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NETSMART TECHNOLOGIES INC

Form 10-Q

August 01, 2002

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 June 30, 2002  
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 (I.R.S. Employer  
incorporation or organization) 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 July 31, 2002: 3,696,709  
=====

Netsmart Technologies, Inc. and Subsidiaries

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### NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, ----- 2002 ----- Unaudited -----	December 31, ----- 2001 -----
<b>Assets:</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents	\$ 3,677,329	\$ 3,837,226
Accounts Receivable - Net	5,996,985	5,876,970
Costs and Estimated Profits in Excess of Interim Billings	4,167,661	3,783,356
Deferred taxes	500,000	500,000
Other Current Assets	91,108	128,232
	-----	-----
Total Current Assets	14,433,083	14,125,784
	-----	-----
Property and Equipment - Net	370,409	366,356
	-----	-----
<b>Other Assets:</b>		
Software Development Costs - Net	524,098	686,301
Customer Lists - Net	2,380,500	2,618,145
Other Assets	202,783	210,787
	-----	-----
Total Other Assets	3,107,381	3,515,233
	-----	-----
Total Assets	\$ 17,910,873	\$ 18,007,373
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

### NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

June 30,

December

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	----- 2002 ----- Unaudited -----	----- 2001 -----
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Current Portion - Long Term Debt	\$ 500,000	\$ 500,
Current Portion Capital Lease Obligations	15,102	28,
Accounts Payable	580,683	688,
Accrued Expenses	459,946	359,
Interim Billings in Excess of Costs and Estimated Profits	4,125,997	3,959,
Deferred Revenue	419,497	685,
	-----	-----
Total Current Liabilities	6,101,225	6,222,
	-----	-----
Capital Lease Obligations - Less current portion	6,962	12,
Long Term Debt - Less current portion	1,500,008	1,750,
Interest Rate Swap at Fair Value	80,691	74,
	-----	-----
Total Non Current Liabilities	1,587,661	1,837,
	-----	-----
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 3,724,747 shares at June 30, 2002, 3,719,247 shares at December 31, 2001	37,247	37,
Additional Paid in Capital	20,890,534	20,856,
Accumulated Comprehensive loss - Interest Rate Swap	(80,691)	(74,
Accumulated Deficit	(10,325,293)	(10,570,
	-----	-----
	10,521,797	10,247,
Less: Cost of shares of Common Stock held in treasury - 28,038 shares at June 30, 2002 and December 31, 2001	299,810	299,
	-----	-----
Total Stockholders' Equity	10,221,987	9,947,
	-----	-----
Total Liabilities and Stockholders' Equity	\$ 17,910,873	\$ 18,007,
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

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### NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

	Six months ended June 30,		Three months ended June 30,	
	2002	2001	2002	2001
<b>Revenues:</b>				
Software and Related Systems and Services:				
General	\$ 6,299,687	\$ 5,833,078	\$ 3,447,798	\$ 2,447,798
Maintenance Contract Services	3,022,288	2,472,791	1,513,798	1,513,798
Total Software and Related Systems and Services	9,321,975	8,305,869	4,961,596	4,961,596
Data Center Services	955,395	933,620	485,702	485,702
Total Revenues	10,277,370	9,239,489	5,447,298	5,447,298
<b>Cost of Revenues:</b>				
Software and Related Systems and Services:				
General	4,450,324	4,062,096	2,441,743	2,441,743
Maintenance Contract Services	1,771,212	1,611,175	896,137	896,137
Total Software and Related Systems and Services	6,221,536	5,673,271	3,337,880	3,337,880
Data Center Services	526,945	506,614	266,012	266,012
Total Cost of Revenues	6,748,481	6,179,885	3,603,892	3,603,892
Gross Profit	3,528,889	3,059,604	1,843,406	1,843,406
<b>Selling, General and Administrative Expenses</b>				
Research and Development	2,484,522	2,218,934	1,281,327	1,281,327
	684,460	641,311	355,531	355,531
Total	3,168,982	2,860,245	1,636,858	1,636,858
Income from Operations before Interest	359,907	199,359	206,548	206,548
Interest Income	20,453	6,670	11,274	11,274
Interest Expense	108,661	60,859	57,287	57,287
Income before Income Tax Expense	271,699	145,170	160,535	160,535

