

SMART ONLINE INC
Form 10-Q/A
November 22, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

**FORM 10-Q/A
(Amendment No.1)**

(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, 2005

OR

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

Commission File Number: 333-119385

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

Delaware
**(State of other jurisdiction of
incorporation or organization)**

95-4439334
**(IRS Employer
Identification No.)**

2530 Meridian Parkway, 2nd Floor
Durham, North Carolina 27713
(Address of principal executive offices)

(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 is an accelerated filer (as described in Rule 12b-2 of the Securities Exchange Act of 1934). Yes [] No [X]

As of June 30, 2005, there were approximately 12,498,435 million shares of the Registrant's Common Stock outstanding.

Smart Online, Inc.

INDEX

PART I. FINANCIAL INFORMATION

| | Page No. |
|---|-----------------|
| Item 1. Financial Statements: | 3 |
| Balance Sheets as of June 30, 2005 (unaudited) and December 31, 2004 | 3 |
| Statements of Operations (unaudited) for the three months and six months ended June 30, 2005 and 2004 | 4 |
| Statements of Cash Flows (unaudited) for the three months and six months ended June 30, 2005 and 2004 | 5 |
| Notes to Financial Statements (unaudited) | 6 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (including Risk Factors) | 16 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 50 |
| Item 4. Controls and Procedures | 50 |

PART II. OTHER INFORMATION

| | |
|--|----|
| Item 1. Legal Proceedings | 50 |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | 51 |
| Item 3. Defaults Upon Senior Executives | 51 |
| Item 4. Submission of Matters to a Vote of Securities Holders | 51 |
| Item 5. Other Information | 51 |
| Item 6. Exhibits | 51 |
| Signatures | 52 |

EXPLANATORY NOTE

The purpose of this Amendment No. 1 to Quarterly Report on Form 10-Q/A is to restate the unaudited financial statements of Smart Online, Inc. (the "Company") for the quarter ended June 30, 2005, filed with the Securities and Exchange Commission ("SEC") on August 15, 2005 to correct the accounting treatment of certain warrants. As originally filed in its Form 10-Q, Smart Online incorrectly reported \$506,000 of expense associated with certain warrants issued during 2003. Since these warrants were part of permanent equity, Smart Online should not have applied the mark to market provisions of Emerging Issues Task Force (EITF) 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company's Own Stock*. The Items which are amended and restated herein are:

1. Part I, Item 1 - Financial Statements (including applicable footnotes);
2. Part I, Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations (including Risk Factors); and
3. Part II, Item 6 - Exhibits

Except as otherwise expressly noted herein, this Amendment No. 1 to Quarterly Report on Form 10-Q/A does not reflect events occurring after the August 15, 2005 filing of our Quarterly Report on Form 10-Q in any way, except as those required to reflect the effects of this restatement of our financial statements for the periods presented, as deemed necessary in connection with the completion of restated financial statements.

The remaining Items contained within this Amendment No. 1 to our Quarterly Report on Form 10-Q/A consist of all other Items originally contained in our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005 in the form filed with the SEC on August 15, 2005. These remaining Items are not amended hereby, but are included for the convenience of the reader. In order to preserve the nature and character of the disclosures set forth in such Items as originally filed, except as expressly noted herein, this report continues to speak as of the date of the original filing, and we have not updated the disclosures in this report to speak as of a later date. While this report primarily relates to the historical periods covered, events may have taken place since the original filing that might have been reflected in this report if they had taken place prior to the original filing.

PART I. FINANCIAL INFORMATION**Item 1. FINANCIAL STATEMENTS****Smart Online, Inc.
Balance Sheets**

| | June 30, 2005 (Unaudited) (Restated) | December 31, 2004 |
|--|---|----------------------------------|
| Assets | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 552,407 | \$ 173,339 |
| Marketable securities | - | 395,000 |
| Accounts receivable, net | 30,706 | 30,904 |
| Other accounts receivable | - | 43,455 |
| Prepaid expenses | 259,739 | 24,850 |
| Total current assets | 842,852 | 667,548 |
| PROPERTY AND EQUIPMENT, net | 141,600 | 75,636 |
| INTANGIBLE ASSETS, net | 15,394 | 16,623 |
| OTHER ASSETS | 13,540 | 13,894 |
| TOTAL ASSETS | \$ 1,013,386 | \$ 773,701 |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 190,283 | \$ 186,382 |
| Accrued payroll | 160,088 | 110,079 |
| Accrued payroll taxes, penalties and interest | 11,528 | 574,827 |
| Deferred revenue | 531,479 | 721,689 |
| Total current liabilities | 893,378 | 1,592,977 |
| LONG-TERM LIABILITIES: | | |
| Deferred compensation, notes payable and interest | - | 1,091,814 |
| Total long-term liabilities | - | 1,091,814 |
| Total liabilities | 893,378 | 2,684,791 |
| COMMITMENTS AND CONTINGENCIES | - | - |
| STOCKHOLDERS' EQUITY (DEFICIT): | | |
| Common stock, \$.001 par value, 45,000,000 shares authorized, shares issued and outstanding: | | |
| June 30, 2005 - 12,498,435; December 31, 2004 —11,631,832 | 12,498 | 11,632 |
| Additional paid-in capital | 38,000,363 | 34,809,832 |
| Accumulated deficit | (37,892,853) | (36,732,554) |
| Total stockholders' equity (deficit) | 120,008 | (1,911,090) |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | \$ 1,013,386 | \$ 773,701 |

See Notes to Financial Statements

SMART ONLINE, INC.
STATEMENTS OF OPERATIONS
(unaudited)

| | Three Months Ended | | Six Months Ended | |
|----------------------------|--------------------|---------------|------------------|---------------|
| | June 30, 2005 | June 30, 2004 | June 30, 2005 | June 30, 2004 |
| | (Restated) | | (Restated) | |
| REVENUES: | | | | |
| Integration fees | \$ 252,198 | \$ 89,931 | \$ 381,720 | \$ 193,750 |
| Syndication fees | 103,602 | 30,621 | 195,642 | 61,242 |
| OEM revenue | 12,000 | 13,750 | 24,000 | 28,436 |
| Web services | 25,731 | 18,276 | 40,890 | 34,990 |
| Other revenues | 12,585 | 755 | 17,102 | 2,130 |
| Related party revenues | - | 82,512 | - | 165,025 |
| Total revenues | 406,116 | 235,845 | 659,354 | 485,573 |
| COST OF REVENUES | 21,911 | 43,408 | 53,638 | 100,427 |
| GROSS PROFIT | 384,205 | 192,437 | 605,716 | 385,146 |
| OPERATING EXPENSES: | | | | |
| General and administrative | 724,162 | 593,250 | 1,243,198 | 1,042,507 |
| Sales and marketing | 287,946 | 179,232 | 582,678 | 277,631 |
| Development | 246,403 | 127,643 | 501,630 | 292,021 |