ITEX CORPORATION

Annual Report
2002-2003

A MESSAGE TO OUR SHAREHOLDERS

Fiscal 2003, ending July 31, 2003 was a year of turmoil at ITEX Corporation. In many respects, it was not a good year. Our client base contracted and overhead, expenses and salaries exceeded revenue. We failed to execute a franchise expansion plan, which contributed to our losses. Ongoing litigation remains as ITEX's "Achilles heel" and continues to be a drag on profits.

OK, that's the bad news. The good news is that we discovered these negative trends and adopted the necessary changes to improve the overall performance and financial condition of the Company.

We temporarily ceased franchise marketing, reduced our headcount, lowered salaries and renegotiated or cancelled *dozens* of non-essential contracts and recurring marketing expenses. We made the decision to divest our corporate-owned offices and focus on expanding the Broker Network and enhancing our payment processing technology. Simply stated, we created an efficient, focused business model. Franchise expansion isn't dead; it is only sidelined until we can execute this model in a profitable manner.

We have begun the process of bringing solid bottom line profits to ITEX. In doing so, these accomplishments have occurred during the last few months of Fiscal 2003 and already in Fiscal 2004:

- Significantly reduced corporate overhead and cancelled non-essential projects
- Sold four corporate-owned offices
- Received $150,000 in cash from the sale of offices
- Generated $2,100,000 in receivables from office sales
- Doubled our assets from $1.9 million to $3.8 million
- Consolidated and relocated corporate headquarters to a technology office complex located in Bellevue, Washington.

Going forward, we intend to capitalize on our payment system technology and to increase the support to our Broker Network. We plan to expand the existing Network by assisting ITEX Brokers in acquiring their local competitor(s), thus growing the overall Network. ITEX is focused on centralized data, efficient transaction processing and on expanding our Broker Network. We will continue to invest in our technology.

With this annual report you are also receiving a copy of our Form 10-QSB for the first quarter of fiscal 2004. As the latest 10-QSB shows, we have returned to profitable operations. I am confident we can deliver positive results and increased profitability in Fiscal 2004, and do so in a manner that earns your trust.

Sincerely yours,

Steven White
Chairman of the Board
Interim CEO

ITEX CORPORATION

DESCRIPTION OF BUSINESS

ITEX Corporation ("ITEX" or the "Company") began its business in 1986. Through our franchisees and Independent Licensed Broker ("ILB") network in the United States and Canada, we provide a business-to-business payment system for retail, professional, media and other corporate members. Our business services and payment system enable over $170 million a year in trade transactions to be processed between approximately 14,000 member businesses which, collectively, make up the ITEX trade exchange ("ITEX Exchange"). We administer the ITEX Exchange and act as a third-party record-keeper for transactions entered into by the members. We enable our member businesses to increase sales, open new markets and utilize the full business capacity of their enterprises by providing a private trade currency.

The Company manages the ITEX Exchange utilizing a private currency called "ITEX Trade Dollars," to enable our members to purchase from and sell their products or services to other members using ITEX Trade Dollars instead of cash. A Trade Dollar is an accounting unit used by the ITEX Exchange to record the value of transactions as determined by the parties in the exchange. ITEX Trade Dollars denote the right to receive goods or services available from other trade exchange members, or the obligation to provide goods or services to other exchange members. Trade Dollars may only be used in the manner and for the purpose set forth in the rules of the ITEX Exchange. Trade Dollars are not intended to constitute legal tender, securities or commodities.

We assist members in marketing their products and services through our broker and franchise network, newsletters, e-mail, faxes, trade directors, on our website at www.itex.com and through other promotional means. Sales are primarily conducted by members directly, but can be facilitated by our trade directors, ILBs and franchisees. Sales are generally made at or near prevailing retail prices.

The use of the ITEX Exchange assists businesses to increase sales and market share, decrease cash expenditures, reduce surplus inventory and take advantage of underutilized capacity. Trade is especially useful to businesses where the variable costs of products or services are low, such as hotels, media, and other service related businesses. For example, a hotel that has not filled its rooms by the end of the day has lost potential revenue, but still has nearly the same overhead associated with owning and maintaining its facility.

The Internal Revenue Service considers trade dollar income to be equivalent to cash income and a trade dollar expense to be equal to a cash dollar of expense. ITEX is obliged under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) to send Form 1099-B to each of our members and to the Internal Revenue Service (which the Company does electronically). The Form 1099-B reflects the total trade dollar sales made by the member for the calendar year. Trade dollars earned are required to be reported as gross income in tax returns. Expenditures of trade dollars may be reported as deductions in tax returns if they qualify as a deductible business expense or as other deductions that are permitted by the Internal Revenue Code.

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

(in thousands)

Our Management's Discussion and Analysis (MD&A) contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in "Business Risks" and elsewhere in this report.

Overview

ITEX Corporation manages the ITEX Exchange and acts as third-party record-keeper for transactions between members of the exchange. We charge association fees for each of the 13 four-week accounting cycles per year, as well as percentage based commissions on transactions. We also receive fees paid in ITEX Trade Dollars, which we use to pay a portion of our own operating expenses and to provide merchandise for sale for Trade Dollars to ITEX Exchange members.

In December 2002, the Company was notified by an insurgent group that it intended to solicit proxies to elect a slate of four nominees to the board of directors of ITEX Corporation. The nominees believed excessive compensation was being paid by ITEX to its directors and that the financial resources of the Company could be redirected more efficiently on behalf of stockholders. At the Annual Meeting on January 31, 2003, shareholders elected the insurgent group, which was lead by Steven White, the current Chairman of the Board.

The new board immediately acted to terminate cash compensation to its directors. Subsequently, in March 2003, the Company terminated the employment of its Chief Financial Officer. In June 2003, the Company terminated the employment of its Chief Executive Officer and also its Chief Operating Officer. The Company is operating under the leadership of Steven White, Chairman of the Board, acting as Interim Chief Executive Officer and Interim Chief Financial Officer, and Alan Zimmelman, Director, acting as Interim Chief Operations Officer.

During the fiscal year ending July 31, 2003, we had five corporate-owned offices in addition to our more than sixty ILBs and franchisees in the United States and Canada. Between August 8 and October 2, 2003, three of these offices were sold: in Toronto (Ontario), New York and Sacramento, leaving two corporate-owned offices located in Seattle and Vancouver, British Columbia.

Pro Forma Combined Statement of Operations

The following unaudited pro forma condensed consolidated financial information gives effect to the disposition of the New York, Toronto and Sacramento, ("NYTS") corporate-owned offices of ITEX Corporation. These pro forma statements are presented for illustrative purposes only. The pro forma adjustments are based upon available information and assumptions that we believe are reasonable. The pro forma condensed consolidated financial statements do not purport to represent what the consolidated results of operations or financial position of ITEX Corporation would actually have been if the disposition of the NYTS corporate-owned offices had in fact occurred on the dates that we refer to below, nor do they purport to project the results of operations or financial position of ITEX Corporation for any future period or as of any date, respectively. The unaudited pro forma financial information reflecting the disposition of our NYTS corporate-owned offices provided below and as part of the Form 10-KSB filing, updates the pro forma information included as part of our report on Form 8-K filed October 28, 2003. The unaudited pro

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

forma condensed consolidated statements of operations for the periods presented were prepared with the historical statements of operations of ITEX Corporation for the full fiscal year ended July 31, 2003, giving effect to the dispositions as though they had occurred on August 1, 2002.

	Fiscal Year end July 31, 2003	Pro Forma Adjustments	Pro Forma
Revenues	$10,595	$ 17	$10,612
Trade exchange revenue	10,595	17	10,612
Costs and expenses			
Costs of trade exchange revenue	6,384	1,026	7,410
Selling, general and administrative expenses	3,539	(839)	2,700
Costs and expenses of regulatory and litigation matters	580	–	580
Depreciation and amortization	547	(225)	322
Proxy costs	187	–	187
Total operating expenses	11,237	(38)	11,199
Income (loss) from operations	(642)	55	(587)
Other income (expense)			
Interest income (expense), net	(51)	37	(14)
Gain on sale of securities	–	–	–
Miscellaneous, net	66	–	66
	15	37	52
Net Income	$ (627)	$ 92	$ (535)
Basic and diluted loss per common share	$ (0.04)		$ (0.03)
Weighted average pro forma shares outstanding - basic and diluted	17,773		17,773

Management expects that the sale of the NYTS offices will make a significant contribution toward reducing our expense levels during fiscal 2004, as well as a positive contribution toward our profitability. However, the unaudited pro forma combined condensed financial information is presented for illustrative purposes only and does not indicate the operating results that actually

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

would have occurred if the disposition of NYTS had been consummated on August 1, 2002, nor our fiscal 2004 operating results. This pro forma financial information should be read in conjunction with our audited July 31, 2003 financial statements and notes thereto contained in this report, as well as the unaudited pro forma financial information, notes and assumptions filed with this report. See "Financial Statements."

