INTEGRITY MEDIA INC
Form 10-Q
May 17, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2004

Commission File No. 000-24134

Integrity Media, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware	63-0952549
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

1000 Cody Road
Mobile, Alabama 36695

(Address of Principal Executive Offices, Zip Code)
(251) 633-9000

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

The number of shares outstanding of each of the issuer s classes of common stock, as of May 14, 2004, the latest practicable date, was as follows:

Class	Outstanding
Class A Common Stock, $0.01 par value	2,384,783
Class B Common Stock, $0.01 par value	3,385,000

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PART I.
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTEGRITY MEDIA, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	Mar 31, 2004	Dec 31, 2003
	(Unaudited)	
ASSETS		
Current Assets		
Cash	$ 1,924	$ 3,142
Trade receivables, less allowance for returns and doubtful accounts of $2,524 and $2,300	12,510	10,847
Other receivables	269	143
Inventories	8,106	7,389
Other current assets	6,038	6,835
Total current assets	28,847	28,356
Property and equipment, net of accumulated depreciation of $7,537 and $7,179	10,826	10,909
Product masters, net of accumulated amortization of $22,829 and $22,321	4,995	4,737
Other assets	7,200	7,503
Total assets	$ 51,868	$ 51,505
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Current portion of long-term debt	$ 2,690	$ 2,690
Line of Credit	5,300	4,500
Accounts payable and accrued expenses	4,627	7,746
Royalties payable	7,522	6,630
Other current liabilities	4,062	1,909
Total current liabilities	24,201	23,475
Long-term debt	6,447	7,119

Other long-term liabilities	719	630
Total liabilities	31,367	31,224
Commitments and contingencies		
Minority interest	622	563
Stockholders Equity		
Preferred stock, $.01 par value; 500,000 shares authorized, none issued and outstanding	0	0
Class A common stock, $.01 par value; 7,500,000 shares authorized; 2,384,783 shares issued and outstanding	24	24
Class B common stock, $.01 par value, 10,500,000 shares authorized; 3,385,000 shares issued and outstanding	34	34
Additional paid-in capital	13,001	13,001
Unearned compensation	(345)	(371)
Retained earnings	7,385	7,181
Accumulated other comprehensive income (loss)	(220)	(151)
Total stockholders equity	19,879	19,718
Total liabilities and stockholders equity	$ 51,868	$ 51,505

The accompanying notes are an integral part of these condensed consolidated financial statements.

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INTEGRITY MEDIA, INC.
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except per share data)
(Unaudited)

	Three Months Ended March 31	
	2004	**2003**
Net sales	$21,479	$18,560
Cost of sales	10,533	9,619
Gross profit	10,946	8,941
Marketing and fulfillment expenses	4,310	3,218
General and administrative expenses	5,957	4,695
Income (loss) from operations	679	1,028
Other expenses		
Interest expense, net	154	102
Other income (expenses), net	(32)	(21)
Income before minority interest and taxes	493	905
Provision for income taxes	230	329
Minority interest, less applicable taxes	59	60
Net income	$ 204	$ 516
Adjustments to determine comprehensive income		
Foreign currency translation adjustments	(69)	110
Comprehensive income	$ 135	$ 626
Net income, basic	$ 0.04	$ 0.09
Net income, diluted	$ 0.03	$ 0.09
Weighted average number of shares outstanding		
Basic	5,619	5,599

Diluted	6,062	5,954

The accompanying notes are an integral part of these condensed consolidated financial statements.