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Income Taxes Expense	26,000	11,000	18,000	
	-----	-----	-----	-----
Net Income	\$ 245,699	\$ 134,170	\$ 142,535	\$
	=====	=====	=====	=====
Earnings Per Share of Common Stock:				
Basic:				
Net Income	\$ .07	\$ .04	\$ .04	\$
	=====	=====	=====	=====
Weighted Average Number of Shares of Common Stock Outstanding				
	3,695,923	3,555,733	3,696,709	3,
	=====	=====	=====	=====
Diluted:				
Net Income	\$ .06	\$ .04	\$ .04	\$
	=====	=====	=====	=====
Weighted Average Number of Shares of Common Stock and Common Stock Equivalents Outstanding				
	4,047,746	3,832,539	4,055,479	3,
	=====	=====	=====	=====

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)

	Six months ended June 30,	
	2002	2001
	----	----
Operating Activities:		
Net Income	\$ 245,699	\$ 134,170
	-----	-----
Adjustments to Reconcile Net Income to Net Cash Provided by (Used in) Operating Activities:		
Depreciation and Amortization	517,606	513,996
Issuance of Warrants and Options for Services	24,873	--
Changes in Assets and Liabilities:		
[Increase] Decrease in:		
Accounts Receivable	(120,015)	(1,080,455)
Costs and Estimated Profits in Excess of Interim Billings	(384,305)	(371,665)
Other Current Assets	37,124	39,700
Other Assets	8,004	(90,961)
Increase [Decrease] in		
Accounts Payable	(107,999)	53,576
Accrued Expenses	100,038	(378,931)
Interim Billings in Excess of		

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Costs and Estimated Profits	166,767	232,428
Deferred Revenue	(266,072)	(167,292)
	-----	-----
Total Adjustments	(23,979)	(1,249,604)
	-----	-----
Net Cash Provided by (Used In) Operating Activities	221,720	(1,115,434)
	-----	-----
Investing Activities:		
Net Cost of AIMS Acquisition	--	(779,700)
Acquisition of Property and Equipment	(121,811)	(82,799)
	-----	-----
Net Cash Used In Investing Activities	(121,811)	(862,499)
	-----	-----

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)

	Six months ended June 30,	
	2002	2001
	-----	-----
Financing Activities:		
Proceeds from Long Term Loan	\$ --	\$2,500,000
Payment of Capitalized Lease Obligations	(19,360)	(16,531)
Net Proceeds from Stock Options Exercised	9,550	21,834
Payments of Term Loan	(249,996)	--
	-----	-----
Net Cash (Used in) Provided by Financing Activities	(259,806)	2,505,303
	-----	-----
Net (Decrease) Increase in Cash and Cash Equivalents	(159,897)	527,370
Cash and Cash Equivalents - Beginning of Period	3,837,226	2,418,947
	-----	-----
Cash and Cash Equivalents - End of Period	\$3,677,329	\$2,946,317
	=====	=====
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 110,703	\$ 42,153
Income Taxes	\$ 14,727	\$ 114,366

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Non Cash Financing Activities:

The fair value of the interest rate swap calculated at June 30, 2002 was \$80,691.

Non Cash Investing Activities:

Value of Common Stock issued in AIMS Acquisition                      --                      \$ 376,200

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - (Unaudited)

For the Six Months Ended June 30, 2002

Common Stock \$.01 Par Value Authorized	Shares	Amount
	-----	-----
15,000,000 Shares		
Beginning Balance - December 31, 2001	3,719,247	\$ 37,192
Common Stock Issued - Exercise of Options	5,500	55
	-----	-----
Ending Balance - June 30, 2002	3,724,747	\$ 37,247
	=====	=====

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - (Unaudited)

For the Six Months Ended June 30, 2002

Additional Paid-In Capital Common Stock:	Shares	Amount
	-----	-----
Beginning Balance - December 31, 2001		\$ 20,856,166
Common Stock Issued - Exercise of Options		9,495
Issuance of Warrants and Options		24,873
		-----
Ending Balance - June 30, 2002		\$ 20,890,534
		=====
Accumulated Deficit		
Beginning Balance - December 31, 2001		\$(10,570,992)

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Net Income		245,699	-----
Ending Balance - June 30, 2002		\$ (10,325,293)	=====
Accumulated Comprehensive Loss - Interest Rate Swap:			
Beginning Balance - December 31, 2001		\$ (74,875)	
Change in Fair Value of Interest Rate Swap		(5,816)	-----
Ending Balance - June 30, 2002		\$ (80,691)	
Treasury Stock			
Beginning Balance - December 31, 2001	28,038	\$ (299,810)	-----
Ending Balance - June 30, 2002	28,038	\$ (299,810)	-----
Total Stockholders' Equity		\$ 10,221,987	

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED 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 June 30, 2002 and the results of its operations for the six and three months ended June 30, 2002 and 2001 and the changes in cash flows for the six months ended June 30, 2002 and 2001. The results of operations for the periods ended June 30, 2002 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, 2001.

