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NETSMART TECHNOLOGIES INC

Form 10-Q

May 15, 2001

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

Form 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For Quarter Ended March 31, 2001
Commission File Number 0-21177

NETSMART TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|--|
| Delaware | 13-3680154 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

| | |
|--|------------|
| 146 Nassau Avenue, Islip, NY | 11751 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (631) 968-2000

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 ☐

Number of shares of common stock outstanding as of May 1, 2001: 3,502,209

Netsmart Technologies, Inc. and Subsidiaries

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NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

| | March 31, 2001 (Unaudited) | December 31, 2000 |
|--|----------------------------------|----------------------|
| Assets: | | |
| Current Assets: | | |
| Cash and Cash Equivalents | \$ 1,686,693 | \$ 2,418,947 |
| Accounts Receivable - Net | 4,562,813 | 4,688,598 |
| Costs and Estimated Profits in Excess of Interim Billings | 4,404,496 | 4,068,255 |
| Deferred taxes | 494,000 | 494,000 |
| Other Current Assets | 178,117 | 144,942 |
| | ----- | ----- |
| Total Current Assets | 11,326,119 | 11,814,742 |
| | ----- | ----- |
| Property and Equipment - Net | 534,570 | 512,281 |
| | ----- | ----- |
| Other Assets: | | |
| Software Development Costs - Net | 742,596 | 822,645 |
| Customer Lists - Net | 1,981,513 | 2,064,832 |
| Other Assets | 83,714 | 86,213 |
| | ----- | ----- |
| Total Other Assets | 2,807,823 | 2,973,690 |
| | ----- | ----- |
| Total Assets | \$14,668,512 | \$15,300,713 |
| | ===== | ===== |

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

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CONSOLIDATED BALANCE SHEETS

| | March 31, 2001 (Unaudited) | December 31, 2000 |
|--|----------------------------------|----------------------|
| Liabilities and Stockholders' Equity: | | |
| Current Liabilities: | | |
| Capital Lease Obligations | \$ 36,530 | \$ 35,756 |
| Accounts Payable | 926,230 | 807,298 |
| Accrued Expenses | 982,252 | 1,154,647 |
| Interim Billings in Excess of Costs and Estimated Profits | 2,984,070 | 3,350,697 |
| Deferred Revenue | 331,975 | 608,444 |
| | ----- | ----- |
| Total Current Liabilities | 5,261,057 | 5,956,842 |
| | ----- | ----- |
| Capital Lease Obligations - Less current portion included above | 31,118 | 40,458 |
| | ----- | ----- |
| Commitments and Contingencies | | |
| Stockholders' Equity: | | |
| Preferred Stock - \$.01 Par Value, 3,000,000 Shares Authorized; None issued and outstanding | | |
| Common Stock - \$.01 Par Value; Authorized 15,000,000 Shares; Issued 3,530,247 shares at March 31, 2001, 3,524,692 shares at December 31, 2000 | 35,302 | 35,246 |
| Additional Paid in Capital | 20,462,669 | 20,454,391 |
| Accumulated Deficit | (10,821,824) | (10,886,414) |
| | ----- | ----- |
| | 9,676,147 | 9,603,223 |
| Less cost of shares of Common Stock held in treasury - 28,038 shares at March 31, 2001 and December 31, 2000 | 299,810 | 299,810 |
| | ----- | ----- |
| Total Stockholders' Equity | 9,376,337 | 9,303,413 |
| | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$ 14,668,512 | \$ 15,300,713 |
| | ===== | ===== |

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

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----- CONSOLIDATED STATEMENTS OF INCOME - (Unaudited) -----

| | Three months ended March 31, | |
|--|---------------------------------|--------------|
| | 2001 | 2000 |
| | ---- | ---- |
| Revenues: | | |
| Software and Related | | |
| Systems and Services: | | |
| General | \$ 3,065,355 | \$ 4,323,930 |
| Maintenance Contract | | |
| Services | 1,044,262 | 767,258 |
| | ----- | ----- |
| Total Software and Related | | |
| Systems and Services | 4,109,617 | 5,091,188 |
| Data Center Services | 465,224 | 510,175 |
| | ----- | ----- |
| Total Revenues | 4,574,841 | 5,601,363 |
| | ----- | ----- |
| Cost of Revenues: | | |
| Software and Related | | |
| Systems and Services: | | |
| General | 2,191,543 | 2,754,226 |
| Maintenance Contract | | |
| Services | 634,475 | 520,343 |
| | ----- | ----- |
| Total Software and Related | | |
| Systems and Services | 2,826,018 | 3,274,569 |
| Data Center Services | 266,531 | 242,070 |
| | ----- | ----- |
| Total Cost of Revenues | 3,092,549 | 3,516,639 |
| | ----- | ----- |
| Gross Profit | 1,482,292 | 2,084,724 |
| Selling, General and | | |
| Administrative Expenses | 1,104,725 | 1,087,491 |
| Cost of Warrants Issued and Their Extensions | -- | 181,000 |
| Research and Development | 285,311 | 321,956 |
| | ----- | ----- |
| Total | 1,390,036 | 1,590,447 |
| Income before Interest Expense and | | |
| Provision for Income Taxes | 92,256 | 494,277 |
| Interest Expense | 22,466 | 57,477 |
| | ----- | ----- |
| Income before provision for income taxes | 69,790 | 436,800 |
| Provision for income taxes | 5,200 | -- |
| | ----- | ----- |

