

SIMTROL INC  
Form 10-Q  
August 23, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

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

For the quarterly period ended June 30, 2010

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-10927

SIMTROL, INC.

(Exact name of smaller reporting company as specified in its charter)

Delaware  
(State of  
incorporation)

58-2028246  
(I.R.S. Employer  
Identification No.)

520 Guthridge Ct., Suite 250  
Norcross, Georgia 30092  
(Address of principal executive offices)

(770) 242-7566  
(Issuer's telephone number)

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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) 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.

Large accelerated filer ☐

Accelerated filer ☐

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

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

As of August 20, 2010 registrant had 15,090,902 shares of \$.001 par value Common Stock outstanding.

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SIMTROL, INC. AND SUBSIDIARIES  
Form 10-Q  
Quarter Ended June 30, 2010

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SIMTROL, INC.  
PART I – FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

SIMTROL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (unaudited)	December 31, 2009
<b>ASSETS</b>		
Current assets		
Cash	\$ 24,766	\$ 18,596
Accounts receivable	12,781	30,549
Inventory	18,857	19,128
Prepaid expenses and other current assets	14,179	20,173
Interest receivable	1,263	4,603
Total current assets	71,846	93,049
Certificate of deposit-restricted	-	29,911
Property and equipment, net	37,861	60,176
Right to license intellectual property, net	8,719	8,719
Note receivable, net of deferred revenue of \$363,789 and \$400,000, respectively	-	-
Total assets	\$ 118,426	\$ 191,855
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
Current liabilities		
Accounts payable	\$ 351,862	\$ 222,457
Accrued expenses	69,445	100,374
Deferred revenue	26,188	29,638
Derivative liabilities	72,078	518
Notes payable, net	387,138	562,250
Total current liabilities	906,711	915,237
Derivative liabilities	788,952	136,231
Deferred rent payable	19,005	20,459
Total liabilities	1,714,668	1,071,927
<b>Commitments and contingencies</b>		
<b>Stockholders' Deficit:</b>		
Preferred stock, \$.00025 par value; 10,000,000 shares authorized;		
Series A Convertible: 770,000 shares designated; 672,664 outstanding; liquidation value of \$2,017,992	167	167
Series B Convertible: 4,700 shares designated; 4,264 outstanding; liquidation value of \$3,198,000	1	1
Series C Convertible: 7,900 shares designated; 5,534 outstanding; liquidation value of \$4,150,000	14	14
Common stock, 400,000,000 shares authorized; \$.001 par value; 15,090,902 and 13,725,921 issued and outstanding	15,090	13,726

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Additional paid-in capital	80,759,533	79,832,011
Accumulated deficit	(82,371,047)	(80,725,991)
Total stockholders' deficit	(1,596,242)	(880,072)
Total liabilities and stockholders' deficit	\$ 118,426	\$ 191,855

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

SIMTROL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	2010	2009
<b>Revenues:</b>				
Software licenses	\$ 5,900	\$ 1,000	\$ 52,575	\$ 76,321
Service and hardware	52,497	19,103	98,041	195,068
Total revenues	58,397	20,103	150,616	271,389
<b>Cost of revenues:</b>				
Software licenses	-	-	-	300
Service and hardware	25,953	6,146	42,492	114,116
Total cost of revenues	25,953	6,146	42,492	114,416
Gross profit	32,444	13,956	108,124	156,973
<b>Operating expenses:</b>				
Selling, general, and administrative	258,444	595,628	596,288	1,374,278
Research and development	69,367	289,008	171,468	600,873
Total operating expenses	327,811	884,636	767,756	1,975,151
Loss from Operations	(295,367)	(870,680)	(659,632)	(1,818,178)
<b>Other income/(expenses):</b>				
Amortization of debt discount-warrant fair value and note conversion feature	(219,648)	(80,408)	(355,339)	(80,408)
Finance expense	-	-	(956,960)	-
Amortization of debt issuance costs	-	(5,781)	-	(5,781)
Gain/(loss) on derivative liabilities	1,375,601	(160,706)	1,072,175	(101,506)
Interest income	5,838	3,825	11,691	9,810
Interest expense	(24,309)	(12,173)	(53,087)	(12,593)
Total other income/(expense), net	1,137,482	(255,243)	(281,520)	(190,478)
Net Income/(loss)	842,115	(1,125,923)	(941,152)	(2,008,656)
Dividends on convertible preferred stock paid in common stock	(38,500)	(359,338)	(38,500)	(359,338)
Deemed dividend on convertible preferred stock	(72,541)	-	(665,404)	-
Net income/(loss) attributable to common stockholders	\$ 731,074	\$ (1,485,261)	(1,645,056)	\$ (2,367,994)
<b>Net income/(loss) per common share, basic and diluted:</b>				
Basic	\$ 0.05	\$ (0.14)	\$ (0.12)	\$ (0.22)
Diluted	\$ 0.01	\$ (0.14)	\$ (0.12)	\$ (0.22)
<b>Weighted average shares outstanding:</b>				
Basic	13,821,655	10,935,736	13,799,354	10,883,077
Diluted	64,882,399	10,935,736	13,799,354	10,883,077

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



SIMTROL, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Six Months Ended June 30,	
	2010	2009
<b>CASH FLOWS USED IN OPERATING ACTIVITIES:</b>		
Net loss	\$ (941,152)	\$ (2,008,656)
Adjustments to reconcile net loss to net cash used in operating activities:		
Issuance of common stock for services	-	3,255
Depreciation and amortization	23,418	38,974
Impairment of right to license intellectual property	-	18,499
Amortization of debt discounts	355,339	80,408
Finance expense	956,960	-
Stock-based compensation	221,234	424,687
(Gain)/loss on derivative liabilities	(1,072,175)	101,506
Loss on disposal of property	-	6,513
Changes in operating assets and liabilities	208,343	167,991
Net cash used in operating activities	(248,033)	(1,166,822)
<b>CASH FLOWS USED IN INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(1,103)	(18,267)
Redemption of certificate of deposit	30,306	-
Net cash provided by/(used) in investing activities	29,203	(18,267)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from notes payable issuance	225,000	537,329
Net cash provided by financing activities	225,000	537,329
Increase/(decrease) in cash and cash equivalents	6,170	(647,760)
Cash and cash equivalents, beginning of the period	18,596	997,048
Cash and cash equivalents, end of the period	\$ 24,766	\$ 349,288
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Refinancing of notes payable and accrued interest	\$ 646,295	\$ -
Common shares issued for notes payable extension	\$ 3,748	\$ -
Issuance of common stock for payment of preferred stock dividends	\$ 38,500	\$ 359,338

