on the Company's common shares when the assets of the Fund reach $200,000,000. The options will have a strike price of $.65 per share and mature 10 years from the closing date. The securities issued in connection with this transaction will be issued on a private placement basis. In June of 2005, the liability relating to this acquisition was reduced to approximately $222,000 to reflect the assets in the acquired funds as of June 30, 2005.

On December 19, 2003, the Company acquired the management rights to the Maine and New Hampshire Tax-Saver Bond Funds from Forum Financial Group. The two funds had combined assets of approximately $43 million at the time of acquisition. The purchase agreement called for total consideration of approximately $750,000. The majority of the purchase price, or approximately $425,000, was paid upon closing. The remaining consideration of approximately $325,000, which was subject to adjustment based on retention of assets in the funds, was placed in an escrow account that was to be paid out on the first anniversary of the closing date. The total purchase price was paid with cash generated from a private offering of preferred stock. In December of 2004, the final payment of approximately $285,000 was made, which reflected the assets in the acquired funds at the one year anniversary.

On September 19, 2003, the Company acquired the management rights to the four stock funds in the Willamette Family of Funds. The four funds had combined assets of approximately $63 million at the time of acquisition. The purchase agreement called for total consideration of approximately $1,400,000. The majority of the purchase price, or approximately $900,000, was paid upon closing. The remaining consideration of approximately $500,000, which is subject to adjustment based on retention of assets in the funds, is to be paid as follows: $350,000 within five business days of the one year anniversary of the closing date, and $150,000 within five business days of the two year anniversary of the closing date. The total purchase price will be paid by utilizing a commercial bank loan and lines of credit, as well as available cash on hand. In September of 2004, the one year anniversary payment of approximately $323,000 was made, which reflected the assets of the acquired funds as of the one year anniversary. In June of 2005, the liability for the two year anniversary payment was reduced to approximately $97,000 to reflect the assets in the acquired funds as of June 30, 2005.

On May 23, 2003, the Company acquired the management rights to the CNB Funds, which included the $13 million Canandaigua Equity Fund, a large-cap growth fund, and the $1 million Canandaigua Bond Fund. The purchase agreement called for total consideration of approximately $285,000. The majority of the purchase price, or approximately $160,000, was paid upon closing. The remaining consideration of approximately $125,000, which was subject to adjustment based on retention of assets in the funds, was to be paid as follows: $62,500 at the one year anniversary of the closing date, and $62,500 at the two year anniversary of the closing date. The total purchase price was paid by using available cash on hand. In June of 2004, the one year anniversary payment of approximately $44,000 was paid, which reflected the assets in the acquired funds as of the one year anniversary. In June of 2005, the final payment of approximately $26,000 was made, which reflected the assets in the acquired funds at the two year anniversary.

On May 30, 2003, the Company acquired 100% of the equity stock of Abbington Capital Management, Inc. The purchase consideration was comprised of 700,000 shares of unregistered $.0001 par value common stock of the Company determined by both parties to have a total value of $210,000. The common stock was issued in a private transaction, exempt from registration, pursuant to the following delivery schedule: 200,000 shares at closing; 200,000 shares on August 31, 2003; 200,000 shares on December 31, 2003; and 100,000 shares on April 30, 2004. As a part of the transaction, the Company received a license for the Portfolio Manager's Stock Selection Matrix, a quantitative investment model for managing equity portfolios. The shares were issued in a private transaction exempt from registration under federal securities laws or any state registration requirements and are subject to the resale restrictions on unregistered securities.

NOTE 5 - GOODWILL

The changes in the carrying amount of goodwill for the six month period ended June 30, 2005, are as follows:

		Mutual Fund Services		Broker-Dealer Services		Total
Balance as of January 1, 2005	$	6,950,733	$	2,478,752	$	9,429,485
Goodwill acquired during the period		333,055		-		333,055
Goodwill acquisition price adjustment during the period (see Note 4)		(63,163)		-		(63,163)
Impairment losses		-		-		-
Balance as of June 30, 2005	$	7,220,625		2,478,752		9,699,377

The Company tests goodwill for impairment annually, during the second quarter of each fiscal year, at the reporting unit level using a fair value approach, in accordance with the provisions of SFAS 142. The annual testing resulted in no impairment charges to goodwill in 2005. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value, goodwill will be evaluated for impairment between annual tests.

