

Digitiliti Inc
Form 10-Q
August 22, 2011
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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 June 30, 2011

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 No. 000-53235

DIGITILITI, INC.

(Exact name of Registrant as specified in its charter)

Delaware

26-1408538

(State or Other Jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

266 East 7th Street, 4th Floor
St. Paul, Minnesota 55101

(Address of Principal Executive Offices)
(651) 925-3200

(Registrant's telephone number, including area code)
N/A

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

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
		(Do not check if 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

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As of August 22, 2011, the Registrant had 68,846,307 shares of common stock issued and outstanding at \$.001 per share par value.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

DIGITILITI, INC.
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	June 30, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS		
Cash	\$206,915	\$27,557
Restricted cash	50,000	—
Accounts receivable	408,671	333,687
Prepaid and other current assets	258,567	247,970
Total current assets	924,153	609,214
Property and equipment, net	99,773	158,105
Software license, net	299,692	436,608
Deferred financing costs	125,865	4,466
Other assets	6,322	6,322
Total assets	\$1,455,805	\$1,214,715
LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$672,739	\$692,923
Accrued expenses	693,313	554,978
Deferred income	9,989	9,989
Notes payable, net of unamortized discount of \$1,289 and \$0	48,711	231,540
Note payable — related party	66,000	—
Current maturities of convertible debt, net of unamortized discounts of \$434 and \$0	589,566	782,941
Current maturities of capital lease obligations	—	23,308
Total current liabilities	2,080,318	2,295,679
Convertible debt, non-current, net of unamortized discounts of \$524,714 and \$0	1,276,414	250,000
Other liabilities	3,607	3,607
Total liabilities	3,360,339	2,549,286
STOCKHOLDERS' DEFICIT		
Series A Convertible Preferred Stock, \$0.001 par value; 1,200,000 shares authorized for Series A, 668,720 and 724,187 shares issued and outstanding	669	724
Series B Convertible Preferred Stock, \$1.00 par value; 2,000,000 shares authorized for Series B, 420,000 shares issued and outstanding	420,000	420,000
Common stock, \$.001 par value; 125,000,000 shares authorized, 68,846,307 and 68,209,298 shares issued and outstanding	68,846	65,700
Additional paid-in capital	25,565,098	24,409,477
Accumulated deficit	(27,959,147)	(26,230,472)
Total stockholders' deficit	(1,904,534)	(1,334,571)
Total liabilities and stockholders' deficit	\$1,455,805	\$1,214,715
See accompanying notes to unaudited consolidated financial statements.		

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DIGITILITI, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2011	2010	2011	2010
REVENUES	\$481,714	\$539,007	\$892,743	\$1,164,134
COST OF REVENUES	(361,272)	(378,397)	(880,331)	(680,368)
GROSS PROFIT (LOSS)	120,442	160,610	12,412	483,766
OPERATING EXPENSES				
Selling and marketing	95,981	201,285	239,046	376,578
General and administrative	540,468	1,117,976	904,043	1,615,979
Research and development	131,289	262,241	279,142	531,983
Total Operating Expenses	767,738	1,581,502	1,422,231	2,524,540
LOSS FROM OPERATIONS	(647,296)	(1,420,892)	(1,409,819)	(2,040,774)
OTHER EXPENSES				
Loss on extinguishment of debt	—	318,294	71,634	318,294
Interest expense	171,695	1,879,849	247,222	2,107,979
Total other expenses	171,695	2,198,143	318,856	2,426,273
NET LOSS	\$(818,991)	\$(3,619,035)	\$(1,728,675)	\$(4,467,047)
NET LOSS PER SHARE — BASIC AND DILUTED	\$(0.01)	\$(0.08)	\$(0.03)	\$(0.10)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING — BASIC AND DILUTED	67,780,394	45,663,981	67,273,030	43,503,332

See accompanying notes to unaudited consolidated financial statements.

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DIGITILITI, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six months ended	
	June 30,	
	2011	2010
OPERATING ACTIVITIES		
Net loss	\$(1,728,675)	\$(4,467,047)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	63,202	166,868
Amortization of software license	136,916	149,332
Beneficial conversion feature on converted notes	—	1,478,707
Amortization of deferred financing costs	33,586	36,849
Amortization of debt discounts	96,023	317,205
Loss on extinguishment of debt	71,634	318,294
Warrant expense	49,548	387,959
Common shares issued for services	67,528	113,495
Employee stock option expense	227,041	147,085
Changes in operating assets and liabilities:		
Accounts receivable	(74,984) 52,641
Prepaid and other current assets	(10,597) 63,039
Accounts payable	12,292	75,928
Accounts payable — related parties	—	(7,861)
Accrued expenses	218,576	291,325
Deferred income	—	10,722
Deferred rent	(764) (4,792)
Net cash used in operating activities	(838,674) (870,251)
INVESTING ACTIVITIES		
Restricted cash	(50,000) —
Purchase of property and equipment	(4,870) (40,596)
Purchase of software license	—	(5,538)
Net cash used in investing activities	(54,870) (46,134)
FINANCING ACTIVITIES		
Proceeds from notes payable	50,000	—
Cash paid for debt issuance costs	(11,250) —
Proceeds from sale of common stock, net of issuance costs	63,000	1,214,050
Proceeds from exercise of warrants	—	500,900
Payments on capital lease obligations	(23,308) (24,939)
Proceeds from notes payable — related parties	66,000	—
Proceeds from convertible debt	1,310,000	—
Payments on notes payable	(231,540) (364,572)
Payments on convertible debt	(150,000) (95,000)
Net cash provided by financing activities	1,072,902	1,230,439