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results.

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ significantly from those estimates under different assumptions and conditions. We believe that the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require our most difficult, subjective, and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Revenue Recognition

We recognize revenue from various cash fees charged in managing the ITEX Exchange. When persuasive evidence of an arrangement exists, the transaction has occurred or the monthly service has been provided, the charges are fixed and determinable and no major uncertainty exists with respect to collectibility.

We charge members of the trade exchange an association fee of $20 cash per four-week accounting cycle (two hundred sixty dollars annually) and $10 ITEX Trade Dollars each cycle (one hundred thirty Trade Dollars annually) in accordance with its ITEX Exchange member agreements. Association fees can be paid by cash, check or by using our Preferred Member Autopay system.

We also receive cash transaction fees based on the value of the trade transaction, from both the buyer and the seller. Members are billed at the end of each four-week accounting cycle. If a member pays automatically by credit card or electronic funds transfer through our Preferred Member Autopay system, the cash fee is 5% of the trade dollar amount of the member's purchases and sales during the billing period. If a member pays by check or otherwise after receiving a statement at the end of each four-week cycle, the cash fee is 7 1/2% of the trade dollar amount of that member's purchases and sales during the period. Currently, approximately 85% of member payments are made automatically through electronic funds transfer or by credit cards using the Preferred Member Autopay system.

As described below under accounting for trade dollar activity, we historically have not recorded revenues for trade dollars earned for management of the ITEX Exchange and as a result of transactions entered into by the Company as a member of the exchange.

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

Accounting for Trade Dollar Activity

We receive trade dollars for monthly services provided to our ITEX Exchange members, and as transaction fees for exchanges made by its members. We also expend trade dollars in the acquisition of goods and services used in our operations. Historically, we have spent virtually all trade dollars earned for broker commissions, advertising, salaries and legal settlements. Because there is no readily estimable or determinable value for these goods and services, they are not reflected in the accompanying financial statements. We have historically spent more trade dollars than we have earned.

Transactions that originate from the creation of trade dollars expended for goods or services do not qualify as exchanges under APB 29 and, accordingly are not reflected in the accompanying financial statements.

Transactions that involve the exchange of goods or services for other goods or services are accounted for in accordance with APB 29 and the interpretations contained in EITF 93-11 and 99-17. Accordingly, we generally record exchanges at the carrying value of goods or services exchanged, which is typically zero, as the fair values of the goods or services exchanged lack readily determinable fair values within reasonable limits as we have no history of receiving cash in similar transactions, and therefore the earnings process has not been completed.

Valuation of Customer Lists

We assess the possible impairment of our customer lists whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important that could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results
- Significant changes in the manner of our use of the acquired assets or the strategy for our overall business
- Significant negative industry or economic trends; significant decline in our stock price for a sustained period
- Our market capitalization relative to net book value

We look primarily to the undiscounted future cash flows in our assessment of whether or not long-lived assets have been impaired. At July 31, 2003, we determined no impairment was appropriate.

Results of Operations

The following table sets fourth, for the periods indicated, our selected consolidated financial information for the fiscal years ended July 31, 2003 and 2002, with amounts also expressed as a percentage of total revenues:

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

	Fiscal Years Ended July 31,			
	2003		2002	
	Amount	Pct*	Amount	Pct*
Revenue:				
Trade Exchange	10,595	100%	10,137	100%
Costs and expenses:				
Trade exchange	6,384	60%	5,383	53%
Selling, general and administrative	3,726	35%	4,354	43%
Regulatory and litigation	580	5%	458	5%
Depreciation and amortization	547	5%	712	7%
	11,237	106%	10,907	108%
Loss from operations	(642)	-6%	(770)	-8%
Other income (expense)	15	0%	177	2%
Loss before taxes	(627)	-6%	(593)	-6%

* Percent of Total Revenue

For the fourth quarter of fiscal 2003, revenue was $2,452, up 11% from $2,210 for the fourth quarter of fiscal 2002. Revenue for the full fiscal year ended July 31, 2003 was $10,595, up 4.5% from $10,137 for fiscal 2002.

The fourth quarter of fiscal 2003 showed a loss of $766 after realizing several write-downs for uncollectable GST tax, plus a reserve for accounts receivable and a large legal accrual. This compares to a fourth quarter profit of $103 for fiscal 2002. The net loss for fiscal 2003 is $627 compared to a net loss of $593 during fiscal 2002. In addition, during the fourth quarter we settled several outstanding lawsuits, incurring over $105 in legal fees and settlements. The large legal accrual reserved in the fourth quarter was made in that we are currently facing lawsuits from three former executives terminated during 2003 and other litigation, and as a result recognized an aggregate contingent liability of $400 during the fourth quarter for these claims. The Company plans to vigorously defend itself against the plaintiffs. See Note 12 – Legal Proceedings for further details.

Trade Exchange Revenue and Costs

Total trade exchange revenue increased 4.5% to $10,595 in 2003 from $10,137 in 2002. Following are the components of association fees and transaction fees applicable to the ITEX trade exchange, which are included in the consolidated totals:

Revenues by Category	2003	2002
Association fees	$ 3,052	$ 3,018
Transaction fees	7,271	7,042
Franchising	50	–
Other fees	222	77
	$ 10,595	$ 10,137

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

The average number of members of the ITEX Exchange during fiscal 2003 and 2002 and the average trade exchange revenue per member were as follows (actual numbers):

	2003	**2002**
Average number of members	14,867	19,204
Average annual revenue per member	$ 713	$ 528

Our member base dropped by 23% primarily due to a tightening of cash credit controls, which restricted former members from participating in the ITEX system. Total costs of trade exchange expenses as a percentage of total trade exchange revenue were 60% and 53% in fiscal 2003 and 2002, respectively. These costs of revenue are ILB and franchise commissions, which totaled $6,384 during the 2003 fiscal year, and $5,383 during fiscal 2002. The increase is a result of increased broker commissions related to the divesture of corporate-owned offices to Independent Licensed Brokers or franchises during fiscal 2002. This trend will continue into fiscal 2004, as a result of the sale of additional corporate-owned offices, including those located in Toronto, Ontario, New York and Sacramento.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased $628, or 14%, from $4,354 in fiscal 2002 to $3,726 in fiscal 2003. The reduction in expenses was primarily due to the reduction in salary, wages and benefits of $820. The decrease in salary and wages is a result of the sale of the corporate-owned offices in the prior fiscal year. In addition, during fiscal year 2003 we continued our restructuring efforts which resulted in additional salary and wage reductions. This trend will continue into fiscal 2004, as a result of the sale of corporate-owned offices, including those located in Toronto, New York and Sacramento.

Depreciation and Amortization

Depreciation and amortization decreased $165 or 23% from $712 in fiscal 2002 to $547 in fiscal 2003. The decrease is a result the disposal of the corporate headquarters building during the second quarter of fiscal 2002. In addition, we made an agreement with our primary lease vendor in the fourth quarter of fiscal year 2002 to settle all current and future capital lease payments at a discounted rate. The net effect was a reduction of depreciation expense of $125. We are currently leasing office space in the same building for $13 per month.

Regulatory and Litigation

Regulatory and litigation costs increased to $580 during fiscal 2003, from $458 in fiscal 2002.

Other Income and Expense

We recognized net miscellaneous income of $66 in fiscal 2003 and $195 in fiscal 2002.