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



SIMTROL, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010 AND 2009  
(Unaudited)

Note 1 – Nature of Operations and Basis of Presentation

Simtrol, Inc., formerly known as VSI Enterprises, Inc., was incorporated in Delaware in September 1988 and, together with its wholly-owned subsidiaries (the "Company"), develops, markets, and supports software based audiovisual control systems and videoconferencing products that operate on PC platforms. The Company operates at a single facility in Norcross, Georgia and its sales are primarily in the United States.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in conformity with accounting principles generally accepted in the United States of America and the instructions to Form 10-Q. It is management's opinion that these statements include all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the condensed consolidated financial position as of June 30, 2010, and the condensed consolidated results of operations, and cash flows for all periods presented. Operating results for the three and six months ended June 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The Company has evaluated and included subsequent events through the filing date of this Form 10-Q.

Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. It is suggested that these unaudited condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto as of December 31, 2009 and for each of the two years ended December 31, 2009, and 2008, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission on March 26, 2010.

Certain amounts in the 2009 condensed consolidated financial statements have been reclassified for comparative purposes to conform to the presentation in the 2010 consolidated financial statements. These reclassifications have no effect on previously reported net loss.

Note 2 – Going Concern Uncertainty

As of June 30, 2010, the Company had cash totaling \$24,766 and negative working capital of \$837,261. Since inception, the Company has not achieved a sufficient level of revenue to support its business and incurred a net loss of 941,152 and used net cash of \$248,033 in operating activities during the six months ended June 30, 2010. While this cash used in operations has decreased significantly from prior year, the Company will require additional funding to fund its development and operating activities during the third quarter of 2010 of at least \$75,000. During the six months ended June 30, 2010, the Company received \$225,000 of net proceeds from the issuance of notes payable and entered into an agreement whereby it exchanged outstanding debt and unpaid interest in the amount of \$562,250 and \$84,045, respectively (see Note 6), in a new convertible note offering. This offering was principally used to fund operations. Historically, the Company has relied on private placement issuances of equity and debt. The Company has commenced efforts to raise additional capital through a private placement of debt securities and warrants. No assurance can be given that the Company will be successful in raising this capital. If capital is successfully raised through the issuance of debt, this will increase interest expense and the warrants will dilute existing shareholders. If the Company is not successful in raising this capital, the Company may not be able to continue as a going concern. In that event, the Company may be forced to cease operations and stockholders could lose their entire investment in the Company.

Also, anti-dilution provisions of the existing Series A, B, and C Convertible Preferred stock might result in additional dilution to existing common shareholders if such financing results in adjustments to the conversion terms of the convertible preferred stock. The issuance of the convertible notes in the first half of 2010 resulted in dilution to existing common shareholders as terms of the convertible debt resulted in adjustments to the conversion terms of the convertible preferred stock. (See note 6). However, if the Company was unable to obtain this additional funding, its business, financial condition and results of operations would be adversely affected.

Even if the Company obtains additional equity capital, the Company may not be able to execute its current business plan and fund business operations for the period necessary to achieve positive cash flow. In such case, the Company might exhaust its capital and be forced to reduce expenses and cash burn to a material extent, which would impair its ability to achieve its business plan. If the Company runs out of available capital, it might be required to pursue highly dilutive equity or debt issuances to finance its business in a difficult and hostile market, including possible equity financings at a price per share that might be much lower than the per share price invested by current shareholders. No assurance can be given that any source of additional cash would be available to the Company. If no source of additional cash is available to the Company, then the Company would be forced to significantly reduce the scope of its operations or possibly seek court protection from creditors or cease business operations altogether.

These matters raise substantial doubt about the Company's ability to continue as a going concern. The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The condensed consolidated financial statements do not include any adjustments relating to the recoverability of the recorded assets or the classification of the liabilities that might be necessary should the Company be unable to continue as a going concern.

### Note 3 – Selected Significant Accounting Policies

#### Revenue recognition

The Company follows the guidance of the ASC 605-10-599, which provides for revenue to be recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery or installation has been completed, (iii) the customer accepts and verifies receipt, and (iv) collectability is reasonably assured. Certain judgments affect the application of its revenue policy. Revenue consists of the sale of device control software and related maintenance contracts on these systems. Revenue on the sale of hardware is recognized upon shipment. The Company generally recognizes revenue from Device Manager<sup>TM</sup> software sales upon shipment as it sells the product to audiovisual integrators, net of estimated returns and discounts. Revenue on maintenance contracts is recognized over the term of the related contract.

#### Inventory

The Company purchases certain hardware connectivity devices to allow connectivity of devices with different interfaces in classrooms. The inventory is stated at the lower of cost or market value and is recorded at the actual cost paid to third-party vendors. The Company accounts for the inventory using the first-in, first-out ("FIFO") method of accounting.

#### Gain/(Loss) Per Share

ASC 260 requires the presentation of basic and diluted earnings per share ("EPS"). Basic EPS is computed by dividing loss attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS includes the potential dilution that could occur if options or other contracts to issue common stock were exercised or converted.

The Company currently has outstanding convertible debt and convertible preferred stock that would lower the EPS as reported by the Company if converted. The following table reconciles the numerator and denominator for the calculation of diluted EPS:

For the  
three months ended  
June 30, 2010

Basic net income attributable to common stockholders		
Numerator:		
Basic net income attributable to common shareholders	\$	731,074
Convertible debt interest	\$	23,741
Amortization of debt discounts	\$	219,648
Gain on derivative liabilities due to convertible debt	\$	( 325,565)
Deemed preferred dividend on convertible preferred stock	\$	72,541
Dividends on convertible preferred stock paid in common stock	\$	38,500
Net income available to common stockholders	\$	759,939
Weighted average basic shares outstanding		13,821,655
Net income per basic share	\$	0.05
Denominator:		
Weighted average basic shares outstanding		13,821,655
Weighted average effect of dilutive securities:		
Convertible preferred stock		34,876,086
Convertible debt		16,184,658
Weighted average diluted shares outstanding		64,882,339
Net income per diluted share	\$	0.01

The following equity securities are not reflected in diluted loss per share for the six months ended June 30, 2010, and the three and six months ended June 30, 2009 because their effects would be anti-dilutive:

	June 30, 2010	June 30, 2009
Options	6,774,700	7,270,950
Warrants	62,948,795	28,427,465
Convertible Preferred Stock	36,059,048	22,286,656
Convertible Notes Payable	18,186,954	1,529,156
Total	123,969,497	59,514,227

Accordingly, basic and diluted net loss per share are identical for the six months ended June 30, 2010 and 2009, respectively, as well as the three months ended June 30, 2009.