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NET INCREASE IN CASH	179,358	314,054
Cash at beginning of year	27,557	141,086
Cash at end of year	\$206,915	\$455,140
SUPPLEMENTAL CASH FLOWS INFORMATION		
Cash paid for interest	\$30,316	\$56,842
Cash paid for income taxes	—	—
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Convertible debt issued for debt issuance costs	64,000	—
Warrants issued for debt issuance costs	79,735	—
Accrued interest converted to convertible debt	8,844	—
Debt discount due to warrants issued with debt	370,388	—
Debt discount due to beneficial conversion feature	126,729	—
Common stock issued for the conversion of Series A preferred stock	277	—
Common stock issued for debt and accrued interest	103,109	3,167,833
Preferred stock issued for accrued interest	—	723,895
Common stock issued for liabilities	—	12,879
Notes payable issued for maintenance fees	—	56,634
Accrued interest converted to debt principal	—	21,107

See accompanying notes to unaudited consolidated financial statements.

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DIGITILITI, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

The accompanying unaudited interim consolidated financial statements of Digitiliti, Inc. (the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and with the instructions to Form 10-Q and Article 8 of Regulation S-X under the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes included in the Company’s Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission (“SEC”) on April 14, 2011. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

Software Revenue Recognition

The Company derives its revenue from sales of its products and services. Product revenue is derived from sales of the Company’s DigiBak and DigiLibe service.

The DigiBak service provides an offsite storage solution through a “utility based computing philosophy” where customers pay for the gigabytes of data they store in the DigiBak vault.

The DigiLibe service is a multiple element software sales arrangement that is comprised of three key components that act as one: Client Agent, Information Director, and Archive Information Store.

For multiple element software license sales arrangements that do not require significant modification or customization of the underlying software, we recognize revenue when: (1) we enter into a legally binding software arrangement with a customer for the license of software, (2) we deliver the software, (3) price is deemed fixed or determinable and free of contingencies of significant uncertainties and (4) collection is probable.

For sales arrangements with multiple elements, we defer revenue for any undelivered elements, and recognize revenue when the product is delivered or over the periods in which the service is performed. If we cannot objectively determine the fair value of any undelivered element included in bundled arrangements, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

Restricted Cash

The restricted cash of \$50,000 as of June 30, 2011 represents funds held in escrow to be released upon the closing of the second tranche of the \$1,500,000 Junior Secured Convertible Debt Offering (see Note 4).

Correction of a Prior Period

During the year ended December 31, 2010, the Company discovered and corrected an error related to options granted to an employee that were inadvertently omitted from the Company’s employee stock option expense from April 2008 through September 30, 2010. The error resulted in an understatement in stock compensation expense and additional

paid in capital. In accordance with the SEC's Staff Accounting Bulletin Nos. 99 and 108 (SAB 99 and SAB 108), the Company evaluated this error and, based on an analysis of quantitative and qualitative factors, determined that the error was immaterial to each of the prior reporting periods affected. However, if the adjustments to correct the cumulative effect of the above error had been recorded in the year ended December 31, 2010, the Company believes the impact would have been significant and would impact comparisons to prior periods. Therefore, as permitted by SAB 108, the Company corrected, in the current filing, previously reported results for the three and six months ended June 30, 2010.

The following table shows the impact of the error to the unaudited Consolidated Statements of Operations for the three and six months ended June 30, 2010:

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	Three Months Ended June 30, 2010		
	As		
	Previously Reported	Adjustments	As Revised
General and administrative	\$1,078,605	\$39,371	\$1,117,976
Total operating expenses	1,542,131	39,371	1,581,502
Net loss from operations	(1,381,521)	(39,371)	(1,420,892)
Net loss	\$(3,579,664)	\$(39,371)	\$(3,619,035)
Net loss per share — Basic and Diluted	\$(0.08)	\$—	\$(0.08)
Weighted average shares outstanding — Basic and Diluted	45,663,981	—	45,663,981
	Six Months Ended June 30, 2010		
	As		
	Previously Reported	Adjustments	As Revised
General and administrative	\$1,537,236	\$78,743	\$1,615,979
Total operating expenses	2,445,797	78,743	2,524,540
Net loss from operations	(1,962,031)	(78,743)	(2,040,774)
Net loss	\$(4,388,304)	\$(78,743)	\$(4,467,047)
Net loss per share — Basic and Diluted	\$(0.10)	\$—	\$(0.10)
Weighted average shares outstanding — Basic and Diluted	43,503,332		