

SMART ONLINE INC
Form 10-Q
May 14, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2010

OR

- Transition report pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934

Commission File Number: 001-32634

SMART ONLINE, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-4439334
(I.R.S. Employer
Identification No.)

4505 Emperor Blvd., Ste. 320
Durham, North Carolina
(Address of principal executive offices)

27703
(Zip Code)

(919) 765-5000
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of May 11, 2010, there were approximately 18,342,542 shares of the registrant's common stock, par value \$0.001 per share, outstanding.

SMART ONLINE, INC.

FORM 10-Q

For the Quarterly Period Ended March 31, 2010

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

SMART ONLINE, INC.
BALANCE SHEETS

	March 31, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 22,477	\$ 119,796
Accounts receivable, net	-	13,056
Note receivable	-	-
Prepaid expenses	222,710	240,840
Total current assets	245,187	373,692
Property and equipment, net	243,075	258,450
Capitalized software, net	433,509	450,782
Unbilled receivable, non-current	-	-
Prepaid expenses, non-current	73,800	110,700
Intangible assets, net	150,000	150,000
Other assets	1,095	2,496
TOTAL ASSETS	\$ 1,146,666	\$ 1,346,120
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	\$ 752,800	\$ 518,309
Notes payable	2,147,183	1,964,281
Deferred revenue	27,215	40,115
Accrued liabilities – Nouri	1,802,379	1,802,379
Accrued liabilities	2,432,503	2,623,959
Total current liabilities	7,162,080	6,949,043
Long-term liabilities:		
Notes payable	10,279,790	9,785,255
Deferred revenue	11,940	5,601
Total long-term liabilities	10,291,730	9,790,856
Total liabilities	17,453,810	16,739,899
Commitments and contingencies		
Stockholders' equity (deficit):		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at March 31, 2009 and December 31, 2008	-	-
Common stock, \$0.001 par value, 45,000,000 shares authorized, 18,342,542 and 18,333,122 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively	18,343	18,333
Additional paid-in capital	67,040,385	67,036,836
Accumulated deficit	(83,365,872)	(82,448,948)
Total stockholders' deficit	(16,307,144)	(15,393,779)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 1,146,666	\$ 1,346,120

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

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SMART ONLINE, INC.
STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended	
	March 31, 2010	March 31, 2009
REVENUES:		
Subscription fees	\$ 136,258	\$ 241,782
Professional service fees	62,775	118,773
License fees	87,800	11,250
Hosting fees	44,272	72,211
Other revenue	32,795	37,671
Total revenues	363,900	481,687
COST OF REVENUES	365,934	492,601
GROSS PROFIT	(2,034)	(10,914)
OPERATING EXPENSES:		
Sales and marketing	152,635	299,539
Research and development	32,005	276,879
General and administrative	672,419	895,590
Total operating expenses	857,059	1,472,008
LOSS FROM OPERATIONS	(859,093)	(1,482,922)
OTHER INCOME (EXPENSE):		
Interest expense, net	(210,695)	(127,998)
Gain on legal settlements, net	152,863	6,000
Other income	-	10,267
Total other expense	(57,832)	(111,731)
NET LOSS	\$ (916,925)	\$ (1,594,653)
NET LOSS PER COMMON SHARE:		
Basic and fully diluted	\$ (0.05)	\$ (0.09)
WEIGHTED-AVERAGE NUMBER OF SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE:		
Basic and fully diluted	18,342,542	18,333,518

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

SMART ONLINE, INC.
STATEMENTS OF CASH FLOWS
(unaudited)

	Three Months Ended	
	March 31, 2010	March 31, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (916,925)	\$ (1,594,653)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	16,209	164,288
Amortization of deferred financing costs	-	-
Provision for doubtful accounts	179,517	223,993
Equity-based compensation	3,561	53,144
Gain on disposal of assets	-	(10,267)
Changes in assets and liabilities:		
Accounts receivable	(121,343)	44,435
Notes receivable	(45,118)	(3,250)
Prepaid expenses	55,029	79,556
Other assets	1,401	(1,251)
Accounts payable	234,492	10,417
Deferred revenue	(6,561)	(47,951)
Accrued and other expenses	(191,456)	196,647
Net cash used in operating activities	(791,194)	(884,892)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(835)	(14,565)
Proceeds from sale of equipment	-	45,362
Capitalized software	17,273	(114,078)
Net cash provided by (used in) investing activities	16,438	(83,281)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt borrowings	1,982,698	2,925,511
Repayments of debt borrowings	(1,305,261)	(1,937,651)
Net cash provided by (used in) financing activities	677,437	987,860
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(97,319)	19,687
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	119,796	18,602
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 22,477	\$ 38,289
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 228,981	\$ 127,750
Income taxes	\$ -	\$ 10

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

SMART ONLINE, INC.
NOTES TO FINANCIAL STATEMENTS
(unaudited)

1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business - Smart Online, Inc. (the "Company") was incorporated in the State of Delaware in 1993. The Company develops and markets software products and services targeted to small businesses that are delivered via a Software-as-a-Service ("SaaS") model. The Company sells its SaaS products and services primarily through private-label marketing partners. In addition, the Company provides website consulting services, primarily in the e-commerce retail and direct-selling organization industries. The Company maintains a website for potential partners containing certain corporate information located at www.smartonline.com.

Basis of Presentation - The financial statements as of and for the three months ended March 31, 2010 and 2009 included in this Quarterly Report on Form 10-Q are unaudited. The balance sheet as of December 31, 2009 is obtained from the audited financial statements as of that date. The accompanying statements should be read in conjunction with the audited financial statements and related notes, together with management's discussion and analysis of financial condition and results of operations, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission (the "SEC") on April 15, 2010 (the "2009 Annual Report").

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). In the opinion of the Company's management, the unaudited statements in this Quarterly Report on Form 10-Q include all normal and recurring adjustments necessary for the fair presentation of the Company's statement of financial position as of March 31, 2010, and its results of operations and cash flows for the three months ended March 31, 2010 and 2009. The results for the three months ended March 31, 2010 are not necessarily indicative of the results to be expected for the fiscal year ending December 31, 2010.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. During the three months ended March 31, 2010 and 2009, the Company incurred net losses as well as negative cash flows, is involved in a class action lawsuit (See Note 7, "Commitments and Contingencies," in the 2009 Annual Report), and had deficiencies in working capital. These factors indicate that the Company may be unable to continue as a going concern.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts or classification of liabilities that might be necessary should the Company be unable to continue as a going concern. At May 11, 2010, the Company does have a commitment from its convertible secured subordinated noteholders to purchase up to an additional \$4.65 million in convertible notes upon approval and call by the Company's Board of Directors. There can be no assurance that, if the noteholders do not purchase the \$4.65 million