All warrants and options to purchase common stock outstanding at June 30, 2010 had exercise prices greater than the Company's stock price and are not included in the calculation of diluted earnings per share for the three months ended June 30, 2010.

#### Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks. The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the condensed consolidated statements of operations. For stock-based derivative financial instruments, the Company uses the Black-Scholes option pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on the term of the underlying derivative instrument. See Note 9.

#### Note 4 – Income Taxes

The Company files income tax returns for Simtrol, Inc. and its subsidiaries in the United States with the Internal Revenue Service and with various state jurisdictions. As of December 31, 2009, the tax returns for Simtrol, Inc. for the years 2006 through 2008 remain open to examination by the Internal Revenue Service and various state authorities.

#### Accounting for Uncertainty in Income Taxes

Effective January 1, 2007, the Company adopted the FASB's guidance on accounting for uncertainty in income taxes. In accordance with this guidance, interest costs and related penalties related to unrecognized tax benefits are required to be calculated, if applicable. No interest and penalties were recorded during the years ended December 31, 2009 and 2008, respectively. As of December 31, 2009 and 2008, no liability for unrecognized tax benefits was required to be recorded.

## NOL Limitations

The Company's utilization of NOL carryforwards may be subject to an annual limitation due to ownership changes that have occurred previously or that could occur in the future as provided in Section 382 of the Internal Revenue Code of 1986 ("Section 382"), as well as similar state and foreign provisions. In general, an ownership change, as defined by Section 382, results from transactions increasing the ownership of certain stockholders or public group in the stock of a corporation by more than fifty percentage points over a three-year period. Since its formation, the Company has raised capital through the issuance of capital stock and various convertible instruments. The Company continually performs tests for ownership change under Section 382 and believes no ownership change, as defined by Section 382, has taken place as a result of transactions that have increased the ownership of certain stockholders.

The Company has not utilized any of its NOL carryforwards as it has never reported taxable income. The Company recognized deferred tax assets of approximately \$19.8 million, primarily relating to net operating loss carry forwards of approximately \$49.1 million at June 30, 2010. The losses expire through 2030. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company considers projected future taxable income and tax planning strategies in making this assessment. At present, the Company does not have a history of income to conclude that it is more likely than not that the Company will be able to realize all of its tax benefits; therefore, a valuation allowance of \$19.8 million is established for the full value of the deferred tax assets at June 30, 2010. The valuation allowance increased by \$149,000 during the six months ended June 30, 2010 due to losses incurred during the current year exceeding previous losses that expired unutilized during the period. For the six months ended June 30, 2009, the valuation allowance decreased by approximately \$736,000, due to certain net operating losses expiring unused. A valuation allowance will be maintained until sufficient positive evidence exists to support the reversal of any portion or all of the valuation allowance net of appropriate reserves. Should the Company be profitable in future periods with supportable trends, the valuation allowance will be reversed accordingly.

## Note 5 – Stockholders' Equity

During the six months ended June 30, 2010 and 2009, respectively, the Company issued 6,666 and 35,625 shares of common stock valued at \$400 and \$6,600 to members of the Board of Directors for attendance at meetings. These amounts were recorded as selling, general, and administrative expense. The Company did not issue any shares during the three months ended June 30, 2010.

## Note 6 – Notes Payable

During the six months ended June 30, 2010, the Company completed the sale of \$871,295 of Participation Interests ("Participation Interests") in a secured master promissory note ("Master Note") and five-year warrants to purchase 17,925,900 shares of common stock at an exercise price of \$0.05 per share to accredited private investors. The Master Note includes \$646,295 of interest and principal exchanged on February 4, 2010 from past due notes payable originated on May 29, 2009. A total of \$746,295 of the Participation Interests were originated on February 4, 2010, \$100,000 on May 18, 2010, and \$25,000 on June 30, 2010.

The net proceeds of this offering were used for working capital and general corporate purposes. Important terms of the Master Note include:

- The Master Note bears interest at the rate of 12% per annum, is payable December 31, 2010 ("Maturity Date") and can be pre-paid at any time. Accrued interest is payable in cash on the Maturity Date.
-

The Maturity Date of the Master Note may be extended by the Company for two 30-day periods. If the Company elects to extend the Maturity Date, the Company will pay a 5% Extension Fee at the conclusion of each such 30-day Extension Period, payable at the option of the Company in cash or the Company's common stock. If the Extension fee is paid in common stock, the common stock will be deemed to have a value per share equal to the greater of \$0.375 or the 10-day simple average of closing prices on the Over The Counter Bulletin Board ("OTCBB") for the 10 trading days preceding the date the payment is due.

- The Master Note is secured by all of the Company's cash and cash equivalents, accounts and notes receivable, prepaid assets, and equipment. The Master Note and Participation Interests will be convertible into equity securities on the following terms:

- If the Company closes a “Qualifying Next Equity Financing” before the Maturity Date, the then-outstanding balance of principal and accrued interest on the Master Note will automatically convert into shares of the “Next Equity Financing Securities” the Company issues. “Next Equity Financing Securities” means the type and class of equity securities that the Company sells in a Qualifying Next Equity Financing or a Non-Qualifying Next Equity Financing. If the Company sells a unit comprising a combination of equity securities, then the Next Equity Financing Securities shall be deemed to constitute that unit. Upon conversion, the Company would issue that number of shares of Next Equity Financing Securities equal the quotient obtained by dividing the then-outstanding balance of principal and accrued interest on the Master Note by the price per share of the Next Equity Financing Securities.
- If the Company closes a “Non-Qualifying Next Equity Financing” before the Maturity Date, the then-outstanding balance of principal and accrued interest represented by a Participation Interest can be converted, at the option and election of the investor, into shares of the “Next Equity Financing Securities” the Company issues.
- A “Qualifying Next Equity Financing” means the first bona fide equity financing (or series of related equity financing transactions) occurring subsequent to the date of issue of the Master Note in which the Company sells and issues any securities for total consideration totaling not less than \$2.0 million in the aggregate (including the principal balance and accrued but unpaid interest to be converted on all our outstanding Participation Interests in the Master Note) at a price per share for equivalent shares of common stock that is not greater than \$0.05 per share.
- A “Non-Qualifying Next Equity Financing” means that the Company completes a bona fide equity financing but fails to raise total consideration of at least \$2.0 million, or the price per share for equivalent shares of common stock is greater than \$0.05 per share.
- At any time prior to payment in full of this Note, an Investor may convert all, but not less than all, of such Investors interest in this Note (as represented by such Investor’s Participation Interest) into that number of shares of the Company’s common stock equal to (A) the principal balance plus accrued but unpaid interest hereunder due and payable to the investor in accordance with such Investor’s Participation Interest, divided by \$0.05.