(3) Income per share - The following table sets forth the components used in the computation of basic and diluted earnings per share:

	Six Months Ended June 30,		Three Mon
	2002	2001	2002
	-----	-----	-----
Numerator:			
Net income	\$ 245,699	\$ 134,170	\$ 142,53
Denominator:			
Weighted average shares	3,695,923	3,555,733	3,696,70
	-----	-----	-----
Effect of dilutive securities:			



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Employee stock option	351,359	276,806	358,30
Stock warrants	464	--	46
	-----	-----	-----
Dilutive potential common shares	351,823	276,806	358,77
	-----	-----	-----
Denominator for diluted earnings per share-adjusted weighted average shares after assumed conversions	4,047,746	3,832,539	4,055,47
	=====	=====	=====

(4) Income Taxes - The provision for income taxes for the period ended June 30, 2002, reflects a deferred tax provision of approximately \$77,000 offset by a reduction in the deferred tax asset valuation allowance of the same amount.

(5) During the quarter ended March 31, 2002, stock options to purchase 5,500 shares were exercised and the Company received gross proceeds of \$9,550. As a result, common stock and additional paid in capital increased by \$55 and \$9,495 respectively.

(6) The Company was a defendant in a previously-reported arbitration proceeding commenced in March 2001 seeking damages of \$635,000 for an alleged breach of a staff augmentation services agreement. This action was settled, and the settlement had no material adverse effect on the results of operations of the Company.

In October 2000, the Company's subsidiary, Creative Socio-Medics, commenced an action against the City of Richmond, in the Supreme Court of the State of New York, County of Suffolk, which action was subsequently removed to the United States District Court for the Eastern District of New York, for failure to pay more than \$1 million pursuant to a contract between the Company and Richmond. Richmond advised the court that it intended to move to dismiss the complaint for lack of personal jurisdiction in New York and improper venue. The parties are currently engaged in discovery on jurisdictional issues. In November 2000,

Richmond filed a complaint in the Circuit Court for the City of Richmond, Richmond, Virginia, alleging, among other things, that the contract with Creative Socio-Medics was procured through fraudulent misrepresentations concerning the nature of the work to be performed and the price for the services and that Creative Socio-Medics failed to perform its obligations under the agreement, seeking damages of \$373,000 and a finding that it owes no additional amounts to Creative Socio-Medics. The parties entered into a stipulation staying the Richmond action until a determination of Richmond's jurisdictional challenges to the New York action. The Company believes it has valid claims against Richmond and intends to vigorously pursue those claims. We also believe that the allegations contained in Richmond's complaint are without merit and we intend to vigorously defend against those claims.

(7) In March 2002 the stockholders approved the Company's 2001 Long Term Incentive plan, covering 180,000 shares of common stock. In March 2002, the Company issued options to its employees to purchase 179,000 shares of common stock at a price of \$2.50 which was the fair market value at the date of grant. In June 2002, the Company issued 13,000 options to employees and a director with exercise prices ranging from \$2.38 to \$2.40. These options were issued from previous Long Term Incentive plans.

(8) The Company currently classifies its operations into two business segments:

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(1) Software and Related Systems and Services and (2) Data Center Services. Software and Related Systems and Services is the design, installation, implementation and maintenance of computer information systems that provide comprehensive healthcare information technology solutions including billing, patient tracking and scheduling for inpatient and outpatient environments, as well as clinical documentation and medical record generation and management. Data Center Services involve Company personnel performing data entry and data processing services for customers. Intersegment sales and sales outside the United States are not material. Information concerning the Company's business segments are as follows:

Six Months Ended June 30,	Software and ----- Related Systems	Data Center	Consolidated
-----	and Services	Services	-----
2002			
Revenue	\$ 9,321,975	\$ 955,395	\$10,277,370
Income before income taxes	124,101	147,598	271,699
Total identifiable assets at June 30, 2002	16,292,536	1,618,337	17,910,873
2001			
Revenue	\$ 8,305,869	\$ 933,620	\$ 9,239,489
Income (loss) before income taxes	(39,011)	184,181	145,170
Total identifiable assets at June 30, 2001	16,318,319	1,737,848	18,056,167