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INTEGRITY MEDIA, INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(Unaudited)

	Three months ended March 31	
	2004	**2003**
Cash flows from operating activities		
Net income (loss)	$ 204	$ 516
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	666	486
Amortization of product masters	714	813
Minority interest	59	59
Stock compensation	26	27
Trade receivables (net)	(1,663)	(80)
Other receivables	(126)	(87)
Inventories	(717)	(196)
Other assets	914	(358)
Accounts payable, royalties payable and accrued expenses	(2,227)	(570)
Other current and non current liabilities	2,243	1,550
Net cash provided by (used in) operating activities	93	2,160
Cash flows from investing activities		
Purchases of property and equipment	(275)	(1,552)
Payments for product masters	(1,095)	(889)
Purchase of Sarepta Music (Pty) Ltd, net of cash	0	(191)
Net cash used in investing activities	(1,370)	(2,632)
Cash flows from financing activities		
Net borrowings under line of credit	2,600	500
Payments under line of credit	(1,800)	0
Principal payments of long-term debt	(672)	(678)
Borrowings under term facility	0	900
Net cash provided by (used in) financing activities	128	722

Effect of exchange rate changes on cash	(69)	110
Net increase (decrease) in cash	(1,218)	360
Cash, beginning of year	3,142	4,821
Cash, end of period	$ 1,924	$ 5,181
Supplemental disclosures of cash flow information		
Interest paid	$ 169	$ 105
Income taxes paid	$ 44	$ 0

Supplemental disclosure of non-cash investing activities:

On March 31, 2003, the Company purchased Sarepta Music (Pty) Ltd. In conjunction with the purchase, the Company assumed all outstanding assets and liabilities as of the purchase date.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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INTEGRITY MEDIA, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2004 AND MARCH 31, 2003
(UNAUDITED)

Note 1 BASIS OF PRESENTATION AND SUMMARY OF ACCOUNTING POLICIES

Integrity Media, Inc. (the Company) is a media/communications company that produces, publishes and distributes Christian music, books and related products. The Integrity Music Group consists of two areas: Integrity Music, the leader in Praise and worship music, and INO Records, LLC, a Christian artist label. The Integrity Music Group s product formats include cassettes, compact discs, videos, DVDs and printed music. Integrity Music produces Praise and Worship music in different musical styles for specific audiences such as live worship music, gospel music and children s music. INO Records produces Adult Contemporary/Pop music by several well-known Christian artists. The Integrity Music Group sells all music-related products and Integrity Publishers, Inc. sells all book products. Products are sold mainly by direct-to-consumer marketing and wholesale trade methods. A principal direct-to-consumer marketing method of distribution is continuity programs whereby subscribers receive products at regular intervals. On September 30, 2003, the name of M2 Communications L.L.C. was changed to INO Records LLC.

Integrity Music Europe Limited was formed in 1988, Integrity Media Australasia Pty Ltd (formerly Integrity Music PTY Limited) was formed in 1991, Integrity Media Asia Pte Ltd was formed in 1995, and Sarepta Music (Pty) Ltd was acquired in March 2003. These subsidiaries serve to expand the Company s presence in Western Europe, Australia and New Zealand, Singapore and South Africa, respectively, and other than Integrity Music Europe Limited, in which P. Michael Coleman has a 35% ownership interest, all are wholly-owned by the Company. Celebration Hymnal LLC was formed in 1997 as a 50/50 joint venture with Word Entertainment for the purpose of producing and promoting The Celebration Hymnal. Due to the Company s ability to control the venture, the Company consolidates the venture and Word Entertainment s interest in the joint venture is presented as minority interest in these financial statements. Integrity Publishers, Inc. was formed in August 2001 for the purpose of publishing and distributing Christian books. This division began shipping its first books in the third quarter of 2002. Enlight, Inc. was purchased in March 2002 to acquire certain book publishing trademarks and domain names. INO Records, LLC (formerly M2 Communications L.L.C.), an artist-based, independent Christian music company, was purchased in June 2002. Integrity Direct, LLC was formed December 31, 2002, to create a smoother interaction between the Company and its direct sales to churches and individuals.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the financial statements for the year ended December 31, 2003 contained in the Company s Annual Report on Form 10-K. The unaudited condensed financial information has been prepared in accordance with the Company s customary accounting policies and practices. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of results for the interim period, have been included.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

Operating results for the quarter ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

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For a summary of the Company s significant accounting policies, please see the financial statements for the year ended December 31, 2003 contained in the Company s Annual Report on Form 10-K.