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

GENERAL

Integrity Mutual Funds, Inc., derives a portion of its revenues and net income from providing investment management, distribution, shareholder services, fund accounting, and related services to the open-end investment companies known as "Integrity Mutual Funds," "Integrity Managed Portfolios," and "The Integrity Funds," hereinafter collectively referred to as "the Funds." Integrity Mutual Funds currently consists of three open-end investment companies, including ND Tax-Free Fund, Inc., Montana Tax-Free Fund, Inc., and Integrity Fund of Funds, Inc. Integrity Managed Portfolios consists of one open-end investment company containing six separate series, including the Kansas Municipal Fund, Kansas Insured Intermediate Fund, Nebraska Municipal Fund, Oklahoma Municipal Fund, Maine Municipal Fund, and New Hampshire Municipal Fund. The Integrity Funds consists of one open-end investment company containing eight separate series, including Integrity Equity Fund, Integrity Value Fund, Integrity Small Cap Growth Fund, Integrity Health Sciences Fund, Integrity Technology Fund, Integrity High Income Fund, Integrity Municipal Fund, and Integrity Growth & Income Fund. Capital Financial Services, Inc. ("CFS"), the Company's broker-dealer subsidiary, provides another substantial portion of revenues through sales of mutual funds and variable and fixed insurance products.

The Company organizes its current business units into two reportable segments: mutual fund services and broker-dealer services. The mutual fund services segment provides investment advisory, distribution, and administrative services to the Funds. The broker-dealer services segment distributes securities and insurance products to retail investors through a network of registered representatives.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Most of the businesses were acquired as a unit and the management at the time of the acquisitions was retained.

Segment Information

For the	Mutual Fund	Broker-Dealer

Second Quarter Ended	Services	Services	Total
June 30, 2005			
Revenues	$ 1,287,992	$ 3,343,201	$ 4,631,193
Interest expense	69,210	-	69,210
Depreciation and amortization	30,792	207	30,999
Income (loss) before income tax benefit (expense)	(223,715)	169,733	(53,982)
Income tax benefit (expense)	84,564	(66,600)	17,964
Net income (loss)	(139,151)	103,133	(36,018)
June 30, 2004			
Revenues	$ 1,217,102	$ 3,034,137	$ 4,251,239
Interest expense	78,500	-	78,500
Depreciation and amortization	25,598	271	25,869
Income (loss) before income tax benefit (expense)	(175,844)	167,236	(8,608)
Income tax benefit (expense)	63,335	(65,500)	(2,165)
Net income (loss)	(112,509)	101,736	(10,773)

For the Six Months Ended	Mutual Fund Services	Broker-Dealer Services	Total
June 30, 2005			
Revenues	$ 2,506,826	$ 6,672,388	$ 9,179,214
Interest expense	131,294	-	131,294
Depreciation and amortization	53,682	416	54,098
Income (loss) before income tax benefit (expense)	(320,356)	356,852	36,496
Income tax benefit (expense)	124,666	(139,900)	(15,234)
Net income (loss)	(195,690)	216,952	21,262
Segment assets	12,733,593	1,479,354	14,212,947
Expenditures for segment assets	24,657	-	24,657
June 30, 2004			
Revenues	$ 2,551,954	$ 6,005,953	$ 8,557,907
Interest expense	157,864	-	157,864
Depreciation and amortization	50,888	334	51,222
Income (loss) before income tax expense	(22,131)	327,727	305,596
Income tax expense	(6,353)	(128,400)	(134,753)

Net income (loss)	(28,484)	199,327	170,843
Segment assets	13,213,744	1,503,703	14,717,447
Expenditures for segment assets	21,005	1,477	22,482

Reconciliation of Segment Information

		For the Three Months Ended June 30, 2005	June 30, 2004
Revenues			
Total revenues for reportable segments	$	4,631,193	4,251,239
Profit			
Total reportable segment profit	$	(36,018)	(10,773)