Three Months Ended June 30,	Software and ----- Related Systems	Data Center	Consolidated
-----	and Services	Services	-----
2002			
Revenue	\$ 4,961,596	\$ 485,702	\$ 5,447,298
Income before income taxes	80,174	80,361	160,535
2001			
Revenue	\$ 4,196,252	\$ 468,396	\$ 4,664,648
Income (loss) before income taxes	(36,516)	111,896	75,380

(9) During the quarter ended June 30, 2002, the Company issued warrants to purchase 200,000 shares in connection with a financial advisory agreement whereby the Company will pay consulting fees in addition to the issuance of warrants. These warrants, which expire over various times ranging from one to two years, were valued at \$.24 per warrant, which represented the costs of the services based upon the contractual agreement. The agreement may be terminated by either party. The warrants have the following exercise price and vesting dates for the number of shares set forth below.

Shares	Exercise Price	Vesting Date
-----	-----	-----
50,000	\$2.70	April 10, 2002
30,000	\$4.00	June 1, 2002
30,000	\$5.00	September 1, 2002
30,000	\$6.00	November 1, 2002

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30,000	\$7.00	January 1, 2003
30,000	\$8.00	February 28, 2003

During the quarter ended June 30, 2002, the Company charged to operations \$19,200 as costs related to the April 10 and June 1, 2002 warrants. The Company is scheduled to charge to future operations the amounts of \$7,200 each for the September 2002 through February 2003 warrants.

During the quarter ended June 30, 2002, the Company issued 10,000 options for services rendered. These options were valued at \$.57 per option based upon the Black-Scholes calculation and a charge was made to operations in the amount of \$5,673. These options have an exercise price of \$2.75 per option, which was the market value of the stock at the time of issuance and will expire on April 22, 2003.

In July 2002, the Company extended the expiration date of warrants to purchase 448,535 shares of common stock at \$12.00 per share, from July 31, 2002 to January 31, 2003.

(10) New Accounting Pronouncements - Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets" became effective for the Company during the period ended June 30, 2002. The provisions of these interpretations that are applicable to the Company were implemented on a prospective basis as of January 1, 2002, which had no material effect on the Company's financial statements.

SFAS No. 143, "Accounting for Asset Retirement Obligations" became effective for the Company during the period ended June 30, 2002. The provisions of these interpretations that are applicable to the Company were implemented on a prospective basis as of January 1, 2002, which had no material effect on the Company's financial statements.

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" became effective for the Company during the period ended June 30, 2002. The provisions of the interpretations that are applicable to the Company were implemented on a prospective basis as of January 1, 2002, which had no material effect on the Company's financial statements.

On April 30, 2002 the Financial Accounting Standards Board issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 145 eliminates the requirement that gains and losses from the extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect and eliminates an inconsistency between the accounting for sale-leaseback transactions and certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Generally, SFAS No. 145 is effective for transactions occurring after May 15, 2002. The adoption of this standard is expected to have no impact to the Company.

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

#### Results of Operations

The most significant portion of our revenue is derived from fixed price software development contracts and licenses. We principally 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. This largest

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component of total revenue, which is generated primarily from time spent by our technical personnel, may be adversely affected during the third and fourth quarters of our fiscal year when vacation and holidays occur.

Six months Ended June 30, 2002 and 2001

Our revenue for the six months ended June 30, 2002 (the "June 2002 period") was \$10,277,000, an increase of \$1,038,000, or 11%, from our revenue for the six months ended June 30, 2001, (the "June 2001 period") which was \$9,239,000. The largest component of revenue was turnkey systems labor revenue, which increased by \$164,000 to \$3,549,000 in the June 2002 period, from \$3,385,000 in June 2001 period, reflecting a 5% increase. Revenue from third party hardware and software increased to \$1,378,000 in the June 2002 period, from \$1,353,000 in the June 2001 period, which represents an increase of 2%. Sales of third party hardware and software are made in connection with the sales of 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 increased to \$955,000 in the June 2002 period, from \$934,000 in the June 2001 period, reflecting an increase of 2%. License revenue increased to \$912,000 in the June 2002 period, from \$483,000 in the June 2001 period, reflecting an increase of 89%. 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. This increase was partially due to the sale of our licensed programs to an existing customer, which enables the customer to roll out our software within its entire organization. While this is an example of our ability to resell into our existing client base, there are no assurances that we will be able to duplicate these sales with other customers. Maintenance revenue increased to \$3,022,000 in the June 2002 period, from \$2,473,000 in the June 2001 period, reflecting an increase of 22%. As turnkey systems are completed, they are transitioned to the maintenance division. Revenue from the sales of our small turnkey division decreased to \$461,000 in the June 2002 period, from \$612,000 in the June 2001 period, reflecting a decrease of 25%.