EARNINGS PER SHARE OF COMMON STOCK

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average of common shares outstanding for the period. Diluted earnings per share is calculated by dividing income available to common stockholders by the weighted average of common shares outstanding assuming issuance of potential dilutive common shares related to options, warrants, restricted stock, convertible debt, or other stock agreements.

Recent Accounting Pronouncements:

The Company adopted the disclosure requirements of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure-an Amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, effective January 1, 2003. SFAS No. 148 amends SFAS No. 123 Accounting for Stock-Based Compensation to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, the Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments pertaining to the alternative methods of transition are effective for financial statements for fiscal years ended after December 15, 2002. The amendments to the disclosure requirements are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. As permitted by SFAS No. 148 and SFAS No. 123, we continue to apply the accounting provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations in accounting for our stock option plans and our employee stock purchase plan and the disclosure-only provisions of SFAS No. 123 as amended by SFAS 148. We did not record stock-based compensation expense in the twelve months ended December 31, 2003 and December 31, 2002, as all options granted under our plans had an exercise price equal to fair market value. The adoption of the additional disclosure requirement did not have a significant impact on our reported results of operations, financial position or cash flows. SFAS No. 148 requires us to provide pro forma disclosure of the impact on our results of operations had we adopted the expense measurement provisions of SFAS No. 123.

SFAS No. 148 requires us to provide pro forma disclosure of the impact on our results of operations had we adopted the expense measurement provisions of SFAS No. 123. SFAS No. 123 permits the use of either a fair value based method or the intrinsic value method to measure the expense associated with our stock option plans and our employee stock purchase plan. The pro forma impact on our results of operations had we adopted the fair value based method of SFAS No. 123 using the Black-Scholes option-pricing model are shown below:

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	Three Months Ended March 31	
	2004	2003
Net Income (Loss) as reported	$ 204	$ 516
Deduct:		
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	44	46
Pro forma net income (loss)	$ 160	$ 470
Net income (loss) per share:		
Basic as reported	$ 0.04	$ 0.09
Diluted as reported	$ 0.03	$ 0.09
Basic Pro forma	$ 0.03	$ 0.08
Diluted Pro forma	$ 0.03	$ 0.08

Note 2 LONG TERM DEBT

On April 25, 2001, the Company entered into a $20 million, five-year secured credit facility with LaSalle Bank. The credit agreement included a $6 million line of credit, and term loans of $14 million. Through this credit facility, the Company refinanced its previous credit facility with Bank Austria Creditanstalt. Effective January 29, 2004, the line of credit increased from $6 million to $9 million. At March 31, 2004, there was $5.3 million outstanding under the line of credit and $9.1 million outstanding under the term loans. At March 31, 2003, there was $500 thousand outstanding under the line of credit and $9.7 million outstanding under the term loans. The loans with LaSalle carry an interest rate of 4.3%.

Note 3 SEGMENT INFORMATION

Summarized financial information concerning the Company s reportable segments is shown in the following table, in thousands:

	Three months Ended March 31	
	2004	2003
Net Sales		
Retail	$ 7,737	$ 8,239
Direct to Consumer	3,274	3,934
International	2,620	2,257
Book Publishing	5,608	2,073

Other	2,955	3,092
Eliminations	(715)	(1,035)
Consolidated	$ 21,479	$ 18,560
Operating profit (before minority interest)		
Retail	$ 1,190	$ 1,420
Direct to Consumer	164	750
International	40	304
Book Publishing	1,485	23
Other	807	834
Eliminations	0	0
Consolidated	3,686	3,331
General corporate expense	(3,039)	(2,324)
Interest expense, net	(154)	(102)
Income before income taxes and minority interest	$ 493	$ 905

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Note 4 PURCHASE TRANSACTION

On March 31, 2003, the Company purchased all assets and assumed the outstanding liabilities of Sarepta Music (Pty) Ltd. The Company paid, net of cash acquired, $191 thousand to complete the transaction. The Company accounted for this transaction under the purchase method of accounting and accordingly, allocated the purchase price to cash, accounts receivable, fixed assets and intangibles.