The Investor Warrants have a term ending on the earlier to occur of (i) the fifth anniversary of the Investor Warrant issue date; or (ii) the closing of a change of control event. The Investor Warrants will have a cashless exercise feature and anti-dilution provisions that adjust both the exercise price and quantity if subsequent equity offerings are completed where the Company issues common stock at a lower effective price per share than the exercise price. The Investor Warrants were valued using the Black-Scholes option pricing model and the following assumptions:

#### Assumptions

Risk-free rate	1.79%-2.38%
Annual rate of dividends	0
Volatility	106.0%-110.8%
Average life	5 years

The fair value of the warrants, \$665,993, was classified as a discount on the notes payable issued during the six months ended June 30, 2010, and are classified as derivative liabilities due to their re-pricing provisions. The amount will be amortized over the life of the notes and \$174,354 and \$282,521 was amortized as finance expense during the three and six months ended June 30, 2010. See Note 9.

The fair value of the conversion feature of the notes payable, \$324,482, was also determined using Black-Scholes option pricing model and the following assumptions:



Assumptions

Risk-free rate	0.22%-0.33%
Annual rate of dividends	0
Volatility	105.5%-110.8%
Term of notes	6-11 months

The fair value of the conversion feature of the notes payable was recorded as a derivative liability due to the re-pricing provision and \$173,503 of the fair value was classified as a debt discount and will be amortized over the life of the notes. Amortization totaling \$45,294 and \$72,817 was charged as additional finance expense in the three and six months ended June 30, 2010 for the conversion feature option of the debt. The balance of the fair value of \$150,979 of the note conversion feature for those notes originated in February 2010 was recorded as an additional finance expense because the fair value of the conversion feature and the warrants exceeded the face value of the notes payable. See Note 9.

Pursuant to the terms of the Certificates of Designation of Preferences, Rights, and Limitations (the “Certificates”) of the Series A Convertible Preferred Stock, Series B Convertible Preferred Stock, and Series C Convertible Preferred Stock of the Company, the issuance of the convertible notes payable with \$0.05 conversion price in each instance during 2010 represents a Dilutive Issuance and adjusts the Conversion Shares of each class of Convertible Preferred Stock as follows:

- Series A changes from 4 shares common per one share of preferred to 6.5 shares common
- Series B changes from 2,000 shares common per one share of preferred to 3,234 shares common
- Series C changes from 2,000 shares common per one share of preferred to 3,234 shares common

The common share equivalents represented by the three Series of Convertible Preferred Stock as of June 30, 2010, therefore, increased as follows:

- Series A from 2,690,656 to 4,372,316
- Series B from 8,528,000 to 13,789,766
- Series C from 11,068,000 to 17,896,956

The fair value of the increased number of common shares resulting from the change in conversion rates of \$72,541 and \$665,404 was recorded as a deemed preferred dividend in the three months and six months ended June 30, 2010.

#### Note 7 - Stock Based Compensation

On January 1, 2006, the Company adopted, using the modified prospective application, ASC 718, “Compensation-Stock Compensation” (“ASC 718”), which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Under ASC 718, share-based payment awards result in a cost that will be measured at fair value on the awards’ grant date based on the estimated number of awards that are expected to vest. Compensation costs for awards that vest will not be reversed if the awards expire without being exercised.

Equity-based compensation expense is measured at the grant date, based on the fair value of the award, and is recognized over the vesting periods. The expenses are included in selling, general, and administrative or research and development expense depending on the grant recipient.

Under ASC 718, share-based payment awards result in a cost, measured at fair value on the awards’ grant date, based on the estimated number of awards that are expected to vest. Stock compensation expenses under ASC 718 were \$97,026 and \$201,028 during the three months ended June 30, 2010, and 2009 respectively. Of these totals, \$11,711 and \$44,981 was classified as research and development expense and \$85,315 and \$156,047 was classified as selling, general, and administrative expense for the three months ended June 30, 2010 and 2009, respectively. Stock compensation expenses under ASC 718 were \$221,234 and \$424,687 during the six months ended June 30, 2010 and 2009, respectively. Of these totals \$26,780 and \$90,593 were classified as research and development expense and \$194,454 and \$334,094 were classified as selling, general, and administrative expensed during the six months ended

June 30, 2010 and 2009, respectively.

The Company uses historical data to estimate option exercise and employee termination data within the valuation model and historical stock prices to estimate volatility. The fair value for options to purchase 785,000 and 150,000 shares issued during the six months ended June 30, 2010 and 2009, respectively, were estimated at the date of grant using a Black-Scholes option-pricing model to be \$27,299 and \$17,603, with the following weighted-average assumptions.

Assumptions	For the six months ended June 30,	
	2010	2009
Risk-free rate	1.44%	1.90%
Annual rate of dividends	0%	0%
Volatility	113.4%	107.8%
Average life	3.6 years	5 years

For the three months ended June 30, 2010 and 2009, respectively, the Company did not grant any stock options.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. The Company's employee stock options have characteristics significantly different from those of traded options, and changes in the subjective input assumptions can materially affect the fair value estimate.