		For the Six Months Ended June 30, 2005	June 30, 2004
Revenues			
Total revenues for reportable segments	$	9,179,214	8,557,907
Profit			
Total reportable segment profit	$	21,262	170,843
Assets			
Total assets for reportable segments	$	14,212,947	14,717,447
Elimination of intercompany receivables		(78,392)	(78,392)
Consolidated assets	$	14,134,555	14,639,055

A substantial portion of the Company's revenue depends upon the amount of assets under its management/service. Assets under management/service can be affected by the addition of new funds to the group, the acquisition of another investment management company, purchases and redemptions of mutual fund shares, and investment performance, which may depend on general market conditions.

ASSETS UNDER MANAGEMENT/SERVICE

By Investment Objective
In Millions

As of June 30,		2005		2004	% Change
FIXED INCOME					
Tax-Free Funds	$	235.4	$	282.7	(16.7)%
Taxable Funds (Corporate/Government)		38.3		5.8	560.3 %
TOTAL FIXED INCOME FUNDS	$	273.7	$	288.5	(5.1)%
EQUITY					
Fund of Funds	$	6.2	$	6.6	(6.1)%
Equity Funds		103.8		72.1	44.0 %
TOTAL EQUITY FUNDS		110.0		78.7	39.8 %
TOTAL ASSETS UNDER MANAGEMENT/SERVICE	$	383.7	$	367.2	4.5 %
Average for the six month period	$	369.5	$	378.8	(2.5)%

Assets under the Company's management/service were $383.7 million at June 30, 2005, an increase of $23.6 million (6.6%) from December 31, 2004, and an increase of $16.5 million (4.5%) from June 30, 2004.

RESULTS OF OPERATIONS

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net income (loss)	$ (36,018)	$ (10,773)	$ 21,262	$ 170,843
Earnings per share:				
Basic	$ (.00)	$ (.00)	$ .00	$ .01
Diluted	$ (.00)	$ (.00)	$ .00	$ .01

The Company reported a net loss for the quarter ended June 30, 2005, of $36,018, compared to a net loss of $10,773 for the same quarter in 2004. Net income for the six months ended June 30, 2005, was $21,262, compared to $170,843 for the same period in 2004.

Operating revenues

Total operating revenues for the quarter ended June 30, 2005, were $4,631,193, an increase of 8.9% from June 30, 2004. Total operating revenues for the six months ended June 30, 2005, were $9,179,214, an increase of 7.3% from June 30, 2004. The increases are primarily the result of increased commission income.

Fee income for the quarter ended June 30, 2005, increased 4.5% compared to June 30, 2004. This increase was due primarily to fees received in connection with new funds that were acquired and/or set up during 2004 and 2005. Fee income for the six months ended June 30, 2005, decreased 1.9% over the same period in 2004. The decrease is due primarily to a decrease in average assets under management/service. The Company receives fees for providing investment advisory services to the Funds. Investment advisory fees constituted 8% of the Company's consolidated revenues for the six months ended June 30, 2005. The Company also receives fees from the Funds for providing transfer agency, fund accounting, and other administrative services. These fees constituted 10% of the Company's consolidated revenues for the six months ended June 30, 2005.

The Company earns Rule 12b-1 fees in connection with the distribution of Fund shares. A portion of these fees are paid out to other broker-dealers, with the remaining amount retained by the Company to pay for expenses related to the distribution of the Funds. These fees constituted 7% of the Company's consolidated revenues for the six months ended June 30, 2005.