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

Liquidity and Capital Resources

We experienced net losses and negative cash flows from operations during each of the last two fiscal years. As of July 31, 2003, we had an accumulated deficit of $29,980. During fiscal 2003, we primarily funded our operations through our investing and financing activities. We experienced a modest net increase in our cash position of $14 during fiscal 2003, compared to a decrease in our net cash of $916 during the previous fiscal year. At July 31, 2003, we had approximately $104 in cash and cash equivalents.

	2003	2002
Net cash provided by (used in)		
Operating activities	$ (74)	$ (615)
Investing activities	69	123
Financing activities	19	(424)
Net increase (decrease)	14	(916)

Operating Activities

During fiscal 2003, our operating activities used net cash of $74 compared to the use of net cash in operations of $615 in fiscal 2002. The reduction in the net cash consumed by operating activities for 2003 was primarily attributable to (i) reduced selling, general and administrative expenses due to the sale of corporate-owned offices.

Potential increases in net cash were offset by (i) the funding of legal expenses, (ii) proxy costs related to the 2002-2003 election contest, and (iii) a general reduction in our accounts payable and current liabilities.

Investing Activities

We reported net cash provided by investing activities of $69 in fiscal 2003 compared to $123 in net cash provided by investing activities in fiscal 2002. The $54 change was primarily due to the sale of corporate-owned offices in the prior fiscal year, which generated $88 in proceeds.

Financing Activities

We reported net cash provided by financing activities of $19 in fiscal 2003, compared to net cash used by financing activities of $424 in fiscal 2002. The difference primarily reflects the payment of the note payable resulting from the purchase of Ubarter Canada from Network Commerce Inc. in fiscal 2002.

Fiscal 2004 plans

We are continuing to implement the ITEX business plan which includes supporting our independent broker and franchise network, expanding the ITEX Exchange, improving our systems and services, developing enhanced trade exchange software, promoting our brand while seeking

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

new brokers, franchisees and members, improving our member retention and customer service performance, and acquiring local and regional trade exchanges.

We believe our success also rests upon our ability to control operational costs while engaging in a strategy of controlled growth to ensure the effective performance of our employees, ILBs, franchisees, and members. We strive to direct the financial resources of the Company with greater efficiency on behalf of stockholders. In furtherance of this objective, during June 2003 we announced our intent to divest some or all of our corporate-owned trade offices. Between August 8 and October 2, 2003, three of these offices were sold, as discussed above. We intend to seek opportunities during fiscal 2004 to sell the remaining two corporate-owned offices.

Despite our fourth quarter loss during fiscal 2003 resulting from several write-downs and reserves, management anticipates profitable operations during the first quarter of fiscal 2004. During that quarter, we expect to recognize a $1,429 gain from the sale of three corporate-owned offices. Overall, we believe our efforts to restructure the Company and reduce overhead will be successful. We expect to be able to fund our activities from operations during fiscal 2004. In addition, we expect to be able to grow our available cash each quarter along with achieving profitability for fiscal 2004. However, there is a significant uncertainty. As discussed in Note 12 – Legal Proceedings of the Notes to Financial Statements – we are subject to various claims and lawsuits. We accrued an aggregate liability during the fourth quarter of fiscal 2003 for these claims, which itself offset prior net income and resulted in a loss for the entire fiscal year. It is possible that one or more of these matters could be resolved in a manner that ultimately would have a material adverse impact on our business, and could negatively impact our profitability, our revenues, operating margins, net income, and possibly our ability to sustain operations.

As of July 31, 2003, ITEX had a $300 short-term note payable, bearing interest of 16% with principal due on December 31, 2003. The note originated in third quarter of fiscal 2001. In December 2002, the Company further incurred costs associated with this note by foregoing the interest, by only paying $0.1 per month. The $3.9 interest continued to accrue at a 16% APR. In addition, the Company paid the lender a 4% renewal charge of $12 annually. As of July 31, 2003, the note, including principal and interest totaled $330. Total interest expense incurred in 2003 and 2002 was $48 and $69, respectively, with total cumulative interest paid and accrued as of July 31, 2003 totaling $148, an effective annual percentage rate of 21%. This note was secured by certain personally owned real property of the wife of a former President and CEO of the Company. In a subsequent event, the note was paid in full with loan proceeds made available by the Chairman of the Company. See Note 14 – Related Party Transactions of the Notes to Financial Statements.

Trade Dollars Earned and Expended

The Company earns ITEX Trade Dollars as compensation for management of the ITEX Exchange and as a result of transactions entered into by the Company as a member of the exchange.

In fiscal 2003, the Company earned 4,121 trade dollars and expended 7,986 trade dollars. In fiscal 2002, the Company earned 5,915 trade dollars and expended 6,910 trade dollars.

During the fiscal year ended July 31, 2003, the company received goods and services using trade dollars to pay for such items. As described in the Critical Accounting Policies below, exchanges

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

involving trade dollars have generally not been reflected at any value in the Company's financial statements. Management believes these goods and services are a necessary part of conducting business. If, in the future, the Company is unable to pay for such goods and services using trade dollars, the Company's cash expenses could increase and potentially reduce operating profits.

Trade dollars are not legal tender and do not reflect the fair value of the goods and services received. The fair value would be significantly less than the amounts presented. The Company expends trade dollars for many items. The Company would not necessarily expend these amounts if it were required to spend cash.

Since inflation of the US dollar has been moderate in recent years, inflation has not had a significant impact on the Company. Inflation affecting the US dollar is not expected to have a material future effect. The Company does not guarantee the utilization of, or market for ITEX Trade Dollars. In addition, the Company can expend ITEX Trade Dollars in excess of those credited to the Company's account.

Recently Issued Accounting Standards

In November 2002, the FASB published interpretation No, 45 "Guarantor's Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". The Interpretation expands on the accounting guidance of Statements No. 5, 57, and 107 and incorporates without change the provisions of FASB Interpretation No. 34, which is being superseded. The Interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002, regardless of the guarantor's fiscal year-end. The disclosure requirements in the Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company is currently evaluating what effect the adoption of this statement will have the Company's financial statements. The Company does not expect the adoption of this statement to have a material effect on the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure". This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation" to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based compensation. In addition, SFAS 148 amends the disclosure provision of SFAS 123 to require more prominent disclosure about the effects of an entity's accounting policy decisions with respect to stock-based employee compensation on reported net income. The effective date for this Statement is for fiscal years ended after December 15, 2002. The Company does not expect the adoption of this statement to have a material effect on the Company's financial statements.

In April 2003, the SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" was issued. This statement amends and clarifies the accounting and reporting

ITEX CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS *(Continued)*

for derivative instruments, including instruments embedded in other contracts such that contracts with comparable characteristics are accounted for similarly. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except for hedging relationships designated after June 30, 2003. Currently we do not expect SFAS No. 150 to have a material effect on our financial statements.

In May 2003, the SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" was issued. This statement establishes standards for how to classify and measure certain financial instruments with characteristics of both liabilities and equity. Many instruments that were previously classified as equity will be required to be reported as liabilities under SFAS No. 150. This statement is effective for financial instruments entered into or modified after May 31, 2003 and at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable instruments. Currently we do not expect SFAS No. 150 to have a material effect on our financial statements.

ITEX CORPORATION

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

The Company's common stock trades on the OTC Bulletin Board under the symbol "ITEX.OB". The range of high and low bid prices for the Company's common stock for each quarter during the two most recent fiscal years is as follows:

Fiscal Year Ended July 31,	**2003**		**2002**	
	High	Low	High	Low
First Quarter	$0.14	$0.095	$0.30	$0.11
Second Quarter	$0.15	$0.10	$0.15	$0.07
Third Quarter	$0.21	$0.13	$0.25	$0.05
Fourth Quarter	$0.21	$0.12	$0.22	$0.07

This table reflects the range of high and low bid prices for our common stock during the indicated periods, as published by the OTC Bulletin Board. The quotations merely reflect the prices at which transactions were proposed, and do not necessarily represent actual transactions. Prices do not include retail markup, markdown or commissions.

There were approximately 910 holders of record of our common stock as of July 31, 2003.

ITEX CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

For the fiscal years ended July 31, 2003 and 2002

INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders
ITEX Corporation
Sacramento, California

We have audited the accompanying consolidated balance sheets of ITEX Corporation as of July 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended July 31, 2003 and 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ITEX Corporation as of July 31, 2003, and the results of their operations and their cash flows for the years ended July 31, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America.