On March 2, 2004, the Company issued a press release announcing the execution of a merger agreement with Kona Acquisition Corp. that would have the effect of taking the Company private. Kona Acquisition Corp. is wholly owned by P. Michael Coleman, Integrity s principal stockholder, President and Chief Executive Officer. The closing of this merger is contingent upon Kona s financing and approval by a majority of Integrity s stockholders who are unaffiliated with management.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Net sales for the three months ended March 31, 2004 increased $2.9 million, or 15.7%, to $21.5 million from $18.6 million for the three months ended March 31, 2003. The increase was primarily due to a $3.5 million increase in sales for Integrity Publishers. Also contributing to the increase were approximately $800 thousand in sales from the soundtrack of The Passion of the Christ . Negatively impacting revenues for the quarter was a decline in Songs4Worship sales, which decreased 65.8% or $1.9 million, from $2.8 million in the first quarter of 2003 to $968 thousand in the first quarter of 2004.

Sales in the Retail segment decreased $502 thousand or 6.0% to $7.7 million for the three months ended March 31, 2004, compared to $8.2 million in the same period in 2003. Though favorably impacted by the $800 thousand in sales of The Passion of the Christ soundtrack, sales in the retail segment were negatively impacted by a decrease of approximately $1.0 million in Songs4Worship sales and a decrease of approximately $500 thousand in sales of the Company s iWorship albums. Sales of the iWorship albums had a favorable impact in the first quarter, 2003 due to the carryover of its successful launch in the fall of 2002. Revenues for INO Records were down 8.6% from $2.7 million for the three months ended March 31, 2003 to $2.5 million for the same period in 2004. A new release from Mercy Me, Undone , was released in April, 2004 and debuted at number 12 on the Billboard Top 200 sales chart.

Sales in the Direct to Consumer segment decreased $512 thousand or 13.0% to $3.4 million for the three months ended March 31, 2004, compared to $3.9 million in the same period in 2003. The decrease was due to a decline of $578 thousand in Songs4Worship sales.

International sales increased 16.1%, or $363 thousand, to $2.6 million for the three months ended March 31, 2004 compared to $2.3 million in the same period 2003. The increase was due to sales of $392 thousand for Sarepta in the first quarter, 2004 compared to none in the same period in 2003. Sarepta was acquired on March 31, 2003 and therefore the Company recognized no revenues from Sarepta in the first quarter, 2003.

Book Publishing sales increased 171%, or $3.5 million, to $5.6 million for the three months ended March 31, 2004 compared to $2.1 million for the same period 2003. Two books accounted for the increased sales in 2004 It s Not About Me by Max Lucado with sales of $2.4 million; and The Ten Offenses by Pat Robertson with sales of $1.2 million. It s Not About Me hit number 8 on the New York Times Hardcover Advice Bestseller list. Also favorably impacting first quarter, 2004 revenues were a new scrapbook series called Integrity s Scrapbook of Memories , which generated revenues of approximately $1.2 million and sales of approximately $725 thousand for a devotional book called His Passion .

Sales in the Other segment declined slightly from $3.1 million for the three months ended March 31, 2003 to $3.0 million for the same period 2004 due primarily to decreases in Copyright income of $117 thousand.