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| | | |
|--|-----------|------------|
| Net Income | \$ 64,590 | \$ 436,800 |
| | ===== | ===== |
| Earnings Per Share of Common Stock: | | |
| Basic: | | |
| Net Income | \$.02 | \$.14 |
| | ===== | ===== |
| Weighted Average Number of Shares of Common Stock Outstanding | 3,499,126 | 3,088,632 |
| | ===== | ===== |
| Diluted: | | |
| Net Income | \$.02 | \$.12 |
| | ===== | ===== |
| Weighted Average Number of Shares of Common Stock Outstanding | 3,798,553 | 3,705,964 |
| | ===== | ===== |

See Notes to Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)

| | Three months ended March 31, | |
|--|---------------------------------|------------|
| | 2001 | 2000 |
| | ---- | ---- |
| Operating Activities: | | |
| Net Income | \$ 64,590 | \$ 436,800 |
| | ----- | ----- |
| Adjustments to Reconcile Net Income to Net Cash (Used in) Operating Activities: | | |
| Depreciation and Amortization | 228,182 | 159,919 |
| Financing Costs Related to Issuance and Extension of Warrants | -- | 181,000 |
| Changes in Assets and Liabilities: | | |
| [Increase] Decrease in: | | |
| Accounts Receivable | 125,785 | (906,460) |
| Costs and Estimated Profits in Excess of Interim Billings | (336,241) | (181,804) |
| Other Current Assets | (33,175) | (78,607) |
| Other Assets | 2,499 | 66,307 |
| Increase [Decrease] in | | |
| Accounts Payable | 118,932 | (65,529) |
| Accrued Expenses | (172,395) | 244,937 |
| Interim Billings in Excess of Costs and Estimated Profits | (366,627) | 38,414 |
| Deferred Revenue | (276,469) | (10,240) |
| | ----- | ----- |
| Total Adjustments | (709,509) | (552,063) |
| | ----- | ----- |

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| | | |
|--|-----------|-----------|
| Net Cash (Used In) Operating Activities | (644,919) | (115,263) |
| | ----- | ----- |
| Investing Activities: | | |
| Acquisition of Property and Equipment | (87,103) | (50,746) |
| Software Development Costs | -- | (221,339) |
| | ----- | ----- |
| Net Cash (Used for) Investing Activities | (87,103) | (272,085) |
| | ----- | ----- |

See Notes to Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)

| | | |
|---|---------------------------------|--------------|
| | Three months ended March 31, | |
| | ----- | ----- |
| | 2001 | 2000 |
| | ---- | ---- |
| Financing Activities: | | |
| Payment of Short-Term Notes | \$ -- | \$ (647,272) |
| Payment of Capitalized Lease Obligations | (8,566) | (6,031) |
| Net Proceeds from Warrant Exercise | | 906,306 |
| Net Proceeds from Stock Options Exercised | 8,334 | 145,804 |
| | ----- | ----- |
| Net Cash (Used in) Provided by Financing Activities | (232) | 398,807 |
| | ----- | ----- |
| Net (Decrease) Increase in Cash and Cash Equivalents | (732,254) | 11,459 |
| Cash and Cash Equivalents - Beginning of Period | 2,418,947 | 204,989 |
| | ----- | ----- |
| Cash and Cash Equivalents - End of Period | \$1,686,693 | \$ 216,448 |
| | ===== | ===== |
| Supplemental Disclosure of Cash Flow Information: | | |
| Cash paid during the period for: | | |
| Interest | \$ 22,466 | \$ 57,477 |
| Income Taxes | \$ 39,128 | \$ 27,298 |

See Notes to Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

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----- CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - (Unaudited) -----

For the Three Months Ended March 31, 2001

| Common Stock \$.01 Par Value Authorized | Shares | Amount |
|---|-----------|-----------|
| | ----- | ----- |
| 15,000,000 Shares | | |
| Beginning Balance | 3,524,692 | \$ 35,246 |
| Common Stock Issued - Exercise of Options | 5,555 | 56 |
| | ----- | ----- |
| Ending Balance | 3,530,247 | \$ 35,302 |
| | ===== | ===== |