A summary of option activity under the Company's 1991 Stock Option Plan and the Company's 2002 Equity Incentive Plan as of June 30, 2010 and changes during the six months then ended are presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Term (in years)
Outstanding January 1, 2010	6,894,700	\$ 0.67	
Granted	785,000	\$ 0.05	
Exercised	-	\$ -	
Terminated	-	\$ -	
Expired	(250)	\$ 4.70	
Forfeited	(904,750)	\$ 0.54	
Outstanding at June 30, 2010	6,774,700	\$ 0.63	6.6
Exercisable at June 30, 2010	4,772,528	\$ 0.72	5.8

The weighted-average grant-date fair values of options granted during the six months ended June 30, 2010 and 2009 were \$0.04 and \$0.12, respectively. No options were exercised during the six months ended June 30, 2010. The intrinsic value of the Company's stock options at June 30, 2010 is \$0.

As of June 30, 2010, there was \$281,463 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the 2002 Equity Incentive Plan. That cost is expected to be recognized over a weighted average period of 1.3 years.

At June 30, 2010, 18,126,800 options remain available for grant under the 2002 Equity Incentive Plan. No options are available to be issued under the 1991 Stock Option Plan.

On January 18, 2010, the Company granted options to purchase 785,000 shares of stock to six employees with an exercise price equal to the fair market value of the stock on that date. The shares vest on the one-year anniversary of the grant date.

#### Note 8 - Major Customers

Revenue from two customers and four customers comprised 95% and 91% of condensed consolidated revenues for the three and six months ended June 30, 2010, respectively. At June 30, 2010, related accounts receivable of \$9,313 from one of these customers comprised 73% of consolidated receivables.

Revenue from four customers comprised 91% and 92% of consolidated revenues for the three and six months ended June 30, 2009, respectively.



## Note 9 – Derivatives

In September 2008, the FASB finalized Update ASC 815-40, “Derivatives and Hedging”, “Contracts in an Entity’s Own Equity”. Under the update, instruments which do not have fixed settlement provisions are deemed to be derivative instruments. The warrants issued to a placement agent and investors in 2005 (“2005 Warrants”) do not have a fixed settlement provision because their exercise price may be lowered if the Company issues securities at lower prices in the future. Also, convertible notes and warrants issued to investors in a private placement of convertible notes and warrants on May 29, 2009 (“2009 Warrants”) do not contain a fixed settlement provision. (See Note 6). In accordance with the update, 2005 Warrants were re-characterized as derivative liabilities in 2009 and the 2009 Warrants were classified as derivative liabilities. The update requires that the fair value of these liabilities be re-measured at the end of every reporting period with the change in value reported in the statement of operations.

In February 2010, in accordance with the anti-dilution provisions of the 2005 Warrants to purchase 1,233,691 shares of common stock, warrant holders had the exercise prices of the warrants adjusted from \$0.375 per share to \$0.05 per share. Also, in accordance with the anti-dilution provisions of certain warrants to purchase 2,998,667 shares of common stock that were issued on May 29, 2009, warrants to purchase an additional 19,491,336 shares of common stock were issued to these holders and their exercise prices were adjusted from \$0.375 to \$0.05 per share. A finance expense charge of \$17,168 was recorded on that date to reflect the fair value of the exercise price adjustments to the 2005 Warrants. A finance expense charge of \$788,812 was recorded on that date to reflect the fair value of the quantity and exercise price adjustments to the 2009 Warrants. In conjunction with the notes payable issued during the six months ended June 30, 2010, the Company issued warrants to purchase 17,425,900 shares of common stock with an exercise price of \$0.05 (“2010 Warrants”). The exercise price of these warrants adjusts downward if the Company issues any future convertible debt or equity instruments with exercise prices lower than \$0.05 (See Note 6).

The embedded conversion feature of the notes payable issued by the Company in during the six months ended June 30, 2010 is classified as a short-term derivative liability due to the re-pricing mechanism in the note terms and the December 31, 2010 due date of the notes.

The Derivative Warrants and Notes Payable conversion features were valued using the Black-Scholes option pricing model and the following assumptions:

	June 30, 2010	Dec. 31, 2009
<b>2005 Warrants:</b>		
Risk-free rate	0.17%	0.20%
Annual rate of dividends	0	0
Volatility	106.0%	113.4%
Weighted Average life (years)	0.08	0.5
<b>2009 Warrants:</b>		
Risk-free rate	1.79%	2.69%
Annual rate of dividends	0	0
Volatility	106.0%	113.4%
Weighted Average life (years)	3.9	4.4
<b>2010 Warrants:</b>		
Risk-free rate	1.79%	-
Annual rate of dividends	0	-
Volatility	106.0%	-

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Weighted Average life (years)	4.6-5.0	-
2010 Convertible Notes Payable		
Risk-free rate	0.22%	-
Annual rate of dividends	0	-
Volatility	106.0%	-
Weighted Average life (years)	0.5	-
Total Fair Value	\$ 861,030	\$ 136,749

ASC 815-40 was implemented in the first quarter of 2009 and is reported as the cumulative effect of a change in accounting principles. At January 1, 2009, the cumulative effect on the accounting for the warrants was recorded as decrease in additional accumulated deficit by \$1,599,708. The difference was recorded as derivative liability for \$110,663. At June 30, 2009, the derivative liabilities associated with the Placement Agent and 2005 Warrants were revalued, the \$66,763 increase in the derivative liability at June 30, 2009 is included as other expense in the Company's condensed consolidated statement of operations for the three months ended June 30, 2009. The fair value of the 2009 Warrants was estimated at \$450,770 at the date of issuance and this amount was classified as a derivative liability and as a discount on the notes payable issued on that date. This amount will be amortized over the life of the convertible notes and \$80,408 was amortized as a financing expense during the six months June 30, 2009. The 2009 Warrants were revalued as of June 30, 2009 and the \$93,943 increase in the value of the derivative liability is included as other expense in the Company's condensed consolidated statement of operations for the three months ended June 30, 2009.

At June 30, 2010, the derivative liabilities associated with the 2005 Warrants, 2009 Warrants, 2010 Warrants and the conversion feature of the notes payable were revalued, and the \$1,375,601 decrease in the derivative liability at June 30, 2010 is included as other income in the Company's condensed consolidated statement of operations for the three months ended June 30, 2010. The decrease in value during the three and six months ended June 30, 2010 was primarily due to the decline in the Company's stock price to \$0.02 at June 30, 2010, as well as the expiration of certain warrants and the shorter remaining term of the warrants and note payable at that date.