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Gross profit for the Company increased $2.0 million or 22.4% to $10.9 million for the three months ended March 31, 2004, compared to $8.9 million for the same period in 2003 due primarily to the increase in sales for the quarter. Gross profit as a percentage of sales increased to 51.0% for the three-month period ended March 31, 2004 from 48.2% for the same period in 2003 mainly because of the higher margin sales of Book Publishing. Margins for Book Publishing were 60.9% for the three months ended March 31, 2004 compared to 53.0% for the same period 2003. This increase was primarily because the new scrapbook series called Integrity s Scrapbook of Memories and the devotional book His Passion carry no royalty obligations.

The gross profit percentage in the Retail segment increased slightly to 45.7% for the three months ended March 31, 2004, from 44.3% in the same period in 2003 due primarily to product mix. The gross margin percentage in the Direct to Consumer segment increased to 59.7% for the three-month period ended March 31, 2004, from 56.8% in the same period of 2003, due to the reduction in the lower margin Songs4Worship sales and changes in product mix. The gross profit percentage in the International segment decreased to 45.2% for the three-month period ended March 31, 2004, from 50.9% for the same period in 2003, due to the lower margin sales of Sarepta and to product mix changes. In the Other segment, the gross profit percentage increased to 31.2% for the three months ended March 31, 2004, from 29.1% for the same period in 2003 due to higher inventory reserves and higher amortization expense related to unamortized product masters recorded in 2003.

The following table shows the gross margin by operating segment:

	Three Months Ended March 31,	
Gross margin	**2004**	**2003**
Retail	45.7%	44.3%
Direct to Consumer	59.7%	56.8%
International	45.2%	50.9%
Book Publishing	60.9%	53.0%
Other	31.2%	29.1%
Eliminations	12.31%	8.5%
Consolidated	51.0%	48.2%

Marketing and fulfillment expenses increased $1.1 million, or 33.9% to $4.3 million or 20.0% of net sales for the three months ended March 31, 2004, as compared to $3.2 million or 17.4% of net sales for the same period in 2003. The increase in marketing and fulfillment expenses for the three months ended March 31, 2004 is primarily attributable to the increased marketing and fulfillment expenses for Book Publishing due to its additional revenues, and to increases in marketing expenses in the Direct to Consumer segment.

General and administrative expenses increased $1.3 million or 26.9% to $6.0 million or 27.7% of net sales for the three months ended March 31, 2004, as compared to $4.7 million or 25.3% of net sales for the same period in 2003. The increase for the three months ended March 31, 2004 is attributable to additional expenses for Book Publishing, G&A expenses for Sarepta (acquired on March 31, 2003), additional depreciation expense for the new corporate facility (occupied in June, 2003), additional depreciation of the Company s new software system (operational in July, 2003), and professional fees related to the proposed going-private transaction.

Operating profit in the Retail segment decreased $273 thousand, or 19.2%, to $1.1 million, or 15.1 % of net sales for the three months ended March 31, 2004, from $1.4 million, or 17.2% of net sales for the same period in 2003 due primarily to increases in marketing expenses. Operating profit in the Direct to Consumer segment decreased $543 thousand, or 72.4%, to $207 thousand, or 6.0% of net sales, for the three months ended March 31, 2004, from $750 thousand, or 19.1% of net sales, in the same period in 2003 due primarily to lower sales and higher marketing expenses. Operating profit in the International segment decreased $264 thousand, or 86.8% to $40 thousand, or 1.5% of net sales, for the three-month

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period ended March 31, 2004, from $304 thousand, or 13.5% of net sales, for the same period in 2003 due to lower gross margins and increases in general and administrative expenses. Operating profit for the book publishing segment increased $1.5 million, or 630%, to $1.5 million, or 26.5% of sales for the three-month period ended March 31, 2004, from $23 thousand, or 1.1% of sales for the same period 2003 due to increased revenues for the 2004 comparable period. Operating profit in the Other segment was basically the same for both comparable periods $807 thousand in 2004 compared to $834 thousand in 2003.

Net interest expense increased $52 thousand or 51% to $154 thousand for the three-month period ended March 31, 2004, as compared to $102 thousand for the same period in 2003. The increase for the three months ended March 31, 2004 was due to a higher debt levels in 2004 compared to 2003.