Commission income includes CFS commissions and 12b-1 fees associated with the sale of mutual funds and insurance products. The Company pays the registered representatives a portion of this income as commission expense and retains the balance. Commission income also includes underwriting fees associated with sales of Fund shares subject to front-end sales loads ("FESLs"), as well as contingent deferred sales charges ("CDSCs") earned in connection with redemptions of Fund shares subject to CSDCs, and the dealer commission associated with sales of Fund shares subject to FESLs, which is paid out to other broker-dealers as commission expense. Commission income increased 10.5%, to $3,457,546 for the quarter ended June 30, 2005, from $3,127,934 for the same period in 2004. Commission income increased 10.6%, to $6,927,000, for the six months ended June 30, 2005, from $6,262,900, for the same period in 2004. The increases are primarily the result of the recruitment of several new registered representatives in CFS. Commission revenues constituted 75% of the Company's consolidated revenues for the six months ended June 30, 2005.

Operating expenses

Total operating expenses for the second quarter and six months ended June 30, 2005, were $4,633,762 and $9,041,633, respectively, representing increases of 10.4% and 11.3% compared to the same periods in 2004. The increases are a result of the net activity in the major expense categories, as described in the paragraphs that follow.

Compensation and benefits

Total compensation and benefits expense for the quarter ended June 30, 2005, was $795,276, an increase of 18.1% from June 30, 2004. Total compensation and benefits expense for the six months ended June 30, 2005, was $1,465,503, an increase of 23.9% from the same period in 2004. The increases result primarily from the addition of several new employees to the Company over the past 12 months, annual compensation and benefit increases, increased overrides paid to certain employees, and a 401(k) match of up to 4% of employee deferrals that was implemented effective January 1, 2005.

In May of 2004, the Company implemented a restructuring of wholesaler compensation to a base salary plus incentive formula. At the time of implementation, five wholesalers were added to the Company. The primary function of the wholesalers is to market the Company's Funds to registered representatives. Currently, the wholesaling team consists of 16 wholesalers, four of which are employees of the Company. The remaining members of the wholesaling team are independent contractors working on a straight commission basis. They are allowed up to $500 per month in general and administrative expenses to support their sales effort. Management expects to continue to expand the wholesaling team to as many as 20 wholesalers in 2005. The Company's compensation and benefits expense may continue to increase as a result of this effort.

Commission expense

Total commission expense for the quarter ended June 30, 2005, and the six months ended June 30, 2005, was $3,106,232 and $6,248,083, an increase of 10.8% and 10.6%, respectively, as compared to the same periods in 2004. The increases are related to the increases in commission income.

General and administrative expenses

Total general and administrative expenses for the quarter ended June 30, 2005, were $624,625, an increase of 3.7% from June 30, 2004. Total general and administrative expenses for the six months ended June 30, 2005, were $1,121,717, an increase of 4.0% from June 30, 2004. The increases are primarily attributable to expenses incurred relating to new funds that were acquired and/or set up during 2004 and 2005.

Sales commissions amortized

Sales commissions paid to brokers and dealers in connection with the sale of shares of the Funds sold without a FESL are capitalized and amortized on a straight-line basis. The Company amortizes the sales commissions relating to some of the Company's sponsored funds over eight years, which best approximates management's estimate of the average life of investor's accounts in these funds and coincides with conversion of Class B shares to Class A shares. CDSCs received by the Company are recorded as a reduction of unamortized deferred sales commissions. Amortization of deferred sales commissions for the quarter ended June 30, 2005, and the six months ended June 30, 2005, decreased 18.4% and 5.5%, respectively, as compared to the same periods in 2004.

Depreciation and amortization

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142 - Goodwill and Other Intangible Assets. Under SFAS 142, the Company no longer amortizes its goodwill and certain other intangibles over their estimated useful life. Rather, they will be subject to at least an annual assessment for impairment by applying a fair-value based test. There were no impairment adjustments made during the quarter ended June 30, 2005.

Liquidity and capital resources

Net cash used by operating activities was $11,013 during the six months ended June 30, 2005, as compared to net cash provided by operating activities of $201,016 during the six months ended June 30, 2004. The primary reason for this decrease was a decrease in net income.

Net cash used by investing activities for the six months ended June 30, 2005, was $121,467, compared to net cash used by investing activities of $30,398 for the six months ended June 30, 2004. The 2005 activity includes the acquisition of the management rights to two mutual funds, purchases of computer equipment, and the remodeling of several areas of the Company's office building.