#### Note 10 - Fair Value Measurement

##### Valuation Hierarchy

ASC 820 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on the Company's own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of June 30, 2010:

	Total Carrying Value at June 30, 2010	Fair Value Measurements at June 30, 2010		
		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Derivative liabilities	\$ 861,030	\$ -	\$ -	\$ 861,030

The derivative liabilities are measured at fair value using quoted market prices and estimated volatility factors based on historical quoted market prices for the Company's common stock, and are classified within Level 3 of the valuation hierarchy.



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The following table sets forth a summary of the changes in the fair value of our Level 3 financial liabilities that are measured at fair value on a recurring basis:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Beginning balance	\$ (2,143,430)	\$ (51,463)	\$ (136,749)	\$ (110,663)
Net unrealized gain/(loss) on derivative financial instruments	1,375,601	(160,706)	1,072,175	(101,506)
New derivative liabilities issued	(93,201)	(450,770)	(1,796,456)	(450,770)
Ending balance	\$ (861,030)	\$ (662,939)	\$ (861,030)	\$ (662,939)

## Note 11 – Subsequent Events

The Company issued an additional \$25,000 convertible note payable and warrants to purchase 500,000 shares of common stock with an exercise price of \$0.05 per share on August 19, 2010. Pursuant to the terms of the Certificates of the Series A Convertible Preferred Stock, Series B Convertible Preferred Stock, and Series C Convertible Preferred Stock of the Company, the issuance of the convertible notes payable with \$0.05 conversion price represents a Dilutive Issuance and adjusts the Conversion Shares of each class of Convertible Preferred Stock as follows:

- Series A changes from 6.5 shares common per one share of preferred to 6.54 shares common
- Series B changes from 3,234 shares common per one share of preferred to 3,270 shares common
- Series C changes from 3,234 shares common per one share of preferred to 3,270 shares common

The common share equivalents represented by the three Series of Convertible Preferred Stock as of June 30, 2010, therefore, increased as follows:

- Series A from 4,372,316 to 4,399,223
- Series B from 13,789,766 to 13,943,280
- Series C from 17,896,956 to 18,096,180

The fair value of the increased number of common shares resulting from the change in conversion rates of approximately \$8,000 will be recorded as a deemed preferred dividend in the three and nine months ended September 30, 2010.

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

The following discussion highlights the material factors affecting our results of operations and the significant changes in the balance sheet items. The notes to our condensed consolidated financial statements included in this report and the notes to our consolidated financial statements included in our Form 10-K for the year ended December 31, 2009 should be read in conjunction with this discussion and our consolidated financial statements.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We prepare our unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- **Revenue recognition.** We follow the guidance of the ASC 605-10-599 which provides for revenue to be recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery or installation has been completed, (iii) the customer accepts and verifies receipt, and (iv) collectability is reasonably assured. Certain judgments affect the application of its revenue policy. Revenue consists of the sale of device control software and related maintenance contracts on these systems. Revenue on the sale of hardware is recognized upon shipment. The Company generally recognizes revenue from Device Manager™ software sales upon shipment as it sells the product to audiovisual integrators, net of estimated returns and discounts. Revenue on maintenance contracts is recognized over the term of the related contract.

- Capitalized software development costs. Our policy on capitalized software development costs determines the timing of our recognition of certain development costs. In addition, this policy determines whether the cost is classified as development expense or is capitalized. Software development costs incurred after technological feasibility has been established are capitalized and amortized, commencing with product release, using the greater of the income forecast method or on a straight-line basis over the useful life of the product. Management is required to use professional judgment in determining whether research and development costs meet the criteria for immediate expense or capitalization. We did not capitalize any software and research and development costs during either 2010 or 2009 and all assets were fully amortized by December 31, 2006. Our research and development efforts during 2009 and 2010 primarily involved product improvements to our Device Manager and Video Visitation products to improve their functionality and ease of use for end users.

•**Derivative Financial Instruments.** We do not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks and we evaluate all of our financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the condensed consolidated statements of operations. For stock-based derivative financial instruments, we use the Black-Scholes option pricing model to value the derivative instruments at inception and on subsequent valuation dates. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on the term of the underlying derivative instrument. See Note 9 to our condensed consolidated financial statements.

## FINANCIAL CONDITION

During the six months ended June 30, 2010, total current assets decreased approximately 23% to \$71,846 from \$93,049 at December 31, 2009. The decrease in assets was primarily due to the approximately \$248,000 of cash used to fund operations during the period.

Total liabilities increased \$642,741 during the six months ended June 30, 2010 due primarily to the issuance of convertible notes payable and warrants during the current year classified as derivative liabilities due to their repricing provisions, as well as past due accounts payable for office rent and professional services.

See Note 2 to the unaudited condensed consolidated financial statements regarding the Company's going concern uncertainty.

The Company does not have any material off-balance sheet arrangements.

## RESULTS OF OPERATIONS

Three Months Ended June 30, 2010 and 2009

### Revenues

Revenues were \$58,397 and \$20,103 for the three months ended June 30, 2010 and 2009, respectively. The increased revenues of \$38,294 during the current year were due primarily to higher service revenues. Current period revenues represent a significant decrease compared to the three months ended March 31, 2010 and we have taken additional steps to decrease our cash used from operating activities. The effects of inflation and changing prices on revenues and loss from operations during the periods presented have been de minimus. Due to our small customer base, we face the risk of fluctuating revenues should any of our customers discontinue using our products.

### Cost of Revenues and Gross Profit

Cost of revenues increased \$19,807, or 222%, for the three months ended June 30, 2010 compared to the three months ended June 30, 2007 due primarily to higher service revenues during the current year.

Gross margins were approximately 56% and 69% for each of the three months ended June 30, 2010 and 2009, respectively. The lower margins during the current period are due to the higher mix of lower margin service sales during the current period.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses were \$258,444 and \$595,628 for the three months ended June 30, 2010 and 2009, respectively. The decrease in the expenses for three-month period ended June 30, 2010 resulted primarily from a decrease in headcount which occurred during the second half of 2009 and first quarter of 2010, as well as reduced salaries for certain personnel in order to reduce cash used from operations. These ongoing efforts to reduce cash used from operations have reduced cash usage significantly, but have not resulted in positive cash flow from operations, and we require additional fundraising to fund operations. Decreased stock-based compensation of approximately \$71,000 was due to lower stock option fair values for grants made to employees during the current period, as well as decreases in the number of options that vested during the period due to full vesting of prior grants.

During the three months ended June 30, 2010 and 2009, respectively, stock-based compensation of \$85,315 and \$156,047 was included in selling, general, and administrative expense to record the amortization of the estimated fair value of the portion of previously granted stock options that vested during the current period.