The Company recorded income tax provisions of $230 thousand and $329 thousand for the three months ended March 31, 2004 and 2003, respectively. The Company s effective tax rate for the first three months of 2004 was 46.7%, compared to 38.9% for the first three months of 2003. The increase in the effective tax rate in 2004 is because the Company is not realizing any tax benefit from losses incurred in both the UK and Singapore subsidiaries due to significant net operating loss carryovers in both of these subsidiaries. These losses are not being recognized because the Company has determined that it is more likely than not that the tax benefit of these current year losses will not be realized. The Company expects that its effective tax rate for the year 2004 will be approximately 43% to 46%.

Net income for the three months ended March 31, 2004 decreased $312 thousand or 60.5% to $204 thousand, from $516 thousand for the same period in 2003.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically and will continue to finance its operations primarily through cash generated from operations and from borrowings under a line of credit and term loan as needed. The Company s need for cash varies from quarter to quarter based on product releases and scheduled marketing promotions. The Company s principal uses of cash historically have been the production and recording of product masters to build the Company s product master library, author and artist advances and debt service. It is from these product masters that the Company s products are duplicated and distributed to customers. The Company believes that its working capital and funds available under its credit facility will be sufficient to fund its operating and capital requirements for the fiscal year ending December 31, 2004 and beyond.

On April 25, 2001, the Company entered into a $20 million, five-year secured credit facility with LaSalle Bank. The credit agreement included a $6 million line of credit, and term loans of $14 million. Through this credit facility, the Company refinanced its previous credit facility with Bank Austria Creditanstalt. Effective January 29, 2004, the line of credit increased from $6 million to $9 million. At March 31, 2004, there was $5.3 million outstanding under the line of credit and $9.1 million outstanding under the term loans. At March 31, 2003, there was $500 thousand outstanding under the line of credit and $9.7 million outstanding under the term loans. The loans with LaSalle carry an interest rate of 4.3%. For the three months ended March 31, 2004, the Company had average daily borrowings under the LaSalle credit facility of $15.3 million at an average interest rate of 4.3%. At the Company s option, the LaSalle credit facility bears interest at the bank s base rate plus a margin ranging from 0.00% to 0.50%, or LIBOR plus a margin ranging from 2.25% to 3.00%. The actual margin is a function of the Company s leverage ratio as calculated quarterly.

Cash provided by operating activities totaled $94 thousand for the three months ended March 31, 2004, compared to cash provided by operating activities of $2.2 million for the three months ended March 31, 2003. The decrease from 2003 to 2004 resulted primarily from increases in accounts receivable and inventory balances.

Investing activities used \$1.4 million and \$2.6 million during the three months ended March 31, 2004 and 2003, respectively. Investing activities for the three months ended March 31, 2004 consisted of

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capital expenditures for computer equipment totaling $275 thousand and investments in product masters totaling $1.1 million. Investing activities for the three months ended March 31, 2003 consisted of the purchase of Sarepta Music (Pty) Ltd for $191,000 on March 31, 2003, capital expenditures for computer equipment and capital improvements to existing buildings totaling $1.6 million and investments in product masters totaling $889,000. The investment in product masters for the three months ended March 31, 2004 relates primarily to development of products scheduled for release within the next six to eighteen months.

The Company made principal payments on its LaSalle facility of $672,500 and $672,500 in the three months ended March 31, 2004 and 2003, respectively.

During the three months ended March 31, 2004 and 2003, the Company did not make any distributions to Word Entertainment, its 50% partner in the Celebration Hymnal LLC joint venture.