Net cash provided by financing activities during the six months ended June 30, 2005, was $385,715. The major financing activities for the period were the payment of $250,000, in January of 2005, to repurchase 500,000 common shares, pursuant to the put privilege that was exercised by the previous owners of Capital Financial Services, Inc., the receipt of $550,025 in short-term bank loans in January and February of 2005, the retirement of $595,000 of subordinated debentures that matured on June 30, 2005, and the sale of $844,000 of subordinated corporate notes in May and June of 2005.

At June 30, 2005, the Company held $1,120,762 in cash and cash equivalents, as compared to $867,528 at December 31, 2004. Liquid assets, which consist of cash and cash equivalents, securities available-for-sale and current receivables increased to $2,505,033 at June 30, 2005, from $2,058,301 at December 31, 2004. The Company is required to maintain certain levels of cash and liquid securities in its broker-dealer subsidiaries to meet regulatory net capital requirements.

The Company has historically relied upon sales of its equity securities and debt instruments, as well as bank loans for liquidity and growth. In January of 2004, the Company repurchased 500,000 common shares for $250,000 under a put option related to its acquisition of CFS. In March of 2004, the Company paid approximately $160,000 of 2003 tax obligations. In June of 2004, the Company borrowed $200,000 on a non-revolving bank line of credit, and $100,000 on a revolving bank line of credit that was used, along with existing cash on hand, to repay $962,000 of corporate notes that matured on June 30, 2004. $200,000 of the bank debt was repaid in December of 2004, and the remaining balance of $100,000 was repaid in May of 2005. Also in 2004, the Company made additional payments of approximately $367,000 relating to the acquisitions of the management rights to the Canandaigua and Willamette Funds.

The Company has significant cash requirements to meet several liabilities coming due in 2005. In January of 2005, the Company repurchased 500,000 common shares for $250,000 pursuant to a put option related to its acquisition of CFS, which was paid by utilizing a short-term bank loan. The six-month bank loan carried an interest rate of 2.00% over the prime rate and was repaid in July of 2005. The Company received an additional $300,025 in short-term bank debt in February of 2005 to be used primarily for working capital. This debt carried an interest rate of 6.75% and was also repaid in July of 2005. In June of 2005, the Company borrowed $100,000 on its revolving bank line of credit and made a final payment of approximately $26,000 relating to its acquisition of the management rights to the Canandaigua Funds. The Company had $595,000 of subordinated debentures that matured on June 30, 2005. These subordinated debentures were repaid by utilizing proceeds received from the issuance of the Company's new 9 ¼% subordinated corporate notes, which mature on January 1, 2011. The outstanding balance of subordinated corporate notes on June 30, 2005, was $844,000. Additionally, the Company will make a final payment of approximately $97,000 in September of 2005 relating to the acquisition of the management rights to the Willamette Funds.

Management believes that the Company's existing liquid assets, together with the continued issuance of 9 ¼% subordinated corporate notes, will provide the Company with sufficient resources to meet its cash requirements during the next twelve months. In addition to the liabilities coming due in the next twelve months, management expects that the principal needs for cash may be to advance sales commissions on Funds subject to CDSCs, acquire additional investment management or financial services firms, acquire the management rights to additional outside mutual funds, repurchase shares of the Company's common stock, and service debt. Management also expects to realize increases in expenses associated with regulatory compliance with the Sarbanes-Oxley Act of 2002, including increased legal, audit, staff, and consultant expenses.

Sales of fund shares with FESLs provide current distribution revenue to the Company in the form of the Company's share of the FESLs, and distribution revenue, over time, in the form of 12b-1 payments. Sales of fund shares with CDSCs provide distribution revenue, over time, in the form of 12b-1 payments and, if shares are redeemed within 5 years, CDSCs. However, the Company pays commissions on sales of Fund shares subject to CDSCs, reflects such commissions as a deferred expense on its balance sheet and amortizes such commissions over a period of up to eight years, thereby recognizing distribution expenses. Therefore, to the extent that sales of Fund shares subject to CDSCs increases over time relative to sales of shares subject to FESLs, current distribution expenses may increase relative to current distribution revenues in certain periods, which would negatively impact the Company's cash flow in such periods. In addition, the Company may need to find additional sources of funding if existing cash flow and debt facilities are insufficient to fund commissions payable to selling broker-dealers on shares subject to CDSCs if sales of Fund shares subject to CDSCs increase significantly.