See Notes to Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

----- CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - (Unaudited) -----

For the Three Months Ended March 31, 2001

| Additional Paid-In Capital | Shares | Amount |
|---|--------|-----------------|
| | ----- | ----- |
| Beginning Balance | | \$ 20,454,391 |
| Common Stock Issued - Exercise of Options | | 8,278 |
| | | ----- |
| Ending Balance | | \$ 20,462,669 |
| | | ===== |
| Accumulated Deficit | | |
| Beginning Balance | | \$ (10,886,414) |
| Net Income | | 64,590 |
| | | ----- |
| Ending Balance | | \$ (10,821,824) |
| | | ===== |
| Treasury Stock | | |
| Beginning Balance | 28,038 | \$ (299,810) |
| | ----- | ----- |

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| | | |
|----------------------------|--------|--------------|
| Ending Balance | 28,038 | \$ (299,810) |
| | ----- | ----- |
| Total Stockholders' Equity | | \$ 9,376,337 |
| | | ===== |

See Notes to Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) In the opinion of the Company, the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position of the Company as of March 31, 2001 and the results of its operations for the three months ended March 31, 2001 and 2000 and the changes in cash flows for the three months ended March 31, 2001 and 2000. The results of operations for the three months ended March 31, 2001 are not necessarily indicative of the results to be expected for the full year.

(2) The accounting policies followed by the Company are set forth in Notes 1 and 2 to the Company's consolidated financial statements as filed in its Form 10-K for the year ended December 31, 2000.

(3) Income per share - Income per share is computed by dividing the net income for the period by the weighted average number of shares of common stock. The common stock equivalents are assumed converted to common stock when dilutive.

(4) During the period ended March 31, 2001, stock options to purchase 5,555 shares were exercised and the Company received gross proceeds of \$8,334. As a result, common stock and additional paid in capital increased by \$56 and \$8,278.

(5) The Company is a defendant in an arbitration proceeding commenced in March 2001 seeking damages of \$635,000 for an alleged breach of a staff augmentation services agreement. The Company believes that it has valid legal defenses to such action.

(6) In May 2001, the Company acquired intellectual property and certain other assets of Advanced Institutional Management Software, Inc. for a combination of cash and stock valued at approximately \$900,000.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

A significant portion of our revenue is derived from fixed price software development contracts and licenses. We recognize this revenue on the estimated percentage of completion basis. Since the billing schedules under the contracts differ from the recognition of revenue, at the end of any period, these contracts generally result in either costs and estimated profits in excess of billing or billing in excess of cost and estimated profits. The largest

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component of our revenue is based upon the time spent by our technical personnel on a project. As a result, during the third and fourth quarters, when many of our employees are on vacation and holidays, our revenue could be affected.

Three Months Ended March 31, 2001 and 2000

Our revenue for the three months ended March 31, 2001 (the "March 2001 period") was \$4,575,000, a decrease of \$1,027,000, or 18%, from our revenue for the three months ended March 31, 2000 (the "March 2000 period"), which was \$5,601,000. The largest component of revenue was turnkey systems labor revenue, which decreased to \$1,673,000 in the March 2001 period, from \$1,855,000 in the March 2000 period, reflecting a 10% decrease. This decrease reflects an industry wide slow down in information technology purchasing activity. Revenue from third party hardware and software decreased to \$772,000 in the March 2001 period, from \$1,482,000 in the March 2000 period, which represents a decrease of 48%. Sales of third party hardware and software are made in connection with the sales of turnkey systems and were affected by the decline in revenue from turnkey systems. These sales are typically made at lower gross margins than our behavioral health systems and services revenue. The data center (service bureau) revenue decreased to \$465,000 in the March 2001 period, from \$510,000 in the March 2000 period, reflecting a decrease of 9%. This decrease is substantially the result of a smaller client base. License revenue decreased to \$271,000 in March 2001 period, from \$648,000 in the March 2000 period, reflecting a decrease of 58%. License revenue is generated as part of a sale of a behavioral health information system pursuant to a contract or purchase order that includes delivery of the system and maintenance and is affected by the decline in revenue from turnkey systems. Maintenance revenue increased to \$1,044,000 in March 2001 period, from \$767,000 in the March 2000 period, reflecting an increase of 36%. As turnkey systems are completed, they are transitioned to the maintenance division. Revenue from the sales of our small turnkey division increased to \$350,000 in the March 2001 period, from \$338,000 in the March 2000 period, reflecting an increase of 4%.

Revenue from contracts from government agencies represented 43% of revenue in the March 2001 period and 45% of revenue in the March 2000 period.

Gross profit decreased to \$1,482,000 in the March 2001 period from \$2,085,000 in the March 2000 period, reflecting a decrease of 29%. The decrease in gross margin was substantially attributable to the decrease in our license revenue mentioned above. This decrease was partially offset by the gross margins related to the increase in maintenance revenue. Our maintenance revenue gross margin continues to improve since the core costs and infrastructure investment has previously been established.