On March 2, 2004, the Company issued a press release announcing the execution of a merger agreement with Kona Acquisition Corp. that would have the effect of taking the Company private. Kona Acquisition Corp. is wholly owned by P. Michael Coleman, Integrity s principal stockholder, President and Chief Executive Officer. The closing of this merger is contingent upon Kona s financing and approval by a majority of Integrity s stockholders who are unaffiliated with management. Upon final execution of this merger, the following changes will occur in the Company s debt structure: the LaSalle term loan will increase by $1.5 million; an additional $15 million in debt will be obtained through a mezzanine lender; and the maximum line of credit with LaSalle will increase from $9 million to $12 million. The Company believes that should the merger occur, the plan financing will be adequate to fund the Company s operations for at least the next 12 months.

Recent Accounting Pronouncements:

The Company adopted the disclosure requirements of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure-an Amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, effective January 1, 2003. SFAS No. 148 amends SFAS No. 123 Accounting for Stock-Based Compensation to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, the Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The amendments pertaining to the alternative methods of transition are effective for financial statements for fiscal years ended after December 15, 2002. The amendments to the disclosure requirements are effective for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002. As permitted by SFAS No. 148 and SFAS No. 123, we continue to apply the accounting provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations in accounting for our stock option plans and our employee stock purchase plan and the disclosure-only provisions of SFAS No. 123 as amended by SFAS 148. We did not record stock-based compensation expense in the twelve months ended December 31, 2003 and December 31, 2002, as all options granted under our plans had an exercise price equal to fair market value. The adoption of the additional disclosure requirement did not have a significant impact on our reported results of operations, financial position or cash flows. SFAS No. 148 requires us to provide pro forma disclosure of the impact on our results of operations had we adopted the expense measurement provisions of SFAS No. 123.

SFAS No. 148 requires us to provide pro forma disclosure of the impact on our results of operations had we adopted the expense measurement provisions of SFAS No. 123. SFAS No. 123 permits the use of either a fair value based method or the intrinsic value method to measure the expense associated with our stock option plans and our employee stock purchase plan. The pro forma impact on our results of operations had we adopted the fair value based method of SFAS No. 123 using the Black-Scholes option-pricing model are shown below:

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	Three Months Ended March 31	
	2004	2003
Net Income (Loss) as reported	$ 204	$ 516
Deduct:		
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	44	46
Pro forma net income (loss)	$ 160	$ 470
Net income (loss) per share:		
Basic as reported	$ 0.04	$ 0.09
Diluted as reported	$ 0.03	$ 0.09
Basic Pro forma	$ 0.03	$ 0.08
Diluted Pro forma	$ 0.03	$ 0.08

Special Cautionary Notice Regarding Forward-Looking Statements

Certain of the matters discussed in this report including matters discussed under the caption Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations, may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words expect, anticipate, intend, plan, believe, seek, estimate, and similar expressions are intended to identify such forward-looking statements. The Company s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including without limitation those discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations Risk Factors in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2003. All written or oral forward-looking statements attributable to the Company are expressly qualified in their entirety by these cautionary statements. Any forward-looking statements represent management s estimates only as of the date of this report and should not be relied upon as representing estimates as of any subsequent date. While the Company may elect to update forward-looking statements at some point in the future, the Company specifically disclaims any obligation to do so, even if its estimates change.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company s market risk is due to fluctuations in interest rates as they pertain to the Company s borrowings under its credit facility. As of April 25, 2001, the Company paid interest on borrowings at either LaSalle s base rate or an Adjusted LIBOR, plus an Interest Rate Margin. The Interest Rate Margin is based upon the Leverage Ratio as of the last day of a fiscal quarter. Prior to April 25, 2001, under the Bank Austria credit facility, the Company paid interest on borrowings at either the lender s base rate plus 0.75%, or LIBOR plus 2%. Prior to September 2000, the interest rate was the bank s base rate plus 1 1/2% or LIBOR plus 3%. In the event that interest rates were to increase 100 basis points, the Company s interest expense would increase and income before income tax would decrease by $38,332, assuming current debt levels are maintained. (This amount is determined solely by considering the impact of the hypothetical change in the interest rate on the Company s borrowing cost without consideration of other factors such as actions management might take to mitigate its exposure to interest rate changes.)