Revenue from contracts from government agencies represented 43% of revenue in the June 2002 period and 42% of revenue in the June 2001 period. This reflects a slight increase in new government contracts.

Gross profit increased to \$3,529,000 in June 2002 period from \$3,060,000 in the June 2001 period, reflecting an increase of 15%. Our gross margin percentage increased to 34% in the June 2002 period from 33% in the June 2001 period. This increase was substantially the result of an increase in our license and maintenance revenue mentioned above.

Selling, general and administrative expenses were \$2,485,000 in the June 2002 period, reflecting an increase of 12% from the \$2,219,000 in the June 2001 period. This increase was substantially in the area of general insurance, settlement of certain litigation, increase in the provision for bad debts and investor public relations costs.

We incurred product development expenses of \$684,000 in the June 2002 period, an increase of 7% from the \$641,000 in the June 2001 period. During the June 2002 period, we continued to invest in improved functionality and technology in our products.

Interest expense was \$109,000 in the June 2002 period, an increase of \$48,000, or 79%, from the \$61,000 in the June 2001 period. This increase was substantially the result of interest associated with the \$2,500,000 term loan, which we made in June 2001.

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Interest income of \$20,000, for the June 2002 period is generated from short-term investments made with a substantial portion of the proceeds received from the term loan.

We have a federal net operating loss tax carry forward of approximately \$11 million. In the June 2002 period, a deferred tax provision in the amount of \$77,000 was offset by a reduction in the deferred tax valuation allowance of the same amount. Therefore, in the June 2002 period we provided for taxes in the amount of \$26,000. This provision was based upon certain state taxes. We made a similar provision in the June 2001 period in the amount of \$11,000.

As a result of the foregoing factors, in the June 2002 period, we had a net income of \$246,000, or \$.07 per share basic and \$.06 per share diluted. For the June 2001 period, we had net income of \$134,000, or \$.04 per share basic and diluted.

Three Months Ended June 30, 2002 and 2001

Our revenue for the three months ended June 30, 2002 (the "June 2002 quarter") was \$5,447,000, an increase of \$782,000, or 17%, from our revenue for the three months ended June 30, 2001, (the "June 2001 quarter") which was \$4,665,000. The largest component of revenue was turnkey systems labor revenue, which increased by \$201,000 to \$1,913,000 in the June 2002 quarter, from \$1,712,000 in June 2001 quarter, reflecting a 12% increase. Revenue from third party hardware and software increased to \$886,000 in the June 2002 quarter, from \$581,000 in the June 2001 quarter, which represents an increase of 52%. Sales of third party hardware and software are made in connection with the sales of 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 increased to \$486,000 in the June 2002 quarter, from \$468,000 in the June 2001 quarter, reflecting an increase of 4%. License revenue increased to \$378,000 in the June 2002 quarter, from \$212,000 in the June 2001 quarter, reflecting an increase of 78%. 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. Maintenance revenue increased to \$1,514,000 in the June 2002 quarter, from \$1,429,000 in the June 2001 quarter, reflecting an increase of 6%. As turnkey systems are completed, they are transitioned to the maintenance division. Revenue from the sales of our small turnkey division increased to \$271,000 in the June 2002 quarter, from \$262,000 in the June 2001 quarter, reflecting an increase of 3%.

Revenue from contracts from government agencies represented 44% of revenue in the June 2002 quarter and 40% of revenue in the June 2001 quarter. This increase reflects a slight amplification in new government contracts.

Gross profit increased to \$1,843,000 in June 2002 quarter from \$1,577,000 in the June 2001 quarter, reflecting an increase of 17%. Our gross margin percentage remained constant at 34%.

Selling, general and administrative expenses were \$1,281,000 in the June 2002 quarter, reflecting an increase of 15% from the \$1,114,000 in the June 2001 quarter. This increase was substantially in the area of general insurance, settlement of certain litigation and an increase in the provision for bad debts.

We incurred product development expenses of \$356,000 in the June 2002 quarter, which represented no change from the \$356,000 in the June 2001 quarter. During the June 2002 quarter, we continued to invest in improved functionality and technology in our products.