Ehrhardt Keefe Steiner & Hottman PC

October 24, 2003
Denver, Colorado

ITEX CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	July 31, 2003	July 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 104	$ 90
Accounts receivable, net of allowance of $200 and 50	674	896
Receivable-corporate office sales (Note 2)	57	74
Prepaid and other current assets	153	130
Total current assets	988	1,190
Property and equipment, net of accumulated depreciation of $670 and $561 (Note 3)	158	241
Purchased member lists, net (Note 4)	502	941
Receivable - regional office sales, less current portion (Note 2)	200	253
Other assets	72	82
Total assets	$ 1,920	$ 2,707
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable (Note 5)	$ 324	$ 300
Accounts payable	265	435
Accounts payable to independent licensed brokers	874	680
Accrued payroll and taxes	137	242
Deferred revenue, current portion	67	64
Accrued audit and legal fees	437	350
Accrued legal settlements	79	82
Other current liabilities (Note 6)	127	365
Total current liabilities	2,310	2,518
Deferred revenue	91	149
Stockholders' (deficit) equity (Note 8)		
Common stock, $.01 par value; 50,000 shares authorized; 18,170 and 17,727 shares issued and outstanding, respectively	182	177
Additional paid-in capital	29,313	29,226
Foreign currency translation	14	—
Treasury stock, at cost (2 shares)	(10)	(10)
Accumulated deficit	(29,980)	(29,353)
Total stockholders' (deficit) equity	(481)	40
Total liabilities and stockholders' (deficit) equity	$ 1,920	$ 2,707

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

ITEX CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share amounts)

	For the fiscal years ended July 31, 2003	2002
Revenue:		
Trade exchange revenue	10,595	10,137
	10,595	10,137
Costs and expenses:		
Costs of trade exchange revenue	6,384	5,383
Selling, general and administrative	3,726	4,354
Costs and expenses of regulatory and litigation matters	580	458
Depreciation and amortization	547	712
	11,237	10,907
Loss from operations	(642)	(770)
Other income (expense):		
Other interest income (expense), net	(51)	(81)
Gain on sale of securities	—	63
Miscellaneous, net	66	195
	15	177
Loss before income taxes	(627)	(593)
Income taxes (expense) benefit	—	—
	(627)	(593)
Net loss	$ (627)	(593)
Average common and equivalent shares:		
Basic	17,733	17,050
Diluted	17,733	17,050
Net loss per common share:		
Basic	$ (0.04)	(0.03)
Diluted	(0.04)	(0.03)

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

ITEX CORPORATION

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

For the fiscal years ended July 31, 2003 and 2002 *(in thousands)*

	Common Stock Shares	Common Stock Amount	Additional paid in Capital	Unrealized gain on marketable securities	Accumulated deficit	Foreign Currency Translation	Treasury stock	Total
Balance, July 31, 2001	15,849	$ 159	$ 28,977	$ 34	$ (28,760)	$ —	(10)	400
Stock issued to employees and board members	1,155	12	91	—	—	—	—	103
Stock issued to outside consultants	250	2	27	—	—	—	—	29
Stock issued to previous board	140	1	104	—	—	—	—	105
Disposal of building at 3400 Cottage Way	333	3	27	—	—	—	—	30
Release of unrealized gain	—	—	—	(34)	—	—	—	(34)
Net loss	—	—	—	—	(593)	—	—	(593)
Balance, July 31, 2002	17,727	177	29,226	—	(29,353)	—	(10)	40
Stock issued to employees	100	1	21	—	—	—	—	22
Stock issued to outside consultants	140	2	27	—	—	—	—	29
Stock issued to new board	160	2	34	—	—	—	—	36
Exercise of stock options	43	—	5	—	—	—	—	5
Foreign Currency Translation	—	—	—	—	—	14	—	14
Net Loss	—	—	—	—	(627)	—	—	(627)
Balance, July 31, 2003	18,170	182	29,313	—	(29,980)	14	(10)	(481)

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

ITEX CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOW

(in thousands)

	Year ended July 31, 2003	2002
Cash flows from operating activities		
Net (loss) income	$ (627)	$ (593)
Items to reconcile to net cash (used in) operations:		
Gain on sale of regional offices	—	(303)
Recognition of imputed interest from regional office receivables	(12)	—
Loss on disposal of building	—	190
Gain on lease settlement	—	(31)
Stock based compensation	87	132
Gain on sale of securities	—	(63)
Depreciation and amortization	548	712
Change in allowance for uncollectible receivables	150	—
Changes in operating assets and liabilities:		
Accounts receivable	72	185
Prepaids and other assets	(13)	(8)
Accounts payable, other current liabilities and deferred revenue	(415)	(236)
Other long term liabilities	—	—
Accounts payable to independent licensed brokers	194	(600)
Non-current deferred revenue	(58)	—
Net cash provided by (used in) operating activities	(74)	(615)
Cash flows from investing activities:		
Proceeds from sales of regional offices	82	88
Proceeds from sales of securities	—	64
Net cash used in acquisition of business assets	(13)	—
Purchase of property and equipment	—	(29)
Net cash provided by (used in) investing activities	69	123
Cash flows from financing activities:		
Borrowings (repayments) of third party indebtedness	—	(424)
Stock options excercised	5	—
Net cash provided (used in) by financing activities	5	(424)
Effect of exchange rates on cash and cash equivalents	14	—
Net increase (decrease) in cash and equivalents	14	(916)
Cash and equivalents at beginning of period	90	1,006
Cash and cash equivalents at end of period	104	90
Supplemental cash flow information		
Cash paid for interest	68	92
Cash paid for income taxes	—	7

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

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the fiscal years ended July 31, 2003 and 2002

(In thousands, except per share amounts)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

ITEX Corporation ("ITEX" or the "Company") was incorporated in October 1985 in the State of Nevada. The Company operates a business-to-business payment system for retail, professional, media and other corporate members for which it acts as third-party record-keeper and in many cases, an independent broker for transactions between members of the exchange. The Company collects monthly association fees and percentage based transaction fees. In addition, the Company provides merchandise for sale to its members for trade dollars.

A summary of significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows:

Revenue Recognition

ITEX recognizes revenue from various cash fees charged in managing the trade exchange when persuasive evidence of an arrangement exists, the transaction has occurred or the monthly service has been provided, the charges are fixed and determinable and no major uncertainty exists with respect to collectibility.

The Company charges members of the trade exchange an association fee of $20 cash per four-week accounting cycle, $260 annually, and $10 ITEX Trade Dollars each cycle, $130 Trade Dollars annually, in accordance with its trade exchange member agreements. Association fees can be paid by cash, check or by using the Company's Preferred Member Autopay system.

ITEX also receives cash transaction fees based on the value of the barter transaction, from both the buyer and the seller. Members are billed at the end of each four-week accounting cycle. If a member pays automatically by credit card or electronic funds transfer through the Company's Preferred Member Autopay system, the cash fee is 5% of the trade dollar amount of the member's purchases and sales during the billing period. If a member pays by check or otherwise after receiving a mailed statement at the end of each four-week cycle, the cash fee is 7 1/2% of the trade dollar amount of that member's purchases and sales during the period. Currently, approximately 85% of member payments are made automatically through electronic funds transfer or by credit cards using the Preferred Member Autopay system.

As described below under accounting for transactions in trade dollars, the Company historically has not recorded revenues for trade dollars received in exchanges with its trade exchange members.

Ongoing Independent Licensed Brokers and Franchise Related Revenue

Franchisees and existing Independent Licensed Brokers (ILB) are paid a percentage of revenues collected by the Company, which ranges from 40% to 75% depending on the volume of transactions of the members they service and net increases in the number of members enrolled during each 28-day accounting cycle. Receipts are recorded as revenue and payments to ILBs and franchisees are included in costs of sales.

Accounting for Trade Dollar Activities

The Company receives trade dollars for monthly services provided to its ITEX Exchange members and as transaction fees for exchanges made by its members. The Company also expends trade dollars in the acquisition of goods or services used in its operations. When reasonably determinable, the Company records these transactions at the fair value of the goods or services received. Historically, the Company has spent virtually all trade dollars for broker commissions, advertising, salaries and legal settlements. Because there is no readily estimable or determinable value for these goods and services, they are not reflected in the accompanying financial statements. The Company also has the ability to spend or create trade dollars with no obligations to the exchange. The Company has historically spent more trade dollars that it has earned.