FORWARD-LOOKING STATEMENTS

When used herein, in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases, and in other Company-authorized written or oral statements, the words and phrases "can be," "expects," "anticipates," "may affect," "may depend," "believes," "estimate," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Such statements are subject to certain risks and uncertainties, including those set forth in this "Forward-Looking Statements" section, which could cause actual results for future periods to differ materially from those presently anticipated or projected. The Company does not undertake and specifically disclaims any obligation to update any forward-looking statement to reflect events or circumstances after the date of such statements.

The Company derives substantially all of its revenues from two sources; commission revenue earned in connection with sales of shares of mutual funds, variable insurance products, and fixed insurance products; and fees relating to the management of, and provision of services to, the Funds. The fees earned by the Company are generally calculated as a percentage of assets under management/service. If the Company's assets under management/service decline, or do not grow in accordance with the Company's plans, fee revenues and earnings would be materially adversely affected. Assets under management/service may decline because redemptions of Fund shares exceed sales of Fund shares, or because of a decline in the market value of securities held by the Funds, or a combination of both.

In seeking to sell Fund shares and market its other services, the Company operates in the highly competitive financial services industry. The Company competes with approximately 8,000 open-end investment companies that offer shares to the investing public in the United States. The Company also competes with the financial services and other investment alternatives offered by stock brokerage and investment banking firms, insurance companies, banks, savings and loan associations, and other financial institutions, as well as investment advisory firms. Most of these competitors have substantially greater resources than the Company. The Company sells Fund shares principally through third-party broker-dealers. The Company competes for the services of such third party broker-dealers with other sponsors of mutual funds who generally have substantially greater resources than the Company. Banks in particular have increased, and continue to increase, their sponsorship of proprietary mutual funds distributed through third-party distributors. Many broker-dealer firms also sponsor their own proprietary mutual funds, which may limit the Company's ability to secure the distribution services of such broker-dealer firms. In seeking to sell Fund shares, the Company also competes with increasing numbers of mutual funds that sell their shares without the imposition of sales loads. No-load mutual funds are attractive to investors because they do not have to pay sales charges on the purchase or redemption of such mutual fund shares. This competition may place pressure on the Company to reduce the FESLs and CDSCs charged upon the sale or redemption of Fund shares. However, reduced sales loads would make the sale of Fund shares less attractive to the broker-dealers upon whom the Company depends for the distribution of Fund shares. In the alternative, the Company might itself be required to pay additional fees, expenses, commissions, or charges in connection with the distribution of Fund shares, which could have a material adverse effect on the Company's earnings.

The fact that the investments of some Funds are geographically concentrated within a single state makes the market value of such investments particularly vulnerable to economic conditions within that state. In addition, the states in which the investments of the Funds, as a group, are concentrated are themselves concentrated in certain regions of the United States. The Company's fee revenues may, therefore, be adversely affected by economic conditions within such regions.

The following factors, among others, could cause actual results to differ materially from forward-looking statements, and future results could differ materially from historical performance:

- General political and economic conditions which may be less favorable than expected;
- The effect of changes in interest rates, inflation rates, the stock markets, or other financial markets;
- Unfavorable legislative, regulatory, or judicial developments;
- Incidence and severity of catastrophes, both natural and man-made;
- Changes in accounting rules, policies, practices, and procedures which may adversely affect the business;
- Terrorist activities or other hostilities that may adversely affect the general economy.