The Company is also exposed to market risk from changes in foreign exchange rates and commodity prices. The Company does not use any hedging transactions in order to modify the risk from these foreign currency exchange rate and commodity price fluctuations. The Company also does not use financial instruments for trading purposes and is not a party to any leveraged derivatives.

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ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company s management, including the President and Chief Executive Officer (CEO), and the Chief Financial Officer (CFO), of the effectiveness of the design and operation of the Company s disclosure controls and procedures. Based on that evaluation, the Company s management, including the CEO and CFO, concluded that the Company s disclosure controls and procedures as of the end of the period covered by this report, were effective in timely bringing to their attention material information related to the Company required to be included in the Company s periodic SEC filings.

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PART II.
OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

Exhibit Number	Exhibit Description
3(i)	Certificate of Incorporation of the Registrant, as amended (incorporated by reference from Exhibit 4(a) to the Registrant s Registration Statement on Form S-8 (File No. 33-84584) filed on September 29, 1994).
3(i).1	Certificate of Amendment to the Certificate of Incorporation of the Registrant, dated July 21, 1995, (incorporated by reference from Exhibit 3(i).1 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 1995).
3(i).2	Certificate of Amendment to the Certificate of Incorporation of the Registrant, dated May 24, 2002 (incorporated by reference from Exhibit 3(i).2 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
3(ii)	Bylaws of the Registrant, as amended (incorporated by reference from Exhibit 3(ii) to the Registrant s Registration Statement on Form S-1 (File No. 33-78582), and amendments thereto, originally filed on May 6, 1994).
4.1	See Exhibits 3(i), 3(i).1 and 3(ii) for provisions of the Certificate of Incorporation, as amended, and Bylaws, as amended, of the Registrant defining rights of holders of Class A and Class B Common Stock of the Registrant.
4.2	Form of Class A Common Stock certificate of the Registrant (incorporated by reference from Exhibit 4 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2001).
10.1	Eighth Amendment to Credit Agreement by and between Integrity Media, Inc., Integrity Publishers, Inc., Integrity Direct, LLC, INO Records, LLC, and LaSalle Bank National Association, dated January 29, 2004 (incorporated by reference from Exhibit 10.28 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003)
10.2	Agreement and Plan of Merger by and among Integrity Media, Inc., Kona Acquisition Corp., and P. Michael Coleman dated March 1, 2004 (incorporated by reference from Exhibit 10.29 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer.
32.1	Certification of Chief Financial Officer of Integrity Media, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	

Certification of Chief Executive Officer of Integrity Media, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

On March 2, 2004, Integrity Media, Inc. (the Company) filed a Form 8-K announcing the execution of a merger agreement with Kona Acquisition Corp., an entity wholly owned by P. Michael Coleman, the Company s co-founder, principal stockholders, President and Chief Executive Officer, that would have the effect of taking the Company private. The closing of the merger is subject to a number of conditions, including Kona s financing and approval by a majority of the Company s stockholders who are unaffiliated with management.

On March 31, 2004, the Company filed a Form 8-K, disclosing the filing of a Form 12b-25 on March 30, 2004 due to the Company s inability to file its Annual Report on Form 10-K for the year ended December 31, 2003 (the Form 10-K) by the prescribed date of March 30, 2004 without unreasonable effort or expense because the Company was in the process of restating its earnings for the fiscal years ended December 31, 2001 and 2002, which affected certain quarters of 2003.

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SIGNATURES

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

	Integrity Media, Inc.
Date: May 14, 2004	/s/ P. Michael Coleman P. Michael Coleman Chairman, President and Chief Executive Officer
Date: May 14, 2004	/s/ Donald S. Ellington Donald S. Ellington Senior Vice President of Finance and Administration (Principal Financial and Accounting Officer)

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