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

Transactions that originate from the creation of trade dollars expended for goods or services do not qualify as exchanges under APB 29 and, accordingly are not reflected in the accompanying financial statements.

Transactions that involve the exchange of goods or services for other goods or services are accounted for in accordance with APB 29 and the interpretations contained in EITF 93-11 and 99-17. Accordingly, the Company generally records exchanges at the carrying value of goods or services exchanged which is typically zero, as the fair values of the goods or services exchanged lack readily determinable fair values within reasonable limits as the Company has no history of receiving cash in similar transactions, and therefore the earnings process has not been completed.

IRS Requirements

While the accounting policies described above are used for financial reporting purposes, the Internal Revenue Service requires, for purposes of taxation, that the Company recognize revenues, expenses, assets, and liabilities for all transactions in which the Company either receives or spends ITEX trade dollars using the ratio of one U.S. dollar per ITEX Trade Dollar. The Company accounts for ITEX Trade Dollars internally, in addition to cash, in statements to members and independent licensed brokers and in other ways necessary for the operation of the trade exchange and the business of the Company.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated.

Net Revenue and Deferred Revenue

The Company charges cash association fees to each member and individual cash transaction fees from the buyer and seller. Revenues related to the monthly association fees and transaction fees are recognized immediately. Revenues related to new membership fees and related commissions are deferred and amortized over the average life of a membership, approximately four (4) years.

Cash and Cash Equivalents

Cash and cash equivalents includes all cash and highly liquid investments with maturities at the date of purchase of 90 days or less.

Concentrations of Credit Risk

At July 31, 2003, the Company maintained its major cash balances at one financial institution located in Portland, Oregon and two financial institutions in Canada. The balances are insured by the Federal Deposit Insurance Corporation up to $100 and by the Canadian Deposit Insurance Corporation up to $39. At July 31, 2003, the Company's had no uninsured cash balance.

Property and Equipment

Property and equipment are stated at cost and include those additions and improvements that add to productive capacity or extend useful life. When property or equipment are sold or otherwise retired, the cost and related accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in the statement of operations. The costs of repair and maintenance are charged to expense as incurred. Depreciation is computed using the straight-line method over useful lives of three to five years.

Intangible Assets

The Company amortizes costs of customer lists acquired in business combinations using the straight-line method over the estimated life of four years.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recovered. The Company looks primarily to the

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

undiscounted future cash flows in its assessment of whether or not long-lived assets have been impaired. At July 31, 2003, the Company determined no impairment was appropriate.

Other Assets

The Company accounts for holdings of equity securities of other companies pursuant to Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). The Company's equity securities generally qualify under the provisions of SFAS No. 115 as available for sale. As of July 31, 2003 the Company was not holding any such securities.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109. Under SFAS No. 109, an asset and liability approach is required. Such approach results in the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the book carrying amounts and the tax basis of assets and liabilities.

Income (Loss) Per Share

The Company prepares its financial statements in accordance with the provisions of Statement of Financial Accounting Standards No. 128, "Earnings per Share", which requires presentation on the face of the statement of operations for both basic and diluted earnings per share. Basic earnings per share excludes potential dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity.

Fair Value of Financial Instruments

All of the Company's significant financial instruments are recognized in its balance sheet. The carrying value of financial assets and liabilities generally approximates fair value as of July 31, 2003.

Estimates and Assumptions

Management uses estimates and assumptions in preparing financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets, liabilities, revenue, expenses, gains and losses, and disclosures about contingent assets and liabilities. Significant estimates include the fair value of non-monetary transactions, various litigation matters described herein and the recoverability of certain intangible assets. Actual results may vary from estimates and assumptions that were used in preparing the financial statements.

Reclassifications

Certain reclassifications have been made to the financial statements of prior years to conform to the July 31, 2003 presentation. Such reclassifications had no effect on the results of operations or stockholders' equity.

Recent Accounting Pronouncements

In November 2002, the FASB published interpretation No, 45 "Guarantor's Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". The Interpretation expands on the accounting guidance of Statements No. 5, 57, and 107 and incorporates without change the provisions of FASB Interpretation No. 34, which is being superseded. The Interpretation elaborates on the existing disclosure requirements for most guarantees, including loan guarantees such as standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002, regardless of the guarantor's fiscal year-end. The disclosure requirements in the Interpretation are effective

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

for financial statements of interim or annual periods ending after December 15, 2002. The Company is currently evaluating what effect the adoption of this statement will have the Company's financial statements. The Company does not expect the adoption of this statement to have a material effect on the Company's financial statements.

In December 2002, the FASB issued SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure". This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation" to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based compensation. In addition, SFAS 148 amends the disclosure provision of SFAS 123 to require more prominent disclosure about the effects of an entity's accounting policy decisions with respect to stock-based employee compensation on reported net income. The effective date for this Statement is for fiscal years ended after December 15, 2002. The Company does not expect the adoption of this statement to have a material effect on the Company's financial statements.

In April 2003, the SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" was issued. This statement amends and clarifies the accounting and reporting for derivative instruments, including instruments embedded in other contracts such that contracts with comparable characteristics are accounted for similarly. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except for hedging relationships designated after June 30, 2003. Currently we do not expect SFAS No. 150 to have a material effect on our financial statements.

In May 2003, the SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" was issued. This statement establishes standards for how to classify and measure certain financial instruments with characteristics of both liabilities and equity. Many instruments that were previously classified as equity will be required to be reported as liabilities under SFAS No. 150. This statement is effective for financial instruments entered into or modified after May 31, 2003 and at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable instruments. Currently we do not expect SFAS No. 150 to have a material effect on our financial statements.

NOTE 2 —CORPORATE OFFICE RECEIVABLES

During fiscal 2002, the Company sold its corporate-owned offices in Portland, Lafayette, Orlando, Jensen Beach, Houston, and St. Louis to independent licensed brokers.

Office Location	Date of Sale	Sale Amount	Balance at July 31, 2003	Current Portion	Long Term Portion	Projected Payoff Date
Portland, OR	October, 2001	$ 92	$ 58	$ 15	$ 43	September, 2006
Lafayette, LA	October, 2001	$ 38	$ 22	$ 9	$ 13	July, 2005
Orlando, FL	September, 2001	$ 78	$ 44	$ 15	$ 29	January, 2006
Jensen Beach, FL	October, 2001	$ 50	$ 20	$ 5	$ 15	July, 2009
Houston, TX	November, 2001	$ 97	$ 85	$ 6	$ 79	September, 2014
St. Louis, MO	March, 2002	$ 35	$ 28	$ 7	$ 21	December, 2007
		$ 390	$ 257	$ 57	$ 200	

The corporate-owned offices sold carried a net book value of $112 (consisting of $8 in fixed assets and $104 in member lists) in exchange for receivables of $415. The Company recognized a gain in fiscal year 2002 of $303, included in miscellaneous income (expense). In fiscal year 2003, the Jensen Beach note was written down by $25 to reflect a negotiated settlement between the Company and the buyer.

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

NOTE 3 –PROPERTY AND EQUIPMENT

Fixed Asset Type	Estimated Useful Life	Balance July 31, 2003	Accumulated Depreciation July 31, 2003	Net Book Value Value
Computers	3 years	$ 265	$ 240	$25
Software	3 years	$ 12	$5	$7
Equipment	5 years	$ 413	$ 311	$ 102
Furniture	5 years	$ 138	$ 114	$ 24
		$ 828	$ 670	$ 158

Property and equipment is depreciated using the straight line method over the asset's estimated useful life. Depreciation expense for property and equipment was $108 and $256 for the fiscal years ending July 31, 2003 and 2002, respectively.

NOTE 4 –PURCHASED MEMBER LISTS

At July 31, 2003, the cost of acquired member lists was $2,027, less accumulated amortization of $1,525, for a net carrying value of $502. These amounts include the new member lists acquired in the purchases of the Canada, Seattle and Sacramento brokerages.