Item 3. Controls and Procedures

Within the 90-day period prior to the filing of this report, the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of June 30, 2005, and that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed and summarized, and reported within the time periods specified by the SEC's rules and forms.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies or material weaknesses.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On May 16, 2005, the Company was approved to issue a $2 million maximum intra-state subordinated corporate note offering, limiting the sale in North Dakota to North Dakota residents only. The subordinated corporate notes do not represent ownership in the Company. The subordinated corporate notes carry an interest rate of 9 ¼% per annum, payable annually, and mature on January 1, 2011. The Company can call the subordinated corporate notes at par anytime after December 1, 2007, and will be offered by the Company to an unlimited number of accredited investors and up to 35 sophisticated non-accredited investors. These securities have not been registered under the Securities Act of 1933, as amended (the "Act"), and will be offered and sold in reliance on exemptions from the registration of the Act provided by Section 4(2) of the Act and Rule 505 of Regulation D and exemptions available for intrastate offerings. As of August 12, 2005, the Company has sold $2,000,000 of subordinated corporate notes to eighteen sophisticated non-accredited investors and twenty-nine accredited investors.

In connection with the acquisition of the management rights to the IPS Millennium Fund and the IPS New Frontier Fund from IPS Advisory, Inc. ("IPS Advisory"), as described in Note 4 - Business Acquisitions, the Company provided IPS Advisory with compensation of 250,000 common shares on May 10, 2005. The remaining consideration of approximately 406,000 common shares, which is subject to adjustment based on retention of assets in the fund, is to be issued as follows: 203,000 common shares at the one year anniversary of the closing date, and 203,000 common shares at the two year anniversary of the closing date. The securities issued in connection with this transaction will be issued on a private placement basis.

Small Business Issuer Repurchases of Equity Securities:

Period	Total Number of Shares Purchased	Average Price Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
April 2005	0	$.00	0	$597,754
May 2005	0	$.00	0	$597,754
June 2005	0	$.00	0	$597,754
Total	0	$.00	0	$597,754

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Shareholders held on May 27, 2005, the following proposals were adopted by the margins indicated:

1. To elect a Board of Directors of the Company.

Number of votes cast for:

Vance A. Castleman10,421,526

Peter A. Quist10,458,247

Myron D. Thompson10,481,238

Robert E. Walstad10,391,892

Richard H. Walstad10,450,505

Robert Mau10,481,238

Vaune M. Cripe10,481,238

Steven Lysne10,481,238

2. To ratify the selection of Brady, Martz & Associates, P.C., as the Company's independent auditors for the fiscal year ending December 31, 2005.

For10,485,535

Against 106,334

Abstain 10,778

Item 5. Other Information

On January 27, 2005, the Company entered into a joint venture agreement with All Season Financial Advisors. In accordance with the agreement, the Company will set up a Fund as a new series under The Integrity Funds trust called the Integrity All Season Fund. The Company's wholly-owned subsidiary, Integrity Money Management, Inc., will serve as the Fund's investment advisor. All Season Financial Advisors will serve as the Fund's investment sub-advisor. SMH Capital Advisors, Inc., will also serve as the Fund's investment sub-advisor for approximately 20% of the assets. The Company's wholly-owned subsidiary, Integrity Funds Distributor, Inc., will serve as distributor to the Fund, and the Company's wholly-owned subsidiary, Integrity Fund Services., will serve as administrator, transfer agent, and fund accountant to the Fund. The initial set-up of the Fund will not require a material cash outlay by the Company. Integrity plans to launch the All Season Fund in the third quarter of 2005.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

4.4	Subordinated Corporate Note Subscription Agreement
4.5	Form of Subordinated Corporate Note
31.1	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act and Rules 13a-14(a) and 15d-14(a) of the Exchange Act
31.2	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act and Rules 13a-14(a) and 15d-14(a) of the Exchange Act
32.1	CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act and 18 U.S.C. Section 1350
32.2	CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act and 18 U.S.C. Section 1350

(b) Reports on Form 8-K

None

INTEGRITY MUTUAL FUNDS, INC., AND SUBSIDIARIES

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.

	INTEGRITY MUTUAL FUNDS, INC.
Date: August 12, 2005	By /s/ Robert E. Walstad
	Robert E. Walstad Chief Executive Officer, Chairman, and Director
Date: August 12, 2005	By /s/ Heather Ackerman
	Heather Ackerman Chief Financial Officer