Selling, general and administrative expenses were \$1,105,000 in the March 2001 period, reflecting an increase of 2 % from the \$1,088,000 in the March 2000 period. This increase was substantially in the area of sales and marketing costs and was partially offset by a decrease in administrative costs.

In the March 2000 period, we issued warrants for services rendered. We also extended one series of our warrants for fourteen months. An aggregate of \$181,000 was charged to operations for the warrant issuance and the warrant extension. As a result of the extension of the warrants in the March 2000 period, we raised additional equity of

\$1,153,000 from the exercise of the warrants. There were no similar costs in the March 2001 period.

We incurred product development expenses of \$285,000 in the March 2001 period, a decrease of 11% from the \$322,000 in the March 2000 period. During the March

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2001 period, we continued to invest in improved functionality and technology in our products, but at a lesser extent than the March 2000 period.

Interest expense was \$22,000 in the March 2001 period, a decrease of \$35,000, or 61%, from the \$57,000 in the March 2000 period. This decrease was the result of lower borrowings during the March 2001 period.

We have a net operating loss tax carry forward of approximately \$7 million. However, in the March 2001 period, we provided for income taxes in the amount of \$5,200. This provision was based upon federal alternative minimum tax calculations as well as certain state taxes where we do not have any net operating loss carry forwards.

As a result of the foregoing factors, in the March 2001 period, we generated a net income of \$65,000, or \$.02 per share (basic and diluted). For the March 2000 period, we generated net income of \$437,000, or \$.14 per share (basic) and \$.12 per share (diluted).

Liquidity and Capital Resources

We had working capital of \$6.1 million at March 31, 2001 as compared to working capital of \$5.9 million at December 31, 2000. The increase in working capital for the March 2001 period was substantially due to net income after adding back depreciation and amortization.

During the March 2001 period, our cash requirements were generated from operations. We have an accounts receivable financing agreement with an asset based lender which permits us to borrow up to 80% of eligible accounts receivable up to a maximum of \$3.5 million. We did not use this facility during the March 2001 period, and there were no outstanding borrowings under this facility. The maximum amount available under our borrowing base formula at March 31, 2001 was \$1.6 million.

At March 31, 2001, accounts receivable and costs and estimated profits in excess of interim billings were approximately \$9 million, representing approximately 178 days of revenue based on annualizing the revenue for the March 2001 period, although no assurance can be given that revenue will continue at the same level as the March 2001 period.

Based on our outstanding contracts and our continuing business, we believe that our cash flow from operations, the availability under our financing agreement and our cash on hand will be sufficient to enable us to continue to operate without additional funding, although it is possible that we may need additional funding if our business does not develop as we anticipate or if our expenses, including our software development costs relating to our expansion of our product line and our marketing costs for seeking to expand the market for our products and services to include smaller clinics and facilities and sole group practitioners exceed our expectation.

An important part of our growth strategy is to acquire other businesses that are related to our current business. Such acquisitions may be made with cash or our securities or a combination of cash and securities. To the extent that we require cash, we may have to borrow the funds or issue equity. We have no commitments from any financing source and we may not be able to raise any cash necessary to complete an acquisition. If we fail to make any acquisitions our future growth may be limited.

In May 2001, we acquired intellectual property and certain other assets of Advanced Institutional Management Software, Inc. for a combination of cash and

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stock valued at approximately \$900,000. We anticipate using our credit facility to fund the cash portion of the purchase price. We anticipate that we will incur development expenses for enhancements in the acquired software.

Forward Looking Statements

Statements in this Form 10-Q include forward-looking statements that address, among other things, our expectations with respect to the development of our business. In addition to these statements, other information including words such as "seek," "anticipate," "believe," "plan," "estimate," "expect," "intend" and other similar expressions are forward looking statements. Actual results could differ materially from those currently anticipated due to a number of factors, including those identified in our Annual Report on Form 10-K for 2000 under "Risk Factors," those discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-Q and our Form 10-K for 2000 and elsewhere, and in other documents which we file with the Securities and Exchange Commission.

Part II

Item 1. Legal Proceedings

The Company is a defendant in an arbitration proceeding commenced in March 2001 by Price Waterhouse Coopers LLP, seeking damages of \$635,000 for an alleged breach of a staff augmentation services agreement. The Company believes that it has valid legal defenses to such action.

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.

NETSMART TECHNOLOGIES, INC.

| | | |
|---|--|--------------|
| /s/ James L. Conway ----- James L. Conway | Chief Executive Officer and Director (Principal Executive Officer) | May 14, 2001 |
| /s/ Anthony F. Grisanti ----- Anthony F. Grisanti | Chief Financial Officer (Principal Financial and Accounting Officer) | May 14, 2001 |