Changes in the carrying amount of member lists for the year ended July 31, 2003 are summarized as follows:

Balance as of July 31, 2002	$ 941
Amortization	$ (439)
Balance as of July 31, 2003	$ 502

NOTE 5 –NOTES PAYABLE

As of July 31, 2003 ITEX had a $300 short-term note payable, bearing interest of 16% with principal due on December 31, 2003. The note originated in third quarter of fiscal 2001. In December, 2002 the Company further incurred costs associated with this note by foregoing the interest, by only paying $0.1 per month. The $3.9 interest continued to accrue at a 16% APR. In addition the Company paid the lender a 4% renewal charge of $12 annually. As of July 31, 2003, the note, including principle and interest totaled $330. Total interest expense incurred in 2003 and 2002 was $ 48 and $69, respectively, with total cumulative interest paid and accrued as of July 31, 2003 totaling $148, an annual percentage rate over 21%. This note was secured by certain personally owned real property of a former President and CEO of the Company. In a subsequent event, the loan was paid in full with loan proceeds from the Chairman of the Company. See Note 14 – Related Party Transactions of the Notes to Financial Statements.

NOTE 6 –OTHER CURRENT LIABILITIES

At July 31, 2003, the balance in other current liabilities consists primarily of an accrual for the annual shareholders' meeting, and the Goods and Service Tax (GST) payable to the Canadian government totaling $30 and $75 respectively.

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

NOTE 7 –COMMITMENTS AND CONTINGENCIES

The Company conducts a portion of its business utilizing leased facilities in various cities in which it operates. Certain lease agreements provide for payment of insurance, maintenance and other expenses related to the leased property. Certain lease agreements also provide an option for renewal at varying terms. The Company also leases a portion of its equipment and furniture under operating leases. The aggregate future minimum commitments under operating leases are as follows:

Fiscal year ending July 31,	
2004	$ 78
2005	31
2006	3
Total	$ 112

Office rent expense for the periods ended July 31, 2003 and 2002 amounted to $248 and $315, respectively. Equipment rent expense for the periods ended July 31, 2003 and 2002 amounted to $71 and $100, respectively.

In the ordinary course of business, the Company may be subject to litigation matters and claims that are normal for its operations. The results of litigation and claims cannot be predicted with certainty. For the employment-related and other pending litigation matters, ITEX recognized an aggregate contingent liability of $400 during the fourth quarter ended July 31, 2003, to cover potential losses from and future expenses relating to these claims. See NOTE 12 for detailed discussion of legal matters.

NOTE 8 –STOCKHOLDERS' EQUITY

The Company adopted the following incentive stock option plans under which common stock may be purchased by employees, officers, directors and consultants of the Company. All option prices are at market price at the date of grant.

Date of Plan Adoption	Number of Shares Authorized	Grant Period	Date of Stockholder Approval
February 11, 1994	200,000	10 years	February 10, 1995
October 26, 1994	750,000	10 years	February 10, 1995
December 15, 1995	1,250,000	10 years	May 3, 1996
September 3, 1997	965,000	10 years	February 9, 1999

The following summarizes activity for the fiscal years ended July 31, 2003 and 2002 activity (actual numbers)

	Number of Options		
	Available	Granted	Option Price per Share
Balance, July 31, 2001	86,000	4,416,000	$0.40 - $6.13
Granted	(1,290,000)	1,290,000	$0.08 - $0.21
Cancelled	3,506,000	(3,506,000)	$0.08 – $6.13
Balance, July 31, 2002	2,302,000	2,200,000	$0.40 - $6.13
Granted	(70,500)	70,500	$0.11 - $0.13
Cancelled	2,080,000	(2,080,000)	$0.08 - $6.13
Balance, July 31, 2003	2,7744,500	190,500	

In the fiscal year 2003, the Company issued options to purchase 71 shares of common stock to employees, officers and directors. Options to purchase 2,080 shares of common stock were canceled during the period

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

according to the terms of the option agreements. The exercise price of options granted were equal to the fair market value as determined by the closing bid price for the Company's common stock on the date of grant. Exercise prices varied from $0.08 to $0.21. The options vest 25% immediately and 25% each year. Employee options expire if they are not exercised within 30 days of termination of employment.

The weighted average contractual life of options granted through July 31, 2003, is 5 years. The weighted average exercise prices for the options outstanding at July 31, 2003 are as follows:

Exercise Price Range	Common Stock Options	Weighted Average Exercise Prices
$0.09 – $0.75	190.500	$0.24

Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with. FASB Statement No. 123,"Accounting for Stock-Based Compensation." Statement 123 allows for the Company to account for its stock option plans in accordance with APB Opinion No. 25,"Accounting for Stock Issued to Employees" using the intrinsic value method. The Company granted options to purchase 71 and 1,290 shares of common stock to employees and directors during the years ended July 31, 2003 and 2002.

The following table summarizes the difference between the fair value and intrinsic value methods and the pro forma net income and net loss per share amounts for the years ended July 31, 2003 and 2002 had the Company adopted the fair value-based method of accounting for stock-based compensation.

	Years ended July 31,	
	2003	2002
Difference between fair value and intrinsic value methods (additional compensation expense)	$5	$97
Net (loss) income	(632)	(690)
Net (loss) income per share - basic	(.04)	(.04)
Net (loss) income per share - diluted	(.04)	(.04)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions used for grants in fiscal 2003 and 2002: dividend yield of zero, expected average annual volatility of 148%, average annual risk-free interest rate of 3.5 and 4.5%, and expected lives of five and three years.

Because Statement 123 method of accounting has not been applied to options granted prior to August 1, 1996, the resulting pro forma compensation cost may not be representative of that to be expected in future years. The impact on future years is not known or reasonably estimable.

Statement 123 also applies to transactions in which an entity issues its equity instruments to acquire goods or services from non-employees.

Shares Issued

In fiscal year 2003, the Company issued 442 shares to board members, executives and outside consultants.The effect of this transaction was an increase of $4 in common stock and $87 in additional paid-in capital. Shares issued include an annual grant to outside board members of 40 shares each in lieu of cash compensation.

NOTE 9 –INCOME TAXES

Comparative analysis of the provision (credit) for income taxes for the fiscal years ended July 31, 2003 and 2002 follows:

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

	Years ended July 31, 2003	2002
Current		
Federal	$ —	$ —
State	—	—
	$ —	$ —
Deferred		
Federal	—	—
State	—	—
Tax (benefit) expense	$ —	$ —

The computed income tax expense (credit) differs from applying the U.S. federal income tax rate due to losses before income taxes for the years ended July 31, 2003 and 2002 and because of realization of net operating losses in the years ended July 31, 2003 and 2002. The following reconciles expected income tax effects at a range of 34% to the provision (credit) for income taxes:

	Years ended July 31, 2003	2002
Taxes at U.S. federal statutory rate	$ (214)	$ (283)
Change in deferred tax valuation allowance other than realization of net operating loss	214	283
Other, net	—	—
Tax (benefit) expense	$ —	$ —

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at July 31, 2003 and 2002 are presented below:

	Years ended July 31, 2003	2002
Deferred tax assets:		
Net trade activity included for income tax purposes not recognized for financial reporting	$ —	$ —
Investments and assets impaired for financial reporting not disposed of for tax purposes	1,051	1,069
Amortization	557	598
Net operating loss carryforward	5,657	5,418
Capital loss carryforward	—	—
Other	554	673
	$7,819	7,758
Deferred tax liabilities:		
Amortization	—	(63)
Net deferred tax assets	7,819	7,695
Valuation allowance	(7,819)	(7,695)
	$ —	$ —

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

In assessing the realizability of deferred tax assets, management considers whether it is more likely that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generating of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible. At this time, management has concluded that it is not likely that the Company will realize the benefits of these deductible differences as there can be no assurance that the Company will generate the necessary taxable income in any future periods.

NOTE 10 —401(k) SAVINGS PLAN AND BONUS PLAN

Employees of the Company may participate in a 401(k) savings plan, whereby the employees may elect to make contributions pursuant to a salary deduction agreement upon meeting age and length of service requirements. The Company may make optional matching contributions of 50% of electing employees' deferrals, up to a ceiling amount of 3% of gross annual wages. There were no matching contributions to the plan for the years ended July 31, 2003 and 2002.