#### Research and Development Expenses

Research and development costs were \$69,367 and \$289,008 for the three months ended June 30, 2010 and 2009, respectively. The reduction in expenses is due primarily to reduced headcount, lower stock-based compensation, and lower overhead and outside development costs due to attempts to reduce cash flow used by operations. During the three months ended June 30, 2010 and 2009, we did not capitalize any software development costs related to new products under development as our research and development efforts during 2009 and 2010 primarily involved product improvements to our Device Manager™ and Video Visitation products to improve their functionality and ease of use for end users.

During the three months ended June 30, 2010 and 2009, respectively, stock-based compensation of \$11,711 and \$44,981 was included in research and development expense to record the amortization of the estimated fair value of the portion of previously granted stock options that vested during the current period. The lower stock-based compensation resulted primarily from the lower number of options that vested during the period and the lower fair value of grants made during the three months ended March 31, 2010.

#### Other Income/(Expense)

Other income of \$1,137,482 for the three months ended June 30, 2010 consisted primarily of \$1,375,601 to record to record the gain on derivative liabilities during the current period for the decrease in estimated fair value of warrants and the conversion feature of our notes payable. The decrease in value resulted primarily from a decrease in our stock price from March 31, 2010, the expiration of certain warrants during the period, the shorter remaining outstanding term of the warrants and notes, and the decrease in interest rates during the period. Additionally, we recorded \$219,648 expense to record amortization of the fair value of the warrants granted to noteholders as part of the convertible notes we issued in during the current year. See notes 6 and 10 to our condensed consolidated financial statements.

Other expense of \$255,243 during the three months ended June 30, 2009 consisted primarily of a \$160,706 loss on our derivative liabilities during the period as well as \$80,408 to record amortization of the fair value of warrants issued to noteholders in our May 29, 2009 private placement of convertible notes payable and warrants. The loss on derivative liabilities during the period was due primarily to the increase in our stock price from \$0.16 at March 31, 2009 to \$0.28 at June 30, 2009 as well as to the issuance of warrants to purchase 2,998,667 shares of common stock issued in the May 29, 2009 private placement.

#### Net Income and Net Income Attributable to Common Stockholders

Net income for the three months ended June 30, 2010 was \$842,115 compared to a net loss of \$1,125,923 for the three months ended June 30, 2009. The net income resulted primarily to the gain on derivative liabilities due to the decrease in our stock price and shorter remaining terms for our warrants and notes payable. Our lower operating loss of approximately \$575,000 during the current period resulted primarily from lower operating expenses were due to efforts to use less cash from operating activities. Net income attributable to common stockholders of \$731,074 during the three months ended June 30, 2010 and net loss attributable to common stockholders of \$1,485,261 for the three months ended June 30, 2009 included \$38,500 and \$359,338 to record the value of common stock dividends paid on June 30, 2010 and 2009, respectively, to Series A, Series B, and Series C Convertible Preferred Stock holders. See note 7 to the condensed consolidated financial statements.

Net income attributable to common shareholders included a charge of \$72,541 for the three months ended June 30, 2010 to record the increased fair value of the conversion feature of the preferred stock resulting from the change in the conversion rate of our convertible preferred stock as a result of our additional financings received in May and June 2010.

Six Months Ended June 30, 2010 and 2009

Revenues

Revenues were \$150,616 and \$271,389 for the six months ended June 30, 2010 and 2009, respectively. The 45% decrease in revenues earned during the six months ended June 30, 2010 were primarily due to Curiax Arraigner and Curiax Court Recording software and hardware revenues in conjunction with a sale at one county in 2009 and two larger installations in the education market. Both sales involved significant amounts of lower margin hardware. The effects of inflation and changing prices on revenues and loss from operations during the periods presented have been de minimus. Due to our small customer base, we face the risk of fluctuating revenues should any of our customers discontinue using our products.

Cost of Revenues and Gross Profit

Cost of revenues decreased \$71,924, or 63%, for the six months ended June 30, 2010 compared to the six months ended June 30, 2009 due primarily to lower current year revenues and hardware costs associated with the Curiax Arraigner and Court Recording sales above as these sales involved a higher mix of hardware revenues.

Gross margins were approximately 72% and 58% for the six months ended June 30, 2010 and 2009, respectively.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses were \$596,288 and \$1,374,278 for the six months ended June 30, 2010 and 2009, respectively. The 57% decrease in the expenses for six month period ended June 30, 2010 resulted primarily from a decrease in headcount which occurred during the second half of 2009 and first half of 2010, as well as reduced salaries for certain personnel in order to reduce cash used from operations. These ongoing efforts to reduce cash used from operations have reduced cash usage significantly, but have not resulted in positive cash flow from operations, and we require additional fundraising to fund operations. Decreased stock-based compensation of approximately \$140,000 was due to lower stock option fair values for grants made to employees during the current period, as well as decreases in the number of options that vested during the period due to full vesting of prior grants.

Research and Development Expenses

Research and development expenses were \$171,468 and \$600,873 for the six months ended June 30, 2010 and 2009, respectively. During the three months ended June 30, 2010 and 2009, we did not capitalize any software development costs related to new products under development as our research and development efforts during 2009 and 2010 primarily involved product improvements to our Device Manager<sup>TM</sup> and Video Visitation products to improve their functionality and ease of use for end users.

The 71% decrease in expense during the current period resulted primarily from lower salaries and taxes of approximately \$301,000 due to personnel reductions, as well as lower stock-based compensation of approximately \$64,000 due to the lower number of options that vested during the period and the lower fair value of grants made during the three months ended March 31, 2010. Also, in order to reduce cash used from operations, we have discontinued the use of outsourced software development services, for which we incurred approximately \$17,000 in the six months ended June 30, 2009.

Other Income/(Expense)



Other expense of \$281,520 for the six months ended June 30, 2010 consisted primarily of \$956,960 to record the finance expense associated with the issuance of certain warrants in conjunction with the February 2010 financing as well as the excess of the fair value of the warrants and the conversion feature of the notes payable versus the actual proceeds received from the offering. Additionally, we recorded \$355,339 expense to record amortization of the fair value of the warrants granted to noteholders as part of the convertible notes we issued in February and May 2010, and \$1,072,175 to record the gain on derivative liabilities during the current period for the decrease in estimated fair value of warrants and the conversion feature of our notes payable. The value of the derivative liabilities decreased significantly at June 30, 2010 due to the decrease in our stock price, expiration of certain warrants, and shorter remaining outstanding, terms and lower interest rates at that date. See notes 6 and 10 to our condensed consolidated financial statements.