Interest expense was \$57,000 in the June 2002 quarter, an increase of \$19,000,

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or 50%, from the \$38,000 in the June 2001 quarter. This increase was substantially the result of interest associated with the \$2,500,000 term loan, which we made in June 2001.

Interest income of \$11,000, for the June 2002 quarter is generated from short-term investments made with a substantial portion of the proceeds received from the term loan arrangement.

We have a federal net operating loss tax carry forward of approximately \$11 million. In the June 2002 quarter, a deferred tax provision in the amount of \$43,000 was offset by a reduction in the deferred tax valuation allowance of the same amount. Therefore, in the June 2002 quarter we provided for taxes in the amount of \$18,000. This provision was based upon certain state taxes. We made a similar provision in the June 2001 quarter in the amount of \$5,800.

As a result of the foregoing factors, in the June 2002 quarter, we had a net income of \$143,000, or \$.04 per share basic and diluted. For the June 2001 quarter, we had net income of \$70,000, or \$.02 per share basic and diluted.

### Liquidity and Capital Resources

We had working capital of \$8.3 million at June 30, 2002 as compared to working capital of \$7.9 million at December 31, 2001. The increase in working capital for June 2002 period was substantially the result of our net income after adding back depreciation and amortization and partially offset by the acquisition of equipment and principal payments of the term loan.

In June 2001, we entered into a financing arrangement with Fleet Bank. This financing provides us with a five-year term loan of \$2.5 million, as well as a two year \$1.5 million revolving line of credit. The term loan bears interest at a fixed rate of 7.95% per annum and the revolving line of credit is priced at the prime rate. Under our revolving line of credit, we can borrow up to 75% of eligible receivables up to a maximum of \$1.5 million. The maximum available to us at June 30, 2002 under the borrowing base formula was \$1.5 million. The proceeds of the term loan are intended to be used for acquisitions as well as for product modifications specific to California requirements. The revolving line of credit will be utilized for general working capital needs. We have not used the revolving line of credit from inception through June 30, 2002. We have made principal payments on the \$2.5 million term loan and the amount outstanding at June 30, 2002 is \$2,000,000.

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. 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.

A 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. If we fail to make any acquisitions our future growth may be limited to only internal growth. As of the date of this Form 10-Q quarterly report, we did not have any agreements or understandings with respect to any acquisitions, and we cannot give any assurance that we will be able to complete any acquisitions.

### Forward-Looking Statements

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Statements in this Form 10-Q quarterly report may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may, and probably will, differ materially from what is expressed or forecasted in the forward-looking statements due to numerous factors, including those described above and those risks discussed from time to time in this Form 10-Q quarterly report, and in other documents which we file with the Securities and Exchange Commission. In addition, such statements could be affected by risks and uncertainties related to product demand, market and customer acceptance, competition, government regulations and requirements, pricing and development difficulties, as well as general industry and market conditions and growth rates, and general economic conditions. Any forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Form 10-Q.

### Part II

#### Item 1. Legal Proceedings

The previously reported arbitration proceeding commenced in March 2001 by PriceWaterhouse Coopers LLP, seeking damages of \$635,000 for an alleged breach of staff augmentation services agreement has been settled for a modest payment by us. The settlement did not have a material effect on our financial position or the results of our operations.

#### Item 4. Submission of Matters to a Vote of Security Holders.

On March 7, 2002, we held our 2002 annual meeting of stockholders.

The following individuals were elected as directors:

Name	Number of Votes
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Edward D. Bright	3,065,809
James L. Conway	3,183,824
John F. Phillips	2,974,940
Gerald O. Koop	3,040,505
Francis J. Calcagno	3,135,424
Joseph G. Sicinski	3,077,374

The following proposals were approved as follows:

	Votes For	Votes Against	Abstain
Approval of the amendment to the 2001 Long Term Incentive Plan	3,071,481	68,446	4,468
Approval of the selection of Richard A. Eisner & Co., LLP as independent auditors for 2001	3,135,588	2,863	5,944

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Item 6. Exhibits and Reports on Form 8-K

(b) Reports on Form 8-K

During the quarter ended June 30, 2002, we filed a Form 8-K, with a report date of May 14, 2002, relating to Item 4 - Changes in Registrant's Certifying Accountants.

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 (Principal Executive Officer)	August 1, 2002
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/s/Anthony F. Grisanti ----- Anthony F. Grisanti	Chief Financial Officer (Principal Financial and Accounting Officer)	August 1, 2002
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