NOTE 11 —FAIR VALUE OF FINANCIAL INSTRUMENTS

The following estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Financial Accounting Standards Board Statement No. 107 requires the disclosure of fair value for financial instruments. The following disclosures are made in accordance with the requirements of that Statement. The estimated fair value has been determined by the Company using appropriate valuation methodologies and available or quoted market information.

	Carrying Amount	Fair Value
Assets		
Cash	$ 104	$ 104
Accounts receivable	674	674
Corporate office receivable	57	57
Liabilities		
Accounts payable	$ 265	$ 265
Accounts payable to brokers	874	874
Current portion long-term debt	324	324

The carrying values of cash, accounts receivable, notes receivable, accounts payable, and portion of receivables due to independent licensed brokers approximates their fair value at July 31, 2003.

The fair value of current and long-term portions of long-term indebtedness is based on rates currently available to the Company for debt of similar terms and remaining maturities. There are no quoted market prices for the debt or similar debt.

ITEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

NOTE 12 –LEGAL PROCEEDINGS

In July 2003, ITEX, together with directors Eric Best, John Wade, Steven White and Alan Zimmelman, became parties to a legal proceeding initiated by Daniela Calvitti, former CFO of ITEX (Daniela C. Calvitti v. ITEX Corporation, Eric Best, John Wade, Steven White, Alan Zimmelman, and DOES 1 through 50, inclusive, filed in the Sacramento County Superior Court, Case No. 03AS04123). Ms. Calvitti seeks damages from ITEX and its directors on several theories of relief, including retaliation, wrongful termination in violation of public policy, breach of written contract, breach of the implied covenant of good faith and fair dealing, employment related defamation, intentional infliction of emotional distress and negligence. Plaintiff's complaint was subsequently amended to add claims for interference with contract and business, and misrepresentation in relation to securities. Plaintiff seeks damages to be determined at trial, together with exemplary or punitive damages and an award of attorneys' fees and costs. The claim arises out of the termination of plaintiff's employment with the Company during March 2003. The Company believes it had cause to terminate the employment of plaintiff under the terms of her employment agreement, and that plaintiff's claims are without merit.

In August 2003, ITEX, together with Lakemont Capital and directors Eric Best, John Wade, Steven White and Alan Zimmelman, became parties to a legal proceeding initiated by Lewis "Spike" Humer, Jr. and Melvin Kerr, former CEO and COO of ITEX, respectively (Lewis "Spike" Humer, Jr., Melvin Kerr v. ITEX Corporation, Lakemont Capital, Eric Best, John Wade, Steven White, Alan Zimmelman, and DOES 1 through 50, inclusive, filed in the Sacramento County Superior Court, Case No. 03AS04427). The plaintiffs seek damages from ITEX and its directors, as well as Lakemont Capital, on several theories of relief, including breach of express contract, breach of implied covenant of good faith and fair dealing, violation of Labor Code 1102.5, termination in violation of public policy, intentional misrepresentation of fact and negligent misrepresentation of fact. Plaintiffs seek damages to be determined at trial for lost income and benefits, for mental distress, emotional distress and mental anguish, as well as punitive damages, prejudgment interest, and an award of attorneys' fees and costs. The claim arises out of the termination of plaintiffs' employment with the Company in June 2003. The Company believes it had cause to terminate the employment of each of the two plaintiffs under the terms of their respective employment agreements, and that plaintiffs' claims are without merit.

The Company will initially seek to strike plaintiffs' claims relating to punitive damages and emotional distress. Despite management's belief that ITEX had cause to terminate the employment of each of the three plaintiffs, the outcome of this matter cannot be predicted at this time and if either plaintiff is successful in obtaining a jury verdict, the award could be substantial and have a material adverse affect on the Company.

In a related employment matter, Lewis Humer and Melvin Kerr filed claims with the Labor Commissioner of the State of California (Case Nos. 08-40720 and 08-40721, respectively) for unpaid vacation pay, wages and expenses totaling $20 and $5, respectively, and requesting penalties of $22 and $19, respectively.

On May 13-15, 2003, a jury trial was completed in the case of Moore, et al v. ITEX Corporation, et al. (Wendy Moore, Rocky Moore and Sweetwater Lone Tree Roofing, Inc. v. ITEX Corporation, Itex Trade Exchange, International Trade Exchange, Abilene Trade Exchange, Inc. Adam Keidl and Carol Phelps, filed in the 32nd Judicial District Court of Nolan County, Texas, Cause No. 18,317). The lawsuit involved claims brought under the Texas Deceptive Trade Practices Act that independent representatives of ITEX made certain deceptive representations to induce plaintiffs to join and participate in the ITEX exchange. The Company denied wrongdoing and vigorously defended the claims as asserted in the litigation. The jury found in favor of the lone corporate plaintiff as against all defendants, and awarded Plaintiff $105 in damages (reduced by $50 if the case was not appealed) for which ITEX was jointly and severally liable, plus additional damages of $32 of which ITEX was liable for $10. After the filing of a motion for a new trial, the matter was settled out of court and plaintiffs' claims dismissed with prejudice.

In June 2003, an action was filed by United Trade Network against ITEX related to its opening of a company-owned store in Las Vegas, Nevada, and its employment of John Madera. (United Trade Network v. ITEX Corporation, John Madera, Does I-V, inclusive, filed in District Court, Clark County, Nevada, Case No. A468693). Plaintiff alleged that defendant Madera breached a covenant not to compete, and has alleged theft of trade

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secrets, tortuous interference with economic advantage and breach of contract. Plaintiff sought injunctive relief ordering that the employment of Madera be terminated, that its trade secrets be protected and for compensatory damages in excess of $10. The Las Vegas office was subsequently closed on June 19, 2003, and plaintiff's claims were dismissed with prejudice.

In a matter related to the opening of a broker office in Salt Lake City, an action was filed in May 2003 against ITEX and its former CEO Lewis Humer by an existing ITEX broker (Graham Norris, Sr. and Zibco Corporation, DBA ITEX-in-Utah v. ITEX Corporation, Lewis "Spike" Humer, ITEX of Salt Lake, Eric Laker, Tina Marie Fowler and Does 1-10, filed in Third Judicial District, Salt Lake City, Utah, Case. No. 030909748). The complaint alleges breach of duty of good faith and fair dealing and intentional interference with current and prospective economic relations, and seeks unspecified damages, including punitive damages. Management will endeavor to seek a resolution of the underlying issues, but the outcome of this matter cannot be predicted at this time.

For the employment-related and other pending litigation matters, ITEX accrued $400 during the fourth quarter ended July 31, 2003, to cover potential losses from and future expenses relating to these claims.

The Company is subject from time to time to claims and litigation incurred in the ordinary course of business, which management believes will not have a material effect on the financial position or results of operations of the Company.

NOTE 13 –SUBSEQUENT EVENTS

During the first quarter of fiscal 2004, the Company sold its corporate-owned offices in New York, Toronto, and Sacramento to an independent Broker and franchisees.

Office Location	Date of Sale	Sale Amount	Balance at October 2, 2003	Current Portion	Long-Term Portion	Projected Payoff Date
New York	August, 2003	$ 350	$ 350	$ 62	$ 288	January, 2009
Toronto	August, 2003	$ 600	$ 600	$ 102	$ 498	January, 2009
Sacramento	October, 2003	$ 800	$ 700	$ 99	$ 601	April, 2010
		$ 1,750	$ 1,650	$ 263	$ 1,387	

The corporate-owned offices sold carried a net book value of $321 (consisting of $42 in fixed assets and $279 in member lists) in exchange for receivables of $1,650. The offices sold for a total of $1,750 with one office providing $100 on the date of purchase. The Company will recognize a gain of $1,429 in the first quarter of fiscal year 2004.

NOTE 14 –RELATED PARTY TRANSACTIONS

As of July 31, 2003, we carried a $300 short-term note payable to an individual, bearing interest of 16% with principal due on December 31, 2003. The note originated in the third quarter of fiscal 2001, and carried an initial service charge plus an additional annual renewal fee of 4%. Our payments of interest and service charges under this note during the first two years of its existence resulted in an effective annual interest rate of 21%. In December 2002, the Company further incurred costs associated with this note by foregoing the interest, by only paying $0.10 per month. The unpaid interest continued to accrue at a 16% APR. As of July 31, 2003, the note, including principal and interest totaled $330. At July 31, 2003, the note was secured by certain personally owned real property of a former President and CEO of ITEX.