Other expense during the six months ended June 30, 2009 of \$190,478 consisted primarily of a loss of \$101,506 recorded on our derivative liabilities as well as \$80,408 recorded to amortize the fair value of warrants issued to convertible noteholders in a financing transaction on May 29, 2009.

## Net Loss and Net Loss Attributable to Common Stockholders

Net loss for the six months ended June 30, 2010 was \$941,152 compared to a net loss of \$2,008,656 for the six months ended June 30, 2009. The lower loss during the current period was due primarily to our reductions in expenses to reduce cash used from operations. Net loss attributable to common shareholders included a charge of \$665,404 to record the increased fair value of the conversion feature of the preferred stock resulting from the changes in the conversion rate of our convertible preferred stock as a result of our 2010 financings.

Net loss attributable to common stockholders of \$2,367,994 for the six months ended June 30, 2009 included \$359,338 to record the value of common stock dividends paid to Series A, B, and C Convertible Preferred Stock holders on June 30, 2009. See note 7 to the condensed consolidated financial statements.

## LIQUIDITY AND CAPITAL RESOURCES

### General

Due to a net loss during the six months ended June 30, 2010 of \$941,152, cash used in operating activities amounted to \$248,033 during the six months ended June 30, 2010, and an accumulated deficit of \$82.4 million at June 30, 2010, and our inability to date to obtain sufficient financing to support current and anticipated levels of operations, there is a substantial doubt about the Company's ability to continue as a going concern. Our revenues since inception have not provided sufficient cash to fund our operations.

Our cash used by operations decreased during 2010 primarily due to measures we undertook including terminating employees and reducing the salaries of all employees by 50% effective August 14, 2009. Certain personnel have had their salaries returned to their original levels, but until we significantly increase revenues, we anticipate that we will continue to operate with minimal headcount and reduced salaries for certain employees.

Historically, we have relied on private placement issuances of equity and debt. We need to raise additional working capital during third quarter 2010 to fund our ongoing operations. We have commenced efforts to raise additional capital through a private placement of debt securities and warrants. No assurance can be given that we will be successful in raising this capital. If we successfully raise additional capital through the issuance of debt, this will increase our interest expense and the warrants will dilute our existing shareholders. If we are not successful in raising this capital, we may not be able to continue as a going concern. In that event, we may be forced to cease operations and our stockholders could lose their entire investment in our company.

As of June 30, 2010, we had cash of \$24,766. We currently require substantial amounts of capital to fund current operations and the continued development and deployment of our Device Manager<sup>TM</sup> product line. This additional funding could be in the form of the sale of assets, debt, equity, or a combination of these financing methods. However, there can be no assurance that we will be able to obtain such financing if and when needed, or that if obtained, such financing will be sufficient or on terms and conditions acceptable to us. If we are unable to obtain this additional funding, our business, financial condition and results of operations would be adversely affected. As with our note issuance for approximately \$871,000 during 2010 (\$225,000 new notes issuance and approximately \$646,000 of note principal and interest contributed from our May 2009 financing), such financings may trigger certain anti-dilution provisions of existing warrants and our convertible preferred stock and be dilutive to existing common shareholders. See notes 6 and 10 to our condensed consolidated financial statements.

We used \$248,033 in cash from operating activities during the six months ended June 30, 2010 due primarily to our net loss from operations during the period of \$659,632. During the six months ended June 30, 2010 and 2009, respectively, we used \$1,103 and \$18,267 in investing activities primarily to purchase new computer equipment. In

the six months ended June 30, 2010, we utilized \$30,306 from our certificate of deposit to pay certain past due rent obligations as the certificate of deposit collateralized a standby letter of credit with our landlord. The standby letter of credit has now been drawn to zero balance and all proceeds from the certificate of deposit have been received as of June 30, 2010.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying condensed consolidated balance sheet is dependent upon our continued operations, which in turn is dependent upon our ability to meet our financing requirements on a continuing basis and attract additional financing. The unaudited condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should we be unable to continue in existence.

## FORWARD-LOOKING STATEMENTS

Certain statements contained herein are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, such as statements relating to financial results and plans for future sales and business development activities, and are thus prospective. Such forward-looking statements are subject to risks, uncertainties and other factors, which could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Potential risks and uncertainties include, but are not limited to, economic conditions, competition, our ability to complete the development of and market our new Device Manager product line and other uncertainties detailed from time to time in our Securities and Exchange Commission (“the SEC”) filings, including our Annual Report on Form 10-K and our quarterly reports on Form 10-Q.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required as we are a Smaller Reporting Company.

## ITEM 4T. CONTROLS AND PROCEDURES

Our management, including the Company’s Chief Executive Officer and Chief Financial Officer, evaluated as of June 30, 2010, the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

### Changes in Internal Control Over Financial Reporting

There have been no significant changes in internal controls over financial reporting that occurred during the quarter ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Part II – OTHER INFORMATION

## ITEM 6. EXHIBITS

The following exhibits are filed with or incorporated by reference into this report. The exhibits which are denominated by an asterisk (\*) were previously filed as a part of, and are hereby incorporated by reference from either (i) the Post-Effective Amendment No. 1 to the Company's Registration Statement on Form S-18 (File No. 33-27040-D) (referred to as “S-18 No. 1”) or (ii) ) the Company’s Annual Report on Form 10-KSB for the year ended December 31, 2006 (referred to as “2006 10-KSB”).

Exhibit No.	Description
3.1*	Certificate of Incorporation as amended through March 8, 2007 (2006 10-KSB)
3.2*	Amended Bylaws of the Company as presently in use (S-18 No. 1, Exhibit 3.2)

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- 10.9\* Triton Business Development Services Engagement Agreement dated January 31, 2007 (2006 10-KSB)
- 31.1 Certification of the Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a).
- 31.2 Certification of the Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a).
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

SIMTROL, INC.

Date: August 23, 2010

/s/ Oliver M. Cooper III  
Chief Executive Officer  
(Principal executive officer)

/s/ Stephen N. Samp  
Chief Financial Officer  
(Principal financial and accounting officer)

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