On October 2, 2003, the chairman of the Company acted to relieve ITEX of this loan by loaning the Company $300. The loan was used to pay off the note balance, which had accrued to $345 in exchange for a one-year secured promissory note with interest at 8%, 13% less than the previous effective interest rate. The loan is secured by a security interest in substantially all of our assets.

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As of July 31, 2003 the company paid Lakemont Capital $35 related to the proxy contest at the annual shareholder meeting in February, 2003. At July 31, 2003 Lakemont Capital was due $20. Lakemont Capital, Ltd. is an affiliate of the current Chairman of the Board of ITEX Corporation.

NOTE 15 – SIGNIFICANT FOURTH QUARTER ADJUSTMENTS

Current management assessed the likelihood of collecting the $111 GST receivable from exchange members as remote and has written off to bad debt expense.

The Company performed a detailed review of accounts receivable in the fourth quarter of 2003. As such, management deemed that A/R should be adjusted downward $314. The adjustment consists of a $138 increase in the bad debt reserve and a direct write off of $176 for accounts receivable, both of which were recorded as a direct reduction of revenues in the fourth quarter.

The Company accrued $400 for defense and counter claim cost of three former executives and an Independent Licensed Broker. See Table Below.

Summary of Significant 4th Quarter Adjustments

Goods and Services Tax Write Off	$ 111
Accounts Receivable Write Down	314
Accrued Legal	400
Total Adjustments	$ 825

Goods and Services Tax

In December 2002, the Canadian Customs and Revenue Agency ("CCRA") contacted the company regarding Goods and Services Tax ("GST") that should have been assessed to the ITEX exchange membership base from March 2001 – December 31, 2002. In March 2003, former management billed the unbilled GST, for the eight preceding quarters to the membership base and established a GST receivable of $151 to offset the corresponding liability. A reserved $25 was also established to account for the possibility that the Company may not be able to fully collect on some of the older GST balances. As of July 31, 2003, the collection efforts yielded receipts of $15. Current management has assessed the likelihood of collecting the remaining $111 as remote and as a result of the analysis has written off the remaining balance to bad debt expense. The company remains obligated to pay the remaining tax balance of $78 as of July 31, 2003.

As of July 31, 2003, the Company paid $89, leaving an outstanding balance due CCRA of $78, including interest and penalties totaling $16.

Accounts Receivable

The Company performed a detailed review of accounts receivable in the fourth quarter of 2003. As such, management deemed that A/R should be adjusted downward $314. The adjustment consisted of a $138 increase in the bad debt reserve and a direct write off of $176, both of which were recorded as a direct adjustment to revenues.

(1) accounts receivable over ninety days outstanding average $40 per month; (2) fee reversals from prior transactions average $45 per month; and (3) approximately 50% of the Company's aged receivables, average $230 per month, are collected with exceptions. Therefore, an increase of $138 ($62 had been accounted for in previous periods) to the accounts receivable reserve was necessary as of July 31, 2003. The AR reserve resulted in a reduction of revenues in the fourth quarter. The Company is now assessing the accounts receivable reserve on a quarterly basis.

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Accounts Receivable Allowance Analysis

	Amount	Likelihood of occurrence	Total
AR over 90 days	$ 40	100%	$ 40
Average reversal of fees	45	100%	45
AR aging total	230	50%	115
			200
Total Accounts Receivable (per Balance sheet)			$ 874
Reserve as a percentage of total AR			23%

Legal Accrual

During the fourth quarter of fiscal 2003 the Company became a defendant in three separate legal suits related to three former executives and an Independent Licensed Broker. The Company accrued $400 to cover potential losses from and future expenses relating to these claims. See Note 12 – Legal Proceedings for further details.

Payroll Accrual

During the fourth quarter of fiscal 2003 claims were filed by two former executives for unpaid vacation, wages, and expenses. Although the Company will vigorously defend these claims, a decision was made by management to accrue for the total amount being claimed in both cases totaling approximately $67. See Note 12 – Legal Proceedings for further details.

BUSINESS EXPERIENCE OF ITEX DIRECTORS

Steven White

Steven White, 45, is President of Lakemont Capital, Ltd., a business advisory firm. From June 2000 to June 2001, Mr. White was a Senior Vice President of Network Commerce, a publicly traded Internet-based technology infrastructure and services company. Mr. White managed the sale of the Ubarter.com division to ITEX in two transactions in early 2001. From 1996 to 2000, he served as CEO and President of Ubarter.com, a publicly traded company that offered a range of barter services. Mr. White directed the sale of Ubarter.com to Network Commerce in June 2000. From 1983 to 1996 he was founder and CEO of Cascade Trade Association, a regional provider of business-to-business off-line barter services for small businesses in the Northwest. Mr. White is the former Chairman and President of the National Association of Trade Exchanges (NATE) and a Technology Committee founder.

Eric Best

Eric Best, 32, is CEO of Morse Best Innovation, a custom software consulting, developer and systems integration practice. Prior to founding Morse Best Innovation in 2001, he was a founding partner of MindCorps in 1996, a high-growth software consultancy that served the Internet and Fortune 500 markets. In 1999, Mr. Best and his partners at MindCorps created a complementary software product firm, Emercis Corporation, to provide e-commerce infrastructure tools to business enterprises. Mr. Best orchestrated the sale of MindCorps to Amazon.com in 1999 and the sale of Emercis to Impressa, Inc. in 2000. Joining Amazon.com, he managed business development for the Network from 1999 to 2000. Mr. Best holds degrees in Business Administration and Biology from Seattle Pacific University. Prior to his work in the software industry, he performed immunology research at Bristol-Myers Squibb's Pharmaceutical Research Institute in Seattle. Mr. Best served as a director of Ubarter.com from 1999 to 2000.

John A. Wade

John A. Wade, 41, has served since May 1998 as Chief Financial Officer of Aptimus, Inc., a leader in online direct marketing. Prior to joining Aptimus, Mr. Wade served as the CFO and COO for Buzz Oates Enterprises, a real estate development company. He also has worked as the controller for A&A Properties, Inc., an asset management corporation; the controller for Labels West, a manufacturing company; and as an auditor and taxation specialist at McGladrey and Pullen, an international accounting firm. Mr. Wade has a Bachelor of Science degree in business administration with a concentration in accounting from the San Diego State University School of Business. Mr. Wade served as a director of Ubarter.com from 1999 to 2000.

Alan Zimmelman

Alan Zimmelman, 59, has been primarily engaged since September 1999 as a private investor. From November 1987 until August 1996, he was President of BXI West Los Angeles, a private company involved in the barter business. He has over twenty-five years experience in sales and management, including over 15 years affiliated with companies involved in the barter business, twelve years affiliated with companies in the hotel industry and five years affiliated with companies in hospital administration. He served as Vice President of Operations for Ubarter.com from 1996 through 2000 and as a director from 1997 to 1999.

None of the directors is related to any of the past officers or directors of ITEX.
Steven White Chairman of the Board is acting CEO/CFO.

BOARD OF DIRECTORS

Steven White
Chairman of the Board

Eric Best
Director

John A. Wade
Director

Alan Zimmelman
Director

OUTSIDE LEGAL COUNSEL

Stephen Tollefsen
Tollefsen Business Law PC
Everett Mutual Tower
2707 Colby Avenue, Suite 1116
Everett, Washington 98201

EXECUTIVE OFFICERS

Steven White
Interim Chief Executive Officer
Interim Chief Financial Officer

INDEPENDENT AUDITORS

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7979 East Tufts Avenue
Denver, CO 80237-2843

TRANSFER AGENT

OTR, Inc.
317 SW Alder, Suite 1120
Portland, OR 97204

CORPORATE HEADQUARTERS

ITEX CORPORATION
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An electronic copy of the Company's Form 10-KSB and 10-KSB/A1 for the year ended July 31, 2003, as filed with the Securities and Exchange Commission is available upon request. Requests should be directed to Robert Benson, rob@itex.com. For access to additional financial information, visit the Investor Relations website online at: www.itex.com/investorinfo.